Preface

Developments in the economics of well-being

Jonathan Lepper, HM Treasury and Siobhan McAndrew, University of Manchester

Abstract

The working paper consists of two parts. The first part sets out an analytical review of the empirical evidence on well-being, summarises key research findings, and overviews the potential policy implications as interpreted by a range of schools of thought. The second part looks at the developments in the economics of well-being from a central government perspective. It assesses their potential impact for policy and provides a series of proposals as to how to incorporate well-being evidence into policy appraisal.

In pursuit of its objectives to raise prosperity for all, the Government needs to achieve an appropriate balance between policies that promote well-being and policies that maintain economic incentives to support innovation and growth. Such specific policy proposals need to be evaluated carefully, taking account of their impacts on government objectives for well-being, economic growth, distribution of income and wealth and affordability.

JEL reference: D60, I31, H43

Keywords: Easterlin paradox, relative income, subjective well-being, utility, institutions, policy appraisal.

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Introduction

1.1 Well-being, both subjective and objective, is of fundamental importance for individuals. It is an end for which people strive, alongside others such as autonomy and self-actualisation, and results from us experiencing what, on reflection, we have judged to be good. Well-being depends heavily on personal relationships, social contexts, on our achievements, health and quality of the environment. It may in turn affect our capacity for fulfilling relationships and work, civic engagement, and collective responsibility to others.

1.2 Over the past decade or so well-being has garnered significant attention in academic and policy circles. In particular, the discovery by Richard Easterlin\(^1\) that subjective measures of life satisfaction in the United States have remained flat since 1945, despite considerable increases in national income. This finding, which has been replicated in the majority of western economies, has been interpreted as a challenge to economic growth but has been vigorously contested in recent years.

1.3 This paper reviews the evidence for and against this paradox and assesses what the well-being debate brings to the development and appraisal of public policy.

1.4 Governments already factor well-being considerations into the overall balance of economic, social and environmental policy. Economic policy does not generally seek to prioritise growth per se, but as a means to higher aggregate welfare. Despite the characterisation of economics as the ‘dismal science’, Alfred Marshall, who largely defined the modern discipline, expressed it as follows:

‘Economics is a study of mankind in the ordinary business of life... [and] that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of well-being’.\(^2\)

1.5 In the UK, the Department for Environment, Food and Rural Affairs made a commitment to explore well-being in the UK Government Sustainable Development Strategy Securing the Future published in March 2005\(^3\). This subsequently lead to the publication of a set of sustainable development indicators through which to review progress (including some provisional measures associated with well-being\(^4\)) and the commissioning of research looking at the main links between well-being and the natural environment.\(^5\)

1.6 The Department for Work and Pensions, Department of Health and Department of Children, Schools and Families all include well-being as explicit objectives in their Public Service agreements for 2008-2011\(^6\). The Department for Communities and Local Government is also co-funding pilot studies on practical ways to improve public well-being at local authority level.

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\(^4\) For further information visit www.sustainable-development.gov.uk.
\(^6\) HM Treasury, Meeting the aspirations of the British People 2007. Pre-Budget Report and Comprehensive Spending Review (2207)
1.7 In addition the Treasury’s strategic objectives are to maintain sound public finances, and ensure high and sustainable levels of economic growth, well-being and prosperity for all. The Treasury’s interest goes beyond long term economic prosperity to the specific policy levers of taxation and subsidy which have clear implications for equity and efficiency and thereby well-being itself.

1.8 The expanding research programme in the economics of well-being can provide evidence for policy-makers, to assess how material welfare affects well-being:

- directly through enriching (impoverishing) individuals and expanding (reducing) their material opportunities and choice set; and
- indirectly via impact on the family, the natural environment, or educational, social and cultural institutions, from which people derive intrinsic rewards. By this we mean those activities and relationships which make us happy directly and which are not mediated by the market, but which nonetheless require psychic, social or economic investments.

1.9 Although the well-being agenda is often associated with an anti-growth message, the economics of well-being as a subject is neutral with regard to means and ends. Whether well-being should be achieved via work or personal relationships, or whether higher average well-being should be prioritised ahead of a more equal distribution of well-being, should be for individuals and society to decide through individual actions, the political process and the third sector. It may be that one society chooses to support an environment where individuals have slightly lower average well-being, but more frequent and intense ‘peak experiences’ of happiness, while another chooses an environment where average well-being is higher and more stable and such peak experiences of intense happiness are fewer.

1.10 What research findings can help us understand is how well-being can be achieved, and what the relevant choices and trade-offs might be, which offers a new dimension when analysing different policy options.

1.11 After reviewing the extant literature, we conclude that arguments to support changing macroeconomic policy priorities from prioritising stable economic growth to targeting well-being are inconclusive. There is no consensus that the current policy making process is failing - both prosperity and well-being are high in comparison with the UK historical experience, and with other countries, and indeed the findings of Easterlin are themselves now being contested. The evidence points to the continued need for growth and promoting macro-economic stability, and the targeting of the specific sources of ill-being. It highlights particular priorities:

- alleviation of chronic illness, including mental illness;
- reducing unemployment and inflation;
- strengthening relationships and social capital; and
- ensuring high-quality governance.

1.12 Explicit policy proposals to meet these priorities should however be assessed on a case-by-case basis, taking into account the Government’s objectives for economic growth and well-being and the distribution of income and wealth. In addition any potential measure will also needed to be justified firstly in terms of whether there is an argument for government intervention, secondly on whether the net effect of the proposed measure on well-being is

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7 HM Treasury Group Departmental Strategic Objectives – 2008-2011, p. 3.
positive (taking account of the opportunity cost and possible negative impact on other variables) and finally on whether it is affordable.

1.13 We also identify where further research would be welcome:

- longitudinal studies of well-being which can help identify the direction of causality;
- the importance of relative income for subjective well-being;
- the sources of status for individuals;
- the relationship between subjective well-being at the individual level and objective measures of quality of life at the national level; and
- the relationship between subjective well-being and the environment.
2 Underlying theory and empirical measures

2.1 Chapter Two sets out the various definitions of well-being, reviews a range of different measures and assesses the UK’s performance against these measures on a comparative basis.

What is well-being and how can it be measured?

2.2 Well-being is a generic concept covering both “subjective” well-being (SWB), namely happiness or life satisfaction as self-reported by individuals, and “objective” well-being or quality of life.

Subjective well-being

2.3 There are various definitions for subjective well-being. The leading positive psychologist Ed Diener defines subjective well-being as follows:

“subjective well-being refers to all of the various types of evaluations, both positive and negative, that people make of their lives. It includes reflective cognitive evaluations, such as life satisfaction and work satisfaction, interest and engagement, and affective reactions to life events, such as joy and sadness. Thus, subjective well-being is an umbrella term for the different valuations people make regarding their lives, the events happening to them, their bodies and minds, and the circumstances in which they live”.

2.4 Subjective well-being should not be thought to be arbitrary or unknowable, even if we depend on self-reports for its measurement.

Objective well-being

2.5 Objective indicators measure the quality of life using either a basket of indicators (usually covering economic well-being, social welfare and the environment) or a single composite index. The exact measure, however, is determined by the choice of datasets included, and the weighting system used – and this involves subjectivity on the part of the researcher. Longevity, educational attainment, and the standard of living are often used as indicators. The UK’s Sustainable Development Index, the UN Human Development Index, and the Index of Sustainable Economic Welfare are examples.

2.6 The Sustainable Development Institute has been integrating well-being into DEFRA’s sustainable development policy since 2005, and uses the following Whitehall-agreed definition:

‘Wellbeing is a broad concept... Here, it is understood to be a positive physical, social and mental state; it is not just the absence of pain, discomfort and incapacity. It requires that basic needs are met, that individuals have a sense of purpose, that they feel able to achieve important personal goals and participate in society. It is enhanced by conditions that include supportive personal relationships, strong and inclusive communities, good health, financial and personal

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security, rewarding employment, and a healthy and attractive environment. [However] Wellbeing cannot be fully measured by any single indicator.²

**Measuring subjective well-being**

2.7 Traditionally, economists shied away from attempting to measure individuals’ happiness or utility. Because it is impossible to observe utility (broadly defined as subjective well-being) directly, it was argued that empirics should be drawn from behaviour, and utility inferred through the choices people make. Furthermore, it was thought impossible to compare utility between people, and judge whether two people with scores of 6/10 and 7/10 are ‘less happy’ than another couple with scores of 4/10 and 10/10. This would imply that comparing national averages, for example, would be meaningless.

2.8 Drawing on the lessons of new welfare economics³, it was argued that because we could not compare individuals’ utility, a good principle for policy-making was to follow the Pareto criterion: that society is better off after a policy change if at least one person is better off and nobody is worse off. However, in practice it may be impossible to make any possible change without leaving some worse off. The Kaldor-Hicks criterion, or Potential Pareto Improvement (PPI) approach, therefore provided a modification: an outcome is more efficient if in theory gainers could compensate losers, although this is not actually paid (otherwise the new outcome would Pareto-dominate the former outcome).⁴ This provides a rationale for the cost-benefit analysis method of policy evaluation: the aggregation of the sums that people are willing to pay for the positive consequences of a given policy, by comparison with what people have to be compensated to offset the negative consequences. Cost-benefit analysis apparently provides a method of judging preferred or optimal levels of welfare.

2.9 A related subfield in welfare economics attempted to make social welfare judgements on the basis of national income. An increase in national income may reflect an increase in social welfare under some demanding assumptions, most notably that the distribution of incomes is socially-optimal. Although these assumptions were very restrictive, this kind of result has had influence on practice, particularly the importance of GDP growth in policy discussions.⁵ National income accounts – such as the United Nations System of National Accounts introduced in 1953 – were accordingly used to provide a measure of welfare from the 1950s and 1960s.

