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Gaining Knowledge of the Income-Happiness Nexus through Behavioural Economics and Utility Theory

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ABSTRACT
The dependency between income and happiness has been a major topic of concern in economics, psychology and policy formulation. Although the conventional utility theory has assumed that income has a positive relationship with wellbeing in terms of increased consumption and material security, empirical studies are beginning to indicate that the relationship is intricate, nonlinear, and situation-specific. This synthesis review article combines the wisdom of the utility theory and behavioural economics to come up with a holistic explanation of income-happiness nexus. The paper will utilize current empirical research and theories to explore the joint effects of the diminishing marginal utility, reference dependence, the loss aversion, the institutional contexts, and social comparisons on the subjective wellbeing. The review notes that the literature continues to experience puzzles such as the Easterlin paradox, asymmetries in responding to changes in income, and frustrated achievers, in which increasing incomes do not translate into corresponding increases in happiness. The combination of classical economic model and behavioural processes also helps the paper prove that income is not a relevant and predictable driver of sustained wellbeing. Rather, the results of happiness are determined by the stability of incomes, relative position, inequality, social participation, access to non-income determinants, including health, job quality, and social cohesion. The paper ends with a policy implications and future research directions which underlines the importance of having wellbeing-oriented policy frameworks that should not be based solely on the growth in GDP and income as measures of societal development

Keywords: - Income–Happiness Nexus; Subjective Wellbeing; Behavioural Economics; Diminishing Marginal Utility; Social Comparison; Easterlin Paradox; Wellbeing-Oriented Policy; Economic Growth

INTRODUCTION:

Does having more money guarantee that you will be happier? Since it lies at the intersection of material prosperity and human wellbeing, the question has long been a source of concern for economists, psychologists, and policymakers (Diener and Seligman, 2004). According to classical economic thinking, based on the utility theory, the income is regarded as one of the most important determinants of individual welfare. Increased income raises purchasing power which allows people to buy more goods and services that fulfill needs and tastes thus leading to an increase in utility and life happiness (Wilkinson, 2007; Gazi et. Al., 2025). This reasoning is often supported by the empirical evidence in countries, which indicates that people with higher income levels report about their greater levels of subjective wellbeing (Hirschauer et al., 2015). But not all is a linear and unlimited relationship. According to the principle of diminishing marginal utility, although growth in income at lower income levels results in increasing happiness, with all else held constant, each unit of income provides relatively smaller amounts of happiness as income increases (Abdallah et al., 2009). Consequently, the additional income might add little to the total life satisfaction at some point making it unjustifiable to claim that income is an adequate or sufficient indicator of wellbeing (Gasper, 2005).

What seems to be the contradiction between increasing incomes and happiness stasis at the social level has prompted researchers to consider the issue of the income and happiness relationship more closely. The work of (Easterlin, 2001) is among the most powerful input into this discussion as the author noted that, even though the richer people in a nation are usually happier than the poorer ones, economic growth in the long-term period does not necessarily cause a consistent rise in average happiness in a nation. This is what is commonly known as the Easterlin paradox and this observation implies that wellbeing is significantly dependent on factors other than absolute income. The higher the growth of the economy, the higher the aspirations, expectations and social reference points of people, which might counterbalance the happiness gains brought about by increased income. The result is that it is quite possible to end up on a hedonic treadmill where the gains in the material conditions are rapidly adjusted and do not lead to any sustainable growth of happiness any longer. These lessons undermine objectivist principles of the standard economic model and encourage a more psychologically conscious approach to wellbeing.

Behavioural economics is such an alternative framework, where the psychology of analysis is implied into economics. Instead of presupposing that people compare outcomes in absolute terms, behavioural approaches point towards the fact that the human decision-making is reference dependent, loss averse and socially embedded. The innovative research of (Diener, 2000) and his colleagues proves that people lose more significantly than corresponding gains, which means that a loss in income or status can have a disproportionately negative impact on happiness. In addition, individuals are more likely to compare their wellbeing against other individuals, and therefore subjective wellbeing revolves around social comparisons and relative income. Adaptation also makes matters more difficult: people tend to adapt to richer lifestyles as time goes by, which means that the happiness benefit offered by increasing income would eventually wear down. Cumulatively, these behavioural processes are indicative of the fact that the income versus happiness nexus is dependent on expectations, social context, and psychological processes and not a mere function of consumption possibilities per se.

