

# *A Literature Review on the Explanations and Theories of the Easterlin Paradox*

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**Abstract:** This article is a literature review of the explanations and theories of the Easterlin paradox. The Easterlin paradox had been well researched in multiple interpretation paths, focusing on either the micro or macro level of the paradox. However, it has not been able to provide a perfect explanation for the paradox so that policies can be formulated and implemented. To facilitate future research, the past and latest research on theories of the Easterlin paradox will be organized and criticized. It will be shown that theories of direct and indirect mental mechanisms had their main problem with single factor analysis, while theories of external social mechanisms lacked dynamic analysis. This synthesis of current research will be helpful for further research on the real causes and solutions of the Easterlin paradox.

**Keywords:** Easterlin paradox, Economic growth, Subjective well-being

## 1. Introduction

The topic of happiness or subjective well-being has been hotly debated and well-researched internationally since the 1950s. The research had included various subjects, not only in psychology but also in economics. While the principles and influencing factors of subjective well-being had been deeply studied, controversies existed. One of the most famous would be from the economist Richard Easterlin, who came up with the Easterlin paradox [1]. The Easterlin paradox talks about the fact that wealth does not bring greater happiness. This issue was significant because the fundamental purpose of promoting common prosperity in this new era was to make people rich both materially and spiritually. Jessica Kansky and Ed Diener point out that happiness is strongly linked to many important components of life, such as physical and mental health, social relationships, academic and work performance, and so on, and that it can have a positive impact on these important components. The problem of Easterlin's paradox had resisted the steps towards extensive spiritual prosperity [2]. In order to overcome this phenomenon, suitable explanations of the Easterlin paradox were needed for further policy enactment.

In the past decades, research and studies have given different theories and explanations of the Easterlin paradox from different points of view. However, none of those theories faultlessly explained the paradox or successfully enacted the beneficial policies. Further research into the theories and

schemes for the Easterlin paradox is still needed. This research will be aimed at systematically classifying and sorting out the theories and explanations of this paradox and providing a new research direction and research angle for further research.

## **2. Literature Review**

### **2.1. The Development History of Easterlin Paradox**

In 1974, Easterlin used data from the US and 11 other nations to conduct a cross-national comparative study of happiness. First, he discovered that within a nation, the wealthy reported higher subjective well-being than the underprivileged. Second, when comparing average levels of contentment across nations, there was no discernible difference between wealthy and poor nations. Third, in terms of long-term benefits, a nation's economic growth did not raise the general level of happiness among its citizens. Thus, the micro and macro opposites make up Easterlin Paradox. At the macro level, the focus was on how economic growth affects the general degree of well-being in a country [1].

The origins and progression of the "Easterlin Paradox" were topics that were focused on in this section. To begin with, Easterlin posed two queries in 1973: "Do higher incomes for all people increase overall happiness?" and "Are individuals in wealthy nations generally happier than those in impoverished nations?" [3]. Then, in his empirical study in 1974, Easterlin formulated and argued the famous "Easterlin Paradox". He argued: "On a personal level, more money generally equates to greater happiness across all nations. However, a rise in everyone's income does not correspond to a rise in their level of happiness. The connection between happiness and wealth is a well-known illustration of this logical flaw: What applies to one person may not always apply to the entire" [1]. However, Easterlin was questioned after the theory was named. So, in 1991, Ruut Veenhoven proposed the theory of absolute happiness. The main point of this theory is that "People's happiness is based on their basic requirements as the benchmark; it is their natural and intrinsic sensations and emotions. There is no relative, shifting measure of happiness" [4]. Then, in 1995, Easterlin again argued that developed countries in Europe and the United States had experienced a downward trend in subjective well-being since 1973, despite faster economic growth [5]. Several economists did some further research. In 2008, Betsey Stevenson and Justin Wolfers examined data from almost 100 nations and discovered a link between rising happiness and economic growth [6]. So, in 2010, Easterlin amended the happiness paradox in light of further empirical research showing a positive association between economic growth and prosperity. The newly revised paradox of happiness emphasizes the long-term effects of changes in happiness. Specifically speaking, when a subjective well-being of the nation reaches a particular level as a result of economic development, it may stagnate or even decrease. This is because the potential for economic growth to boost happiness is inherently restricted over the long term [7].

