

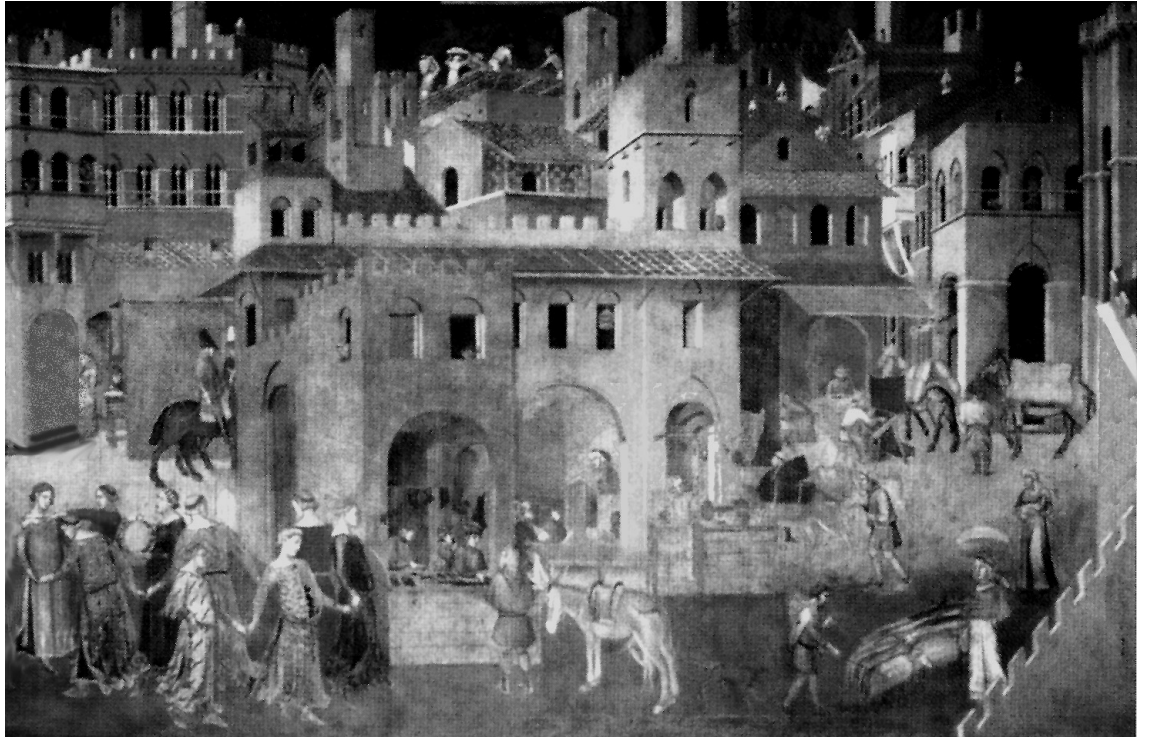
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## Happiness and Economics

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Johannes Hirata

## **Happiness and Economics** Some Ethical Considerations



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*About the cover:*

*In 1999, the tenth anniversary of the St. Gallen Institute for Business Ethics, the first chair in business ethics in a German-speaking country, was marked by a lecture series in which renowned scholars, such as Richard Sennett or Jürgen Habermas, among others, discussed the challenge of how to realize an „economy within society“ (cf. vol. 27 of the St. Galler Beiträge zur Wirtschaftsethik, ISBN 3-258-06156-4). The image that was chosen to advertise this lecture series was a window of a 1339 Frescos of Ambrogio Lorenzetti and shows economy as part of the civil life. The search for a concept of modern business in a republican spirit is of central importance to the institute whose ambition it is to contribute fruitful impulses to the discussion on economic and business ethics in theory and in practice.*

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Johannes Hirata

## **Happiness and Economics**

### **Some Ethical Considerations**

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## Abstract

This Paper makes an attempt to shed some light on a number of ethical issues that arise in empirical research on the relationship between choice, socio-economic conditions, and happiness. It argues that only an ethical perspective allows to appreciate the deeper meaning of happiness and to do justice to its moral dimension. As a principal result of psychological research on the effect of income on happiness it emerges that there is no natural law-like relationship between the two once basic needs are met. Two major consequences of happiness research for economic theory are emphasized. First, the existence of a free will puts limits on the validity of economic decision theory and implies that happiness cannot be separated from morality. Second, the claim that people know best which consumption decisions will make them happy overlooks the pervasiveness of adverse systemic effects of non-coordinated decisions (esp. prisoner's dilemma). Furthermore, it is argued that the happiness we actually value is more than merely *subjective* well-being, and that social welfare is more than happiness. Finally, a few policy implications are discussed.

## Zusammenfassung

Die vorliegende Arbeit unternimmt den Versuch, einige ethische Probleme zu beleuchten, die sich aus der empirischen Untersuchung des Zusammenhangs von Wahlverhalten, sozio-ökonomischen Lebensumständen und Glück („subjective well-being“) ergeben. Es wird die Position vertreten, dass sich die tiefere Bedeutung der Idee von Glück und seine moralische Dimension nur aus einer ethischen Perspektive heraus erschliessen lassen. Als wichtigstes Ergebnis der empirischen Erforschung des Zusammenhangs von Glück und materiellem Wohlstand wird festgehalten, dass es zwischen diesen beiden keinen naturgesetzlichen Zusammenhang zu geben scheint, sobald Grundbedürfnisse befriedigt sind. Als bedeutsame Implikationen der Glücksforschung für die Ökonomik werden herausgestellt (i) dass die Existenz von Willensfreiheit der Gültigkeit der ökonomischen Entscheidungstheorie Grenzen setzt und nahe legt, dass Glück und Moral nicht zu trennen sind, sowie (ii) dass das Vertrauen in die Klugheit individueller Konsumententscheidungen angesichts des negativen Wirkungsgefüges nicht-koordinierter Einzelentscheidungen (insbes. Gefangenendilemma) zu relativieren ist. Des weiteren wird die Position expliziert, dass das letztendlich wertgeschätzte Glück mehr als rein *subjektives* Wohlbefinden ist, und dass gesellschaftliche Wohlfahrt aus mehr als bloss Glück besteht. Schliesslich werden noch einige politische Implikationen diskutiert.



# Introduction

Show me one couple unhappy merely on account of their limited circumstances and I will show you ten who are wretched from other causes.

Samuel Taylor Coleridge (in Myers 1992: 40)

For millennia, happiness has been a central theme of philosophy, and it continues to be so until today. It is also been a foundational principle of economic theory, which is hardly a surprise considering the philosophical roots of this young science. Happiness is also a central concern of our everyday lives. Every language appears to have a word designating the same idea of happiness, and everybody seems to intuitively understand its meaning. Recently—about 30 years ago—happiness has become also an object of study of psychologists and of experimental economists. Yet, despite the common interest, the intellectual approaches to happiness are disparate, and rare are those studies that try to relate the various perspectives.

The present text is an attempt to make a first step into that direction. In fact, happiness seems to be the ideal bridge between philosophy—in particular moral philosophy—and economics because it is so central to both. In economics, happiness plays a pivotal role in the disguise of “utility”. It is held to be the sole motivating force behind human behavior and, at the same time, the ultimate yardstick of individual as well as social welfare. As a corollary, it has been declared the ultimate criterion of ethical principles.

In philosophy, happiness has always been a prominent object of debate in its relation to morality. While one school of thought (e.g., Aristotle, Socrates) sees a harmony between morality and happiness, another (e.g., the Greek Sophists, Nietzsche) believes that morality requires sacrifices in terms of happiness.

In psychology, finally, the concern with happiness has long been neglected. After the second World War, psychology was almost exclusively concerned with mental illnesses and pathologies (Seligman & Csikszentmihalyi 2000: 6). When psychologists finally began to empirically investigate the conditions of happiness, they found many of common sense beliefs confirmed, but they also came up with a couple of surprising results.

The dialogue between the economic, philosophical, and psychological happiness research is obstructed by fundamentally disparate concepts of happiness. While economists rely on an axiomatic conception of happiness, philosophers tend to think of happiness as a transcendental idea, and psychologists consider it a concrete, sometimes even physical, state of mind. Due to this conceptual divergence, scientists of one discipline are quick to discard another’s research as pointless or flawed. They overlook that, by recognizing that they share some common ground, researchers from all disciplines can benefit from each other’s insights. At least, such inter-disciplinary effort might help to put each discipline’s approach into perspective and to find agreement on where to draw disciplinary boundaries.

Making an attempt to bridge these disciplinary cleavages, this study endeavors to shed some light on the relationship between happiness and economics out of a predominantly, but not exclusively, ethical perspective. In particular, this paper will be concerned with four questions: (1) What is the deeper relationship between socio-economic conditions and happiness? (2) What are the implications of happiness research for

mainstream economic theory? (3) What is the normative relevance of happiness research? (4) Which policy implications can be drawn from happiness research?

# Happiness Research

The idea of measuring happiness often encounters initial skepticism. As an inherently subjective state of mind, it is argued, happiness defies objective measurement and scientific analysis. While this objection does have some merit, I will argue, in the first part of this section, that a carefully defined modest conception of happiness is perfectly amenable to rigorous scientific analysis and will deliver meaningful—and immensely valuable—insights. These insights will be documented in the second part of this section.

## Conceptual and methodological issues

If one thinks that one is happy, that is enough to be happy.

Mme de la Fayette, Letter to Gilles Ménage (in Myers 1992: 23)

Since the colloquial use of the term ‘happiness’ involves rather diffuse and varying connotations, psychologists prefer to use the term *subjective well-being* (SWB). To understand the most frequent source of mistaken skepticism, it is crucial to appreciate the meaning of the attribute ‘subjective’. It means that SWB really is the unquestioned perception of each individual himself as expressed on a one-dimensional scale, rather than some transcendental concept of “actual well-being” beyond the consciousness of the person in question. When it is stated, for example, that the SWB of person A is higher today than it was yesterday, this does not—at least not necessarily—mean that this person is actually faring better today than he was yesterday (i.e., in terms of quality of life). It does mean, however, that he judges his well-being more favorable today than he did yesterday.<sup>1</sup> SWB alone, therefore, does not suffice to tell us how good an individual’s life is in an absolute, transcendental sense (in the remainder I will refer to this as “actual well-being” or as “the happiness we actually value”). SWB is not meant to replace such ethical concepts as *eudaimonia* (Aristotle 1998), the good life, or quality of life (Nussbaum & Sen 1993). Of course, it is plausible (and psychometrically supported, as demonstrated below) to suppose that SWB closely follows “actual well-being.” Indeed, once SWB data are interpreted in a specific context, one may find compelling arguments for specific conclusions about “actual well-being”. As long as one is looking at raw data, however, SWB should simply be taken at face value, namely a subject’s statement on her perceived degree of well-being.

To give this discussion some flesh and blood, one should look at the questionnaire items respondents are actually confronted with in surveys. The interest in this study lies primarily with *life satisfaction*, i.e., an assessment of life as a whole rather than particular aspects of it. To measure life satisfaction, the Eurobarometer survey, for example, asks, “On the whole, are you very satisfied, fairly satisfied, not very satisfied, or not at all satisfied with the life you lead?” (Veenhoven 2000). The monumental World Values Survey asks, “Taking all things together, would you say you are very happy, quite happy, not very happy, not at all happy?” (Inglehart 1997: 351). Still another survey asked, “How satisfied are you with your life as a whole these days?”, where answers are indicated on a 7-point scale ranging from “completely satisfied” to “completely dissatisfied” (Andrews & Withey 1976: 67).

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1 A case where reported happiness and actual quality of life obviously diverge in this sense is the case of Olympic silver medal winners who on average report lower SWB than bronze medal winners (Schwarz & Strack 1999: 67).

It is obvious that the wordings of these items differ significantly, and since the concept of SWB is defined by the question that is asked and the response options provided, each item implies a different concept of SWB. However, even though it has been found that responses to questions mentioning the term “happy” are more influenced by hedonic affect, while responses to items mentioning “satisfied” are more influenced by the cognitive evaluation of one’s well-being (Diener 1984, 1994), the precise wording does not matter much for most purposes as long as one compares items that are carefully phrased and psychometrically tested. In this paper, the distinction between (emotional) hedonic affect and (cognitive) satisfaction will only be made when the context requires. For the rest, the terms “happiness”, “(life) satisfaction”, and “subjective well-being” will be used interchangeably.

## Psychometry

Clearly, limits to self-awareness and to linguistic expression mean that reported SWB will not be perfectly identical with what we actually want to tap, namely the construct of “actual well-being”. But we do know pretty accurately how reliable and valid self-report measures of SWB are.

*Reliability*, meaning the degree to which an indicator captures actual variation of the construct being measured, rather than random variation (Larsen & Fredrickson 1999: 43), can be estimated by means of the 15-minute test-retest correlation. Since the concept of life satisfaction, in contrast to current mood, e.g., requires that the answers to two identical questions asked in an interval of 15 minutes be identical, one should ideally expect a perfect correlation of one. To the degree the test-retest correlation falls short of one, respondents will not have given identical answers, perhaps because “actual well-being” falls on a category boundary or because going through the questionnaire changed the respondent’s way of answering questions. Typical results for reliability have been found to be around .7 (Andrews & Withey 1976: 78, 85). To illustrate this with an example, a reliability value of .68 was found for a study with 1,433 subjects of which 54% gave two identical answers (on a 7-point scale), 39% gave two answers in adjacent categories, and 7% gave non-adjacent answers (Andrews & Withey 1976: 79). While this value is less than one might wish in order to draw precise inferences, it clearly demonstrates that the large majority of respondents do not simply guess or respond in an arbitrary fashion.

