

Title: *Restricted Interpersonal Comparability and Measurement of Income Inequality*

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The standard approach in the applied literature on income distribution is to estimate income inequality under the assumption of full interpersonal comparability of income. In order to be meaningful, this approach requires identical prices and qualities of goods as well as uniform norms and consumption habits across regions. To account for relevant non-income heterogeneity between individuals, we propose to partition the municipalities into subgroups determined by geographic locations and prices of basic goods. Based on income data for each of the subgroups a set of subgroup-specific Lorenz curves and corresponding measures of inequality can be estimated. Moreover, when incomes cannot be justified to be comparable across subgroups a weighted average of the subgroup-specific inequality measures can be used as an alternative to the conventional overall measure of inequality. Applying Norwegian household register data for the period 1993-2001, it is demonstrated that the level of and trend in overall inequality as well as the inequality contributions of various income factors are insensitive to whether subgroup-specific Lorenz curves or a country-specific Lorenz curve form the basis of the inequality analysis.