### **2.2. Direct Mental Mechanisms**

A well-researched path of interpretation of the Easterlin paradox is to focus on the direct mental mechanisms given by growth economics. Theories that focus on direct mental mechanisms include the hedonic treadmill and other theories that mainly talk about how people will adapt to higher income or that there is a happiness set point for oneself [8-13].

A serious amount of literature suggests that aspirations adapt to new situations, such as the increase in income during economic growth [8-10]. This theory was in fact first proposed in the early 1970s by Brickman and Campbell, when the term "Easterlin Paradox" was not yet officially named. The phrase "hedonic treadmill" was created first by Brickman and Campbell to explain how people often adjust to both positive and negative experiences and return to their initial baseline level of enjoyment. The idea that "people were on a hedonic treadmill" simply implied that an individual's happiness

would not be substantially changed in the long term by either individual choice or public policy changes [8]. Later in 1974, when the term "Easterlin Paradox" was coined, the explanation given by Easterlin himself was that aspiration also rose with income during economic growth [1]. The increased aspiration will then lead to the adaptation of the increased income, which gives rise to a hedonic treadmill. Further research makes more empirical and supplementary contributions to the theory as well [9,10]. Stutzer had empirically tested the impact of income aspirations on people's utility and had concluded and substantiated the theory that the aspirations of people of higher income reduced their life satisfaction [9]. Additionally, McBride also conducted an experimental study of how multiple factors, including expectations, affect satisfaction and concluded that the results supported the aspirations-based theory of happiness [10].

Around twenty years later, another theory held that individual happiness is a constant of one's own, naming it the "set-point theory" [11-13]. In 1989, a dynamic equilibrium model was proposed that stipulates that every individual has an equilibrium level of subjective well-being on the basis of stable personality traits [11]. The Australian panel data collected by Brickman and Campbell that was supporting the adaptation theory, according to Headey and Wearing being critical, were lacking the practice to test forecasts to determine which of multiple alternatives constitutes a normal baseline for judging recent events. Instead, this study's findings suggest that most people exhibit rather constant patterns of life events [11]. Another study in 1996 was based on this theory and tested additional factors, including the heritability of happiness [12]. The conclusion supports the theory that individuals have a set point for their happiness, which is influenced almost equally by hereditary variables and the consequences of each person's specific experiences. Simply put, under the set-point theory, the differences in human happiness both at a moment and on average are "a matter of chance" [12]. By coming to the conclusion that life satisfaction is kept under homeostatic regulation, which brought life satisfaction back to the set-point when the level of it diverged, Cummins also made a contribution to the set-point theory from a different angle [13].

However, the theories that focused on adaptation or said that happiness is homeostatically controlled appeared to have multiple obvious flaws. Having the reasoning only from a micro- or psychological perspective, it was easy for these theories to fall into some misunderstanding of individualism. The theories will then falsely believe that subjective well-being is due to nothing but perceptual adaptation at the microlevel of oneself. In addition, the studies and research on mental status were not sufficiently supported. In order to measure the change in happiness or subjective well-being over a long period of time during economic growth, long-term tracking was needed. However, while it was difficult to track the individual's mental state, the influence of other external factors on the mental changes was also merely possible to exclude.

### **2.3. Indirect Mental Mechanisms**

Indirect psychological mechanisms suggest that macroeconomic development leads to changes in certain mediating factors, which in turn induce certain psychological mechanisms that impede the enhancement of an individual's subjective well-being, a type of explanation that is represented by the relative income theory.

