

# **Adaptation to income over time**

(Proposal prepared for the SOEP 2008 Conference)

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## **Abstract**

The study establishes a new approach to the analysis of adaptation to income over time. Adaptation is understood as desensitization (sensitization) to the hedonic effect of income resulting from increases (decreases) in income. The theoretical starting point is a utility function that captures the impact of adaptation. An estimator for the rate of adaptation can be obtained by a first differences approach, which is statistically equivalent to a fixed effects model. In contrast to other studies (e.g., Clark et al. 2007; Di Tella et al. 2007), the present approach requires no information about the respondents' income history because no adaptation level—i.e., no internal reference point that corresponds to the average income of the past years—for income comparison is calculated. Accordingly, even respondents who are observed only in two successive waves can be utilized for the empirical analysis.

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 3% (satisfaction with the household income) and 8% (life satisfaction), respectively. Calculating a compensating income variation indicates that an increase in income of roughly 2 percent per year is fully offset by adaptation. Furthermore, 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. Finally, the results indicate that adaptation is asymmetric: People adapt faster to increases (gains) than to decreases (losses) in income. The study concludes that adaptation is not (fully) determined by personality and genetic factors. Hence, higher education and “joyful consumption” (Scitovsky) may lead to lower adaptation and more sustainable well-being such that an escape from the hedonic treadmill is possible.

## **References**

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**Keywords:** adaptation, subjective well-being, financial satisfaction

**JEL Classification:** C23, I31

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