2.10 However, this programme was challenged on various grounds. First, social surveys which included questions on life satisfaction and happiness began to yield large-scale direct information on individual well-being which was shown to be stable for individuals over time. This implied that measures of well-being were reliable and empirical analysis of aggregate well-being might be possible.

2.11 Secondly, writers such as Amartya Sen argued that focus on income measures only assessed the external means that permit individuals to attain various functionings, rather than on ‘valuable capabilities’.⁶ The ‘welfarist’ welfare economic approach uses individual utilities as the exclusive basis of welfare judgements. Sen’s capability approach, by comparison, assesses individual well-being with reference to capability sets that describe what individuals are free to do or to become. This takes into account all the relevant dimensions of life, rather than being purely concerned with either access to resources, or achieved utility; and it is not restricted to

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³ This school was associated with John Hicks, Nicholas Kaldor and Tibor Scitovsky, and challenged the ‘old’ welfare economics of Arthur Pigou and Alfred Marshall.

⁴ There are technical problems with this approach: if utility possibility frontiers intersect, compensation cycling can result. This is known as the Scitovsky paradox, to which Scitovsky suggested an alternative compensation principle, but this does not avoid intransitivity problems.


measures of utility or monetary equivalents of utility. This approach is perhaps the leading alternative to standard welfare economic theory, and any analysis which incorporates multiple dimensions of quality of life is broadly related to this.

2.12 Others suggested that ‘preference satisfaction’ was an empty conception of well-being compared with need fulfilment, individual dignity, opportunity, rights and fairness. Finally, many government policies are explicitly redistributive, and this requires interpersonal welfare comparison according to some criteria, whether tacitly or explicitly formulated. Practical policy formulation can rarely separate out efficiency from distributional concerns.

2.13 Subjective well-being indicators have been developed and in general depend on representative surveys to measure happiness. The surveys require individuals to judge their own happiness by answering a single question or several questions. For example, the Eurobarometer survey asks, ‘On the whole, are you very satisfied, fairly satisfied, not very satisfied, or not at all satisfied with the life you lead?’ This survey provides data on life satisfaction for EU member states, going back to 1973. Other examples include the 0-10 scales for happiness and life satisfaction, as used by the European Social Survey, or the three-step happiness scale used periodically by Eurobarometer: ‘Taking all things together... would you say you are very happy, fairly happy or not too happy?’.

2.14 There are clear limitations to such survey questions and the resulting data. With such scales, there are inevitable ceiling and floor effects: if respondents report a happiness level of 10/10 and subsequently become even happier, this cannot show up in the data. There is also some psychological evidence to suggest that people remember peak experiences, or end experiences from a specific situation, more clearly than moment-by-moment happiness, and this affects their assessment of their subjective “global well-being” or life as a whole. There is also the question of whether measures of life satisfaction or happiness have comparable meanings across personality types, or across cultures.

2.15 A considerable amount of work has gone into the validation of such scales. On the question of the scales being bounded, van Praag has made the following point: ‘It may strike some as strange that happiness would be bounded from below and/or above, as response scales like “1, ..., 10” or “very bad, ..., excellent” seem to suggest. However, in reality we have never met a respondent who, when faced with the question to evaluate his happiness on a (0,10)-scale, would refuse to answer because his happiness level, being a “12” was not included in the scale presented. Each respondent accepts and understands a finite scale where the lower bound stands for “Complete Misery” and the upper bound for “Perfect Bliss”.

2.16 Nevertheless, many psychologists find multi-item scales – such as the twelve-item General Health Questionnaire (GHQ) in the British Household Panel Survey - to be less free of measurement error due to ceiling effects. Regarding the question of whether questions are directly comparable in different languages, Donovan and Halpern report in their wide-ranging survey that studies of differences across linguistic sub-groups within nations show that linguistic

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differences do not account for national differences: German and French speakers living in Switzerland, for example, have higher life satisfaction than German and French neighbours.13

2.17 In addition, well-being does not appear to be the mirror of ill-being – absence of unhappiness or discomfort does not guarantee happiness or satisfaction – and so such questions may only capture and measure positive, rather than negative, affect.14 A further complication is that questions relating to happiness relate to affect, or mood felt at that moment of the survey, whereas questions relating to life satisfaction are more evaluative of the longer term.15

2.18 A more fundamental objection is that we cannot know if a respondent is really happy - it is not easily observable. However, psychologists have studied the reliability of self-reported measures extensively. Self-reported happiness has been shown to correlate with:

- objective characteristics such as unemployment;
- the respondent’s recall of positive versus negative life-events;
- estimates of the respondent’s happiness by friends, family and partner;
- duration of authentic ‘Duchenne’ smiles;16
- physiological responses to stress; and
- ECG measures of prefrontal brain activity.17

2.19 The economist John Helliwell has also found that national suicide data correlates well with self-reported health and happiness in each country, which provides an independent check of the credibility of self-reported measures.18 He concludes that this reliability validates Aristotle’s prescription that people should evaluate their lives with due reflection, and, using empirically derived principles, construct and evaluate their lives more effectively. This also provides a justification, in his view, for the use of such data by social scientists.

2.20 However, Julie Newton of the University of Bath, and formerly of Defra, has emphasised the importance of distinguishing between hedonic well-being, of which happiness and life satisfaction are both examples, and eudaimonic or psychological well-being (PWB), which relates to meaning and self-actualisation. A person has high eudaimonic well-being if they are fully functioning.19 Psychologists accepting this distinction accordingly consider that Aristotle’s dictum relates to eudaimonic rather than hedonic well-being. What constitutes the good life, for example, may not make us either satisfied or happy, while pleasurable activities may undermine our self-actualisation. Nevertheless, the distinction can be problematic, in that the definition of what constitutes ‘self-actualisation’ may depend on expert or elite judgment – as with objective measures of well-being – whereas the use of self-reports allows individuals to reveal their own well-being. In the literature discussed in this review the relevant measure of well-being is usually

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16 Duchenne smiles are those which involve the zygomatic muscles of the cheek and eye, indicate that the person smiling is truly happy, and are instinctively perceived to be genuine.
life satisfaction over the past week or ‘all things considered’\textsuperscript{20}, which includes both affective and evaluative components. A recent review suggests that there is no widely-agreed definition of eudaimonic well-being, which makes empirical analysis difficult; there is a high degree of overlap between the two concepts; and that there is a danger of an elitism in the search for something ‘better’ than SWB, with an artificial moral divide between the two concepts.\textsuperscript{21}

**UK well-being in comparative context**

**(a) Subjective Well-Being Data**

\textsuperscript{20} For example, the version of the question used in the European Social Survey and British Social Attitudes Survey is, ‘All things considered, how satisfied are you with your life as a whole nowadays?’

Figure 2.A: How satisfied are you with life as a whole?

Source: European Social Survey.22

http://www.europeansocialsurvey.org/. The European Social Survey, of which three waves have been undertaken (in 2002/3, 2004/5 and 2006/7, provides rich individual-level data on sociopolitical attitudes, trust in institutions, and political participation across 30 European countries. Population and design weights applied for the graphs in this paper. The 2006/7 round of the ESS also includes as a special module questions on several dimensions of well-being.
Developments in the economics of well-being

2.22 The UK also reports high levels of various correlates of well-being, such as generalized social trust, satisfaction with work, having close friends and satisfaction with the democratic process, as illustrated below in figures 2.C.

Source: European Social Survey.
Figure 2.C: Most people can be trusted, or you can’t be too careful

Figure 2.D: How much of the time do you find your job interesting? Percentage responding at least 4/5 where 0 = ‘none of the time’ and 5 = ‘all of the time’
Figure 2.E: How satisfied are you with the way democracy works in this country? per cent Replying 4/10 or less

Source: European social survey
More conclusive analysis would require a full multivariate analysis at both individual and country levels, to take account of the combined effects of all relevant variables. However, these frequencies suggest that people in the UK apparently find work interesting, generally trust other people, and have personal friends whom they can rely on for support.

(b) Objective measures of quality-of-life

Objective measures of quality of life in the UK are highly dependent upon the indicators used and how they are weighted. Although the individual indicators may be objective measures, the choice of variables to include and the relative weightings used are subjective choices of the researcher. This substitutes subjectivity at the level of the individual survey respondent with that at the level of the researcher. Nevertheless, a variety of such indices indicate that the overall quality of life of people in the UK is high compared with those in other countries.

(i) The Government’s approach to measuring well-being

Defra co-ordinates the Government’s sustainable development strategy, outlined in 2005’s Securing the Future. The strategy states that the goal of sustainable development is to enable all people throughout the world to satisfy their basic needs and to enjoy a better quality of life, without compromising the quality of life of future generations. This involves:

- a stronger commitment to international and societal aspects of development;

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• a more explicit focus on environmental limits;
• prioritising sustainable consumption and production, response to climate change, natural resource protection and ‘sustainable communities’; and
• creation of a new outcome-focused indicator set, including new indicators on well-being.

2.26 The strategy states explicitly that if society makes the wrong choices now, future generations will have to live with a changed climate, depleted resources and without the green space and biodiversity that contributes both to our quality of life and subjective well-being. The strategy document argued that development, growth and prosperity need not be in conflict with sustainability. Environmental sustainability had to be put at the heart of policy-making, recognising the intrinsic value of the local and global environments. Policies to promote better quality environments also have the capacity to improve well-being.24

2.27 As part of the strategy, the first well-being indicators were released in 2007, having been designed in collaboration with academic and practitioner experts, and representatives from across Whitehall.25 Well-being is one of the 68 sustainable development indicators which include, for example, data on greenhouse gas emissions, waste, natural resources such as biodiversity, health, crime, social indicators such as education, and contextual economic indicators. These are generally reported as aggregates and over time so that trends can be displayed; however, this is noted to be less helpful for indicators such as social trust and well-being where national averages tend to be static in developed countries.26 The data are also provided at regional and national level at http://www.sustainable-development.gov.uk/progress/data-resources/, while individual-level responses to the survey which provides the question on life satisfaction, as well as numerous additional questions on attitudes to consumption, energy use and the environment, are available at the UK Data Archive.