J.S. Duesenbery's "relative income hypothesis" was later referenced by Easterlin as a potential explanation for the process that led to the development of the happy paradox [1]. According to the hypothesis, due to the pervasiveness of the psychology of social comparison, subjective pleasure is more dependent on the relative amount of wealth than it is on an individual's absolute level of money. While an increase in income can increase happiness, when all people's incomes increase at the same time, there is no increase in relative individual earnings, and thus the individual does not feel the psychological stimulation of the income increase, which explains the reason the country developed

at a fast pace macroscopically and has failed to bring about an increase in the nation's average happiness [1,14].

Veenhoven et al. questioned the correctness of Easterlin's paradox and naturally did not recognize the soundness of the relative income theory. Veenhoven made three criticisms of the relative income theory, stating that individual happiness is mostly dependent on the satisfaction of human needs and is an innate emotion that is not affected by relative criteria [4]. This view is supported by a number of empirical studies.

Clark et al. emphasized the significance of relative income in explaining the Easterlin Paradox [15]. They propose that individuals' happiness is dependent not only on their absolute income but also on their income relative to others. Social comparisons play a crucial role in shaping individuals' well-being, contributing to the paradoxical relationship between income and happiness [15].

Building upon Clark et al.'s theory, Boyce et al. contends that the rank of income, rather than its absolute value, is a more influential factor in predicting life satisfaction [16]. Their study indicates that people are more concerned about their position in the social hierarchy than their actual income level, further supporting the role of social comparisons in the Easterlin Paradox [16].

Aknin et al. explore the correlation between prosocial spending and levels of well-being [17]. Their findings suggest that individuals who engage in more prosocial spending tend to experience higher levels of happiness. This study implies that how individuals allocate their income, rather than the amount of income itself, can influence their well-being, adding another layer to our understanding of the Easterlin Paradox [17].

Diener et al. investigate the relationship between different aspects of prosperity and happiness worldwide [18,19]. They distinguish between material prosperity (income and wealth) and psychosocial prosperity (social support, freedom, and trust). Their study reveals that while material prosperity predicts life evaluation, psychosocial prosperity is a stronger predictor of positive feelings [18,19]. This reference highlights the importance of non-monetary factors in comprehending the Easterlin Paradox.

In conclusion, this section of the literature review has explored the indirect mental mechanisms underlying the Easterlin paradox. The references reviewed shed light on the role of relative income, social comparisons, prosocial spending, and psychosocial factors in shaping individuals' happiness. Understanding these complex interactions between income, happiness, and psychological factors contributes to a more comprehensive comprehension of the Easterlin Paradox. Further investigations in this area can provide valuable insights for policy-making and other government interventions aimed at enhancing overall well-being in societies.

## 2.4. External Social Mechanisms

The explanation path about external social mechanisms believes that although macroeconomic development itself can improve the subjective well-being of residents, certain social factors tend to change in the process of economic development. These collateral effects will limit the improvement of individuals' subjective well-being, even if they have omitted variables, and the impact of income is not significant compared with other factors affecting happiness. His second explanatory path is based primarily on the theory of omitted variable bias, which occurs when the relevant explanatory variables are not included in the regression model. In other words, it means that you are missing an important factor, which will limit the validity of the findings.

Firstly, Richard Layard has concluded through research that seven factors are central to affecting happiness [20]. He used research such as the US General Social Survey to rank these factors in order of importance; two of these factors are considered central but cannot be ranked due to a lack of investigative evidence. This proves that in addition to income-related factors, there are many other overlooked non-economic factors that also have a strong impact on happiness and are even more

important for happiness [20]. This is also evidenced by the study of Diener and Seligman, who affirm that economic indicators contribute a large amount to happiness in the early stages of economic development [21]. However, as people get richer, income has less of an impact on happiness, and factors such as social connection and enjoyment of work have a more significant effect on this difference. They also point out that non-economic, predictable factors that have a significant impact on the average well-being of societies mainly include social capital, democratic governance, and human rights [21].