The *construct validity* of an indicator reflects the degree to which the indicator actually captures the construct one has in mind. To measure construct validity, psychologists make use of the embeddedness of any theoretical construct in a network of assertions through which the construct is filled with meaning (Diener & Lucas 1999: 214, Larsen & Fredrickson 1999: 44). Just as one verbally defines a theoretical construct by relating it to other commonly intelligible terms, the validity of an estimator can be assessed by verifying if it satisfies these relationships statistically. For example, our interpretation of SWB (and common use of language) implies that happiness will correlate negatively with undernutrition, loneliness, and future anxiety, and positively with smiling frequency, goal attainment, and self-esteem. An indicator that does not yield substantial correlations with these variables will not have much validity. It should be noted that neither reliability nor validity alone is sufficient to assess the adequacy of an estimator. A

good indicator must score high on both criteria, and the selection of the best one may require a weighing of the two qualities.<sup>2</sup>

### Interpersonal comparability and cardinality

The idea that the intensity of happiness, or utility in economic parlance, is comparable across individuals has come under attack from two different sides. The first argument claims that the interpersonal comparison of happiness implies an inadmissible value judgement (Robbins 1935: 139, quoted in Sen 1983b: 265). Yet, this argument is misdirected. A value judgment enters only when a moral principle is invoked stating how such a comparison is to be evaluated (for example, the utilitarian principle that a happier state is morally superior to a less happy one).

The second argument claims that interpersonal comparisons of happiness are impossible because “introspection does not enable *A* to measure what is going on in *B*’s mind, nor *B* to measure what is going on in *A*’s” (Robbins 1935: 140). Strictly speaking, this statement is of course right. But it does not follow from this that interpersonal comparisons of inner states are impossible, for language goes a long way in “measuring what is going on in *B*’s mind”. Thanks to language and our ability to empathize, we *understand*, in the hermeneutic sense of the word, the inner state of a person who tells us she is feeling happy. To be sure, empathy does not give me a precise yardstick that would allow me to know with certainty how another person’s happiness compares to my own happiness. But this is merely a problem of demarcation and is not essentially different from the problem of comparing my own happiness today with that of yesterday. To deny the possibility of interpersonal comparability would mean that one cannot say whether a newly married wife who declares to be “very happy” is actually feeling more or less happy than a mother who has just lost her only son and checks the “very unhappy” answer—a claim which would not only be outright absurd intuitively, but also fail to recognize the nature of language as enabling us to speak about purely internal phenomena.

A related debate revolves around the issue of the scaling of indicators of SWB. Is it merely possible to *rank* different states of mind as more or less happy (ordinal scale), or is it also possible to say *by how much* happier one state of mind is in relation to another (cardinal or ratio scale)? More precisely, cardinality would require that different intervals can be compared with each other in quantitative terms. For example, it should be possible to make a statement like, “the interval between ‘very dissatisfied’ and ‘dissatisfied’ is equal to that between ‘satisfied’ and ‘very satisfied’.” If this is possible, it will also be possible to say that the additional happiness a particular person experiences when watching his favorite movie is, say, twice the happiness he derives from listening to his favorite CD.<sup>3</sup>

While most researchers who bother to deal with this question at all claim to reject cardinality (Diener 1994: 120, Veenhoven 1984), it more often than not creeps back in through the backdoor, usually in the form of taking averages. For if the happiness scale

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2 The statistically trained reader will recognize a close analogy with the statistical criteria of accuracy (corresponding to reliability) and unbiasedness (corresponding to validity) to assess the overall efficiency of an estimator (Wonnacott & Wonnacott 1990: 239).

3 Since people seem to experience a neutral point between happiness and unhappiness (Ng 1980, 1996, 1997), an unhappy state will have to be expressed as a negative multiple of a happy state, just as a company’s loss has to be expressed as a negative multiples of last year’s profit. Equivalently, one can use “happiness units”, defined by an arbitrary interval, in analogy to the currency in which an income statement is expressed.

is taken to be ordinal, taking averages will not make sense. It will simply not be possible to interpret the resulting figure. Yet most researchers publishing on SWB do use averages and therefore implicitly accept cardinality.<sup>4</sup> I will also do so—but then explicitly—, based on the contextual theory by Pardo (1995) which holds that respondents adapt their use of verbal labels in a way that tends to optimize the informativeness of judgments. Empirical evidence for this theory has been produced by van Praag (1991), but I shall not go deeper into this issue at this point.<sup>5</sup>

## Culture and semantics

When comparisons of SWB scores are made across cultures or languages, a frequent objection is that such comparisons are distorted because the word “happiness” has different meanings in different cultures or when translated into different languages (semantic non-equivalence objection). A related objection claims that, even if the meaning of the term “happiness” is identical in different cultures, the historical context will influence how people use the answer scales (relativity objection). In another version of this objection, the concept of SWB is criticized for being insensitive to aspects of the good life it ought to capture from a moral point of view (ethical objection).

The objection on grounds of *semantic non-equivalence* seems to be justified to some extent. It seems plausible to assume that the word “happy” has a slightly different meaning to North Americans than the word “glücklich” does to Germans (or than the word “happy” itself has to Britons). Put differently, a German in an emotional and cognitive state an American would describe as “very happy” might call himself merely “glücklich” (rather than “sehr glücklich”) simply because the German term carries different connotations. In another state of mind the reverse might be true. However, there is strong evidence to believe that these semantic differences are not more significant across cultures than across individuals within a given culture. Empirical studies have found that Flemish and French speaking Belgians, Swiss of different languages, and French and English speaking Canadians “report similar levels of well-being” (Diener 1994: 113). That is, the place of residence seems to dominate language to such an extent that the subtle semantic differences between languages fade into insignificance in the larger analysis.<sup>6</sup> Another study found that the answers of Chinese students (residing in China) to SWB questions were highly correlated when asked in English and in Mandarin two weeks apart (Layard 2003b: 18). While this evidence cannot simply be extrapolated to all languages (the meaning of the word “happiness” in the languages considered may just happen to be very similar, and the Chinese students may not have the same understanding of the word “happy” as Americans do), it seems that the concept of happiness is indeed universal *qua* idea. All languages appear to have a word for happiness (and a separate one for satisfaction, *cf.* Veenhoven 1996: 2). Until evidence is produced to the contrary, it seems safe to assume that the experience of happiness is a human universal

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4 An exception is Inglehart (1997, 1990) who usually reports an index like “percentage of people saying they are ...”. This measure avoids the issue of scaling (though not of interpersonal comparison) but has other shortcomings. A measure “percentage of people saying they are very happy”, for example, would not reflect if a large number of people moved from “fairly happy” to “neither happy nor unhappy”.

5 Kahneman thinks that respondents do not necessarily use the SWB scale cardinally, but that responses can be rescaled in such a way as to yield a “ration scale for instant utility that is calibrated by its relation to duration,” so that two minutes of level-3 pleasure is equivalent to one minute of level-6 pleasure. (Kahneman 1999: 6)

6 Curiously, the SWB scores of German and French speaking Swiss residing just across the border in Germany and France, respectively, did differ from that of their compatriots living in Switzerland.

that is naturally familiar to each human being, just as pain or fear. While one should nevertheless treat cross-cultural comparisons of SWB with caution, such comparisons do seem to reflect more actual differences than spurious variance caused by semantic differences.

The *relativity objection* argues that people in different socioeconomic settings will use the answer scale differently because they will put their judgments into the perspective of their own experiences and aspirations. For example, since people tend to adapt to miserable (and affluent) conditions, when an impoverished person checks the “fairly happy” answer this would in fact constitute a relabelling of the same level of happiness that an affluent person would describe as “not at all happy”. Yet, while there is a point to this assertion, the objection blurs the distinction between the space of subjective experience and the space of objective living conditions.

The *ethical objection* demands that a measure of happiness reflect a minimum set of conditions of a dignified life (Tversky & Griffin 1991: 116-7). For example, a slave who *declares* to be happy after having been sold by his sadistic owner to a benign one, should not, according to this objection, be *considered* happy, for he still lacks the basic ingredients of a dignified life. His self-reported happiness would merely rest on a distortion of his aspirations. This view, however, blurs another distinction, namely that between the space of subjective experience and the space of moral evaluation.

In essence, both the relativity objection and the ethical objection fail to acknowledge the subjective nature of SWB. The more the concept of SWB is charged with normative or objective content, the less valuable it will be as an independent and distinct piece of information. Only a “pure” concept of *subjective* well-being will eventually allow us to identify the relationship between subjective experience and objective living conditions, and to morally assess the role of SWB in a larger concept of the good life. For the sake of conceptual clarity, self-reports of happiness should be taken at face value. We can take assurance in the nature of language that people will declare to be happy when they feel exactly that way.

Having concluded this preparatory discussion, I will now follow Veenhoven in defining life satisfaction as *the degree to which an individual judges the overall quality of her life as a whole in a favorable way* (Veenhoven 1991b: 10). This definition thus gives primacy to judgment (as opposed to affect), and it avoids the imputation of any external normative significance to SWB. It also accords with the three hallmarks of SWB identified by Ed Diener (1994: 106): (1) it captures only *subjective* experience, (2) it requires *positive* experiences, rather than the mere absence of negative ones, and (3) it includes a *global assessment* rather than being limited to a particular life domain or time period.

## Does money make happy? – Empirical evidence

Whoever said money can't buy happiness isn't spending it right.

Lexus advertisement (quoted in Myers 2000: 58)

I regard any considerable increase of human happiness, through mere changes in outward circumstances, unaccompanied by changes in the state of desires, as hopeless.

John Stuart Mill (1969/1833: 15).

This section will present empirical evidence on the relationship between happiness and income (and a few other variables) in order to sketch a first clue to the old question if money makes people happy. The evidence will then be interpreted with reference to a broader field of SWB research.

To begin with, let us step back from the purely economic context and put this question into a larger empirical perspective. Throughout the following discussion, it should be kept in mind that “hard” (i.e., readily measurable) objective life circumstances as a whole account only for a small proportion of the observed variance in SWB, and that the large untraceable proportion of variance among individuals must be attributed to other than these factors. Even extensive studies typically find that all socio-economic and demographic factors together only account for 11% (Andrews & Withey 1976) to 20% (Campbell, Converse, & Rodgers 1976) of observed happiness variance, and no single factor accounts for more than about six percent (Andrews & Withey 1976). Thus, 80% to 89% of variance have to be explained by some combination of “soft” objective life circumstances which are not usually measured (like the quality of one’s family life), one’s childhood, personality traits, and perhaps still other objective and subjective, hard and soft factors. While “personality traits” is prone to be (mis)used as a catch-all term to “explain” whatever variance remains unexplained, there is evidence that a considerable proportion of happiness variance can be accounted for by heredity. A study on monozygotic twins, for example, concluded that 48% of the variability in SWB is herited, while shared family environment accounted for a mere 13% (Tellegen, Lykken, *et al.* 1988, reported by Diener & Lucas 1999, *cf.* also Lykken & Tellegen 1996). While these numbers must not be interpreted as evidence of a genetical *determination* of happiness, they do suggest quite forcefully that people are born with a rather strong genetical *disposition* to be more or less happy.<sup>7</sup>

Beyond such exercises of “happiness accounting”, however, one may believe that happiness cannot be completely decomposed and attributed to deterministic causes, but rather that—for any given specification of life circumstances—people have some personal autonomy in judging their life more or less favorably. While this strand of thought shall be taken up below in more depth, we shall for the time being suppose that happiness is a deterministic result of independent factors and can in principle—even though not practically—be explained 100%.

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<sup>7</sup> A psychological study found that of those prison inmates with a monozygotic twin brother, many of the latter became delinquent as well. However, one twin brother turned out to be a law-abiding criminal *investigator* (Lange 1929, reported in Frankl 2003a: 55), supporting the view that “heredity [merely] supplies the material with which a human being construct himself.” (Frankl 2003a: 56)

Another rather fundamental question is whether life circumstances—if one is married or unemployed e.g.—are the cause of happiness (“bottom up”), or whether happiness is the cause and life circumstances its effect (“top down”). In this perspective, people would be unmarried or unemployed *because* they are unhappy characters, taking (un)happiness as a fixed personality trait. Without going into detail at this point, it has been shown that top down-causation does indeed play a role, but that both directions of causality interact (Headey, Veenhoven, & Wearing 1991).

### Empirical evidence on income and subjective well-being

Turning now to the relationship between happiness and economic factors alone, the evidence will be discussed along two levels of aggregation—individual and national—and two comparison perspectives, cross-section and time series. As illustrated in table 1, this yields a two-by-two matrix and a classification of four categories.

		<i>Comparison perspective</i>	
		Cross-section	Time series
<i>Level of aggregation</i>	Individual	1a	1b
	National	2a	2b

Table 1 - A classification of life-satisfaction research.

1a. Studies with an individual focus in a cross-section perspective investigate differences between people. They analyze a representative sample of a usually geographically defined population (a nation, a municipality ...) and investigate the relationship between the individual scores on SWB and individual characteristics, like age, income, or psychological attributes (neuroticism etc.).

1b. Studies with an individual focus in a temporal perspective are perhaps the least frequently encountered. They require panel data, i.e., follow-up surveys of the same set of subjects over some period of time, which makes them rather costly and difficult to implement. A somewhat more practical but less informative kind of analysis that will be classified with this kind of studies are synthetic cohort analyses (*cf.* Easterlin 2001, Easterlin & Schaeffer 1999). These require several random sample surveys of a given population over an extended period of time which are then grouped by date of birth in brackets of a few years. Thus one can follow, e.g., the development of the cohort born during 1950-59.

2a. Cross-section comparisons with a national focus investigate differences between nations. In this case it is not the micro-data that is analyzed, but national averages of SWB that are set into relation with other aggregate variables (average income, political institutions etc.). These levels and relationships are then compared to other national averages.

2b. Studies with a national focus in a temporal perspective try to identify those factors that correlate with a nation’s average SWB over time. These studies are rather easily done because data are readily available, but the significance of such studies is limited because a large number of potentially relevant independent variables is up against a quite limited number of SWB-data points (SWB data for years before 1970 are available only for a small group of rather homogeneous countries). Nevertheless one finds a few

significant<sup>8</sup> correlations. It is of course possible to combine the two foci or perspectives, in which case a study will fall in more than one category at a time.