(ii) Other ‘objective’ measures of well-being

2.28 One of the best-known indicators in the UN’s Human Development Index. The first UN Human Development Report in 1990 introduced the HDI as a composite human development index which combines indicators of life expectancy, educational attainment and income. This was intended to indicate both social and economic development.27 The scores for the three components are then averaged into a single index, which ranges from 0 to 1. A country scoring below 0.5 is considered to be in the ‘low development’ range while a score above 0.8 indicates high development. Variants reported by the UNDP include Human Poverty Indices for developing countries and OECD members; a Gender-Related Development Index or GDI; and a Gender Empowerment measure or GEM.28

2.29 However, there are potential ceiling effects with the HDI. For the GDP component, Norway, the US and Luxembourg score a full 1.0 because their GDP per capita is higher than $40,000. In 2005, 28 countries scored above 0.9, but would not be thought to be nearing the theoretical limits of human development.

24 See the important review, cited earlier, by Newton, ‘Wellbeing and the Natural Environment’ (2007).
25 The survey was conducted by BMRB. The dataset is available online at the UK Data Archive: SN 5741 - Survey of Public Attitudes and Behaviours toward the Environment, 2007.
27 The educational component is comprised of adult literacy rates and combined gross enrolment for primary, secondary and tertiary education, with adult literacy weighted more heavily. The life expectancy component assumes that 85 years is the maximum and 25 the minimum, so a country with life expectancy of 55 would score 0.5. For GDP, a minimum is set at $100 per capita and a maximum at $40,000, with logarithms taken to reflect the diminishing importance of income as GDP increases. For example, for Turkey in 2005, with a GDP of $8,407 (PPP US$), the GDP index was 0.74: namely log((8,407) – log(100))/(log(40,000) – log(100)). See HDR 2007-2008, p. 356.
2.30 Nevertheless, the HDI illustrates that the UK has progressed since 1975, increasing from 0.853 in 1975 to 0.946 in 2005, as illustrated in Table 1 below, together with selected comparator countries:

**Table 2.A: UN Human Development Index for selected countries, 1975-2005, with rank in 2005**

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>Denmark</th>
<th>France</th>
<th>Germany</th>
<th>Netherlands</th>
<th>New Zealand</th>
<th>Sweden</th>
<th>UK</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>0.851</td>
<td>0.875</td>
<td>0.856</td>
<td>-</td>
<td>0.873</td>
<td>0.854</td>
<td>0.872</td>
<td>0.853</td>
<td>0.87</td>
</tr>
<tr>
<td>1980</td>
<td>0.868</td>
<td>0.883</td>
<td>0.872</td>
<td>0.863</td>
<td>0.885</td>
<td>0.86</td>
<td>0.882</td>
<td>0.86</td>
<td>0.89</td>
</tr>
<tr>
<td>1985</td>
<td>0.88</td>
<td>0.89</td>
<td>0.884</td>
<td>0.871</td>
<td>0.899</td>
<td>0.871</td>
<td>0.893</td>
<td>0.87</td>
<td>0.904</td>
</tr>
<tr>
<td>1990</td>
<td>0.894</td>
<td>0.898</td>
<td>0.907</td>
<td>0.89</td>
<td>0.914</td>
<td>0.88</td>
<td>0.904</td>
<td>0.89</td>
<td>0.919</td>
</tr>
<tr>
<td>1995</td>
<td>0.934</td>
<td>0.916</td>
<td>0.925</td>
<td>0.913</td>
<td>0.934</td>
<td>0.908</td>
<td>0.935</td>
<td>0.929</td>
<td>0.931</td>
</tr>
<tr>
<td>2000</td>
<td>0.949</td>
<td>0.935</td>
<td>0.938</td>
<td>0.928</td>
<td>0.947</td>
<td>0.927</td>
<td>0.952</td>
<td>0.931</td>
<td>0.942</td>
</tr>
<tr>
<td>2005</td>
<td>0.962</td>
<td>0.949</td>
<td>0.952</td>
<td>0.935</td>
<td>0.953</td>
<td>0.943</td>
<td>0.956</td>
<td>0.946</td>
<td>0.951</td>
</tr>
</tbody>
</table>

| Rank   | 3         | 14      | 10     | 22      | 9           | 19          | 6      | 16    | 12    |


2.31 This evidence raises the interesting question why people do not simply move between countries to improve their well-being. If data on well-being are meaningful, they should predict behaviours, with migration providing a potential test. There are various possible interpretations of the cross-national well-being data:

- that conditions in some countries genuinely promote well-being more effectively than in others, and residents of other countries would prefer those outcomes if they had the opportunity to live there (subject to barriers to migration);
- that conditions in some countries reflect different choices between well-being and other variables, such as individual liberty. Residents within each country prefer the social choices and contexts particular to their own country and would not seek to move even if they had the opportunity to do so;
- that there are confounding factors – the residents of various countries may be essentially similar in their preferences, but in one country the population may be younger (or otherwise different in its composition) so that differences are due to composition rather than context, and people would not choose to move; or
- the data reflect cultural values — some people are more likely to say they are happy — and are not comparable across countries.

2.32 Much of the policy literature implicitly assumes that the first holds – and the value of the well-being literature partly depends on well-being differences predicting behaviour. Notably, well-being as an explanatory variable is relatively rare outside health studies and further study would be welcome.29 Nevertheless, David Blanchflower and Chris Shadforth have recently

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29 One example is R. Winkelmann, ‘Unemployment, Social Capital, and Subjective Well-Being’, IZA Discussion Paper 2346 (December 2006), which examines how change in SWB affects active job search and transition to re-employment among the unemployed.
published work which suggests that subjective well-being was predictive of emigration from Eastern Europe to the UK after 2004.30

2.33 The Index of Sustainable Economic Welfare provides an alternative measure of societal development which takes account of the depletion of natural resources, and sustainability requirements. Originally drafted by Herman Daly and John Cobb, the index was further developed by Tim Jackson and Nic Marks under the auspices of the New Economics Foundation. It has been relabelled the ‘Measure of Domestic Progress’ (MDP) in order to avoid the connotations that an increase necessarily generates sustainability or progress. The MDP adjusts UK consumer expenditure for:

- spending to offset social and environmental costs such as crime, spending on private health and education, and pollution;
- longer-term environmental damage and the depreciation of natural capital;
- economic adjustments to provide a higher weighting to ‘prudent investment’ and trade balances;
- rising inequality; and
- imputation for household labour.31

2.34 Using this set of indicators, MDP has exhibited only a weak upwards trend since 1950, with a decline in the 1970s lasting until an upturn in the mid-1990s. The indicator has been criticised for a lack of theoretical foundation, double-counting the costs of climate change, overstating the costs of inequality and for not taking account of rising life expectancy.32

2.35 The New Economic Foundation (NEF) has also developed a ‘Happy Planet Index’ – a composite of ecological ‘footprint’, life-satisfaction and life expectancy measures. The index addresses the argument that aggregate measures of welfare are incomplete if they do not take into account the future costs of remediation or adaptation to a new climate, or indeed are meaningless if the ecosystem itself is jeopardised. However, the importance of global environmental sustainability, and the question of the investments needed to protect it, exists sui generis. Subjective well-being is a separate issue. Conflating the two issues via a single measure results in an index where the objective function of governments is seen as being some combination of well-being, life expectancy and environmental sustainability, the implication being there is no point being happy if future generations will be miserable as a result.33 This approach is open to criticism given that a country may well be able to introduce policies to improve life satisfaction and environmental quality, with no necessary relationship between the two. In addition the HPI looks at sustainability from just an environmental point of view and ignores financial, economic, governmental and social sustainability all of which will have an impact on well-being. This suggests that the HPI is overweighting environmental sustainability at the expense of other aspects of sustainability and intergenerational effects.

33 Note also that Colombia scores highly on the Happy Planet Index, which has been widely reported, but this depends on an observation which may well be biased. See Veenhoven, R., Average happiness in 95 nations 1995-2005, World Database of Happiness, Rank Report 2006-1d, Internet: worlddatabaseofhappiness.eur.nl.
(c) Combining Objective and Subjective Measures: Happy Life Years Expectancy

2.36 Ruut Veenhoven has criticised the UN HDI as a quality-of-life index, and instead proposed a Happy Life Expectancy index (HLE). This adjusts life expectancy for subjective measures of happiness; this differs from the UNHDI which summarises material resources. The HDI is calculated from life expectancy at birth; the adult literacy rate; and GDP per capita, with each equally weighted. Veenhoven criticises the index because it measures quality-of-life using input measures such as economic resources rather than the output – namely, a happy life.

2.37 The HLE index however aims to provide a measure of ‘societal output’ – with happiness and high life expectancy being due to health, for example, rather than health expenditures. Veenhoven notes however that such an output measure is difficult to target via specific interventions. According to Veenhoven, the HLE, illustrated in figure 2.G below, is higher in:

- more individualistic and liberal countries;
- more egalitarian countries, with respect to gender equality and where people tend to choose partners with similar educational qualifications; and
- countries with higher participation in voluntary organisations. Affluence, literacy, freedom and gender equality explained 70 per cent of the variance in happy life-expectancy in nations.

2.38 Veenhoven’s analysis also shows that HLE is not related to unemployment, state welfare, income equality, religiosity or trust in institutions. This contrast with other findings cited may, however, be because the analysis is performed at the national level rather than individual level or hierarchically (namely including both individual and national contexts). Furthermore, taking a simple mean of an ordinal measure may reveal interesting patterns and be useful for illustrative purposes, but may be less statistically sound: we cannot know that a life satisfaction level of 10/10 is actually double 5/10, but only that it ranks more highly.