It is against this backdrop that the current review intends to compilate findings on utility theory and behavioural economics to come up with a deeper insight into the income-happiness nexus. In particular, it tries to accomplish three goals. First, it plots the major theoretical processes by which income can impact wellbeing and these may include consumption and diminishing marginal utility, up to reference dependence, loss aversion and adaptation. Second, it determines what circumstances cause income not to produce a desired boost to happiness, e.g. when escalating aspirations, social comparisons, joblessness, ill health, or work discontent erode the beneficial outcomes of higher income. Third, it outlines the consequences of these discoveries to the study of the economy and the policy of governments especially the constraints of using income growth or gross domestic product (GDP) as a measure of social progress. This review can be used to add a more detailed and realistic picture of wellbeing in which both the material and psychological aspects are taken into consideration by combining traditional and behavioural perspectives.

This integrative approach is anchored on key contributions of scholarship. Along with the income, aspirations, and long-term happiness patterns (Easterlin, 2001) analysis, the institutional and measurement-driven (Frey & Stutzer, 2000) one shows the role of political, social, and institutional factors in modulating the wellbeing outcomes. They have found in their study that democratic involvement, employment security and social trust can have a big impact on happiness irrespective of income. In the meantime, developments in subjective wellbeing measurement by (Diener, 2000) have enhanced the empirical basis of the happiness studies, and allowed better comparisons among individuals, groups and nations. Taken together, these contributions demonstrate that happiness is a multidimensional construct that cannot be fully understood through income alone. By drawing on this rich interdisciplinary literature, the present review sets the stage for a deeper examination of how income interacts with psychological and social factors to shape human wellbeing in contemporary economies (Vendrik & Woltjer, 2007).

2. LITERATURE REVIEW

Nademi and Kalmarzi (2026) re-analyzed the income-happiness relationship by suggesting a combination framework that includes a nonlinear and reciprocal relationship. The authors merged X-means clustering with simultaneous-equations panel modeling based on panel data of 15 European countries between 1995 and 2020. The results showed the inverted U-shaped relationship between the GDP per capita and the life satisfaction. The paper has also established strong bi-directional causality where happiness influenced positively productivity and GDP per capita with time. The findings undermined the income-based models of welfare and reiterated the significance of additional social determinants to maintenance of well-being.

Khalil (2024) explored the problem of the income-happiness paradox through the assessment of the set point theory drawbacks, specifically concerning the explanations put forward by Daniel Kahneman. The paper contended that the difference between the experiencing self and the remembering self was not pertinent to the solution of the paradox. Later on, when Kahneman placed a focus on the evaluation of life and the establishment of the personal goals, this was revealed to be conflicting the main assumptions of the set point theory. The explanation, by insinuating that happiness was not constant both in the case of constant goals and in the case of variable goals, ended up contradicting the concept of hedonic adaptation. The examination made a conclusion that the income-happiness paradox was still unexplained.

Popescu and Reis Mourao (2024) analyzed the connection between innovation performance and the happiness of society based on the data of 130 countries, the timeframe of which was 2011-2022. By using the system GMM regression analysis, the authors discovered that the level of resident happiness was also more common in the countries with higher levels of innovation, especially in the economies of higher income. The findings showed that innovation had a positive impact on societal well-being in that it contributed to economical competitiveness and social development. The research confirmed the hypothesis that innovation made people happier and offered valuable policy implications that could lead to the establishment of sustainable economic development and the quality of life on the national level.

Huang et al. (2024) reevaluated the Easterlin paradox. The study based on panel data on 31 provinces through 11 years and social media content processed with machine learning discovered that GDP per capita has a positive effect on happiness across all provinces provided the income inequality was not above a critical point. Increasing inequality undermined this correlation greatly. The results indicated that economic growth would only increase well-being when there was equitable distribution of income, which added subtle information to the debate on happiness and income.

Kraft & Kraft (2023) examined whether the mediation of the correlation between income and subjective well-being (SWB) was mediated by social comparison processes. The authors used two longitudinal surveys, revealing that the direct impact of income on SWB was not detected in case of the consideration of subjective socioeconomic status and comparison with similar peers. In its place, social comparison was found to be the best predictor of well-being. The mediation analysis revealed that income had an indirect effect on SWB by subjective perceptions instead of the objective levels of income. The paper has emphasized the distinction of psychological and social processes, which include self-esteem and perceived control in determining personal well-being.

Khalil (2022), who made a distinction between two dimensions of happiness that are disclosed by different survey techniques. Owing to cross-sectional surveys, happiness followed the income by making people compare their present well-being with that of the past. However, time-series surveys promoted comparisons against future aspirations, and thus led to stable happiness despite increasing income. This contextual appraisal model balanced-out contradictory empirical data without having to use hedonic adaptation. The research contributed to the understanding of the field of happiness economics because it highlighted the importance of reference points and contexts of evaluation that define reported well-being.