Since then, more and more people have analyzed the impact of factors such as social capital, inequality, life expectancy, democratic governance, working hours, inflation, and unemployment on individual subjective well-being. It turns out that income growth can increase individual happiness, but it also leads to potential factors that may reduce the utility of income growth [22-26].

On the other hand, rising incomes may have some negative potential factors that may reduce the happiness and utility of income growth. For example, the meaningless consumption brought about by rising incomes does not lead to long-term happiness and even creates burdens. Robert Frank, documenting the new boom in conspicuous consumption through economic analysis of individual decisions, found that as incomes rise, the hidden prices people pay for more sophisticated homes, cars, and lifestyles put unnecessary stress on life [27]. Another example is that as incomes rise, hours may also rise. Long working hours have been praised for promoting rapid economic growth in Asia-Pacific countries [27]. However, the side effects of overwork have been discussed but not taken seriously enough. Long working hours have been increasing for decades, leading to health consequences for more and more people due to work stress. The joint WHO/ILO estimate sounded the alarm about this unhealthy but underappreciated practice and highlighted the urgent need to address this health crisis [28].

However, there are still some problems in this research direction, among which single factor analysis and static interpretation are two, although the theory of missing variables reflects the analysis orientation of multiple factors and cannot clarify the dynamic process of changes in each factor with the development of macroeconomics and the correspondence with individual income growth in this process. As a result, it is impossible to provide a reliable explanation for changing trends in happiness. Research should be combined with the context of the times and more integrated into social elements.

### 3. Conclusion

Based on the various theories and explanations under the various interpretation paths mentioned, common defects of the theories could be identified and directions for the further researches in the field may be broadened.

To begin with, as the literature review part was clearly classified into three different interpretation paths of direct or indirect mental mechanisms with external social mechanisms, the theories shared the mistake of single-factor analysis. Theories that focused on adaptation and homeostatic control only concluded that the change in subjective well-being was the result of psychological mechanisms and omitted the influences of external society [10,11,13]. Similarly, although the theories under the indirect mental mechanism were based on the mental effect of the surrounding average income, the effect of the times and environmental background were not considered, which could hardly ever explain the basic reasonings of the Easterlin Paradox [15,16]. For the theories of external social mechanisms, the problem of a lack of dynamic analysis existed, as mentioned in the last section. The static interpretation of the added variable, however, made it nearly impossible to explain the dynamic change in subjective well-being. Thus, based on the analysis and discussion, further research may be focused on a more multivariant and dynamic analysis of the elements with long-term tracking of subjective well-being.

In addition, theories explaining the Easterlin paradox should not be separately analyzed from either a micro or macro perspective but should be combined. The Easterlin paradox, again, was divided into two levels, micro and macro, and was contradicted. However, theories should not simply analyze either one of the micro or macro parts to explain the paradox because the national economic growth at the macro level undeniably impacted the income growth at the micro level, which was a fact that allowed the Easterlin paradox to form. Common theories either discussed the macro results with micro mechanisms or just ignored the micro results of paradox and only analyzed the inhibition of macro variables on subjective well-being. In both cases, flaws in the logical structure existed to explain the paradox. Further research should combine the micro and macro mechanisms, take the two parts of the Easterlin paradox into account, and focus on the micro-based and macro-conditioned effects in order to establish the full logical chain to explain the paradox.

### Authors' Contributions

This article is a literature review on the explanations and theories of the Easterlin paradox that aims to facilitate future research. The innovation point of this article lies in the logical and systematic classification and analysis of previous studies and research in this field, and it clarifies the errors that further research can avoid as well as the directions that can be focused on. As this research was concluded, previous explanations and theories had common mistakes of single factor analysis without combinations of micro and macro levels and lacked dynamic analysis that could really focus on the subjective well-being stagnation mechanism over time. This article provided directions for future research, stating that future research should focus on dynamic analysis at both the micro and macro levels.

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