2.39 Nonetheless, the measure is useful because it is available for a large number of nations and because it differentiates well between different countries, particularly the richer, at which the UN HDI is less successful. On this measure, the UK is ranked 20th, in a list headed by Switzerland, Denmark.

2.40 It is interesting to compare how countries score differently on HLE and the HDI. People in Latin American countries more generally appear to report greater life-satisfaction than their incomes would predict (although Veenhoven notes that the observation for Colombian life-satisfaction, in particular, may be biased). On the other hand, Japan ranks eighth in the HDI, but only at 31 in HLE.

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34 R. Veenhoven, Social Indicators Research, p. 22.
Figure 2.6: Happy Life Expectancy in 91 countries, 1995-2005

3.1 Chapter 3 introduces key empirical finding of the income-happiness (Easterlin) paradox, the catalyst for much research into well-being, and sets out a range of explanations for the phenomenon including a summary of recent analysis rebutting the paradox. The final section examines the key determinants of subjective well-being at the individual level.

The income-happiness (Easterlin) paradox

3.2 Traditional economic theory assumed that higher levels of current personal income led to higher levels of utility – and that even if they did not, this was the best proxy available. However, in 1974 Richard Easterlin compared survey data on happiness with income, both across society and over time. He discovered that although happiness responses were positively correlated with individual income at any point in time, from 1945 aggregate happiness has been flat in the US despite considerable increases in average income. Figure 3.A provides illustrative data for 1973-2006 in the UK: GDP per capita has approximately doubled, but mean life satisfaction has not.

Figure 3.A: Life Satisfaction and GDP per capita in the UK, 1973-2006


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Explaining the Easterlin paradox

3.3 Explanations for the Easterlin paradox fall into various camps. First, it is argued that there are behavioural and psychological reasons: people respond to income change rather differently to how neoclassical economic theory predicts they would. Second, some argue that the relevant variables are not income and well-being so much as wider economic security (or consumption broadly defined) and ill-being. A third camp, which argues that the paradox does not exist, and that the income-well-being relationship has hitherto been wrongly specified, is summarised in the succeeding section.

3.4 It is also useful at this point to bear in mind the difficulty of establishing the direction of causality from cross-sectional surveys such as the US General Social Survey or Eurobarometer. A common criticism of well-being literature is that much of the literature depends on cross-sectional data, where analysis cannot assess the impact of individual dispositions. This means that cross-sectional studies fail to establish, for example, whether causality runs from unemployment to unhappiness, or whether the unhappy are more likely to become unemployed. This criticism extends to the recommendation that panel analysis—whereby analysis is performed on data of a representative set of individuals followed over time—is preferable in that researchers can follow individuals over time and control for such individual traits.

3.5 This is an important critique. However, Clark and Oswald find that results from the British Household Panel Survey, controlling for individual fixed effects, corroborate those from cross-sectional data. They conclude that this finding is important: ‘the biases in cross-section patterns may be less dramatic than has sometimes been supposed’.

3.6 Nevertheless, the regression work on panel data in this area is still relatively small. Panel datasets are relatively young: the BHPS began in 1991, the German Socio-Economic Panel in 1984 and the Australian Household Income and Labour Dynamics (HILDA) in 2001. This means that it is difficult to test the Easterlin hypothesis using such data: relatively few countries have commissioned such surveys, which are expensive, to allow study of international differences and they do not go back far enough compared with country time-series using pooled cross-sectional data, for example drawing on the Eurobarometer survey. It should be borne in mind, therefore, that in many cases the results discussed below describe associations in the data rather than establishing causality. Blanchflower and Oswald conclude that ‘the pragmatic response, here and elsewhere, is that at this point in the history of economic research it is necessary to document patterns and to be circumspect about causality’.

3.7 A related point is that individuals have some measure of control over factors which determine their well-being, such as where they choose to live, their choice of work, or over relationship choice. Results tend to be consistent with expectations—for example, that widows are significantly less happy—but in some cases the absence of a coefficient on a particular factor does not indicate that there is no effect. If people have control over a particular factor, they will engage in that activity or make according choices until the marginal utility is zero. In the absence of randomised control trial, it is difficult to assess the effects of selection. One example is that of number of children: most studies find that there is no effect on SWB from having children, or some negative effect. This is not consistent with the efforts people make to have

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2 Although repeated annually, they do not follow the same individuals over time.
children and the value they derive from parenthood. Shields and Wooden conclude that parents see children as an investment which will make them happy in the long term, even if there are immediate costs in terms of financial and other stress, and this may be missed in cross-sectional studies.

**Psychological explanations for the Easterlin paradox**

3.8 Three major explanations for why income does not necessarily increase well-being include the need-fulfilment hypothesis, the social comparison approach, and hedonic adaptation.

(i) Need-fulfilment theory

3.9 Arthaud-Day and Near, in their review of income-happiness research, set out a clear exposition of need-fulfilment theory explaining that ‘Income should predict well-being to the extent that it enables people to fulfil their innate biological, social and developmental requirements’.6 They describe the relationship between income and happiness as “progressing from a minimum threshold at which basic needs are met, through moderate income levels where individuals have increasing freedom to pursue higher order interests”, such as love, esteem, and self-actualisation. For individuals, income can allow them to fulfil more basic needs, but gains in well-being from need-fulfilment satisfaction taper off at very high levels of income. Societal differences in SWB might then be explained by the resources that nations possess to meet the basic needs of their residents – wealthier nations have cleaner water, lower infant mortality, and lower crime. A recent Australian paper has attempted to operationalise this theory and suggested that at the national level, aggregate social well-being can be increased without increasing economic growth.7 The positive psychologist Ed Diener, however, points out that this approach, followed strictly, implies that well-being results only from the fulfilment of universal human needs and that no other factors are relevant. Absolute income would predict well-being, but comparative income or income-change would not.8 Furthermore, he suggests that it is difficult to identify the higher-order needs scientifically: ‘there are many needs that are not simply homeostatic in nature... if we must infer the needs from people’s levels of SWB, we are in a position in which the theory cannot be rejected’.9

3.10 The evidence also shows that objective factors, which are presumed to reflect the fulfilment of needs correlate only modestly with SWB. It is also the case that in most advanced societies, there is a ceiling effect – most basic needs have been met. Regarding higher-order needs, there is no consensus on what these are, and Diener and Lucas suggest that at the national level such cultural differences will also hinder cross-country comparisons of well-being.10

(ii) Relative standards/social comparison theory

3.11 Again following the description set out by Arthaud-Day and Near, this theory states that people ‘are satisfied when their situation compares favourably to that of a reference group, [or a reference standard], so that relative rather than absolute income predicts happiness... Comparisons may be made with similar or dissimilar others... they may be upward or

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9 Diener and Lucas, ‘Explaining Differences’, p. 43.
downward in direction; and they may serve various motivational functions [such as supporting self-esteem].\textsuperscript{11}

3.12 This approach contrasts with the neoclassical theory of choice and has arisen largely from the prospect theory of Kahneman and Tversky. What matters in choice is not the final outcome so much as change from a reference point, experienced as gains and losses. The utility function - or value function in their terms - is defined over these gains and losses and a great deal of experimental and natural evidence suggests that it is concave in gains and convex in losses.

3.13 A large volume of literature has accordingly evolved to explain the Easterlin paradox as being due to the use of a reference standard.\textsuperscript{12} The classic example is that if we aim to be better off than the Joneses through becoming richer - and then find that the Joneses themselves have become richer too - then we are no happier. Experiments have also shown that people will choose position over absolute income. For example, people generally appear to prefer a situation where their annual income would be $50,000 and the average $25,000, rather than an alternative where their annual income would be $100,000 and the average $200,000.\textsuperscript{13}

3.14 Therefore individual well-being may respond positively to increases in income, but negatively to increases in inequality and relative loss of position. This means that the relationship between income and happiness is stronger within a country at a point in time, than over time by country. This is due to the status benefit of high income within a country – but status is a zero-sum game, so that if one person gains status through being richer, others lose status.\textsuperscript{14} Furthermore, at the individual level, status races can lead to worse outcomes if they crowd out other activities.

3.15 In 1996 Clark and Oswald found, using the first wave of the British Household Panel Study, that the estimated coefficients on income and comparison income in a job satisfaction equation were statistically equal and opposite. This is consistent with a fully relative utility function.\textsuperscript{15} Helliwell and Huang also found, when comparing average household income with those within the same census tract in Canadian General Social Survey data, that the effect of other people’s income on an individual was negative and equal in size to the positive coefficient of the household’s own income: again, life satisfaction appears to be completely relative in income.\textsuperscript{16} Alesina et al. also find that individuals are less happy if inequality is high, and that this effect is stronger in Europe than the US.\textsuperscript{17} Many studies have also found that there is a link between relative status and health outcomes.\textsuperscript{18}

\textsuperscript{11} Arthaud-Day and Near, ‘The wealth of nations and the happiness of nations’.
3.16 However, there may be limits to the anchoring effect of reference standards. Diener et al. found that ethnic group and education background did not provide reference effects for well-being. In the US, black Americans have lower well-being counter to both the social comparison and expectancy explanations.\textsuperscript{19} Using international data, Diener et al also found that average life-satisfaction and global happiness correlated significantly across countries with GNP per capita. They concluded,

‘To the degree that people compare themselves to virtually anybody, the theory becomes harder to rigorously test... [and furthermore], if people’s standards adapt to virtually all conditions, why don’t they adapt to certain expectancies and social comparisons, so that these standards no longer have an effect?’\textsuperscript{20}

3.17 Furthermore, the very poor in Germany appear to be much less happy than expected if using relative income as the standard, perhaps because the impact of absolute income deprivation outweighs the relative income effect.\textsuperscript{21} It is not the case, then, that the very poor simply compare themselves with other very poor people and accordingly are less sensitive to negative relative income as it increases. A further criticism is that the very poor may not compare themselves with other poor people in any case; the very poor may all be part of peer groups where average income is relatively high, for example if they are the only one of a group of siblings or friends to be unemployed.