Oishi et al. (2022) analysed the variation in the income-happiness relationship of various regions across a number of decades. The results indicated that the correlation grew in the United States and Europe with the growth of GDP per capita and income inequality and dropped in the Latin American countries with the loss of inequality. Japan showed no stabilized trend. The findings showed that income inequality cushioned the intensity of income-happiness relationship, which made income more psychologically salient in unequal societies. The paper established that income-happiness relationship differs between economic and distributive settings.

Gaya (2021) found the correlation between income and life satisfaction in South Africa. The authors did not find any direct linear or non-linear correlation between income and life satisfaction. Higher income alleviated severe dissatisfaction although it did not cause an increase in overall life satisfaction. The longitudinal analysis showed that there was no regular trend of increase or decrease in income to happiness over time which supported the Easterlin paradox. The results indicated that income thresholds had abolished severe suffering but were too low to enhance long-term changes on subjective well-being.

Roka (2020), the study has examined how economic growth, happiness, and inequality are connected through panel data of 120 countries in the period 2008- 2016. Using the techniques of fixed effects, random effects and dynamic panel data estimation, the research concluded that GDP growth and income positively determined happiness. Nevertheless, income inequality also grew, and this impact on happiness was negative. The findings showed that one of the drawbacks of economic growth was the inequalities in distribution of incomes. The paper has highlighted the importance of incorporative growth policies to improve happiness whilst managing inequality.

Jain, Sharma and Mahendru (2019) conceptualized the existing body of work on happiness by incorporating the subject, social and environmental views. These authors analyzed the empirical evidence and clustered it into broad themes, and have determined what major causal processes affect happiness. The research has highlighted that happiness was not solely income- and material wealth-based, but multidimensional measurement structures are needed. It also noted methodology and policy issues associated with the objective measurement of happiness. The authors suggested that governments should formulate policies that were aimed at managing psychological, social, and environmental factors that determined well-being as well as economic development.

Table 1: Comparative Analysis of Studies on Income, Happiness, and Well-Being

Author(s) & Year	Data / Sample	Methodology	Key Focus	Main Findings
Nademi & Kalmarzi (2026)	15 European countries (1995–2020)	X-means clustering; simultaneous-equations panel model	Nonlinear and reciprocal income–happiness relationship	The relationship between income and happiness followed an inverted U-shape, and happiness positively influenced productivity and GDP per capita over time.
Khalil (2024)	Conceptual analysis	Critical theoretical review	Limits of set point theory	Set point theory failed to resolve the income–happiness paradox, as

				happiness depended on evolving goals rather than a fixed baseline.
Popescu & Reis Mourão (2024)	130 countries (2011–2022)	System GMM regression	Innovation and happiness	Higher innovation performance was associated with higher societal happiness, especially in high-income countries.
Huang et al. (2024)	31 Chinese provinces (11 years)	Machine learning; fixed effects models	GDP, inequality, and happiness	Economic growth increased happiness only when income inequality remained below a critical threshold.
Kraft & Kraft (2023)	Two longitudinal surveys (n = 1,202)	Regression and mediation analysis	Social comparison and SWB	Income did not directly affect well-being; subjective SES and social comparison fully mediated the relationship.
Khalil (2022)	Cross-sectional and time-series data	Contextual theoretical analysis	Easterlin paradox	Happiness tracked income in cross-sectional contexts but remained stable over time due to
				aspirational comparisons.
Oishi et al. (2022)	USA, Europe, Japan, Latin America (1970s–2010s)	Longitudinal cross-national analysis	Income inequality and happiness	The income–happiness correlation strengthened in high-inequality societies and weakened where inequality declined.
Gaya (2021)	South African panel data (2008–2014)	Repeated measures analysis	Income and life satisfaction	Higher income reduced extreme dissatisfaction but did not increase overall life satisfaction, supporting the Easterlin paradox.
Roka (2020)	120 countries (2008–2016)	Fixed effects; dynamic panel GMM	Growth, inequality, happiness	Economic growth increased happiness but also raised inequality, which negatively affected well-being.
Jain et al. (2019)	Review of empirical studies	Systematic literature synthesis	Multidimensional happiness	Happiness depended on psychological, social, and environmental factors, not income alone, requiring holistic

				policy approaches.

3. METHODS

The paper follows the narrative review approach to combine the theoretical and evidential works that have been influential on the topic of income and happiness relationship in economics and psychology. The idea of a narrative approach is somewhat suitable considering the conceptual and interdisciplinary aspect of the topic which cuts across utility theory, behavioural economics and research in subjective wellbeing. Instead of covering exhaustively, the review focuses on depth, coherence and theoretical relevance. The criteria of selection were used on works of high impact that have contributed to foundational discussions or proposed central processes describing the role of income in happiness. These are classical utility and diminishing marginal utility, behavioural economics models stressing on reference dependence and loss aversion and adaptation, and empirical research that operationalises happiness in terms of subjective wellbeing measures. The combination of these strands is intended to make the review representative of the overwhelming economic logic, as well as those psychological refinements that are countervecting or moderating it.