It should be clear that correlations can never prove causation. The most a correlational analysis can do is lend indirect support to a cause-and-effect hypothesis by a failure to contradict it. Even if a time series analysis shows that the presumed cause is systematically followed by the presumed effect, one cannot be certain that the pattern is not in fact caused by an omitted variable. One therefore has to be vigilant not to interpret a correlation as support, let alone proof, for a cause-and-effect hypothesis just because a result corresponds to common sense expectations.<sup>9</sup>

*Category 1a* – In cross-section studies with an individual focus, income persistently comes out as a highly significant correlate of SWB. In particular, several studies find that in the industrialized countries the relationship is substantial for the lowest quintile, but that it is much smaller or nonexistent over the 75% upper percent of a given country's income distribution (e.g. Glatzer 1991), hinting to a distinct role of poverty. Yet the magnitude of this correlation across all income groups is rather modest in comparison with non-monetary factors. In an ordinary least square regression (OLS regression, the most commonly used statistical regression method) using US data of 1973 through 1998, Blanchflower and Oswald (2000) estimate a linear income coefficient that implies that the happiness differential associated with a \$10,000 annual income differential is about one seventh of that associated with divorce, one sixth of that related to unemployment, and about equal to the "student bonus" (i.e., the additional happiness associated with being a student). In absolute terms, a half-point increase on the three-point happiness scale corresponds to a \$122,000 increase of annual income. If the regression had taken account of the concave shape of the relationship, however, income could be expected to predict larger happiness differences for the lower income categories. Satisfaction with one's income seems to play a much more substantial role than income *per se* (Argyle 1999). The effect of income on SWB seems to be stronger in less developed nations (Diener & Suh 1999: 445).

*Category 1b* – Time series studies with an individual focus are rare and so far have produced inconclusive results. Easterlin's (2001) synthetic cohort analysis has found that life satisfaction is practically constant over the life cycle. Since on average an individual's income increases up to retirement and then falls, one can conclude that for the average earner there is no relation between income and happiness over time. This result is not necessary applicable to large swings of fortune of course. However, a study of lottery winners (P. Brickman, Coates, & Janoff-Bulman 1978) found that those 22 subjects who had won between \$50,000 and \$1,000,000 within the previous year rated their happiness not even 5% higher than a control group (4.0 and 3.82, respectively, on a 5-point scale), and this difference was not statistically significant. On the other hand, the apparently only longitudinal study of the SWB effect of windfall gains based on a random sample found that over a variety of statistical settings, lottery gains (including other gambling gains) were a significant predictor of lower mental stress and higher SWB for the subsequent year (Gardner & Oswald 2001). More specifically, a £100,000 gain was associated with a significant increase of SWB by .32 on a four-point scale, or .6 of the

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8 The term "significant" will be used in its statistical interpretation throughout this paper. When it is used with reference to quantitative results, "significant" will correspond to p-values lower than .05, and "highly significant" to those smaller than .01. The term will not be used to evaluate the magnitude of an effect.

9 My use of the word "effect" in the following discussion of statistical results does not imply causality but merely a statistical relationship.

standard deviation of the SWB score distribution (n=9493, among which 2607 lottery winners). However, the data do not yet allow to assess the long term effects of lottery gains. An earlier study (S. Smith & Razzell 1975) found that lottery gains encourage major life changes that often turn out negative, so that after initial joy there may remain only little effect on happiness (reported in Argyle 1999: 357).

Another way to assess the influence of income on SWB was pioneered by van Praag (van Praag 1993, van Praag & Frijters 1999). He asked people how much income they would deem “very good”, “good”, “sufficient” etc. and set their responses into relation with their current income. He found that the answers could be summarized quite well by a lognormal function, which allowed him to deduce an own-income elasticity of welfare of about .6. This implies that, after an individual has seen his income rise by 1%, the income amounts a particular individual ascribes to the labels “very good”, “good”, “sufficient” etc. will rise by .6%. In other words, only 40% of the additional income effectively contributes to higher well-being, 60% evaporate through an adjustment effect.

An earlier study asked people to indicate those items from a list of 29 consumer durables (washing machine etc.) “the acquisition of which would realize the household’s conception of an appropriate standard of living.” (Schmolders & Biervert 1972: 214). It appeared that the number of unsatisfied aspirations were virtually identical for all but the highest (of six) income groups, even though ownership varied by a factor of two across the lower five income groups only. “As incomes increase,” the authors concluded, “former luxuries are included into the purchase horizon of average households.” (Schmolders & Biervert 1972: 215)

*Category 2a* – Cross-section studies with a national focus consistently produce a positive relationship between per capita GNP and average SWB that in most cases turns out to level off among the affluent countries (Diener & Suh 1999, Veenhoven 1991a). The strength of the correlation between per capita purchasing power and average SWB has been found to be a highly significant  $r = .58$  (Diener, Diener, & Diener 1995: 859) or even  $r = .64$  (Schyns 1998: 15), implying that 34% or 41%, respectively, of the cross-country variance in SWB can be accounted for by income alone.

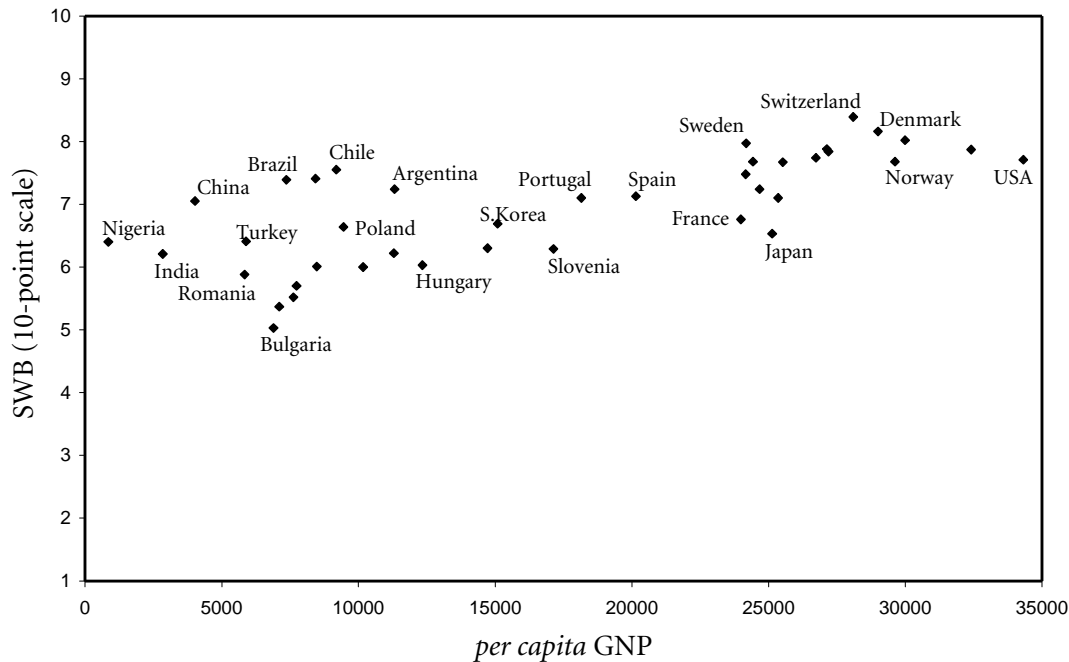
The magnitude of the relationship can be illustrated by the range of the data: in the beginning of the 1990s, the Netherlands scored 3.39 on a four-point happiness scale with a per capita income of \$15,695, while Hungary scored 2.72 with \$6116 (Schyns 1998). Assuming that happiness rises in proportion with  $\log_2(\text{income})$  (i.e., obeying the law of diminishing returns), this suggests that a doubling of income is associated with an increase of happiness by .50 on the four-point scale.

A closer inspection of cross-country data reveals considerable singular differences between economically similar countries, and at the same time an astonishing closeness of economically different ones. For example, in one study (Diener & Suh 1999), France (6.8 on a ten-point scale) was closer to India (6.2) than to Denmark (8.2) in terms of life satisfaction (*cf.* fig. 1). Even though singular comparisons need to be treated with caution, these data underscore the limitations of correlational evidence. Correlations must only be interpreted as general trends and cannot be expected to make precise predictions for singular cases.<sup>10</sup> See fig. 1 for an exemplary presentation of the relationship between income and SWB.

Another consistent finding is that many formerly communist countries score substantially lower on SWB than their income would predict. The lowest SWB score re-

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<sup>10</sup> Only when the correlation comes very close to the maximum value of 1, and when the number of observations is sufficiently large, this caveat may be dropped.



Note: SWB data are from the World Values Surveys, presumably from 1994. GNP figures are expressed in purchasing power parity in 2001 and taken from the UNDP's Human Development Report (2003).

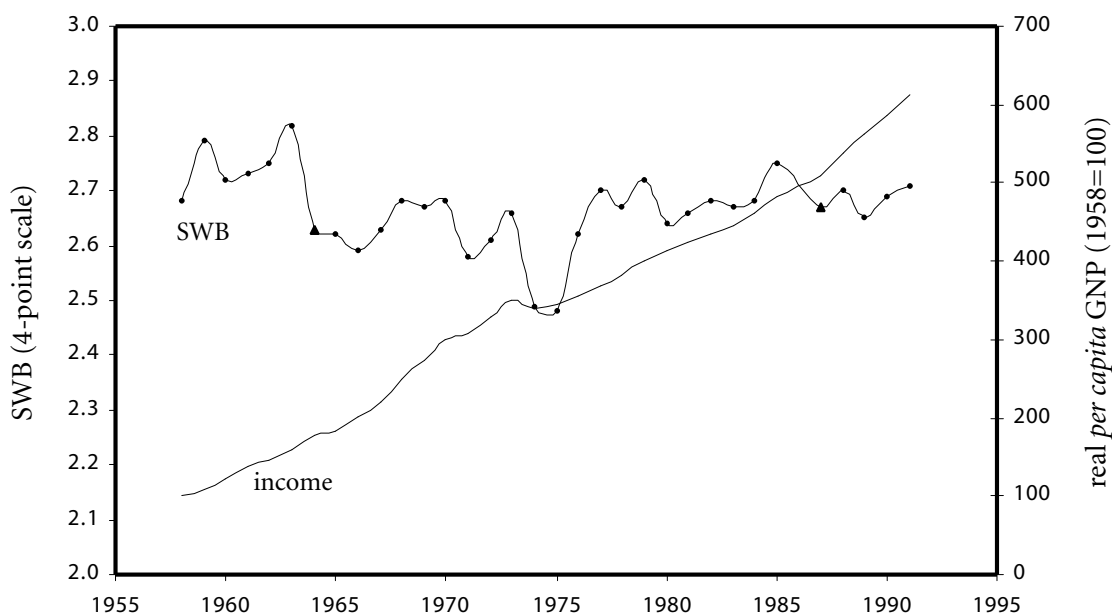
Source (of SWB-data): Diener & Suh (1999).

Figure 1: Income and SWB across countries.

ported by most studies after 1990 is that of one or another Eastern European country, rather than one of the even poorer countries in Africa or Asia.

*Category 2b* – Time-series studies with a national focus spanning several decades are only available for a small set of countries. Yet, a general income-SWB correlation has not been found. While income has risen manifold between World War II and the 1990s in most countries studied, SWB tends to remain constant in most cases, rose for a few and fell for others during particular decades. A striking case is Japan, for which a particularly long time series is available. During the period from 1958 to 1987, real per capita GNP rose by 400%, increasing car ownership from 1% to 60% of households, yet no significant response of mean satisfaction to income can be identified in the data (fig. 2; for the statistical results *cf.* Hirata 2001: 32). Data for the US indicate that SWB stagnated or even fell slightly after 1970 (Lane 2000b: 352). Kenny (1999) analyzed ten countries for which he could obtain longer consistent time series (with at least ten observations each) and found two negative and one positive significant correlations between income and happiness, with the rest being insignificant. In a more recent paper, Hagerty and Veenhoven (2003) undertake a new attempt to show that SWB rises with income. While their data do show a positive long-term effect, the presentation of the data is selective, and some results seem to be wrong due to scaling or calculation errors.<sup>11</sup> Future research should give a better idea of the extent to which their results can be generalized.

<sup>11</sup> This carelessness is obviously “imported” from Diener and Oishi (2000) who fail to disclose the specification of their model (in particular the interpretation of ‘slopes’ on p. 203). Hagerty and Veenhoven’s interpretation of the scale seems to be wrong since it implies implausible figures, such as a rise of SWB in Portugal by 2.16 points on a 4-point scale within 8 years, or by 0.9 points in Japan over 22 years, which is clearly not correct (as can be seen in fig. 1).



Note: Question wordings were modified in 1964 and in 1987.

Sources: SWB data from Veenhoven (2000); GNP data from Summers, Heston, *et al.* (2001). Reprinted from Hirata (2001: 32).

Figure 2: Income and SWB in Japan 1958 – 1991.

An indirect way to measure the relationship between SWB and income over time has been explored by a Gallup poll that asked people, “What is the smallest amount of money a family of four needs to get along in this community?” (Frank 1999: 73-4). Over the period from 1950 to 1986 (the last year this question was asked), the money amount people mentioned rose almost exactly in proportion with per capita income, remaining practically constant at about two thirds of that value.

This finding is corroborated by studies in which people in the US were asked whether they considered each of ten big ticket consumer items (car, house, fashionable clothes etc.) “to be part of the ‘good life’, that is ‘the life you’d like to have’, and also whether they actually had those items.” (Easterlin 2001: 477). Between 1979 and 1995 and for two distinct age cohorts, the number of items desired rose by virtually the same increment as the number of items actually owned.

### More correlates of subjective well-being

The question of the relationship between income and SWB is just one among many aspects investigated in the literature. Here a few more correlates relevant to economics shall be reported.

