

Adaptation to income over time: A weak point of subjective well-being

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Abstract

This paper holds the view that the intertemporal comparison of people's subjective evaluations of their lives and living conditions are only meaningful to the extent the standard of judgement is unaltered. In consequence, the inferences from an analysis of intertemporal changes in subjective well-being are restricted since it is indistinct whether such changes are caused by a variation in the living conditions or by an adjustment of standards. This is a weak point of subjective well-being measures. The present study investigates the change in the satisfaction judgements resulting from adaptation to income over time. Adaptation is understood as desensitization (sensitization) to the hedonic effect of income resulting from an upward (downward) adjustment of the standards induced by increases (decreases) in income. An estimator for the rate of adaptation is derived from an adaptive utility function. Using data on self-reported satisfaction with household income and global life satisfaction from the German Socio-Economic Panel Study (SOEP), it is found that adaptation leads to a reduction in the hedonic effect of income of approximately 4% (satisfaction with the household income) and 6% (life satisfaction), respectively. Calculating a compensating income variation indicates that an increase in income of roughly 2% year is fully offset by adaptation. Furthermore, the results indicate that adaptation is asymmetric: People adapt faster to increases (gains) than to decreases (losses) in income. Finally, it is found that the rate of adaptation varies with education: Respondents with a high (low) educational attainment exhibit a low (high) propensity to adapt to income.

Keywords: adaptation, financial satisfaction, subjective well-being, standard of judgement

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