Peer-reviewed journal articles published in major economics and psychology journals were used as the main basis of the literature selection process based on the information available on the leading journals, accompanied by influential book chapters and popular policy reports. Empirical studies have been selected because they are considered to be methodologically sound, have relevance to the income-happiness nexus, and use large-scale survey or panel data, which can be used to compare across income groups, time, or countries. The specific focus was on research that directly tests the behavioural mechanisms which could be relative income effects, aspiration gaps, or adaptation dynamics and not income as a sole objective determinant of wellbeing. Besides that, significant policy reports concerning wellbeing measurement were also used to put academic debates into context among wider discussions on the assessment and use of happiness and life satisfaction in policy evaluation. The review is purposefully narrow in its coverage: it does not aim at giving a definitive description of all determinants of happiness and it is not heavily involved with neuroscientific or clinical psychological literature. Rather, the emphasis is on economic and behavioural accounts of the relationship between income and happiness, where the analytical clarity is clear but both the viewpoint is integrative. The reasons why these specific sources are used are described in the reference list, and this will enable readers to see how and why the review was conducted.

3. Traditional Economic Theory: Income, Utility, and Diminishing Returns

3.1 Utility theory and the positive income–happiness link

Classical microeconomic theory defines wellbeing as utility that is obtained by consumption of goods and services. In this context, income becomes the center of focus since it defines the capacity of an individual to access resources that will meet the needs and preferences (Stern, 2022). With higher income, people have more freedom of choice regarding consumption, which enables them to ensure better living standards, the higher level of comfort, and the decreased level of material deprivation. The set of increased consumption is presupposed to be directly translated into increased utility, and, consequently, the increased happiness or life satisfaction (Bruni, 2020). This assumption seems to be supported by empirical evidence in the domestic context, because people who have higher incomes tend to have greater subjective wellbeing than those who have less (Vieira Lima, 2014). The correlation is especially close at the bottom of the income distribution, where further income might make a big difference, to necessities including food, housing, healthcare, and education (Petrakis, 2020). In these settings, growth of income reduces the financial stress and insecurity, which result in significant improvements in perceived wellbeing. In this sense, income is considered as a useful and objective proxy of welfare and economic development is synonymous to the growth in happiness. The utility-based model hence offers a very straightforward and instantly attractive explanation of the importance of incomes in wellbeing, the cornerstone of classical economic thought regarding the income-happiness relationship (Bardhan and Udry, 1999).

3.2 Diminishing marginal utility and the plateau effect

Although the utility theory would predict the positive relationship between income and happiness, the theory also includes the concept of diminishing marginal utility (Easterlin, 2005). This principle is based on the fact that the more the income one has, the less the extra satisfaction he or she gets on each extra unit of income. In practice, large wellbeing benefits are achieved due to the first increments of income, as they satisfy urgent needs and decrease deprivation. But, when these needs are satisfied, additional income growth is likely to be spent on discretionary expenditure, luxury goods, or even status product purchases that do not add much to happiness in general. Consequently, the level of happiness increases at a high rate at low levels of income but levels off as the income increases. This concave relationship can be used to explain the fact that large inequality in income among high earners is commonly linked to rather small differences in reported life satisfaction. This can be enhanced by the increasing aspirations in the course of life (Layard et al., 2008). There is a tendency to raise expectations, wants, and living standards as the income of individuals rises which compensates the possible increase of the happiness level. Long-term income growth, accordingly, might not lead to any long-lasting increases in the wellbeing, despite the objective increment in material conditions. The diminishing marginal utility idea, therefore, makes an essential concession to the naive belief that the more money one makes the happier he is (Clark et al., 2008).

3.3 Limits of the objectivist approach

The traditional method of utility-based approach, though analytically clear, has significant limitations. This puts a premium on objective income and consumption, which in turn ignores the subjective, social and institutional aspects of wellbeing (Lawsky, 2010). Other aspects of life satisfaction, including job quality, job security, physical and mental health, social relationships, and community belonging are important factors but cannot be well measured solely by income factors. High-income earners might be low-income earners subjected to stress, work-life conflict, loneliness, or poor health, whereas moderate-income earners might be reporting high values of wellbeing because of meaningful work, good social networks, or good institutions (Caporale et al., 2009). In addition, the classical models commonly presuppose constant preferences and rational assessment and dismiss the role of emotions, perception, and social environment in determining wellbeing. The objectivist who focuses on maximizing income or consumption also creates normative concerns because greater reported happiness does not always go in line with greater social interests in equity, sustainability or social cohesion. Institutional arrangements and measurement decisions also make the interpretation of the outcomes of happiness more complicated. Such restrictions indicate that income is not an exhaustive indicator of human wellbeing, and methods based on a combination of psychological and social variables and material conditions should be implemented (Nademi and Kalmarzi, 2026).