**Work status:** Perhaps the most conspicuous and unambiguous correlate of SWB is unemployment. Study after study corroborates the finding that the effect of unemployment on SWB is devastating and much larger than should be expected from the loss of income as such. In a recent panel study, the magnitude of the non-pecuniary unemployment effect was estimated to be about seven times as large as a 90% reduction of one’s income (Winkelmann & Winkelmann 1998).<sup>12</sup> In other words, “the worst thing

<sup>12</sup> Due to the imputed rigidities of the model used to calculate these value, the figures should not be taken at face value but rather as an indication of the massive magnitude of the non-pecuniary unemployment effect.

about losing one's job is not the drop in take-home income. It is the non-pecuniary distress" (Oswald 1997: 1821). Evidence supports the interpretation that the direction of causality runs from unemployment to unhappiness and not the other way round (Oswald 1997).

The view that people value having a job for more than just for the income it generates is corroborated by further evidence. Campbell, Converse, and Rodgers (1976), for example, asked 1114 respondents in the US (who worked at least 20 hours per week): "If you were to get enough money to live as comfortably as you'd like, for the rest of your life, would you continue to work?" Those who said they would were then asked: "Would you continue to work at the same job as you now have?" (Campbell, Converse, & Rodgers 1976: 291). As a result, a total of 69% answered they would continue to work (40% at the same job, 29% at a different one), leaving less than one third saying they would want to stop working.

**Marital status** has equally been found to be strongly correlated to SWB. variables 42 . Married people are considerably more likely to report being "satisfied" or "very satisfied" than people of any other marital status, including those "living as married", and this effect is stronger for women than for men (Andrews & Withey 1976, Blanchflower & Oswald 2000). Even more than being widowed, being divorced or separated correlates negatively not only with SWB, but also with objective health (Lynch 1977, reported in Argyle 1999). Having children has been found to be either unrelated to SWB or to have a small negative effect (Andrews & Withey 1976, Diener 1984). One can therefore safely generalize that marital status is consistently and positively linked to SWB.

**Friendship:** Studies investigating the impact of personal ties on SWB found a clear positive relationship that was comparably large in comparison with other predictors. In an earlier US study, the number of a subject's friends was found to correlate stronger with SWB than family income, intelligence, health, or education (Campbell, Converse, & Rodgers 1976: 368). A later study found that among those reporting fewer than 5 friends, 26% said they were "very happy" compared to 38% of those reporting five or more friends (Myers 2000).

**Gender:** Very few studies have found a significant difference of life satisfaction between men and women, and this is true across cultures (Diener & Diener 1995). Nevertheless, women more often report negative affect than men when negative and positive affect are assessed separately (ibid.). One study on US data also found evidence that during the period from 1972 to 1998, women, but not men, experienced a significant fall of their SWB levels (Blanchflower & Oswald 2000). There also seem to be differences between the underlying pattern of factors influencing the SWB of women and men (Diener & Fujita 1995: 932). In general, then, even if women and men do not seem to be affected by the same factors in identical ways, the observed levels of reported life satisfaction are practically the same.

**Democratic participation:** SWB has consistently been found to depend positively on the degree to which a country is democratic. Since democratic countries also tend to be rich, have long life expectancy and other positive characteristics, however, it is difficult to isolate the effect of democracy on happiness. To circumvent this problem, Frey and Stutzer (2001) have examined the relationship between democracy and SWB within Switzerland. In a cross-regional econometric analysis of all 26 Swiss cantons, they found that institutional factors in the form of direct democracy (via initiatives and referenda) and of federal structure (local autonomy) were systematically and substantially associated with higher SWB-scores. More precisely, it was participation rights—rather than actual participation in political decisions or the outcomes of such decisions—that ap-

peared to enhance life satisfaction. The magnitude of this effect was considerable. Even controlling for a host of possibly confounding variables (income, age, employment status, official language at place of residence etc.), the expected gain in SWB for a person moving from the canton with least participatory rights (Geneva) to that with most (Basel Land) would be larger than that to be expected from moving from the lowest income category (< SFr 2000) to the highest one (> SFr 5000), or about equivalent to the difference between married and divorced (and not re-married) respondents (Frey & Stutzer 2001: 12-13, 29).

Other studies come to different conclusions about the direction of causality, however. Focussing on emerging and transition countries, Inglehart (2000) suggests that economic growth brings about higher SWB which in turn legitimizes the prevailing political order, no matter how democratic or authoritarian. Beyond a certain degree of material prosperity, he argues, people increasingly embrace postmaterialist values—including those typically associated with democracy, such as free speech and political participation—which tends to stimulate democratic institutions and to raise SWB.

## Interpretation

The evidence presented in the previous section clearly cannot be summarized into a single, simple theory of the kind “More money brings more happiness,” or “More money does not bring more happiness.” While cross-section data (category *a*) tend to support the first hypothesis, time-series data (*b*) is supportive of the second. This apparent contradiction has come to be termed the “income paradox”.

While there have been various attempts to solve this paradox, or to show that it is merely the result of poor data and does not even exist in the first place, two distinct theories are particularly convincing in explaining the apparent inconsistency. The *relative income hypothesis* explains why the evidence from individual cross-section data (*1a*) contradicts that of individual time-series (*1b*), while the *cultural SWB hypothesis* explains the contradiction between cross-national cross-section data (*2a*) and cross-national time-series evidence (*2b*).

### The relative income hypothesis

The relative income hypothesis basically states that what a person values, and what she derives happiness from, is not her absolute income, but rather her relative income, i.e., how her income compares to the income distribution of the society she lives in. Imagine a person in the United States in the year 1960 with an annual salary of \$12,000.<sup>13</sup> With about twice the average income of those days, that person would have been called a top-earner, and the best prediction—according to the evidence cited above—is that this person would have described himself as “very happy”. Imagine now that his salary did not change for the following 38 years, a period during which the American real average income rose from \$12950 to \$31050. While, by assumption, his real purchasing power was not reduced, he now earns substantially less than the new average income and, as he compares his own standard of living with that of people around him, he can no longer be expected to feel very happy. In effect, then, the mere fact that other people became richer reduced his subjective well-being. This phenomenon has led some economists to regard increases in consumption as equivalent to environmental pollution since both have a negative external effect on other people’s well-being (Frank 1997a, 1999, Layard

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<sup>13</sup> All income data are expressed in 1996 dollars—i.e. they represent “real” income corrected for inflation—and are taken from Summers, Heston *et al.* 2003.

1980). As such, consumption exhibits the typical characteristics of a prisoners' dilemma (cf. Frank 1997b: 224), i.e., a situation in which the absence of cooperation among individuals means that people find it in their best interest to pursue socially wasteful behavior, leaving everyone worse off than if cooperation took place.

A particularly wasteful variety of the prisoner's dilemma is positional competition (Hirsch 1976, Frank 1985, 1999). A number of goods are by their very nature in fixed supply to a society (or even to the world as a whole), no matter how rich a society becomes. There will always be only so many original paintings by Rembrandt, for example, and there will always be only a small minority who can assume a leading position in their professional career—after all there will always have to be some employees to every employer. Other examples of positional goods are prestigious hotel rooms (or indeed anything prestigious, since being scarce is a condition for prestige), admission to the top-ten business schools, or a lonely cottage. The dilemma is that everybody individually will find it worthwhile to spend effort or money on such positional goods, but no matter how rich people become, there will always be only so many whose efforts will be rewarded.

The relative income effect is the result of a variety of underlying mechanisms. First of all, a given activity, or “functioning” to use Sen's (1985: 10) terminology, may simply be more costly in a richer society. For example, as the destinations of school trips become more distant every year in line with rising incomes, parents have to pay more and more to buy their children the same functioning (which is the participation in a school trip). A child whose parents cannot afford the increasing costs will not only lose a trip to Paris, but probably also inclusion and self-esteem. This effect corresponds to the negative cross-section correlation (1a). On the other hand, those who do make the trip will probably not feel more enthusiastic about visiting Paris than their parents felt about a trip to a neighboring place when they were children, simply because today's children have adapted to remote holiday destinations and take costly trips for granted. This gives rise to the flat time series (1b; more on adaptation below). To the degree the additional expenditure (in real terms!) for school trips is required to merely maintain a given functioning, this effect will be called the *secondary inflation effect*. Analogous to monetary (primary) inflation that reduces the value of one's nominal income, secondary inflation reduces the actual value, i.e., the value in terms of functionings, of one's real income.

On top of the secondary inflation effect, the *frame-of-reference effect* may reinforce the negative relationship in the cross section between average income and SWB by reducing the pleasure an individual derives from a given functioning when comparing it to a better comparison standard. Recall the evidence from two studies cited above (p. 11 and 13) which demonstrates that people always declare to be lacking necessities, and that the number of items they deem necessary is hardly affected by how rich they are in comparison to others (at one point in time), nor by how many items they already managed to acquire thanks to economic growth. As Duesenberry, the pioneer of the relative income hypothesis, already remarked in 1949 (p. 27), “It is not only true that ‘what you don't know won't hurt you,’ but that what you do know does hurt you.” Psychologists have studied this effect more in detail under the labels *relative deprivation* (Stouffer, Suchman, *et al.* 1949) and *social comparison* (Festinger 1954, Olson, Herman, & Zanna 1986).

In a more general sense, the frame-of-reference effect consist in a comparison with counterfactuals, notably the comparison with the counterfactual scenario of what the person thinks *should* be the case (*normative counterfactual*), and with what she thinks *could* very likely be the case (*likelihood counterfactuals*). As technical as this may sound,

such counterfactuals are pervasive considerations in everyday life. A vivid example of a likelihood counterfactual is the phenomenon that people who miss an airplane by 30 minutes seem to be much more upset if they learn that their flight left with a delay of 25 minutes than when it left on time (Kahneman & Tversky 1982, reported in Folger 1986). Even though the airplane is missed anyway, people seem to care about how likely it was they would have got on the airplane anyway. A normative counterfactual seems to be involved when people become dissatisfied with their salary as a company generates huge profits. Workers obviously think they are entitled to a share of the fortune their employer makes. Or as Layard (1980: 747) put it, “I dislike an identical banging at night much less if it is due to the wind than to my neighbors.” While we have no normative expectations towards the wind, we do think that our neighbors *should not* make noise at night, and this counterfactual consideration directly impacts on how unpleasant we perceive a given noise.

Comparing one’s actual situation with likelihood or, even more pertinent, normative counterfactuals can be a rather complex and unpredictable evaluative process. It would seem inappropriate to think of such comparisons as the mechanistic result of a neural clockwork somewhere inside the human brain. Rather, the effect of counterfactuals on SWB should be understood as mediated by *judgment* which by its very nature is not externally determined and ultimately unpredictable (more on this below, p. 32).

While both the secondary inflation and the frame-of-reference effect are social in nature, another effect works independently from social context: *hedonic adaptation*. Generally speaking, hedonic adaptation is the reduction of the hedonic, i.e., SWB-relevant response to a constant or repeated stimulus (Frederick & Loewenstein 1999: 302). Just as the human eye swiftly adapts to bright sunlight as one steps out of a building, restoring the subjective perception of lightness to the initial level (psychophysical adaptation), people quickly adapt to the amenities of a new car or even of a multi-million dollar yacht, reducing the initial excitement to a simple pleasure that is taken for granted (cognitive adaptation). Even if hedonic adaptation does not necessarily go all the way to completely offset the hoped for pleasure (which would in the extreme result in a “hedonic treadmill”, Philip Brickman & Campbell 1971), adaptation systematically goes much further than people anticipate (Loewenstein & Schkade 1999, Gertner 2003). Of course the frame-of-reference effect and hedonic adaptation can in practice not strictly be distinguished and will typically overlap and interact.

To avoid a cynical misinterpretation, it shall be emphasized that the relative income effect starts to operate only above a certain income threshold, i.e., after elementary needs are satisfied. A starving person is of course hungry, and he will be unhappy regardless of how his situation compares to that of others. At what amount this income threshold is to be found is largely a matter of speculation, but a number that has been mentioned by two researchers and which seems to be of a reasonable order of magnitude is \$8,000 per year (presumably 1990 dollars, cf. Kenny 1999, Myers 2000), about the per capita income of Mexico in 1998.

To avoid another misunderstanding, it is not suggested here that additional consumption can in principle not raise SWB. A society seems to have a variety of options to spend its wealth in ways that actually do raise SWB, as Frank (1999) convincingly argues. On the one hand, there are negative conditions to which people do not adapt in terms of SWB, and spending resources to improve these conditions will have a lasting positive effect. Examples of such negative conditions are traffic noise (to which sensitivity *rises* over time) and commuting in dense traffic (Frank 1999: 81). On the other hand, there are positive experiences that we do completely adapt to and which therefore bring

lasting increases of happiness. These include the number of days of vacation per year, autonomy in the workplace, physical exercise, time to socialize etc. (Frank 1999: 84-90). This suggests that economic prosperity can in principle enhance SWB to a larger degree than is currently the case in many affluent countries, but that the effect of income on happiness depends much more on *how* resources are *used* than *how much* resources are *available*. It would be naive to believe that the relationship between income and happiness obeys some cosmic law which can be discovered by statistical analysis.

### **The cultural SWB-hypothesis**

Attempts to apply the relative income hypothesis to the cross-country happiness paradox have failed: comparisons with foreign countries seem to play only a minor role in happiness judgments (Diener, Diener, & Diener 1995). However, even though the correlation between average happiness and average income is pretty strong across countries (at a given point in time), the time-series evidence falsifies the hypothesis that richer countries are happier because of their higher living standards: if this were true, Japan should have seen happiness rise substantially in the second half of the 20<sup>th</sup> century—but in fact happiness did not change at all.

The cultural SWB hypothesis links happiness and income to cultural traits and comes to astonishing results. The cultural dimension that has received most attention is that of individualism/collectivism as defined by Hofstede (1991). According to this definition,

“individualism pertains to societies in which the ties between individuals are loose: everyone is expected to look after himself or herself and his or her immediate family. Collectivism as its opposite pertains to societies in which people from birth onwards are integrated into strong, cohesive in-groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty.” (Hofstede 1991: 51)

Statistically, individualism is a powerful predictor of SWB, more powerful than income (with correlations of  $r=.61$  and  $r=.58$ , resp.). It is an even stronger predictor of income ( $r=.80$ )<sup>14</sup>. Most importantly, though, individualism has been found to remain a significant predictor of SWB when the effect of different income levels is neutralized (i.e., simulating a situation in which income is the same for all countries) while the reverse is not true: Once the effect of individualism/collectivism is taken into account, income no longer is a significant predictor of SWB (Diener, Diener, & Diener 1995). To be sure, different studies have found different results (e.g. Diener & Suh 1999), but again, the hypothesis that rising income per se raises happiness (at least above an annual income of about \$8000) is not consistent with the time-series evidence.