3.18 Social comparison is complex: people choose who to compare themselves to, and to their own past, while the choice of reference group can adapt over time as circumstances change. There is some evidence that happy people compare ‘downwards’, and unhappy people compare themselves against the more successful.

3.19 There is also an emergent literature on how people choose reference groups. This suggest that people make an apparent trade-off between being the biggest fish in a less competitive pond and being challenged and encouraged to improve by choosing a more competitive pond. However, empirical work in this area is at a very early stage.\textsuperscript{22}

3.20 Some theoretical work by Hopkins at the University of Edinburgh also suggests the following:

‘It is assumed that that if there is a status gradient in health or happiness, that is health and happiness are influenced by relative position, then necessarily health and happiness are decreasing in the level of inequality. This is a logical fallacy because there are plausible models of relative concerns in which social standing matters and hence there is a status gradient and yet welfare is increasing in inequality. For example, the most common reason advanced for inequality causing bad health is that low status causes high levels of stress. Yet when one looks at a formal model of status competition it turns out that greater inequality reduces competition and can make people better off’.\textsuperscript{23}

3.21 He adds that the relationship between relative status and well-being could be specified in several different ways. For example, people could care about their rank, or they could care about how much lower or higher they are than others. Secondly, people may care about income and

\textsuperscript{20} Diener et al., ‘Relative or Absolute?’, pp. 218-219.
\textsuperscript{21} C. M. Maarten and G. B. Woltjera, ‘Happiness and Loss Aversion: Is Utility Concave or Convex in Relative Income?’, Journal of Public Economics, 91/7-8 (2007), pp. 1423-1448. They elaborate thus: ‘the average income in the reference group of a person affects her life satisfaction not only since she compares her income with this reference income, but also since her income relative to the reference income affects the extent to which she and her family can participate in social activities in the reference group... When your income is only little below the reference income, this will not be a problem, but... [as your income falls increasingly short of that in your reference group, it becomes increasingly and more than proportionally hard to raise the funds to participate in the social activities of the reference group’.
\textsuperscript{22} Clark et al., ‘Relative Income, Happiness and Utility’, p. 24.
\textsuperscript{23} E. Hopkins, ‘Inequality, Happiness and Relative Concerns: What Actually is their Relationship?’, mimeo, University of Edinburgh, January 2008.
wealth inequality, or consumption inequality - which in turn will affect how they respond to inequality, both in behavioural terms and in their subjective well-being. Thirdly, inequity aversion is not equivalent to concern with relative status - in the former case, a narrowing of income differentials may make you happier, while in the latter case, an increase in the income of people less well-off than you may lower your well-being. These issues may partly explain why empirical studies have had difficulty establishing a robust relationship between inequality and health and between inequality and happiness at the individual level.24

3.22 For national policy purposes, if the average person’s reference group includes people in other countries - for example, peers living in other countries, or the apparent lifestyles of residents of other countries represented in the media - then policy to improve well-being through redistributive policy, or through lowering the target rate of economic growth and pursuing other objectives, will have little effect on well-being if pursued unilaterally. A recent paper by Bjornskov et al. in the Journal of Happiness Studies, using Eurobarometer data for 1973-2002 for 15 European countries, examines whether there are population-wide effects of comparisons with neighbouring countries.25 Acceleration of GDP and government consumption relative to neighbouring countries is found to influence trends in life satisfaction significantly.

3.23 Overall, both relative and absolute income levels clearly matter and the relative importance of absolute income appears to be lower in richer countries. Further research is needed, however, on how important the relative income effect is, and how people choose reference standards and how this varies across income distribution.

(iii) Adaptation theory

3.24 Arthaud-Day and Near26 summarise adaption theory as a phenomenon whereby people appear to react strongly to changes in their life circumstances in the short-term, but quickly become accustomed to them - whether this be a serious injury or winning the lottery. Frederick and Loewenstein define adaptation as ‘a reduction in the affective intensity of favourable and unfavourable circumstances’, and the concept of reversion back to some baseline hedonic level following temporary highs and lows in happiness has been termed the ‘hedonic treadmill’.27 Economists of happiness are generally interested in adaptation to income and consumption, although other work has covered unemployment, marriage, divorce and health. Since we are averse to losses, underestimating our ability to adapt to loss, and overestimating both the likelihood and benefit of gains, this leads us to pursue ongoing gain and the avoidance of loss, even where it is not in our best interests.

3.25 Clark et al. suggest we think about adaptation as us possessing an income reference point dependent on our own past income. The marginal utility of extra income is greater in the short term, but dissipates in the long term as we get used to it (just as the utility of extra income dissipates if others are richer too). This potentially explains the Easterlin paradox of a flattish long-run relationship between income and happiness, but a stronger short-run relationship. Using national-level data, the recent work by Bjornskov et al. in the Journal of Happiness Studies finds that current GDP growth does not affect trends in life satisfaction, but growth relative to growth in the preceding period does. Since accelerated growth is needed to influence trends in life satisfaction, they conclude that the result provides support for Easterlin’s theory that

24 Hopkins, ‘Inequality, Happiness and Relative Concerns’, p. 3.
26 Arthaud-Day and Near, ‘The wealth of nations and the happiness of nations’.
aspirations change over time, thereby accounting for the relatively stable long-run levels of satisfaction.28

3.26 Di Tella et al. recently found, using German panel data, that the effect of an income increase after four years was only about 42 per cent of the effect after one year - the majority of the short-term effect of income vanishes over time.29 The ‘Leyden School’ of van Praag and others also found that, for 20 European countries, $1 increase in the income of a household leads to a 60 cents increase within about two years in what people consider to be an excellent, good, sufficient or bad income. An alternative way to express this is that adaptation over time accounts for around 60 per cent of the effect of income increases – or that income’s long-run effect is only 40 per cent of its short-run effect.30 Income adaptation is therefore high, although not complete.

3.27 Other interesting findings concern the adaptation of lottery winners. Jonathan Gardner and Andrew Oswald investigated winners of moderate lottery prizes, of between £1,000 and £120,000. The lottery wins had a significant impact on well-being, increasing scores on the GHQ scale by 1.4 points (on the 36-point scale) two years after winning, compared with people winning smaller amounts, and those winning nothing.31 This compares with the effect on GHQ of being widowed being -5, suggesting the impact is substantively significant. Thus, within the time-frame of their study (admittedly short), the lottery winners did not return to a previous ‘set point’ of well-being. Diener et al. also note that the relevant time horizon must be specified; there is evidence that personalities can change, even after childhood, and thus the ‘set-point’ altered.32

3.28 Clark et al. however warn that as long as individuals are rational, the mere presence of adaptation is no reason for policy intervention unless it is accompanied by an externality.33 It is not irrational, knowing that the effects of income wear off, to nonetheless choose to be richer rather than poorer and enjoy the well-being benefits while they last. However, if people consistently mispredict their future utilities, and end up less happy than if they had made choices in line with what they would actually have felt, then a paternalistic question arises. This is gaining popularity, but Clark et al. warn that ‘the information required to advocate paternalism is currently far from complete’.34

(b) Well-being, Wealth, and Economic Stability

(i) Wealth and Economic Circumstances

3.29 From the above, it appears that an individual’s income has only a limited impact on well-being. However, some economists believe that it may be wealth rather than income that matters most for well-being, because this provides a better measure of material standard of living, although this is examined less frequently, partly because data on personal wealth is difficult to come by. Although this does supposition does not in itself imply that the Easterlin paradox does not hold.

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34 Clark et al., ‘Relative Income, Happiness and Utility’, p. 56.
Bruce Headey and Mark Wooden of the University of Melbourne tested the combined effects of disposable income and net worth on well-being and ill-being. This indicated a greater impact of economic circumstances more broadly on well-being, than income usually suggests. They use an Australian household panel survey (HILDA) conducted in 2002 which provides measures of life satisfaction, satisfaction with the respondent’s financial situation, financial stress and the SF-36 five-item scale measuring mental ill-health. It also provides an estimate of household wealth as well as income.

Using bivariate correlations, they find a stronger relationship between wealth and well-being than income and well-being (0.15 versus 0.11 for life satisfaction and 0.33 versus 0.27 for financial satisfaction). Using a full multivariate analysis, controlling for demographic and health characteristics, the coefficients for wealth were higher than income for life satisfaction (0.07 versus 0.05) as well as for financial satisfaction (0.22 versus 0.13). An individual moving from the 25th percentile of both wealth and income to the 75th would gain 2 per cent on the life satisfaction scale, and 8.7 per cent on the financial satisfaction scale, with the effect of wealth being greater. They also find that housing and superannuation assets are the most significant components of wealth that affect well-being.

In terms of ill-being, wealth again correlated more highly than income with mental ill-health and financial stress. From the full multivariate analysis, they predict that an individual moving from the 25th to the 75th percentiles of both wealth and income would improve mental health by 1.2 per cent, and reduce financial stress by 6.9 per cent. The improvement in mental health, notably, would be wholly due to wealth.

Overall, they find that wealth matters at least as much as income, so that it should be included as a variable in analysis of well-being. Wealth provides long-term economic security, which people value highly. Other economic aspects of living standards, such as consumption, may also have important effects. The authors conclude that ‘the unimportance of material circumstances has been exaggerated, largely as a consequence of omitting all variables bar income’.