4. Behavioural Economics: Mechanisms That Modify the Income–Happiness Relationship

4.1 Reference dependence and relative income

Unlike the assumption of taking income and wellbeing as absolutely measured, behavioural economics focuses on reference dependence as a key element to happiness (Clark et al., 2006). People determine their income based on a yardstick that can be based on previous income levels, individual expectations, or income levels of other individuals in a group or profession. Consequently, wellbeing is also determined not as strongly by the amount of money one receives in absolute terms but by whether the money is an increase or a decrease of what they consider normal or what should be received. The income growth that only matches those of peers or upward expectations can result in only minimal increment in happiness because such growth is not associated with relative position (Clark et al., 2008). Conversely, even a minor loss or no improvement in income can have a drastic effect on wellbeing when it is perceived as a loss compared to the other ones. This is the reason why even people in booming economies can become dissatisfied as their relative standing is not increasing. The comparison of incomes also adds to the pressure on the competition, as happiness does not rely on the material sufficiency but on the social ranking. Therefore, it is possible that people will be worse despite objective income growth, particularly in unequal societies where income disparities are very prominent. Reference dependence consequently undermines the direct relationship between income and happiness because wellbeing is pegged to social comparisons and expectation and not consumption per se (Vieira Lima, 2014).

4.2 Loss aversion, status quo bias, and mental framing

Loss aversion also changes the income sensitivity to happiness so that people become disproportionately sensitive to decreases (Penedo Prieto, 2018). Individuals are more likely to feel the impact of any loss than an equivalent gain, so when people are deprived of income or feel threatened by financial insecurity, then a loss will have a much more damaging effect on wellbeing than the equivalent gain. This imbalance explains why the economic slowdown, loss of work or employment or reduction in wage levels sometimes have such a dramatic psychological impact, even when the overall income outlook is not in danger. Loss aversion is also a cause of status quo bias, in which people like to stay in their status quo instead of being exposed to the possible losses created by change (Cartwright, 2024). Indicatively, one might not want to change jobs, change residence or engage in business ventures in case of job uncertainty, permanent income, in spite of higher expected financial payoff. Mental framing is an important component of this process: the way the changes in income are framed or perceived can have an impact on the results of the emotional reactions and happiness. Stability in incomes and loss-aversion may thus be important determinants of wellbeing, rather than growth in incomes. This observation explains why the policies that minimize income volatility or cushion individuals against big negative shocks can yield huge wellbeing payoffs, even in the absence of an increase in average income levels (Cesareo, 2018).

4.3 Adaptation (hedonic treadmill)

Adaptation, commonly referred to as the hedonic treadmill, is what is believed to be behind the short-term nature of the effects of income increase on happiness. As people have their income increased, they tend to report a temporary increase in the level of life satisfaction because they live better or feel an accomplishment (Lecouteux, 2015). Nevertheless, in the course of time, individuals get used to such new situations and the increased degree of happiness slowly goes back to its usual level. The expectations shift, the consumption norms shift and what previously seemed as an improvement becomes a commonplace. This mechanism decreases the emotional effect of income growth in the long-term and can be used to discuss why long-term economic growth does not necessarily result in long-term average happiness growth (Micheletti, 2012). Adaptation is also asymmetrical in nature as one can adapt more slowly to negative experiences, like unemployment or a loss of money and this will have long-term impact of reducing wellbeing. The hedonic treadmill thereby nullifies the hypothesis that steady rise in income can increase happiness in a linear way, implying that wellbeing is a dynamic psychological condition instead of a predetermined income (Ayllón and Fusco, 2017).

4.4 Social participation, fairness, and prosocial behaviour

Another aspect of behavioural economics is the extent of social participation and the sense of fairness when it comes to determining the relationship between income and happiness. Personal consumption does not bring about happiness but happiness is inherent in social interactions, membership in the community, and moral judgment of economic results (Koch et al., 2015). People usually find gratification in the involvement in the social life, in being helpful to others, and to the overall welfare. In this regard, income giving through charity or assistance to persons, families and communities can help increase the level of happiness, despite the drainage of individual finances. These activities enhance social affiliation, build identity and foster the feeling of purpose (Camerer and Malmendier, 2007). On the other side, increasing inequality or current views of unjust allocation of income may diminish wellbeing because they lead to resentment, insecurity, or being social outcasts. At the point where people feel that effort and reward do not go hand in hand, income gains might not lead to happiness. Moreover, the growth of aspirations outpacing income can result in frustration even though objective achievements have been made and hence the falling life satisfaction (Vossensteyn, 2005). The relationship between income and happiness revealed by these dynamics shows that income has variable power on happiness not just based on material conditions, but also based on the social sense and perceived equity, which proves that wellbeing needs to be considered as more than just earnings.