The cultural SWB hypothesis assembles these results into two basic arguments. The first has been developed mainly by Kasser and Ryan (1993, 1996) and by Ahuvia (1999, 2002). It states that “the secret to SWB is meeting one’s intrinsic needs,” which in turn is “dependent on ‘being true to one’s inner self’ rather than conforming to social pressure” (Ahuvia 1999). The independent self, in turn, is the “psychological hallmark of an individualist culture (Markus & Kitayama 1991, Wong & Ahuvia 1998)”. This is not to say that the intrinsic needs of the independent self are themselves individualistic—let alone egoistic—in nature. They may very well be genuinely social and compassionate (Lane 2000a, Myers 2000, 2001), but they emerge from an individualistic rather than from a

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<sup>14</sup> This value is not directly comparable with the values above because a component measure, rather than a single-item indicator, of individualism was used. Using the component measure to predict SWB as well, one finds a value of  $r=.77$  (Diener, Diener, & Diener 1995: 859), so that the assertion remains valid.

collectivistic identity.<sup>15</sup> Thus, the individualist's liberation from "networks of social obligation", Ahuvia argues, increases one's ability to make choices that cater to one's intrinsic needs and generate more hedonic satisfaction than choices geared towards meeting external expectations. In economic terminology this would be expressed—at the loss of anthropological subtlety—by stating that the individualist's preferences are dominated by those desires that are most rewarding in terms of utility—namely intrinsic desires—rather than by desires which are external to the independent individual and, hence, yield a lower happiness payoff. The upshot of this theory is that "the direct pleasures of consumption play little part in this phenomenon" (Ahuvia 1999).

Allegations that such a theory be culturally biased or suffer from Westerncentrism are mistaken. Saying that individualism encourages the pursuit of intrinsic desires is not the same as saying that individualist cultures are superior to collectivist ones.

"Defenders of collectivism give away the store when they allow Western psychologists to set the success criteria for a culture. If Western cultures may have the edge in producing happy people, Asian cultures may have the edge in producing people who value and meet their social obligations. In the long run, these cultures will be successful to the extent that they produce the kind of people they value having."

The second argument of the cultural SWB hypothesis posits that individualism tends to be more conducive to economic prosperity than collectivism. More precisely, individualism seems to be an enabling condition for competition which in turn brings about economic growth. Analogous to the Protestant Ethic-hypothesis of Max Weber (1980/1922), individualism, by teaching self-attribution of success and failure and the ideal of self-determination, legitimizes the pursuit of one's private preferences whatever their specific content as long as they do not unduly interfere with others' "pursuit of happiness."

While individualists only feel accountable to such a negative obligation, collectivists feel committed to the positive obligation of meeting in-group expectations. As a result, the freedom of choice among different private goals is more limited in a collectivist culture. Perhaps more adequately, it is the very notions of choice and preference that have a different meaning in collectivist than in individualist cultures (Markus & Kitayama 1991: 240).

The consequences of this difference can be illustrated at the example of status. While collectivist cultures tend to prescribe a specific status for each individual as a function of her age, descent, gender etc., individualist cultures tend to proclaim status as a desirable and legitimate objective for everyone. Now, if all the inhabitants of an individualist society aspire above average socio-economic status, the majority of its population will by definition be unable to meet that aspiration (and the successful minority will be anxious not to lose their position to competitors from below). Therefore, regardless of the society's absolute wealth, people will keep competing for the insignia of a high status, i.e. income, cars, job positions etc. (Hirsch 1976). In effect, then, competition for status is a recipe for economic growth. At the same time, people in such an individualistic culture will be happier than in a collectivist one, but not because they are economically more prosperous, but simply because the individualistic ethic encourages them to meet their private desires rather than those of a group.

Of course it is not suggested here that only individualism leads to economic prosperity. After all, Japan and other Asian countries, all scoring low on individualism, demonstrated the contrary. However, their economic success was arguably not so much driven by competition, but rather by coordination and a culture of ambition, together with a

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15 For a lucid discussion of this distinction and its consequences on SWB cf. Suh (2000).

growth-oriented (rather than competition-oriented) business culture (Iwata 1982). Except for a small and well-defined subset of collectivist cultures—namely Confucian societies (Japan and the Tiger States and more recently China)—hardly any other collectivist country has managed to marry collectivism with sustained economic growth, while almost all individualist cultures today belong to the high-income countries. On the other hand, the Confucian countries in the club of the world's rich are outliers in terms of low anxiety and low SWB (Ahuvia 2002: 26).

# Challenges to Economic Theory

The idea that income buys happiness is one of the assumptions—made without evidence but rather for deductive reasons—in microeconomics textbooks.

(Blanchflower & Oswald 2000: 11)

The results of happiness research challenge conventional economic theory on several accounts. The following discussion will elaborate their implications for two central themes of economics: human decision making and social welfare.

## Decision theory

Systematically speaking, the bulk of economic theory can be considered to be no more than the purely deductive derivation of specific rules from a general principle, to wit the rational utility maximization principle of *homo oeconomicus*. I shall briefly discuss the nature of this principle<sup>16</sup> as it is standardly employed in order to prepare the ground for the subsequent critique.

### The rational utility maximization principle

The economic conception of behavior is best understood as an amalgam of three or four building blocks, depending on whether the conception at hand is purely formal (thin conception) or whether it includes a substantive assertion of what is being maximized (thick conception). These four building blocks are (i) a determinate conception of value, (ii) behavioral determinism, (iii) the rational behavior hypothesis, and, for the thick conception, (iv) a hedonistic reduction (see fig. 3).

#### (i) Determinate conception of value

The determinate conception of value is the idea that, for a given individual and for any given set of alternatives, there is always one best alternative that is determined by that individual's set of preferences.<sup>17</sup> "Best" in this context is to be understood as "in the interest of that individual" or, equivalently, as "best furthering that individual's dominant end".

This dominant end (Hardie 1965, in Rawls 1999/1971), equivalent to the Aristotelian idea of a *summum bonum*, does not need to take the form of an explicit and well-understood concept (like wealth, pleasure, longevity). In its most general form, it is merely a formal, "thin" conception of a mysterious ultimate end that is implicitly encoded in the set of consistent decision rules that provide the solution for every possible conflict of subordinate ends. By convention, economists have labelled this dominant end "utility".

The determinate conception of value does not yet say anything about an individual's actual choice or his ability to identify the best choice. It merely says that all alternatives can be ranked in terms of better or worse by an individual's preferences, in contrast to

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<sup>16</sup> For more comprehensive discussions cf. Zafirovski (1999) and Sen (1983c).

<sup>17</sup> It is of course possible that several alternatives are equally optimal, but we shall ignore this special case for the sake of simplicity. The point is that a definite ranking is assumed to exist, no matter if it is one of superiority or of equality.

indeterminate conceptions of value that allow for alternatives to be incommensurate due to the personal autonomy, and responsibility, to critically examine and revise one's preferences.

**(ii) Behavioral determinism**

Behavioral determinism, as defined here, conceptualizes behavior as the deterministic consequence of given motives, where motives are all those internal factors that enter into the decision process, such as conscious or subconscious purposes, addictive impulses etc. To illustrate this with an example of, say, choosing between an ice cream and a banana, it is assumed that, in a first step, an individual establishes a set of motives by consulting his preferences. For example, he may establish a motive to eat something cold, but another motive to eat healthy food. In a second step, these motives enter the decision process during which they are integrated with each other by means of a decision algorithm, yielding a specific, predictable decision according to the respective strength of each motive. If the individual chooses the ice cream, behavioral determinism will say that this was the necessary consequence of the motivational setting, with the motive for cold food being stronger than that for healthy food. Under an indeterministic conception of behavior, by contrast, the observed decision will not be seen as a necessary consequence of the motivational setting because the individual is believed to be free to weigh these same motives differently. By virtue of this autonomy, the individual could have opted for the banana if he had shown more strength of will and resisted the temptation of the (nevertheless!) more strongly desired ice cream. In this perspective, even after the motives are established, the decision cannot be predicted with certainty because a person may be more or less attentive to different motives, follow more or less blindly his habits, show more or less resolve to live up to his ideals etc. This autonomy to weigh one's motives has to be distinguished from the autonomy to revise one's preferences as discussed above.<sup>18</sup>

(i)	Determinate conception of value (values $\Rightarrow$ dominant end $\equiv$ "utility")
+ (ii)	Behavioral determinism (behavior is determined by motives)
=	Utility maximization axiom (choice is motivated by utility maximization)
+ (iii)	Rational anticipation hypothesis (people make reasonably correct predictions)
=	Rational utility maximization behavior (people reasonably well maximize utility)
(iv)	Hedonistic reduction (utility = happiness)

Figure 3: The identity between preferences, choice, and happiness.

<sup>18</sup> While this distinction introduces a somewhat cumbersome complication, it is forced upon us by the peculiarities of the economic conception of behavior and will help us to better understand its nature.

**(i) + (ii) = The utility maximization axiom**

In economic literature, the determinate conception of value (i) and behavioral determinism (ii) are rarely, if ever, found in isolation. Rather, they appear together as what can be called the utility maximization axiom. Put simply, this axiom holds that human behavior is completely determined by the motivation to maximize utility along a given set of preferences (or “utility function”). As a corollary, the individual is denied any real freedom of choice on both of two levels: neither can he *choose* his values, nor can he choose *against* his values. Choice is simply a mechanical reaction to environmental stimuli, determined by the motivation to maximize utility, which in turn is embodied in a coherent set of preferences “that happen to coexist inside a single skin” (Schwartz 2000: 81). The further implications of the utility maximization axiom shall be discussed in more detail below.

For now it should be noted that the utility maximization axiom as such does not say anything about the correspondence of choice and outcome. Since it merely states that behavior is determined by the *motivation* to maximize utility, it leaves open whether people have sufficient information or intellectual competence to identify the alternative that will actually maximize utility. As long as it is left open how the *ex ante* motivation of choice relates to the *ex post* outcome of choice, it will merely be an empty playing with words. The third building block is meant to fill this void.

**(iii) The rational anticipation hypothesis**

The rational anticipation hypothesis posits that people make reasonably precise predictions of the consequences of alternative choices within the limits of their cognitive capacity and of the information available. More concretely and in the context of utility maximization, this means that an individual exploits reasonably well his cognitive capacities to learn from experiences, to remember, to calculate, to extrapolate, to draw inferences etc., and that he does not make repeated, systematic mistakes.

The use of the somewhat elusive term ‘reasonable’ may appear insufficiently precise, yet the very concept of rationality seems to rest on such an imprecise notion. For example, we say that a person behaves irrationally when she is caught speeding at a radar post the third time on the same day because after having paid two fines she should have learned to slow down when approaching the radar post. By contrast, we would not have called her irrational when she got caught for the first time. Similarly, whether an investor is rational or not is not a question of whether his stocks turn out to be winners or losers, but on how well he used the information that was available to him at the time he made the investment. The criterion that is used to distinguish rational from irrational behavior seems to be if the person *should*, with respect to her cognitive capacities, know the consequences or if she is excused for not knowing them. Rationality does not require perfect knowledge and perfect foresight.

Methodologically, the rational anticipation hypothesis introduces an access point for empirical testing of decision models since behavior is not any more modeled in terms of motives only, but also in terms of outcomes which can then serve as a benchmark to corroborate or to falsify a particular theory.

**(i)+(ii)+(iii) = Rational utility maximization hypothesis**

Taking the utility maximization axiom and the rational behavior hypothesis together, we get the rational utility maximization hypothesis. This hypothesis basically states that people reasonably well maximize their utility. This is the basis for the claim in economics that “each individual knows best what is good for himself.”

However, as such the rational utility maximization hypothesis does not say anything about what utility stands for, what it actually is that people aspire.

#### (iv) Hedonistic reduction

In contrast to the “thin” conception of value which leaves open the nature of the dominant end, a “thick” conception of value spells out what this dominant end actually is. Where economists employ a thick conception—rather the rule than the exception ever since economists recognized that a thin conception results in tautology and is an “almost empty principle” (Popper 1967: 145-6, quoted in Zafirovski 1999)—the dominant end is almost invariably conceptualized as some form of hedonic satisfaction or “psychic income” (Becker 1976/1960: 172). Unfortunately, the precise meaning of this sort of happiness is rarely specified, and even worse, the term “utility” is used in economics both in the thin and in the thick sense, provoking terminological confusion.

Here, the substitution of the thin conception of value by happiness is called *hedonistic reduction* in order to emphasize the self-directed, hedonic quality of the dominant end typically imputed in economics.

### Critique

Most elements of the economic theory of human behavior are axiomatic or tautological and can therefore not be falsified—and neither corroborated—by empirical evidence. However, even for a purely formal model too large a discrepancy between theory and real world phenomena will undermine its *raison d'être*. Furthermore, to the degree ‘utility’ is interpreted as ‘happiness’ in economic theory, such models do become amenable to empirical testing.

