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Heterogeneity in the relationship between income and happiness: A conceptual-referent-theory explanation

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Abstract

This paper puts forward a new explanation to the general finding of a weak relationship between income and happiness; which is based on the conceptual-referent theory of happiness (CRT). CRT studies what conceptual referent for happiness a person has in mind when making a judgment about her happiness. The theory states that the subjective evaluation of life as a whole is influenced by a person's notion of what a happy life is. The theory stresses the importance of heterogeneity; this is: the conceptual referent is not the same for everybody. The paper shows that heterogeneity in the conceptual referent also extends to the relationship between happiness and income. Income is an important explanatory variable for some people, while for others it is completely irrelevant; and this depends on the conceptual referent for happiness a person holds. The existence of heterogeneity in the conceptual referent for happiness and, consequently, in the explanatory structure of happiness has important implications for behavioural economics. Happiness pursuing persons are expected to behave differently if they have different notions of what a happy life is. The empirical analysis is based on a large database from Mexico.

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> "What is the most valuable good that can be pursued?...Most people are pretty much agreed about the name; for both the many and the refined call it happiness,...But as to what happiness is, they disagree" Aristotle, Nicomachean Ethics.

1. Introduction

Numerous investigations deal with the relationship between economic variables and happiness (Mullis, 1990; Veenhoven, 1989, 1991, 1992; Heady, 1991; Douthitt, MacDonald, & Mullis, 1992; Diener, Sandvik, Seidlitz, & Diener, 1993; Diener & Biswas-Diener, 2002; Diener & Oishi, 2000; Diener & Suh, 1997; Easterlin, 2001; Frey & Stutzer, 2000; Fuentes & Rojas, 2001; Oswald, 1997; van Praag & Ferrer-i-Carbonell, 2004; Argyle, 1999, 2002). The general finding of an statistically significant but weak relationship (relatively low coefficients and very low goodness-of-fit coefficients) is a main paradox in the economic literature, which -as a rule- presumes the existence of a strong relationship between income and well-being.

Different theories have been advanced to explain this finding. *The Relative Explanation* states that the impact of income on a person's subjective well-being depends on changing standards based on her expectations and social comparisons (Diener et al., 1993; Easterlin, 1974, 1995; Meadow, Mentzer, Rahtz, & Sirgy, 1992; Parducci, 1968, 1995; Senik, 2003, 2004). If a person's income increases simultaneously with her reference group's income then there is little impact on that person's happiness. *The Absolute Explanation* assumes that income is relevant for subjective well-being as long as it satisfies basic needs; it implies the existence of a threshold beyond which the impact of income on subjective well-being is nil (Veenhoven, 1991, 2000). *The Adaptation Explanation* focuses on a person's ability to adapt to positive and negative events; thus, if a person has high adaptation capabilities she can easily adapt to changes in her income, so that her happiness level does not vary substantially with income (Brickman, Coates, & Janoff-Bulman, 1978). *The Aspiration Explanation* states that the degree of satisfaction experienced by a person is related to the ratio of her satisfied to total desires. Persons whose desires are fully satisfied tend to be happier than persons who have unsatisfied desires (Michalos, 1985). However, total desires are not completely exogenous to income, and as income increases so do total desires; therefore, happiness does not necessarily increase with income (Easterlin, 2001; Fuentes & Rojas, 2001; Stutzer, 2004).

This paper puts forward an alternative explanation to the paradox: *the conceptual-referent theory of happiness* (*CRT*) explanation. According to Veenhoven (1997, p. 3) "Happiness is the degree to which a person evaluates the overall quality of his present life-as-a-whole positively." He also states that "The concept of happiness denotes an *overall* evaluation of life" (p. 4) and that even though it is "clear that it is the subject who makes the appraisal, it is not so clear what the subject appraises" (p. 4) *CRT* states that each person has a conceptual referent for a happy life – the conception or notion to which the term happiness refers to – and that this referent plays a role in the judgment of her life and in the appraisal of her happiness. In consequence, *CRT* studies what conceptual referent for happiness a person has, and it states that a person's judgment about her well-being is contingent on her conceptual referent for happiness. This theory is fully explained in Rojas (2005).