5. Empirical Evidence: Patterns and Puzzles

5.1 Within-country positive correlation (but heterogeneous)

Empirical studies using cross-section surveys data always show that there is a positive correlation between income and life satisfaction within nations (Brzezinski, 2025). Income earners who have high incomes are usually more reportedly happier than those with lower incomes, especially in the society whereby a substantial percentage of the population is unable to afford even the most fundamental needs. In this situation, extra income may lead to significant improvements in living standards, decrease financial pressure, and access more important goods and services, yielding significant wellbeing increases. But this relationship is not so even. There is a significant diversity among people, which means that the amount of income offered cannot explain all the differences in happiness (Schroder, 2018). Issues like employment, job status, physical and mental conditions, marriage and family, and personality types have a tendency to influence wellbeing in the same or even a greater degree as income does. As an example, the lack of jobs or ill health can pile on the happiness of relatively well-paid people to a considerable extent, and at the same time, good relationships within the community and meaningful employment may make relatively low-income earners stay rather happy (Ngamaba, 2017). These results have indicated that although income matters the influence it has is heavily conditional on non-financial factors and the multidimensionality of happiness in societies should be emphasized (Stavrova, 2019).

5.2 The Easterlin paradox and cross-national contrasts

One of the key mysteries of the empirical research is the fact that the long-term growth of income does not necessarily lead to the increase of the average happiness on the national level. Although generally, the wealthier members of a nation are expected to be happier than poorer ones at a specific moment in time, the long-term growth in per-capita income does not always translate into an equivalent increase in the overall reported wellbeing (Exton et al., 2015). This trend is sometimes known as the Easterlin paradox, and it shows a discrepancy between the short-run, cross-sectional associations, and long-run time series relationships. A number of reasons were suggested, such as adjustment to increased income statuses, growing aspirations that follow the growth of the economy, and heightened social comparisons in richer societies (Lomas et al., 2025) . Evidence across borders makes the situation even more difficult. The richer nations tend to record greater average happiness than the poorer nations, but wellbeing discrepancies are usually small among prosperous nations irrespective of huge income diversities. Even though later research contradicts the universality of the paradox by finding positive long-run correlations between income and happiness in the setting of some conditions, the overall implication is as follows: economic growth in itself is not a good predictor of long-run increases in aggregate wellbeing (Pfaff & Hirata, 2013).

5.3 Loss aversion and asymmetric responses to income changes

Empirical research that quantifies wellbeing as reference-dependent indicates that people react to increasing and declining incomes in an imbalanced way. Losses of income, including unemployment loss, wage reduction loss, or economic shock loss, would tend to offer steep and lasting decreases in happiness, whereas the corresponding increase in income would lead to smaller and frequently short-lived ones (Clark et al., 2008; Antonakakis and Ticini, 2025). This imbalance is a result of the psychological disposition to value losses more than gains and negative changes in income are especially harmful to subjective life. Longitudinal data indicates that people tend to respond slowly to income losses particularly when such losses are related to job displacement or long-term insecurity. Conversely, income gain adaptation tends to be quicker, and levels of happiness revert to baseline with time (Leites and Ramos, 2022). These patterns have significant implications on the policies that governments can implement, indicating that preventing large losses of income and ensuring individuals are not subjected to economic insecurity can result in more benefits to wellbeing than policies that aim at increasing average incomes only. Stability and security as opposed to growth alone turn out to be determinants of happiness.

5.4 Frustrated achievers and aspiration gaps

The other valuable empirical observation is that of so-called frustrated achievers, the people whose incomes increase yet the level of life satisfaction does not improve or worsens. This effect is normally seen in cases where the growth of income is matched with an increase in aspirations, expectations, or social comparisons, which is even higher. As people become more economically advanced, they can increase their standards of what is considered a good life, or even benchmark themselves against other more wealthy reference groups, or even be pressurized to live a particular way (Becchetti et al., 2008). In cases where the increases in income do not match these rising standards, people might not end up being satisfied but, instead, disappointed. This serves to explain the reasons why certain middle-income populations are being recorded as experiencing falling wellbeing even though there is apparent material growth. The presence of frustrated achievers makes relative income and expectations especially important to happiness and demonstrates the shortcomings of income growth as a measure of social progress.