### Value

A number of striking experimental results have led psychologists to doubt the appropriateness of the deterministic conception of value. One frequent observation is that minor modifications of the experimental setting lead to completely different subjective appraisals. For example, in one experiment college students were asked to recall an event two years in the past. One group was asked to recall a positive event, another to recall a negative event. Within each group, one subgroup was asked to recall an event that “happened two years ago”, while the other subgroup was asked to recall an event that “happened two years ago, that is, before you came to university”. It appeared that the mere reference to a student’s college entry reversed the outcome: when college entry was not mentioned, students who recalled a negative event reported lower SWB than those who recalled a positive event, while the reverse was true when college entry was mentioned (Schwarz & Strack 1999). While there is a psychological explanation of this effect, which shall not be discussed here (*cf.* Schwarz & Strack 1999, Tversky & Griffin 1991), such phenomena raise more fundamental questions. Amos Tversky, e.g., concluded that

people often do not have well-defined values, and their choices are commonly constructed, not merely revealed, in the elicitation process. (Tversky in Rabin 1997: 2045)

If different elicitation procedures produce different orderings of options, how can preferences and values be defined? And in what sense do they exist? (Tversky, Sattath, & Slovic 1988: 383, quoted in Zafirovski 1999: 72)

## Motives

Both survey data and experiments show that people systematically and consciously make decisions that do not maximize happiness. For example, when presented with a scenario of either working for an annual salary of \$35,000 where one's equally qualified colleagues receive \$38,000, or receiving \$33,000 when one's colleagues earn \$30,000, 84% of the subjects (27 out of 32) said they would choose the \$35,000 job, while 62% of another group (21 out of 34) said they would be more satisfied in the \$33,000 job ( $p < .01$ ) (Tversky & Griffin 1991: 114-15). More generally, Parducci (1995) showed that people systematically are guided in their decisions by a desire for absolute success, but that they actually are more satisfied with relative success (be it relative with respect to others or relative with respect to one's own past experiences). In other words, wanting (choice) is not simply the mirror-image of liking (happiness). Indeed, it has even been shown physiologically that wanting and liking arise from two different neural systems (Berridge 1999), giving rise to behavior of wanting without symptoms of liking, and symptoms of liking without behavior of wanting.

These results do of course not say that expected happiness is not an important motive in decision-making. They do, however, suggest quite forcefully that decisions are motivated by much more than maximizing happiness. In particular, people seem to use learned heuristics of socially established criteria of success that receive much more weight than would be warranted in terms of happiness. Loewenstein and Schkade (1999: 100) put it this way:

In fact, ... many decisions involve little conscious deliberation. People decide based on rules ..., habits ..., and gut feelings, none of which involve explicit predictions of future feelings. The most common source of experimental surprise could therefore be the absence of an explicit prediction in the first place.

## Cognitive limitations

Various experiments have shown that people do make systematic mistakes in predicting how much they will like particular alternatives. Importantly, these errors are not limited to particularly inventive experiments but are pervasive even in everyday situations. For example, research has shown that people tend to overestimate the impact of almost any given aspect of life as soon as attention is drawn to it. This effect, called *focusing illusion* (Schkade & Kahneman 1998), is particularly pronounced when people consider major changes in their lives, such as moving to a different place, buying a new car, suffering an accident etc. Presumably this is because when comparing one's current state with an alternative, the characterizing differences of the state in question are brought to awareness without at the same time being set in proper relation to common features or less salient differences. When someone considers buying a new car, e.g., he will most likely fail to realize that the thrill of novelty will be short-lived and that the satisfaction derived from a new car's convenience will quickly pale into insignificance compared to the (un)happiness related to work status, marriage, companionship etc.

Similarly, people systematically overestimate their taste for diversity. When in an experiment students were asked to choose one out of six snack types for each of three consecutive days to be consumed in class sessions, those who were instructed to choose all three snacks in advance (i.e., on the first day of the experiment) chose substantially more variety than those who chose each snack the day it was to be consumed. This "diversification bias" has been confirmed later (Read & Loewenstein 1995) by the finding that those in the simultaneous choice condition later regretted having opted for variety.

In another series of experiments, patients undergoing a colonoscopy, a painful medical examination procedure, afterwards assessed the treatment as less painful when it was artificially extended by a period of only mild pain (Kahneman 1999). Consequentially, these patients would have preferred the treatment afflicting more actual pain (but less remembered pain). This result is particularly astonishing because it implies a violation of monotonicity: afflicting more pain actually reduced the remembered painfulness, obviously because people only remember the pain intensity at the peak and at the end of an episode while neglecting duration (Kahneman 1999).

### **Significance to economic theory**

The bottom line of this critique at the rational utility maximization hypothesis is that the stipulated identity of preferences, choice, and happiness does not hold. First of all, the notion that people *have* preferences seems to be fundamentally misconceived. People rather *make* their preferences. Secondly, behavior systematically deviates from happiness maximization, both intentionally and erroneously. After all, people sometimes give priority to moral considerations even if this goes at the expense of subjective well-being (for example donating blood, incurring costs for environmental ideals)<sup>19</sup>, and they occasionally take decisions mindlessly. Also, the conclusion that everyone is the best judge of what will make him happy is by no means unchallenged.

These conclusions should not come as a surprise. After all, economic decision theory is built upon psychological *ad hoc* assumptions which qualified primarily on formal, rather than substantive, grounds. They were convenient because they warrant internal consistency and analytical versatility, making them amenable to quantitative analysis, but their correspondence to the subtleties of the human mind does obviously not go very far. Similarly, in the context of consumption, welfare economics relies on an uncritical generalization of the casual observation of individual consumption decisions and their motivations. Yet the history of science has repeatedly demonstrated that extrapolations from common sense truths cannot be relied upon. Such naive reliance proved to be plainly wrong with respect to the celestial movements, the shape of the earth, the origin of species, and many other phenomena. Casual observation is too weak a basis to build a general theory upon, and “common sense may not be a good guide to what happens when a whole society gets richer” (Oswald 1997: 1828).

If now the identity between preferences, choice, and happiness does not hold, the significance of this result to normative economic theory can hardly be overstated. As Sen remarks, “all the important results in this field [i.e., general equilibrium theory] depend on this relationship between behavior and welfare through the intermediary of preference” (Sen 1983a: 67). Welfare economics will have to be reassessed in light of these findings.

## **Welfare economics**

The greatest challenge to welfare economics posed by happiness research is the finding that people derive satisfaction from relative, and not absolute, wealth. In fact, this idea is not a novel one at all. Marx already remarked that

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<sup>19</sup> It is not suggested here that morally motivated behavior generally tends to go at the expense of SWB, but rather that even if most of the time morally motivated choices are conducive to SWB, one should not expect perfect harmony between one and the other.

a house may be large or small; as long as the surrounding houses are equally small, it satisfies all social demands for a dwelling. But if a palace rises beside the little house, the little house shrinks into a hut. (Marx 1933: 268-269)

A similar statement comes from Adam Smith:

A linen shirt, for example, is, strictly speaking, not a necessary of life. The Greeks and Romans lived, I suppose, very comfortably, though they had no linen. But in present times, through the greater part of Europe, a creditable day-labourer would be ashamed to appear in publick without a linnen shirt, the want of which would be supposed to denote that disgraceful degree of poverty, which, it is presumed, no body can well fall into without extreme bad conduct. (A. Smith 1976/1784: 870)

Welfare economic theory, however, has retreated behind its founding father's insight. Generally speaking, it considers welfare to be a monotonously (though not linearly) rising function of consumption. Since an individual's welfare is assumed to be independent from the consumption of other people, it is implied that someone today in the US earning, say, \$1000 today is as well off as someone who earned the purchasing power-equivalent of \$1000 at any point in history or in any country today. This is in clear contradiction with the empirical evidence presented above and with common sense notions of a decent living.

Above it has been noted that the relative income effect can be interpreted as a kind of negative externality from consumption, analogous to environmental pollution. This interpretation makes the relative income effect accessible to welfare economic analysis because the problem of negative externalities is well-known to welfare economists at least since Pigou (1952/1920). Standardly, the most straightforward welfarist recipe to neutralize the effect of a negative externality is to tax the polluting activity in order to discourage it and thereby reduce pollution to the "optimal"<sup>20</sup> level. In the case of the relative income effect, this "polluting" activity is consumption with the pollution being the upward pressure exerted on "the frame of reference as a public good" (Frank 1997a). Now, the idea of taxing consumption (at least in the form of income) is nothing new. What is new, however, is the view that income taxation is not a necessary evil (inflicting a deadweight loss on society and just practiced because public revenues have to come from somewhere), but rather a way to enhance overall efficiency, provided the tax revenues are spent in ways that do actually enhance happiness. Strikingly, a rough estimate of the "optimal" tax rate by LSE economist Richard Layard (2003a: 11) comes out at a tax rate of 60% which is roughly the typical level of marginal taxation of consumption in Europe (taking direct and indirect taxes together).

Another implication for welfare economics would concern the way of thinking about inequality. Traditionally, inequality is a concept beyond the reach of economic theory. A scenario where the rich get richer while the poors' incomes stagnate is not seen as a problem in terms of (new) welfare economics because the criterion of a Pareto improvement is still satisfied: As long as no one loses any income, the improvement of somebody's situation is deemed a social improvement. Concerns of inequality are considered quasi-religious (sometimes labeled "philosophical") and delegated to other disciplines or non-scientific considerations. In the space of happiness, however, rather than in the space of real income, the scenario described would not even satisfy the Pareto criterion because the rising incomes of the already affluent spell deepening destitution for those whose incomes stagnate at a low level (*cf.* Hirsch 1976).

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<sup>20</sup> The quotation marks around "optimal" are meant to indicate that the underlying ethical premise "that there is a book in heaven that contains the answers to all moral dilemmas" (Tugendhat 1995) is not shared by the author.

# Ethical Views on Happiness

When somebody is unhappy and drinks whisky, he will be less unhappy, and the whisky will be the cause for that. But the reason for being unhappy will not be out of the world.

(Frankl 2003b: 37)

In the preceding chapter, economic theory has been criticized from within the economic paradigm. In particular, psychological hedonism (as the anthropological paradigm) and utilitarianism (as the moral paradigm) have so far been taken for granted, and critique has been directed predominantly at concrete hypotheses of economics, rather than at its epistemological foundations.

This chapter, by contrast, will develop several lines of philosophically grounded critique at the underlying premises of both psychology and economics. It will be attempted to show that an explicit and sound ethical standpoint is indispensable in order to make sense of happiness and to assess the normative implications of happiness research.

## Anthropology: choices are prior to preferences

A crucial assumption of economic theory is that preferences are given. “Given” does not mean that preferences cannot change. Rather, it means that preferences are not chosen by the individual who holds them, but rather that they are the purely deterministic result of the interplay of several external factors, such as genetic endowment, socialization, parental education, and experiences in general. In other words, preferences and their changes are thought to be externally determined which is the same as saying that people have no free will.

While this view is at variance with the predominant conviction that we can make free decisions, determinacy seems to be the only available mode of thinking once human behavior, or indeed any phenomenon, is made the object of scientific analysis. Once a “why”-question is asked, an intellectual constraint of causal determination is imposed on the object of analysis: The question practically anticipates the form of the answer. It follows logically that the question whether or not a specific phenomenon is part of the deterministic or non-deterministic domain cannot in its turn be demonstrated, let alone proved, because that would involve circular reasoning. Hence, whether or not there is freedom of will cannot be demonstrated. It can only be reflected upon and be shown to be more or less plausible.

From the above analysis it follows that the economic conception of human behavior is the only possible way of *causally* explaining intentional behavior, i.e., putting—or forcing—it into a deterministic framework. Given a small set of *a priori* requirements, namely intentionality and formal consistency of human behavior, it follows (i) that there must be a dominant end (since otherwise subordinate values would be incommensurable, making choice unpredictable and inconsistent) and (ii) that choice is completely determined by motives representing the dominant end (since otherwise choice would be random and not intentional). In other words, saying that human behavior can be explained—i.e., explained causally in every detail—is virtually identical with saying that people strive for utility maximization and nothing else.

Now, when preferences are not considered *given* but *chosen*, human behavior appears in a paradigmatically different light. In fact, as Harry Frankfurt (1971: 11) argues, a free

will (or more precisely, “second-order volitions”) is what distinguishes a person from a “wanton”, a being that lacks a free will and hence “does not care about his will” (*ibid.* 15). Indeed, what else remains of a person if she is not the master of her choices, if she does not even have the faintest influence on her thoughts or choices? The human mind would be reduced to a passive witness of a brain’s reactions to outside stimuli, all the while being illusioned into actually being that brain and interacting with, not just reacting to, the outside world. The self would be “just the bundle of preferences that happen to coexist inside a single skin,” (Schwartz 2000: 81) rather than the originator of those preferences.

Along with the concept of the person, morality would evaporate into an illusion. When preferences are simply given, nobody can be held responsible for his particular preferences and the ensuing behavior. A thief as much as Mother Teresa would be the deterministic product of genetic heredity and socialization. A drug addict who overcomes his addiction would simply happen to care more about his future, for example, than a drug addict who remains addicted (*cf.* Becker & Murphy 1988). By contrast, free, autonomous individuals could always have chosen differently and are at least partly responsible for their choices.

For happiness, the existence of a free will turns the entire decision theory upside down. When preferences are not given, the solution to the happiness maximization problem is simply not defined. Before an individual knows which course of action will make himself happiest, he has to make up his mind, i.e., he has to choose his preferences. This choice can of course not again be informed by happiness considerations because such information is simply not available (suggesting otherwise would be circular reasoning). Rather, he has to choose his preferences without the help of definite criteria. In making this choice, the individual has two basic alternatives: He can either let himself be pushed by drives and impulses, or he can choose his preferences by reason. In the latter case, he will exercise the human capacity of *volitional rationality* to evaluate incommensurable alternatives, as opposed to *instrumental rationality* which departs from given ends.<sup>21</sup> The criteria for this choice cannot be specified in detail, precisely because such decisions are ultimately free, but they may include considerations of legitimacy, a quest for meaning, or creative inspiration. If in the end a person is happy with his choices—which may or may not be the case—, happiness will be the *result* of this choice, rather than its antecedent *reason*. Or in the words of Rawls (1999/1971: 471),

the self is prior to the ends which are affirmed by it; even a dominant end must be chosen from among numerous possibilities.

