

ECONOMICS OF HAPPINESS

Conceptualization

If one agrees, as most people would, that happiness can be considered the ultimate goal of a person's life, and that what matters most for everybody is to achieve satisfaction with life, it follows that economics should be about individual happiness. The study of satisfaction with life¹ has an intrinsic interest as well as other motivations, such as the evaluation of alternative economic policies and the solution of empirical puzzles that conventional economics find difficult to explain. Concerning this last aspect, probably the most striking paradox in need of an explanation is the very weak correlation found in many studies between income, the most worshiped variable in economics, and happiness. It is a well-established finding² that several countries that experienced a drastic rise in real income since WWII did not have an increase in the self-reported subjective well-being of the population, which has even fallen slightly. At a given point in time, higher income is positively associated with people's happiness, yet over the life cycle, across countries and over time this correlation is very weak, what is known as the Easterlin paradox.

This motivated economists to reach a step beyond standard economic theory' "objectivist" position, based only on observable choices made by individuals. In the traditional approach, individual utility depends only on tangible goods, services and leisure, and is inferred almost exclusively from behavior (or revealed preferences). The axiomatic revealed-preference approach holds that the choices made provide *all* the information required by inferring the utility of individuals. According to Sen (1986) "the popularity of this view may be due to a peculiar belief that choice (...) is the only human aspect that can be observed."

Stemming from a work by Easterlin (1974), and having become substantially relevant in the late 1990s - when economists started to contribute with large-scale empirical

¹ Subjective well-being, happiness and satisfaction can be used interchangeably and is the scientific term in psychology for an individual's evaluation of her experience about life as a whole.

² See Richard Easterlin (1975, 1995, 2001), Blanchflower and Oswald (2000); Diener and Oishi (2000); and Kenny (1999)

analyses of the determinants of happiness in different countries and periods³ - the economic interest in the assessment of individual subjective welfare grew considerably.

A subjective view of utility recognizes that everybody has their own ideas about happiness and good life and that observed behavior is an incomplete indicator for individual well-being. This methodology involves the belief that individuals' happiness can be captured and analyzed by asking people directly about how satisfied they are with their lives. Hence, the variables of interest are based on the judgment of the persons directly involved, following a premise that people are the best judges of the overall quality of their lives, and thus no strategy could be more natural and accurate than to ask them about their well being. The main idea is that the concept of subjective happiness allows us to capture human well being directly, instead of assessing income, or other things which are not truly what most people want but, instead, a means through which one can attain happiness.

Following Frey and Stutzer (2002), “subjective well-being is a much broader concept than decision utility, including experienced utility as well as procedural utility, and is for many people an ultimate goal.” They argue that, for most purposes, happiness or reported subjective well-being are a satisfactory empirical proxy for individual utility. Since people assess their level of subjective wellbeing in relation to circumstances and other people, past experience, and future expectations, they suggest that measures of subjective well-being can serve as proxies for utility. Besides, since the main purpose of measuring happiness is not to compare its levels in an absolute sense but rather to identify the determinants of happiness, as it will be done in our work, it is neither necessary to assume that reported subjective wellbeing is cardinally measurable nor that it is interpersonally comparable. Furthermore, according to Diener (1984) - based in many studies such as Fernández-Dols and Ruiz-Belda (1995), which found a high correlation between reported happiness and smiling, and Honkanen Koivumaa et alli (2001), which found the same correlation between unhappiness, brains and heart activity - "these subjective measures seem to contain substantial amounts of valid variance".

³ For a general survey on happiness research see Kahneman, Diener, and Schwarz (1999) and Frey and Stutzer (2002).

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