Furthermore, researchers have tended to use pre-tax income which omits the redistributive effects of government policy. Household living standards, they conclude, clearly matter substantially for well-being.

(ii) Unemployment and Inflation

The negative impact of unemployment on well-being is one of the most striking in the literature. There are also good reasons to think that this is causal rather than correlative.

In a recent paper, Di Tella and MacCulloch estimate the relationship between ‘contentment’ and unemployment and inflation. They estimate the welfare costs of inflation on the individual relative to those of unemployment using well-being data, rather than attempting to assess the costs in money terms.

They note that economists typically pay more attention to economic growth rather than fluctuations in growth, since downturns typically follow upturns. The estimated costs of business cycles in the US are perhaps only 0.1 per cent of total consumption. By comparison, one estimate for the costs of inflation relative to the output gap was in the order of 20 times greater.

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35 Government-regulated organisational pensions.
in terms of social welfare. Given the difficulty of estimating these costs using traditional economic theory, they suggest a role for behavioural economics, particularly because, when asked directly, people appear to give different rationales for the costs of inflation and unemployment and also weight them differently than the monetary costs would imply.

3.38 Using 1973-2002 Eurobarometer data, they find that a 10 percentage point increase in unemployment reduces average life satisfaction by 0.32 standard deviations, while a 10 percentage point increase in inflation reduces average life satisfaction by 0.24 standard deviations. To put it another way, compared with the status quo, a 10 per cent increase in unemployment leaves the median person as satisfied as the person at the 43rd percentile was before, while a 10 per cent increase in inflation leaves the median person as satisfied as the person at the 45th percentile before. Furthermore, the 90 per cent confidence interval for the ratio of the coefficients on unemployment to inflation is 0.5 to 2.1 - namely it is more likely that people place a greater weight on unemployment than on inflation. They also note that their regressions estimate the cost of unemployment for the average person, but the average person is in employment. The cost of unemployment therefore has to be adjusted by adding the individual cost to the unemployed.

3.39 Di Tella and MacCulloch conclude that their findings have an application for central banks: life satisfaction data can help central banks understand what tradeoffs the public is willing to accept, in terms of unemployment, for inflation – although we should also note that the existence of an inflation-unemployment trade-off is, of course, not universally accepted; rather the consensus is that price stability is a crucial pre-requisite for economic growth. More generally, they highlight the effect on life satisfaction of macroeconomic volatility as well as aggregate or individual income: it may well be that in well-being terms people would be prepared to trade some income for increased stability.

(iii) The Public Sector

3.40 The hypothesised relationship between income and life satisfaction is assumed to exist because when we earn more income we are able to consume more, and this consumption will increase our well-being. However, income is not a good proxy for consumption. We obtain important goods directly from others and from the public sector. Examples include education, healthcare, and transfers-in-kind, which are rarely taken into account in empirical estimations. If consumption of public goods is not directly measured, then proxies such as local area or country income, which are related to public goods via taxation, will attract positive coefficients. This will bias the coefficient on aggregate income upwards.

3.41 More generally, Offer argues that voters use the public sector both to provide collective goods which will improve their well-being, and also as a commitment device to ‘pace’ consumption, overcoming the problems caused by myopia. Failure to consider such processes may lead to the wrong policy prescriptions. Di Tella et al. also note that the welfare state acts a ‘compensating force’ for the psychic as well as financial losses caused by unemployment and inflation - higher unemployment benefits correlate with higher national well-being.
(iv) Income and ill-being

3.42 A final critique is that the Easterlin Paradox may well hold, but nevertheless there is an important and strong relationship between income and ill-being. Prospect theory predicts that loss of income will hurt more than a gain in income gives pleasure. Boes and Winkelmann investigated this effect using 1984-2004 data from the German Socioeconomic Panel. They find that income significantly reduces negative well-being, but it has no effect on positive well-being in a subsample of men living in one-person households. This chimes with the intuition that the presence of an irritant makes us unhappy, but its absence does not necessarily make us happy. The relationship is much weaker for women, which they suggest may be due to social norms and the specific importance of income for male status.

3.43 They accordingly conclude that a single-item measure of subjective well-being may be too restrictive to capture the full impact of income on quality of life. They also note that not accounting for this asymmetry will lead to researchers imposing too-strict assumptions on their models, which may in turn yield spurious results.46

Rebutting the Easterlin Paradox

3.44 Recent empirical work by Ruut Veenhoven and Michael Hagerty in 2006, and Justin Wolfers and Betsey Stevenson in 2008 has challenged the received wisdom that ‘richer does not mean happier’.

3.45 Veenhoven and Hagerty ascribe the Easterlin findings to the data being poor. Trend change in happiness is slow; happiness is probably pro-cyclical; and subjective well-being ratings are usually bounded by the scales used.47 They summarise that ‘happiness ratings are bound to an upper limit and nations that score high are unlikely to increase much over short periods of time. So we need long time series to see whether happiness has risen or not’.48 Veenhoven and Hagerty pooled various time-series for a larger number of countries, and concluded that richer does mean happier at both the individual and aggregate levels, and particularly so for people in poor countries. Inequality in happiness appears to have diminished over time, a trend more pronounced than the rise in average happiness. Furthermore, life expectancy increased over time, meaning gains in happy ‘life years’. They do caution however that ‘data are not unequivocal and there are still many blank spots... certainty must wait until longer and better time series become available’.49

3.46 Wolfers and Stevenson have also written a working paper challenging the paradox. They find that the wording of survey questions has changed over time, but that analysts have not always adjusted responses accordingly. Secondly, individual income has plateaued for the bottom 90 per cent in the US since 1990 (although is not the case for the UK, as illustrated in figure 3.E below). Thirdly, the paradox is again ascribed to data being noisy and scarce.

3.47 Wolfers and Stevenson find the income-happiness gradient to be robust both across countries and over time, with no evidence of a satiation point.50 They introduce some straightforward modifications to the statistical models hitherto employed:

- They suggest that the correct functional form of the income-life satisfaction relationship at the national level is log-linear rather than linear. This means that

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aggregate life satisfaction increases with the log of GDP per capita, rather than arithmetically with the absolute level of GDP per capita. Although there is an apparent flattening of the GDP per capita-life satisfaction relationship when graphed, this is not in fact occurring, as shown when log transformation is used. The authors suggest that the lack of a clear linear relationship drew researchers into positing a ‘satiation point’ beyond which income would not increase happiness, as would be the case if life satisfaction were purely relative in income. They also suggest that while researchers generally use a log transformation for individual-level analysis, to do so for cross-country analysis is ‘a departure from much of the literature’.  

- They constructed an index of average well-being for each country-year (or country-wave) by reporting the coefficient from an ordered probit regression of subjective well-being on country by year fixed effects. The fixed effects are then treated as average well-being within a given country-year. This results in a cardinalisation of the data which is more satisfactory than taking a simple mean, particularly when many questions use scales of different gradations.

- The authors examined the documentation of international surveys, and found that for some countries in some periods the surveys were not representative. For example, in China in the 1981-1984 wave of the World Values Survey, the respondents tended to come from the cities and to be better-educated and earning higher-incomes. This bias was likely to lead to the relationship between GDP per capita and life satisfaction being understated. Furthermore, the authors suspect that the trend in life satisfaction over time has been affected by the order in which questions were asked in the various rounds of the World Values Survey.

3.48 The authors accordingly removed any data from the sample which they believed to be biased, and as a result found a stronger income: life satisfaction relationship, both within countries, across countries, and over time, than hitherto thought. They find a well-being-log income gradient of about 0.4, both between countries, within countries, and over time.

3.49 Their work is still in progress and awaits formal publication. Nevertheless the log income-life satisfaction relationship appears recurrently in their calculations. This implies that economic growth retains an important policy role, both in the lives of individuals and in providing society with resources to provide infrastructure and communal goods.

3.50 The following data may provide some illustration. Figure 3.B plots average life satisfaction over 1995-2005 against absolute levels of GDP per capita in 2005. The relationship appears to be non-linear, with well-being rising steeply with income until a ‘satiation level’ of about $15,000. However, Figure 3.C depicts the same data with the GDP data subject to a log transformation: the relationship continues to be positive even as GDP increases.

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51 Stevenson and Wolfers, ‘Economic Growth and Subjective Well-Being’, p. 5. Note that the income component of the HDI is subject to log transformation.


53 They also provide appropriate caveats: for example, ‘it is worth emphasising that these estimates are both somewhat imprecisely estimated, and fragile’. See Stevenson and Wolfers, ‘Economic Growth and Subjective Well-being’, p. 18. See the webpage for details on caveats for Colombia (life satisfaction 8.1, GDP per capita $7,304) as well as China and Nigeria: these observations may be biased. Veenhoven, R., Average happiness in 95 nations 1995-2005, World Database of Happiness, Rank Report 2006-1d, Internet: worlddatabaseofhappiness.eur.nl
Figure 3.B: Life Satisfaction in 91 nations, 1995-2005, and GDP per capita, 2005

![Graph showing life satisfaction vs. GDP per capita.]

Source: UNHDI (GDP data) and World Database of Happiness, average life satisfaction 1995-2005, http://www1.eur.nl/fsw/happiness/hap_nat/nat_fp.htm. Scores where survey questions were not answered on a 0-10 scale were transformed linearly.

Figure 3.C: Life Satisfaction in 91 nations, 1995-2005, and log GDP per capita, 2005

![Graph showing life satisfaction vs. log GDP per capita.]

