

Data Valuation Methods and Welfare Inferences

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This paper shows, with reference to the Indian National Sample Survey data on consumption distribution, how data valuation methods can distort welfare inferences in applied welfare analysis.

1. Introduction

Interest in inequality estimates is often generated by normative considerations involving welfare judgements. Underlying such an approach is the notion that given the community income a higher degree of inequality is associated with a lower level of social welfare and vice versa. Further, it is assumed that individual utility functions which form the basis of the aggregate social welfare function are functions of real income only so that in any welfare analysis involving comparisons of alternative income distributions it is the distribution of real goods that is of consequence.

Generally, some measure of inequality in distribution is made use of and alternative states of income distribution are ranked on the basis of information contained in such measures. For instance, given two income distributions, their ranking is sometimes done on the basis of the dominance of their respective Lorenz curves. Implicit in such comparisons is the assumption that the commodity bundles - representing real incomes - at the disposal of each and every individual have been valued uniformly, i.e., the same price for the same good across all individuals. So long as one is resorting to such a uniform system of valuation, the relation between an inequality measure of distribution of real income, say $L(Q)$, and that of distribution of money income, say $L(PQ)$ will be monotonic and positive and one's conclusion will remain valid whether they are based on $L(Q)$ or $L(PQ)$. However,