From the *possibility* to autonomously revise one’s preferences follows the *duty* to revise them in particular ways. A person who is *able* to ask “What do I *want* to desire?” is also under the *obligation* to ask “What *should* I desire?” This is because as soon as a person acknowledges other human beings as fundamentally equal in being dignified subjects with inalienable rights, she cannot deny her obligation to respect those rights. The deeper reason for this is that by engaging in the exchange of arguments, a person places herself under the obligation to legitimize her choices and cuts off any retreat into amo-

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<sup>21</sup> The distinction introduced here between *volitional* and *instrumental rationality* is reminiscent of Weber’s (1980/1922: 12) distinction between *value rationality* and *goal rationality*. However, while I share his understanding of goal rationality (corresponding to what is here called instrumental rationality), my concept of volitional rationality is meant to emphasize that one’s choice of values can still be guided by reason, rather than being arbitrary as suggested by Weber.

rality.<sup>22</sup> As a consequence, a person is to be held, at least in part, responsible for what she derives happiness from. That is the reason why we condemn not only the act of hurting another person, but also the mere desire to see innocent people suffer from violence (even if no act of violence actually follows). By the same token, freedom of will implies that a person bears some own responsibility, or merit, for how (un)happy she is. “Happiness is not something that happens to people but something that they make happen” (Csikszentmihalyi 1999).

The upshot of this discussion of the role of the free will is not that it is always wrong to depart from the assumption of utility maximization. Where one is concerned with instrumental rationality only, it is perfectly legitimate to take preferences as given and to regard individuals as mechanical utility maximizers. The problem begins when volitional rationality is concerned. Then, the question of the free will makes all the difference. Alternative conceptions of behavior that do not break with determinism, such as the concept of bounded rationality (Simon 1982/1976), will inevitably boil down to one or another form of utility maximization.<sup>23</sup>

The actual problem, therefore, is one of violating disciplinary boundaries. One of the founding fathers of modern marginalist economics still recognized the limits of the economic domain:

We have never attempted to predict decisions made under conditions of perfect freedom; we have only tried to express the effects of such decisions in terms of mathematics. In our theory each trader may be assumed to determine his utility or want curves as he pleases. (Walras 1954/1877: 256, quoted in Rawls 1999/1971: 489, fn. 27)

Applying theories developed within a deterministic-choice framework to questions of volitional rationality is illegitimate, just as the demand to take account of the free will in a context of instrumental rationality is pointless. This is not to suggest that it is always straightforward to decide whether a given decision problem is to be assigned to the domain of volitional or to that of instrumental rationality. When this decision can be made, however, both approaches should be able to coexist as long as each stays within its domain.

### **The happiness machine**

Demonstrating the consequences of abandoning the free will is not the only way to show the implausibility of the idea that human behavior is entirely motivated by happiness maximization. Another way is to understand the nature of happiness as *the happiness we actually value*, rather than the subjective happiness we experience in a particular situation.

Imagine a machine (Nozick 1989: 104) that can give you pure and unlimited pleasure for an arbitrarily long period.<sup>24</sup> What is more, this machine generates not just blind pleasure but the perfect illusion of happiness. The person connected to this machine will experience a perfect illusion of friendship, love, good music, delicious food etc. and will

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22 A more in-depth treatment of this discourse ethical argument is found in Apel (1973) and Habermas (1983). A more accessible account is given by Ulrich (1998b: 78ff).

23 Simon himself later practically admitted this by stating that “it is difficult to draw a formal distinction between optimizing and satisficing procedures that is so iron-clad as to prevent either from being reinterpreted in the frame of the other.” (Simon 1982/1972: 418)

24 This idea is no pie in the sky anymore. In the brain of rats, a pleasure center could be identified which, when stimulated electronically, makes the rats show all symptoms of pleasure, and this effect does not wear off over time. The rats even neglect food while being in such a state. Technically, the same effect could be exploited in human beings, as seriously advocated by Ng (1997: 1849) who sees the promise of “increasing our welfare by a quantum leap.”

believe to be happy for these reasons, unaware of being locked into that machine. There would be no negative side-effects of using this machine and its use would not imply any costs, nor would it be addictive. Would we call such an experience happiness?

Imagine a person uses the machine while mourning the death of a friend. Even if, while using the machine, he will forget about his friend's demise, we certainly would not call this person happy because the happiness we actually value is more than a sensation. Except, to some degree, for sensual pleasures, happiness is intentional, i.e., directed towards some reason (Spaemann 1989: 41, 73). When we are happy for a friendship, we do not only care about being happy but also about the reason for our happiness. We do not only want to *experience* love, we want to actually *be* loved. We do not only want the pleasure generated by the feeling to be loved, we also want this love to be genuine, to actually *be the case* (Nozick 1989: 106). What is more, we "naturally [desire], not only to be loved, but to be lovely" just as we desire "not only praise, but praise-worthiness" (A. Smith 1976/1759: 113-14). According to Adam Smith, "being lovely", rather than being loved or reaping the happiness from being loved, is the proper desire. "We are happy and contented" when we "believe ourselves to be" lovely, even when we do not actually receive any gratification—even though, when our being lovely is responded to by someone else's love, this "greatly confirms this happiness and contentment" (A. Smith 1976/1759: 114). Similarly, someone who finds out about his spouse's infidelity is not unhappy for having *discovered* it but for his spouse's *being* unfaithful and her not *being* that lovely after all. In short, the sensation of happiness is not separable from its underlying reason. The object of happiness is not the *cause* of happiness but its *content* (Spaemann 1989).

Saying that we care not only about feeling happy but also about something to be the case means progressing from a solipsist concept of happiness towards a self-transcendental concept. The subject that experiences happiness is then no longer—as in the economic conception of behavior—a physical pleasure center somewhere inside the brain, but a reflective mind caring about the state of the world in the absolute. Happiness as a distinctly human state of mind—as opposed to pleasure which can also be ascribed to animals—is inevitably self-transcendental because the human ability to choose one's desires *forces* us to choose them. This is because once a being is knowledgeable—once it has eaten from the tree of knowledge, so to speak—, it cannot retreat behind this mental emancipation and return to its naturalistic state (*cf.* Spaemann 1989: 52, 69). Of course, an individual can choose to live by pure hedonism and just follow his drives and impulses. But then this choice itself is just a particular case of self-transcendental volition: facing the alternatives to either care about plain pleasure only or to care about other states of the world as well, this individual consciously chooses to want only the former. Nevertheless, his choice is for a specific thing to be the case (namely to experience pleasure and care for nothing else) and for another thing not to be the case (namely his caring for other things), thus remaining a self-transcendental volition. Furthermore, such an individual cannot give reasons for his choice because even in the act of speaking he would follow subjective hedonistic principles, rather than intersubjective principles of logic and truth (Spaemann 1989: 52) which are a precondition for meaningful speech.

### **Happiness as a judgment**

A more manifest normative aspect of happiness has been mentioned already in the context of empirical research: normative counterfactuals (p. 16). In contrast to common welfare economic theory, normative counterfactuals make happiness a much more complex concept. They imply that people do not only care about what happens to them,

but also whether the circumstances justify whatever happens to them. The example of a loud noise at night (see above, p. 17) illustrates this: when it is due to the wind, people bother much less than when it is due to the neighbors, and this will have differential consequences on SWB. Empirically, legitimacy considerations have been found to play an important role when people are asked how satisfied they are with their salary. In one study (Berkowitz, Fraser, *et al.* 1987), equity considerations turned out to be the most powerful predictor of satisfaction with pay.

Judgments also play a major role in the assessment of (positive or negative) exceptional events. As illustrated in the example of college students mentioned above (p. 21), one can use the memory of an exceptionally pleasant event either to keep taking delight in its memory, thus raising SWB, or as a contrast to compare current events, thus reducing SWB (because the comparisons will be unfavorable for current events). While it is conceivable that rare experiences of intense happiness may have a negative overall effect on life satisfaction of nostalgic dreamers (Parducci 1995), “a few glorious moments could sustain a lifetime of happy memories for those who can cherish the past without discounting the present” (Tversky & Griffin 1991: 117). Yet, it seems to be almost unpredictable whether a given individual will interpret a past positive event as positive or as negative for her current life. Ultimately, it is up to her free judgment.

As a general conclusion it seems that once judgment is acknowledged to be indeterminate, happiness also has to be considered indeterminate. It is not, as psychologists tend to think, a state “out there” that can in principle be retrieved in some part of the brain if only one knows the correct technique. Rather, it is an indeterminate judgment that respondents construct, rather than retrieve, the moment they are asked.

“If different elicitation procedures produce different orderings of options, how can preferences and values be defined? And in what sense do they exist?” (Tversky, Sattath, & Slovic 1988: 383, in Zafirovski 1999: 72)

## Happiness and welfare

Most publications on happiness research convey the more or less obvious utilitarian message that the maximization of happiness is the ultimate maxim of ethics. While only a few authors subscribe to this principle explicitly (e.g., Ng 1997), most seem to subscribe to utilitarianism implicitly. But there are also some who emphasize that happiness is but one aspect of a good life and that social policy has to be concerned with more than happiness alone (e.g., Ahuvia 1999, Parducci 1968).

While the general problems with utilitarianism have been abundantly dealt with in the philosophical literature (e.g., Rawls 1982, 1999/1971, Ulrich 1998b, Tugendhat 1995), modern happiness research delivers some particularly illustrative examples of the inadequacy of utilitarianism as an ultimate moral principle. Two major problems are concerned with how to deal with the dimension of time. The first concerns the question how to integrate happiness that is recorded at different points in time from different individuals. For example, should the happiness of future generations receive the same weight as the happiness of people living today? In economics, this question has led to a still unresolved debate of whether or not to discount future events. The second issue concerns the problem that remembered pleasure or pain systematically deviates from real-time reports, as described above (p. 26) in the case of patients who can be manipulated into believing that the actually more painful treatment (in terms of real-time reports) was the less painful one. This raises the question whether the surgeon should, on

moral grounds, minimize the *actually experienced* pain or the pain the patient will *remember* the next day (and which will influence his fear of further treatment).

A further, and not entirely new, problem is raised by the alternative between a country's average happiness and sum-total of happiness. If average happiness is taken to be the yardstick of social welfare, killing people (who do not have any friends or relatives whose unhappiness would enter into the social welfare equation) would not mean a worsening of welfare on this account. On the other hand, if the sum-total of happiness was the criterion of welfare, declining average happiness could simply be compensated by population growth.

The upshot of this enumeration is that these problems are prior to utilitarianism, i.e., the questions they raise have to be solved *before* the utilitarian can apply his moral calculus to "solve" moral problems. When trying to answer these questions, the utilitarian must find that he has no criteria to judge which answers are better and which worse because his moral principles are still unfinished, precisely because these answers are lacking. If a utilitarian finds an answer anyway, he must have resorted to moral principles that are systematically prior to utilitarianism. This reasoning shows, once again, that utilitarianism cannot serve as the ultimate moral principle (*cf.* Ulrich 1998b: 77).

Leaving radical utilitarianism aside, one might admit that happiness is a good in the sense that, *ceteris paribus*, more of it is always better. Unlike most goods, such as longevity or material wealth, it seems that you can never have too much of happiness and that there is no tendency for happiness to generate negative side-effects. This is the view adopted here. However, the *ceteris paribus* condition is seldomly satisfied. Sometimes, more happiness means less of another good. Consider the results of an international survey conducted in 1999 in which 3000 women were asked how they think their lives compare to those of their grandmothers (Economist 1999). Besides several general questions on women's rights, the survey asked whether the respondents thought whether they were in a better position than their grandmother's generation and whether they were happier than their grandmother's generation. Astonishingly, while a large majority of women (93%) considered themselves to be better off than their grandmothers, only 46% thought themselves to be happier. While we do not know the particular reasons for these apparently contradictory answers, it is obvious that there is some good that these respondents value so much that they are even willing to exchange some happiness for it. Perhaps these women consider life better because they feel to have more rights and liberties than their grandmothers (which the survey shows they do), even though they feel less happy, perhaps precisely because of these liberties. This interpretation is reminiscent of J.S. Mill's assertion that

it is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied. (Mill 1891: 14)

Changing things for the better may sometimes have a price in terms of lower happiness, and sometimes this might be a price worth to pay.

Looking at happiness research from an ethical perspective unveils another moral problem. In the context of the relative income hypothesis (p. 15) it appeared that money makes people happy to the degree that they are wealthy compared to the social average.

The power of the money in my pocket is far from being merely the liter of milk or the pleasure it buys. It is also the relative lack of money in the pockets of the others. (Giannetti 2002: 80)

If this is true, then the happiness one derives from above-average consumption will be happiness at the expense of others, just as environmental pollution.<sup>25</sup> Yet, the parallel

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<sup>25</sup> *Cf.* the discussion of negative externalities above, p. 27.

with environmental pollution is not very precise because externalities from consumption come in two distinct qualities. First, the negative effect on others may simply be a side-effect of consumption. For example, a salesman may buy an expensive car because he drives a lot and therefore cares about the car's safety, even though he does not at all care about the status his car conveys. This kind of externality is comparable to that of environmental pollution as a side-effect of heating one's house. Second, however, the negative effect on others may be the defining characteristic—or even the very objective—of the good desired. This is the case to the degree an expensive car, for example, is bought for the very purpose to lift oneself above the average. This kind of consumption has been termed *conspicuous consumption* by Thorstein Veblen already in 1899<sup>26</sup> and has no parallel in environmental pollution. The negative effect on others is simply the other side of the coin of conspicuous consumption, even though a particular individual may be unaware of this. The distinction between the first and the second kind of externality—I shall call them *regretted externality* and *intended externality*, respectively—can be characterized with the following thought experiment. Assume that the acquisition of a particular consumption good by individual *A* triggers the simultaneous acquisition of the same good by all other individuals. If *A* under these circumstances still considers the acquisition worthwhile, he will desire the good for its innate qualities and regret the negative externality. If, on the other hand, the consumption good ceases to generate any benefit to *A* when all others also possess the same good, it will have been desired for the externality it inflicts on others.