Source: As in figure 3.B
3.51 The authors also cite an important point relating to the distribution of income and how this affects well-being apart from the ‘relative income effect’. Median income in the UK has risen less steeply since 1973 compared with GDP per capita: an increase of 62 per cent in real terms compared with a 91 per cent increase in GDP per capita. Figure 3.D above illustrates the trend in median income, as well as for other centiles: growth has been more rapid for higher centiles. Where data are skewed – as are income data – the median income may be more representative than the mean. In this case, average life satisfaction may be more weakly related to GDP per capita because the mean and median incomes have diverged. Stevenson and Wolfers point this out for the US between 1972 and 2005:

‘the fruits of economic growth through this period were quite unequally distributed... [using the US Current Population Survey] average real household income grew by only 15 to 20 percent in each of the three bottom quintiles; the fourth quintile experienced growth of 30 percent, and only the top quintile realized income growth of 59 percent... [using the General Social Survey] the average of the log of family income has risen by only around 17 log points since 1972 (equivalent to an annual rate of growth of only around 0.5 percent a year).

‘Based on a happiness-income gradient of around 0.4, it seems reasonable to expect that happiness in the United States would have been basically flat over the past thirty-

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Median income measured by IFS for a two-person child-free household before housing costs; GDP per capita from the Blue Book, data series IHXW.
five years (or more precisely, to have risen by only $0.4 \times 0.17 = 0.07$ points)... consistent with the accumulated evidence of a robust happiness-income link'.

### 3.52
It should be noted, however, that the work is still at a comparatively early stage and awaits publication in a peer-reviewed journal. Andrew Oswald has stated that while the paper is interesting, Easterlin’s findings nonetheless largely hold, while Andrew Deaton suggests that aspects of the Easterlin paradox may yet be valid, given that well-being is multidimensional.

**The main determinants of subjective well-being**

**Box 3.A: Significant correlates of well-being**

Happiness and life satisfaction tends to be higher among:

- Women
- People with many friends
- The young and old
- Married and co-habiting people
- The highly educated
- The healthy
- Those on high incomes
- The self-employed
- People with low blood pressure
- Those having sex once a week with the same partner
- The religious
- Members of non-church organisations
- Volunteers
- Those who exercise
- Those who live in western countries

Those who have had time to adapt to unpleasant life events


### 3.53
Donovan and Halpern provide a detailed overview of the research conducted into the relationship between life satisfaction and a range of other variables in addition to income, these include:

- cross-national and cross-cultural differences and trends;
- genetic, personality and demographic factors;

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56 R. Lever, ‘Money may buy happiness (or not): economists renew debate’, Agence France Presse, 25 May 2008, http://bpp.wharton.upenn.edu/betseys /press per cent20reaction/Easterlin per cent20Paradox/Money_may_buy_happiness_(or_not)_economists per cent20Agence per cent20France per cent20Presse) PDF
Developments in the economics of well-being

• economic situation and work factors beyond income earned;
• education and health factors;
• social life and community relationships; and
• governmental and political factors.  

3.54 We summarise and expand on their main findings below, starting with their broad conclusion that at an individual level:

‘these variables can explain between a third to one half of the variability in life satisfaction. The remainder is made up of measurement errors, unobserved individual differences, unmeasured differences in the quality of people’s experiences, and the interaction between these experiences and their own values. On a national level, the majority of the variability between nations can be explained by these factors’.

We would emphasise in particular that social relationships and health have been found to have a far greater impact on life satisfaction than income.

3.55 Genetics and Personality: Studies of twins and adopted children show that genetics plays a role in explaining individual differences in life satisfaction, although genetics cannot explain differences in life satisfaction at a national level. Related to this, personality factors such as optimism and extroversion and self-esteem have also been found to be associated with life satisfaction. However, Headey cautions against the assumption that individuals all possess a hedonic ‘set-point’ to which we return following habituation to a new stimulus, pointing out that while individual personality differences clearly determine well-being to some extent, longitudinal data also shows that changes in the ‘set-point’ can be lasting as life conditions change. Rather, personality, life events, well-being and ill-being should be understood as being in ‘dynamic equilibrium’. He also notes that choice of sensible life goals can determine well-being, which undermines the central hypothesis of set-point theory. Success goals are negatively correlated with life satisfaction, while family and altruistic goals are positive correlated with life satisfaction.

3.56 Employment: Again Donovan and Halpern note that “there is a positive relationship between job satisfaction and life satisfaction.” Factors influencing job satisfaction include income, personal control, variety, job security and appropriate skill use. They also highlight findings suggesting that unemployment directly reduces happiness, although less so in areas of high unemployment, where family members are also unemployed, or where the individual has been repeatedly unemployed in the recent past. This negative effect does not dissipate over time unemployed. In addition they note that the loss of satisfaction from the social effects of unemployment is far greater than the loss caused by loss of earnings. This point is supported by findings showing that moving from work to being out of the labour market (for example due to retirement) leads to much lower reductions in life satisfaction than being made unemployed.

60 Donovan and Halpern, ‘Life Satisfaction’.
3.57 Inequality and World-Views: Donovan and Halpern\(^2\) cite research by Alesina et al\(^3\) showing that ‘high levels of inequality are associated with low levels of life satisfaction in Europe, but not so much the USA.’ They summarise possible explanations for this finding being potentially due to Europeans inherently preferring more equal societies, or because the perception of higher levels of social mobility in the USA reduces the unhappiness caused by inequality. Various theories have been advanced by leading economists to link ‘beliefs in a just world’, for example believing in the existence of a free and fair society, or in ultimate judgement by a deity, to the acceptance of more uncertain or unequal conditions.\(^4\)

3.58 Sport, recreation and religion: Studies have shown that adults who undertake physical exercise (sporting or otherwise) have higher measures of life satisfaction as do people who have a religious belief.\(^5\) This finding can be explained in part by the social dimensions of organised religion and sport. However, Dolan et al. note that research using large-scale datasets into well-being and exercise is relatively limited. Furthermore, because

‘exercise may not only help to reduce a number of negative outcomes (e.g. weight gain and depressive symptoms), but also promote a range of positive ones (e.g. higher levels of happiness and life satisfaction) it would seem to have high policy potential’.\(^6\)

3.59 Health: Self-reported health has a strong association with life satisfaction.\(^7\) Research on the relative magnitude, however, shows that the effects dissipate over time, with the exception of chronic pain and mental illness.\(^8\) Studies have concluded that the effects of health on happiness are of greater magnitude than employment or marital status,\(^9\) but that, apart from the previously noted exceptions, its effect diminishes once individuals have had the opportunity to adapt to changed circumstances. The psychologist Daniel Kahneman cited a paraplegic, a victim of an accident, who commented in a television interview: ‘You probably think I am unhappy but you are wrong. And I used to think that I knew what suffering was but I was wrong’.\(^10\) However, objective health status shows a much weaker relationship with satisfaction.

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**Box 3.B: Place, well-being and happiness**

‘Most of the variation in the measures of well-being and general happiness [considered separately] is attributable to the individual level. However, some of the variation in both measures is attributable to the household level and a very small proportion of the variation of the well-being measure is attributable to the district level, whereas the variation in the happiness measure attributable to the district level is zero’.


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\(^2\) Donovan and Halpern, ‘Life Satisfaction’.
\(^6\) Dolan, Peasgood, and White, ‘Do We Really Know What Makes Us Happy?’, p. 104.
\(^7\) Dolan, Peasgood, and White, ‘Do We Really Know What Makes Us Happy?’, p. 104.
\(^8\) Layard, Happiness: lessons from a new science, p. 62, citing Frederick and Lowenstein (1999).
3.60 Relationships: Social relationships are perhaps the most important predictor of well-being.\(^{71}\) In a study of the very happy, Diener and Seligman found that all had excellent social relationships.\(^{72}\) They also cite considerable evidence that the relationship is causal: social relationships foster well-being, although in turn, high well-being leads to strong social relationships.\(^{73}\) Donovan and Halpern note in their overview that research has found married people are happier than those who have never married, or who are divorced, widowed or separated. This is a finding which holds across cultures, even allowing for income and age. Being part of a couple without children appears to be beneficial for well-being, while being a lone parent household reduces well-being, whether children are resident or not.\(^{74}\) However, there is a limited amount of evidence that there is some self-selection into relationship types. In 2005, using a 17-year German longitudinal dataset, Frey and Stutzer at the University of Zurich found evidence for people self-selecting into marriage or into remaining single. They also found that people who divorced were both unhappier during the marriage, but also prior to marriage.\(^{75}\)

3.61 Governance: The process and execution of government has been found to have a significant effect on life satisfaction, as Donovan and Halpern\(^{76}\) summarise in their overview: 'the quality of a country’s governance - including stability, control of corruption and the rule of law - have all been found to help explain national differences in well-being [after other factors have been taken into account]'. A study of Switzerland discussed in Chapter Four (paragraph 4.17) below found a positive correlation between average happiness and the canton’s placing on an index of direct democracy.

3.62 Place and local context: Recent work by Ballas and Tranmer has used multilevel models to identify which effects on well-being are individual-level, which are contextual at three further levels of analysis – the household, district and region. This employs data from the British Household Panel Survey (first wave, 1991) and the 1991 UK Census. Such work can identify whether differences between places are due to different characteristics of residents (compositional effects) or due to environmental or other factors such as social capital and cohesion or socio-economic inequality (contextual effects).

3.63 They find that variation in well-being purely ascribable to regional differences is extremely small. Most of the variation in the data was at the individual and household levels with the district level having limited importance. Respondents who had lived at their address for more than five years reported significantly higher well-being, perhaps because they have developed better social networks in their area, or because they have adapted to their circumstances effectively.

3.64 After controlling for the demographic and socio-economic characteristics of the residents, they found that the Newcastle-upon-Tyne district was associated with the highest levels of residual well-being, and Bracknell Forest/Slough with the lowest. Rerunning the model for 2003 data, they found that Cynon Valley and Rhondda, and Merthyr Tydfil, were the only two districts which had significantly lower well-being than the rest of the country, but once the model

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\(^{75}\) A. Stutzer and B. S. Frey, ‘Does marriage make people happy, or do happy people get married?’, Journal of Socio-Economics, 35/2 (April 2006), pp. 326-347

included controls for demographic and socio-economic characteristics, none of the district residuals were significant.

