

The Effects of Income Transparency on Well-Being Evidence from a Natural Experiment (Perez-Truglia, 2020)

In the last century transparency policies have been implemented to increase government trust and social trust. Some examples are disclosing public officials' assets, wages and lobby related activities. Tax records have been disclosed to the public as a transparency policy. Norway made the tax records of every citizen public, although not easily available, in the nineteenth century. In 2001, a newspaper created an online tool which allowed most of the population to search anyone's tax records. This tool displayed full names, net incomes, birth years, among other information. Although this policy's objective was to increase social trust, it had an unintended effect on well-being inequality.

One Sentence Summary

The authors showed evidence that publicly displaying citizens income will increase the well-being gap between the richest and the poorest of a country. Both the differential social treatment from status and how deeply are humans concerned about income status can explain the phenomenon.

Main Findings

People like to compare themselves to other people¹. To no one's surprise, the online tool to search anybody's tax record became quite popular. Norwegians are more likely to search for the tax records of others than the weather. Additionally, on the month of October in 2010 for every five YouTube searches there was one tax record search. In synthesis, Norwegians liked to snoop on their friend's incomes.

An individual can easily compare their income to their neighbors, friend, and coworkers with public tax records. The constant comparison brought an increase/decrease in well-being for rich/poor individuals because of the perception on their income rank. On one hand, a rich person thinks (perception) his rank is not that high in the income distribution. Rich people tend to live with other rich people. It will be harder for someone to pinpoint their exact income rank when they live in a homogeneous (a similar level of income) neighborhood. When tax records are released and their true rank is higher than they thought, their happiness increases. Specifically, the authors found an increase in happiness and self-satisfaction levels for the richest Norwegians. On the other, the public tax records generate frustration to poor people as their perceived income rank will be higher than their actual rank. It is important to note that this effect was found in the entire population and the population with better access to the internet.

There are two potential mechanisms that drive these results. First, when people have a higher social status other people tend to treat them better. This is why there is high demand for expensive clothing and cars. With public tax records, poor individuals have no disguises left to

¹ This phenomenon is linked to the aspirations research. For more information please refer to Aspirations a Review (One-page Econ #15).

avoid the subpar treatment. In simpler words, they will be treated worse because their income rank decreased. Second, the signal of status, in itself, increases and decreases happiness. An increase from the income rank will increase happiness, regardless of social treatment. Sadly, a decrease from income rank is followed by a decrease in happiness.

Concluding Remarks

This paper provides quantitative evidence of a negative effect of making tax records public. However, the authors emphasize that the transparency policy is not bad, it's just flawed. That said, there should be a design reform. For instance, the Norwegian government made searches also public in 2014. This reform decreased the number of searches and snooping behavior because it increased the social cost of snooping. This change in design is a step on the right direction to minimize the unintended consequence of the policy.

References

- Perez-Truglia, R., 2020. The Effects of Income Transparency on Well-Being: Evidence from a Natural Experiment. Am. Econ. Rev. <https://doi.org/10.1257/aer.20160256>.