Conspicuous consumption in this “intended” sense seems to be ethically questionable. Spinoza, writing a century before Kant, already posited that conspicuous consumption should not be a basis for happiness:

Whoever considers himself happy because fate has given a better lot to him than to others, is still ignorant of real happiness. [...] [People should] not desire something which they do not also desire for the rest of mankind. (Marcuse 1962: 119)

In particular circumstances, the legitimacy of conspicuous consumption may be difficult to appraise. This is the case when status is aspired as a means to a legitimate end. For example, an attorney may buy a prestigious car in order to signal her ability (since otherwise potential clients may conclude that she must be very poor at court for not being able to afford a better car), even though she does not personally care about status. Demanding from her to drive a more modest car might mean asking too much, considering the loss in income which might ensue.

In summary, while conspicuous consumption can perhaps not *a priori* be derided as illegitimate, it seems that there are few arguments which might justify it.

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<sup>26</sup> A more recent and very elucidating discussion of conspicuous consumption is found in Frank (1999).

## Policy implications

Why would I need [economic] growth as long as unemployment does not rise? [...] The number of working hours per employee has fallen [in Switzerland], and that subtracts from growth. But whether this has reduced quality of life I dare to doubt.

Klaus Wellershoff<sup>27</sup>

In this chapter I will try to probe the significance of happiness research for public policy. Naturally, happiness research as such cannot produce policy recommendations since these are always ethical in nature, and ethical prescriptions cannot be derived from empirical facts. The present investigation will therefore take a normative stance in arguing that happiness indicators are at least *less inappropriate* indicators for social welfare than those that are currently being used. It will then outline a few benefits to be expected from taking happiness seriously.

### Gross National Happiness

Single-item measures of social welfare, such as GNP or the Human Development Index (HDI), are criticized in principle for being too crude and by construction unfit to provide sufficient information on the goodness of a society. Yet, such criticism should be put into perspective. What is to be criticized is the technocratic belief that one single number exhaustively captures all relevant aspects of social welfare and, consequently, that this single number is to be maximized (or, more generally, optimized). The problem is therefore not the construction of a single-item index as such, but its being elevated to an absolute. As long as a single-item measure is carefully designed and its limitations recognized, such an indicator has a number of practical benefits. Most importantly it can be communicated much easier than lengthy verbal assessments or multi-item statistics and it is more effective in highlighting trends, making comparisons across observations and identifying extreme values. Thanks to their simplicity, there can be little doubt that single-item measures will always be around and that they will play an important role both in academia and in politics.

For most of the past century or so, income (in terms of per capita GNP) has been the most widely used measure of social welfare, and even though its limitations have always been recognized in theory, it continues to remain almost unchallenged in public discourse. Comparisons of social welfare across countries are most often made in terms of per capita GNP, and politicians and voters alike stare at the latest GNP growth figures as if their lives depended on it (as a matter of fact—or perhaps as a consequence—those of politicians do).

Yet, GNP is not only a slightly imperfect indicator of social well-being, it is a seriously flawed one. The most obvious shortcomings shall merely be enumerated here: exclusion of non-economic life circumstances (at least beyond their pecuniary impact); neglect of non-marketed production (especially important in low-income countries); neglect of defensive production (such as abatement costs to undo environmental damages caused by economic growth); blindness towards distribution; and ignorance of the relative-income effect. Yet, the arguably most important shortcoming is what is supposed to be its strength: objectivity. For some reason or another, objectivity has come to be consid-

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<sup>27</sup> Wellershoff (2003). Klaus Wellershoff is chief economist of UBS, one of the two largest Swiss banks.

ered a desirable property of any indicator, perhaps out of social scientists' desire to emulate the analytical precision of the hard sciences. It is obvious, though, that an indicator should be of the same nature as the underlying construct. And since social welfare is a largely subjective construct, an indicator of social welfare should also be subjective.

Subjective well-being is such a subjective indicator, and even though it is still imperfect, it gives a much better view of social welfare than GNP does. In contrast to GNP, SWB adequately captures those economic influences that lower SWB much more than they do GNP (such as unemployment), and it captures non-economic influences that are not captured by GNP at all (such as crime). Focussing on GNP, possible negative side-effects of economic growth—such as loosening of personal bonds, rising rates of depression (Lane 2000b)—go largely unnoticed and are degraded to secondary concerns, especially in times of economic slowdown or recession. On the other hand, being a subjective indicator, SWB is sensitive to those aspects that matter most to people's lives as perceived by themselves, rather than *imputing* from outside, based on an—even empirically falsified—*ad hoc* theory, how well people should be doing if they earn a particular income—an oddly paternalistic concept considering the economist profession's almost religious opposition towards anything paternalistic.

Replacing Gross National Product with *Gross National Happiness* (GNH) is no pie in the sky—the Kingdom of Bhutan has officially adopted GNH as its development concept already in the 1980s (Priesner 1999: 27).<sup>28</sup> Its policy focus is explicitly shaped by concern for “the emotional well-being of the population, the preservation of Bhutan's cultural heritage and its rich varied resources,” as an official government document states (Priesner 1999: 27). Even though Bhutan still counts the increase of incomes among its development objectives, it has in several instances deliberately sacrificed economic profitability for non-economic benefits, especially in the context of forest conservation (Namgyal 2001, Priesner 1999: 50, Thinley 1999). The United Nations Development Programme's (UNDP) Programme Officer to Bhutan concluded “that Gross National Happiness—a vision *sui generis*—has led to an astonishingly smooth and undistorted process of change” and that “Bhutan essentially anticipated the approach of human development which was propagated three decades later as a revolution in development thinking [by the UNDP in 1990]” (Priesner 1999: 24 and 37).

Due to Bhutan's particular history and demographic as well as cultural conditions (with a population of just 750,000), Bhutan's approach can hardly serve as a blue print for other countries. It shall also be reemphasized that Bhutan's rather spiritual concept of happiness is not identical with the psychological concept of subjective well-being employed here (*cf.* footnote 28). Nevertheless, replacing GNP with GNH can be expected—in any place of the world—to play an important role in directing attention towards those aspects that are most relevant to a good life. In particular, GNH would promise to reassess the negative consequences of unemployment, social exclusion, inequality, etc., rather than reducing these aspects to their effects on incomes. Economic policy that takes GNH at least as serious as GNP would see as its primary objective not the maximization of per capita income whatever the costs in terms of well-being, but the furthering of conditions that allow people to live lives they themselves consider good. The objec-

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<sup>28</sup> Happiness was even mentioned as an explicit development goal already in 1960. It is not an imported concept but rather “a popularization of the distinct Bhutanese perception of the fundamental purpose of development, which can be traced throughout the period of development” (Priesner 1999: 27). Therefore it is to be understood as a religiously (Buddhist) inspired notion rather than a psychological one. To my knowledge, no psychological happiness surveys have so far been carried out in Bhutan.

tion that such a focus would undermine economic growth would be entirely misconceived.

The perception of human well-being as the fundamental objective of economic activity ... turns the criticism of western economists, who smile about the economic inefficiency of “Gross National Happiness”, highly irrational. They miss the point—the aim is not economic efficiency, but a maximization of happiness. (Priesner 1999: 37)

As emphasized above, one should not reduce social welfare to *any* single-item indicator. The argument here is therefore not that GNH should be the exclusive guideline for socio-economic development, nor that it would lead to the solution of today’s economic problems. It is merely claimed that, given that single-item indicators will always remain in circulation, GNH would be a less inappropriate indicator of social welfare than GNP. When comparing two countries, *A* and *B*, the information that one has a per capita income of \$34,000 and the other of \$1,800 (a difference by the factor 19) does not allow a strong conclusion about the quality of life in those countries. However, knowing that in country *A* average SWB is 8.1 and in country *B* it is 4.2 (on a 10-point scale) is evidence beyond any reasonable doubt that quality of life is much worse in the latter country.<sup>29</sup>

The ultimate basis for setting policy priorities should be discursive deliberation rather than a quantitative concept of welfare. As the example of women’s rights above (p. 33) shows, a society might sometimes want to sacrifice some happiness for another objective. In addition, happiness indicators are entirely silent about a number of important concerns. How satisfied people feel today does nothing to answer the question how to deal with long-term risks such as climate change, which biomedical interventions should be allowed, or how to treat non-human life. Even though happiness data may provide some content for such debates, these questions cannot be answered by looking at indicators only. The ultimate arbiter of ethical questions can only be a public moral discourse, and indicators can provide content and direction for this discourse, but they can never replace it.<sup>30</sup>

## Understanding the role of institutions for consumption

In the context of private consumption, happiness research suggests rather concrete policy implications. The income paradox suggests that there is quite some potential for institutional measures to enhance social welfare through an influence on consumption decisions.

In the context of the income paradox it has been demonstrated that consumption is a source of SWB only in a relative sense, i.e. in relation to a society’s average consumption, and that this effect stimulates a positional arms races leading to a prisoner’s dilemma. Even if the each consumer’s consumption choices are individually rational, society as a whole would be better off when these arms races were mitigated by setting appropriate incentives or, even better, if they could be entirely avoided by making the “prisoners” cooperate.

In principle there are two levels on which positional arms races can be tackled. First, an appropriate change of the players’ preferences may change their behavior in such a

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<sup>29</sup> Income figures are those of the USA and of Bhutan in 2001 (in purchasing power parity, taken from UNDP (2003)). SWB figures are those of Switzerland and Russia in the 1990s (when the lowest score was Moldova’s with 3.0) and were taken from Veenhoven (2002).

<sup>30</sup> Since this is not the place to elaborate on the underlying reasoning for this claim, the reader is referred to Ulrich (1998b, 1998a) for the full argument.

way as to completely eliminate the dilemma. Second, assuming fixed preferences, one might change the rules of the game and that way incentivate people to cooperate or at least reduce the damage from non-cooperation.

Regarding the first level, the deliberate shaping of preferences or values is sometimes considered illegitimate or patronizing. However, once it is acknowledged that a person's values are unavoidably exposed to social influences—and that, even if they were not, it would be morally indefensible to let children grow up in an environment of moral indifference<sup>31</sup>—the question is no longer *whether* to promote particular values, but *which* values should be promoted.

In the context of the relative-income paradox, it might be desirable (and more efficient) to encourage comparisons with one's own potential rather than with the achievements of others. Teaching children the value of personal development rather than the desirability of status might go a long way in reducing the wasteful competition of the positional rat race (Layard 1980: 744). After all,

one wants people to work not in order to excel over others (a game against persons) but in order to do the job well (a game against nature). (Layard 1980: 744)

Externalities can also be dealt with on a second level by changing the rules of the game. The most obvious and market-based method to do so would be the imposition of taxes on consumption that generates negative external effects (p. 27). Where taxes are impractical or undesirable, one may restrict people's options by legislation or through collective agreements. In the absence of regulations on the maximum amount of hours employees are allowed to work, for example, employees would bid working hours up in order to keep up with a rising consumption standard, to increase their chances for being hired, or to improve their odds for promotion to a higher position. While each employee would be ready to work a few hours more in exchange for these benefits, a general limit on working hours is in the interest of everyone because the benefits depend on relative, and not absolute, working hours. Without the limit, working more hours would be like standing up in a theater (Hirsch 1976: 49): once a few people rise from their seats, everybody *has* to stand up to see anything, but they see as much as before—the only difference being that they end up with sore legs.

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31 Moral indifference would then in turn be a normative demand itself, leading to a paradox. This is exactly the reason why there is no neutrality in taking a stance towards another's values.

## Conclusion

A strong case has been made, in the beginning of this study, that happiness in the sense of subjective well-being should be taken at face value in the context of empirical research. In fact, most researches share this view and have gained a number of valuable insights into various aspects of subjective well-being. Yet, to appreciate what these results imply for anthropological theories and for theories of social welfare, happiness has to be understood in its ethical dimension as well. In fact, as has been argued in the introduction, it is through the integration of the diverse disciplinary perspectives on happiness that advances our understanding of happiness.

If I attempt to distill the main points out of the present discussion of interrelated issues, I would summarize them in three main themes:

1. Happiness research can make a valuable contribution to understanding human behavior. In particular, it offers a methodology to empirically test the widely held hypothesis of psychological hedonism, which has assumed such a pivotal role in economics (in the form of the rational utility maximization hypothesis). It has demonstrated that people make systematic and substantial errors in predicting or remembering hedonic experiences, and it supports the view that people care about more than just their private experience of happiness.
2. Happiness research helps us understand the systemic effects of individual consumption decisions. It shows that prisoner's dilemmas are a pervasive phenomenon in everyday consumption decisions and that—at least in affluent societies—the notion that higher incomes will bring more happiness is an illusion brought about by people's failure to take into account the dynamics of the social context.
3. Taking happiness seriously might redirect public attention towards those domains of life that are most essential to social welfare. While the current focus on income (GNP) leads to an overemphasis on but one instrumental condition of social welfare that only contributes marginally to quality of life (in the affluent countries that is), monitoring subjective well-being and related subjective indicators might remind people that the economy should serve people and not the other way around.

Adopting an interdisciplinary perspective should teach modesty with regard to any single discipline's relevance. Economists and psychologists have to acknowledge that happiness cannot be the only thing that matters. "In life, nothing is everything, not even happiness" (Giannetti 2002: 180). Psychologists can learn from cultural theorists that culture can make a large difference to what matters to people's SWB, and to how important SWB is to people in different cultures (Suh 2000). Philosophers might gain from taking empirical research seriously. They might find, for example, that the moral problems posed by conspicuous consumption are of a distinct quality (due to their inframarginal and systemic nature) and cannot be analyzed in the same way as classical conflicts involving external effects.

Perhaps the most important contribution ethics can make to happiness research is to spell out the consequences of acknowledging that human beings are endowed with a free will. When people can choose their preferences, they can also choose what will make them happy. The entire question of SWB—and consequently the very idea of the good society—appears in a paradigmatically different light if it is not understood as meeting given desires, but as the satisfaction of legitimate expectations in which the active and sensible examination of such expectations themselves has at least as large a role to play

as the means to satisfy them. On the societal level, this means that the ultimate arbiter in deciding between alternative courses of action should not be happiness indicators but public moral discourse, and that the best society is not necessarily the one which is happiest, but the one where people lead a dignified and meaningful life.

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