6. Integrative Framework: When Income Matters Most (and When It Doesn't)

The combination of theoretical discussions with empirical data may indicate that the correlation between income and happiness is not the same or linear at all, but very context and situation-specific (Carr et al., 2016). On the most basic level, absolute income is very important in the determination of wellbeing when people or households find it difficult to sustain basic needs. Additional income can contribute greatly to food, shelter, healthcare, education and safety making the environment less vulnerable and stressful in low-income settings. When this is the case, income growth produces a significant and direct impact on happiness in that it reduces deprivation and increases material security. But beyond a certain level of satisfaction of the first order needs, the extra income becomes less relevant to wellbeing. Once income levels have risen, happiness ceases to be about consumption of material goods and more a perceptions and experiences of income in a social and psychological context which is more inclusive.

In addition to the basic sufficiency, the relative income and social comparisons tend to gain prominence. People can also not compare their position in the economy with that of others, but against colleagues, peers or reference groups (Gough and McGregor, 2007). Consequently, incomes that fail to raise relative position can yield less or no happiness increments. In other situations increased incomes within the society may only enhance competition and comparison which may result in people being unhappy even when there is objective change in the standards of living. The income-happiness relationship is also determined by the risk of incomes falling and volatility. Loss aversion causes the decline of income or economic insecurity to be more intense than the gains that are equivalent. The threat of losing a job or being in debt or other financial difficulties can significantly diminish wellbeing, even in individuals with rather high incomes (Phillimore et al., 2021). This illustrates the significance of income stability and negative shock insurance, which might be more related to long-lasting happiness than income growth by itself (Lederer et al., 2014).

Dynamics of adaptation are also central to the issue of when income is important to happiness. The growth of income is more likely to produce temporary improvements in wellbeing, yet people are likely to adjust to new better conditions over time as expectations and aspirations change accordingly. In the absence of a corresponding shift in health, social relations, or the purpose of work, this increase in income will not be followed by permanent gains in happiness (Hartono and Chuan, 2011). Lastly, income is moderated by more general contextual and institutional variables that determine the translation of income into wellbeing. The positive impacts of income may be increased by strong social safety nets, high quality employment, trust in institutions, and lower rates of inequality to increase insecurity and help foster social cohesion. Quite on the contrary, the wellbeing gains of income growth can be compromised by weak institutions and high inequality. All of these are indicative of a non-linear, context-specific income-happiness association: income is most important when it has been acquired to obtain the necessities and alleviate risk, and least when it is simply a stimulus to consumption in the environment of increasing ambitions and social comparisons (Lindeman, 2014).

7. Policy Implications

The implications of the evidence consulted in the study are significant to economic and social policy, especially to those governments which still focus on the increase of income and gross domestic product as the main parameters of the progress. Although income is a significant situational constituent of wellbeing, by itself, concentration on GDP development offers a false and fragmentary view of welfare in society. This implies that policy makers need to stop using income-based measures and implement direct measures of wellbeing in policy design and evaluation. An indicator of wellbeing that reflects life satisfaction, mental wellbeing, social trust and perceived quality of life enables governments to determine whether the economic benefits are ensuring that people have been enjoying the benefits. This can be used to find policy trade-offs that can raise output, but may damage wellbeing and interventions that can produce high returns on wellbeing at low economic cost. A health policy framework will promote more comprehensive method of development as prosperity is not solitary but is multidimensional.

Another important policy point is the protection against the loss of income and economic insecurity of the individuals. The behavioural evidence demonstrates that the impact of negative shocks and losses is much stronger on happiness than the equivalent gains, implying that policies which decrease the risk of downside can have disproportionately wellbeing benefits. The social insurance programmes like unemployment benefits, health insurance, and income support in times of crisis can stabilize the households and alleviate anxiety in future. These policies reduce the psychological insecurity associated with a sudden decrease in income and promote a lasting drop in wellbeing in the event of job loss or sickness. Notably, the welfare advantages of such safeguards go beyond those individuals right in the middle of the picture since the lower level of insecurity also leads to increased societal stability and trust. This indicates that policies that seek to stabilize income might be more effective in enhancing the happiness of the population as compared to policies that concentrate on increasing the levels of average income.

It is also essential to address the gaps in aspirations and income differences in order to maintain wellbeing in the developing economies. Inequality in distribution of income or the increase in aspirations in comparison with the increase in earnings may lead to frustration and decrease of life satisfaction in spite of the objective improvement. These disparities can be bridged with policies that lessen severe inequality, enhance equity of opportunities and access by most to education, healthcare and social services, thereby enhancing relative wellbeing. Lastly, governments need to allocate a higher level of resources to non-income aspects of happiness, including mental health care, labor quality, social bonding, and community health. Any development in these spheres can provide sustainable wellbeing returns that cannot be obtained with the growth of income alone. It is upon concentrating on these dimensions that the policymakers will be able to create a more resilient, inclusive and truly prosperous society.

8. Limitations and Directions for Future Research

The major shortcoming of the existent literature on the income-happiness relation is the measurement of wellbeing per se. Empirical research is mostly based on self-reported concept of happiness or life satisfaction, which, although its utilization is common and informative, is a subjective concept that is prone to a number of biases. The responses can be subject to either a short-term mood, the cultural expectations of the expression of happiness, the framing of the question or the issue of social desirability. The survey scales can be viewed differently by people in various societies hence making cross country comparison especially difficult. Also, reported wellbeing might not have sufficient breadth to be able to capture more about deeper or longer-term human flourishing, including meaning, purpose, or psychological resilience. On top of problems of measurement, one significant methodological problem is the issue of causal identification. It is hard to determine whether increased income leads to increased happiness or that happier people are more productive and therefore earn more income. Most of the studies are based on cross-sectional correlations that are not adequate to unravel these relations. The unobserved individual characteristics, including optimism or motivation, which simultaneously impact not only income trajectories, but also wellbeing, may bother even longitudinal studies. Consequently, calculation of the extent and strength of income consequences on happiness can be over or understated based on the design and assumptions that are used in the analysis.

Future studies must thus have more methodological emphasis on enhancing causal inference and enhancing insights into the mechanisms that stand behind it. The utilization of high-frequency panel data and natural experiments, including policy reforms, changes in taxes, or unexpected income shocks, is one avenue of future success, as it enables researchers to study how income influences wellbeing in the long run by controlling individual-specific aspects. These designs have the potential to illuminate the short-term and long-term consequences and allow one to differentiate between momentary emotional reactions and enduring alterations in happiness. The other significant avenue is to study personal and cultural heterogeneity. The process of reference group formation, social comparison processes, and adaptation speeds are expected to vary across the societies, levels of income, and demographic groups. The knowledge of such variations could be used to explain the differences in the wellbeing effects of income in some environments compared to others. Also, subsequent research ought to assess integrated policy packages comprising income support and state services, including healthcare, education, and mental health interventions, based on wellbeing outcomes as main measures of achievement. A combination of survey-based wellbeing indicators regarding traditional wellbeing metrics, neuroscientific and biological markers (i.e. stress hormones or neural activity) would help improve the current knowledge of the adaptation and hedonic set-points and would give a more multidimensional manifestation of the role of income on human happiness.

CONCLUSION

The study has explored the income-happiness nexus through the spectacles of the classic utility theory and behavioural economics and indicated that income-wellbeing correlation is much more complex than the initial economic approaches presume. The classical utility theory offers a valuable ground since it explains the significance of income to happiness when it is low as it mitigates deprivation and basic needs are satisfied. The diminishing marginal utility principle also explains why the further increase in income gives less and less wellbeing as income increases. Nevertheless, such frameworks are not enough to understand why long-term economic growth does not always lead to the increase in long-term happiness at the individual or national level. The long-lasting existence of a phenomenon like the Easterlin paradox highlights the weakness of income-oriented strategies to analyse welfare. Behavioural economics adds to this knowledge by demonstrating the psychological and social processes that mediate the nexus between income and happiness. The concepts of reference dependence, comparisons of incomes in relation, aversion to losses, and adaptation essentially changes the way people interpret changes in income. Empirical studies discussed in this paper indicate that income losses and insecurity have negative wellbeing effects that are disproportionately bad whereas income gains do not tend to produce long-term gains. The increase in aspirations and social comparisons also make the association between absolute income and happiness weaker, which is why people and society can become unhappy in spite of material gains. These observations undermine the belief that the expansion of income or GDP will automatically increase wellbeing and demands a more comprehensive assessment instrument, which, in addition to objective and contextual aspects, also considers the subjective element of human wellbeing. Policymaking wise, findings of this review overwhelmingly indicate that the governments should stop focusing on income growth as the main goal of economic policy. More sustained gains in happiness are likely to be achieved through wellbeing-oriented policies that focus on income stability, social protection, reduction in inequality, mental or psychological health, job quality and inclusion. With behavioural information in economic analysis, policymakers will be able to formulate interventions that consider how individuals actually experience income, as opposed to how they should react in idealized models. In general, this review can be added to the increasing body of literature that supports a multidimensional and humanistic approach to development, where the income is perceived as a sufficient but not the only factor of a good and fulfilling life.

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