3.65 Investment in local amenities could clearly have an effect on well-being, but the mechanism would be largely via local housing markets; the better-off would move to regenerated areas as they become more pleasant, while home-owners within regenerated areas may benefit in terms of higher house values. Because people can move and housing markets adjust, however, the effect would not show up at the district level independently of individual or household level characteristics.

Weak correlates of well-being.

3.66 Age: The summary of Easterlin’s (2001) research (presented by Layard77) finds that happiness remains “remarkably static” at different ages despite changes in income and health. Controlling for income and health (and other influences), happiness falls somewhat up to age 40-50, and then rises.78

3.67 Sex: In most countries once income, age and employment status have been controlled for women have been found to be somewhat happier than men. However, Ballas and Tranmer show that in the UK women are less happy than men, while Stevenson and Wolfers have noted that relative female well-being is declining, and has been since the 1970s.79

3.68 Education: appears to have a mixed effect on happiness. Layard80 notes that studies based on survey evidence (Eurobarometer or US General Social Survey) do find some direct impact although it is not clear whether this is on an absolute or relative level. Education can of course have an indirect effect on happiness by raising a person’s income; but it also raises expectations further than are fulfilled, leading to a negative effect on well-being.81 Clark et al. note that since people have a good deal of autonomy over when they finish their education, it is not surprising that the marginal utility of an extra year is zero – otherwise people would shorten or lengthen their educational careers accordingly.82

How important are the various factors?

3.69 There is a good deal of evidence of how individuals rank various factors in importance for their well-being, which also chimes with what is apparent from the survey data at the individual level. The summary table 3.A was compiled by Lord Layard, after work by Helliwell, Blanchflower and Oswald, and Di Tella, McCulloch and Layard.83 To find the effect of a 33 per cent decrease in family income he assumed that the representative individual moved from the sixth decile group to the fourth decile group and to find the effect of a 50 per cent increase in family income he assumed that the relevant person moved from the fourth decile group to the sixth decile group.

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77 Layard, Happiness.
79 Ballas and Tranmer, ‘Happy Places or Happy People?’; B. Stevenson and J. Wolfers, ‘The Paradox of Declining Female Happiness’, mimeo, the Wharton School, University of Pennsylvania (September 2007).
81 Clark and Oswald, ‘Satisfaction and Comparison Income’.
82 Clark et al., ‘Relative Income, Happiness and Utility’, p. 32.
Table 3.A: Effects on happiness of various factors relative to a 50 per cent increase/33 per cent decrease in household income.

<table>
<thead>
<tr>
<th>Effect on happiness index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income:</td>
</tr>
<tr>
<td>Family income down 33 per cent relative to average</td>
</tr>
<tr>
<td>Work:</td>
</tr>
<tr>
<td>Unemployed (rather than employed)</td>
</tr>
<tr>
<td>Job insecure (rather than secure)</td>
</tr>
<tr>
<td>Unemployment rate up 10 percentage points</td>
</tr>
<tr>
<td>Inflation rate up 10 percentage points</td>
</tr>
<tr>
<td>Family:</td>
</tr>
<tr>
<td>Divorced (rather than married)</td>
</tr>
<tr>
<td>Separated (rather than married)</td>
</tr>
<tr>
<td>Widowed (rather than married)</td>
</tr>
<tr>
<td>Health:</td>
</tr>
<tr>
<td>Subjective health down 1 point (on a 5-point scale)</td>
</tr>
<tr>
<td>Income:</td>
</tr>
<tr>
<td>Family income up 50 per cent relative to average</td>
</tr>
<tr>
<td>Freedom:</td>
</tr>
<tr>
<td>Quality of government improves by magnitude of Hungary 1995 from Belarus 1995</td>
</tr>
<tr>
<td>Religion:</td>
</tr>
<tr>
<td>“God is important in my life”</td>
</tr>
<tr>
<td>Responding ‘yes’, holding church attendance constant</td>
</tr>
<tr>
<td>Trust:</td>
</tr>
<tr>
<td>“In general, people can be trusted”</td>
</tr>
<tr>
<td>Responding ‘yes’ rather than ‘no’</td>
</tr>
<tr>
<td>Others saying ‘yes’ rise 50 percentage points</td>
</tr>
<tr>
<td>Morality:</td>
</tr>
<tr>
<td>Tax morality – “Cheating on taxes is never justifiable”</td>
</tr>
<tr>
<td>Responding ‘yes’ rather than ‘no’</td>
</tr>
<tr>
<td>Others saying ‘yes’ rise 50 percentage points</td>
</tr>
</tbody>
</table>

3.70 The Eurobarometer survey has also on occasion provided subjective survey evidence on the factors which most influence of life satisfaction in each of the member states. Table 3.B shows that the most important self-reported factors for the UK were health, income and family. Increases in income and reduction in stress levels were seen as the most important drivers of future happiness with health ranked third. More recently, the UK’s Sustainable Development Indicator set has gathered data about satisfaction over key domains of happiness, as summarised in table 3.C. This found UK respondents most likely to be satisfied with their relationships but least likely to be satisfied with community.
Table 3.B: Most important self-report factors contributing to current and future quality of life in the UK

<table>
<thead>
<tr>
<th>In your opinion which three factors contribute most to your current quality of life?</th>
<th>Most important</th>
<th>2nd most important</th>
<th>3rd most important</th>
</tr>
</thead>
<tbody>
<tr>
<td>health</td>
<td>Income</td>
<td>family</td>
<td></td>
</tr>
</tbody>
</table>

| Which three factors would improve your current quality of life?                     | income         | less stress       | Health             |


Table 3.C: Percentage of UK respondents satisfied with various life domains, 2008

<table>
<thead>
<tr>
<th>Domain</th>
<th>Percentage of respondents very or fairly satisfied</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relationships</td>
<td>88</td>
</tr>
<tr>
<td>Accommodation</td>
<td>86</td>
</tr>
<tr>
<td>Standard of Living</td>
<td>85</td>
</tr>
<tr>
<td>Local Area</td>
<td>82</td>
</tr>
<tr>
<td>Day to day activities</td>
<td>78</td>
</tr>
<tr>
<td>Health</td>
<td>78</td>
</tr>
<tr>
<td>Leisure</td>
<td>73</td>
</tr>
<tr>
<td>Control</td>
<td>72</td>
</tr>
<tr>
<td>Achievement of goals</td>
<td>70</td>
</tr>
<tr>
<td>Future financial security</td>
<td>63</td>
</tr>
<tr>
<td>Community</td>
<td>61</td>
</tr>
</tbody>
</table>


Summary

3.71 Easterlin’s findings that “richer does not mean happier” have stimulated a vast literature on well-being, its determinants and implications for policy, as reviewed in Chapter Four. However, the recent research questioning his findings suggests that consensus has not yet been reached, which emphasises the need for continued research and to analyse all relevant recommendations with due caution.
4
Policy Schools of Thought

4.1 There has been much written on how the results from the economics of happiness should be incorporated into public policy work. If economic growth does little to improve social welfare, as argued by Easterlin, then it should not be a primary goal of government policy. However, if the Stevenson-Wolfers findings are accurate, economic growth is still a valid means to greater well-being, although welfare itself remains the ultimate goal.

4.2 Specific social policy interventions may also promote well-being alongside conventional economic policy. In the tradition of public economics, positive externalities arise from community engagement and reciprocal social interaction, and there is a theoretical role for intervention to promote them. The core activities of the public sector also impact on individual well-being: poor service and corruption are examples. This implies that improving the operation of government and user engagement will increase well-being directly.

4.3 A more paternalistic approach argues that the government can correct systematic errors of judgment – such as myopic failure to save for retirement; or overestimation of the impact of income on individual well-being and underestimation of relationships. More recently, the ‘libertarian paternalist’ approach of Thaler and Sunstein provides a liberal justification for such intervention. Environmental crisis, however, might require enforced behavioural change, beyond such soft intervention.

4.4 In this paper we consider a selection of recommendations from the academic literature on well-being, setting them alongside suggestions from the new economics foundation think tank. There are recurring themes, such as the need to target mental ill-health, or the undesirability of commercial advertising to children, although there are differences in emphasis in the speed of change required and choice of policy levers.

Layarad and the targeting of mental ill-being

4.5 The labour economist Richard Layard wrote an acclaimed and wide-selling text on well-being in 2005, and has since lobbied extensively for a programme of cognitive behavioural therapy (CBT) provision and targeting of ill-being. As mentioned in Chapters Two and Three, well-being, or life satisfaction, and ill-being, or psychological distress, are different dimensions of welfare rather than opposite ends of the same dimension. Headey et al. suggest that well-being and ill-being overlap but are distinct, if not orthogonally distinct. The absence of ill-being, for example, does not guarantee well-being, while well-being does not guarantee the absence of depression or anxiety. We present data on some aspects of comparative ill-being from the European Social Survey below. A notable point is the relatively high ranking of Scandinavian countries where respondents were asked whether they agreed if at times they felt like a failure. Given that Scandinavian countries also tend to report relatively higher well-being, it is worth bearing in mind that question wording may have different cultural meanings in different countries, and that well-being is a complex phenomenon, which the single life satisfaction instrument may not fully capture.

Figure 4.A: Percentage of respondents feeling anxious most or all of the time

Source: European Social Survey, 2006

Figure 4.B: Percentage of respondents feeling depressed most or all of the time

Source: European Social Survey, 2006
Figure 4.C: Percentage of respondents feeling lonely most of all of the time

Source: European Social Survey, 2006

Figure 4.D: Percentage of respondents agreeing/agreeing strongly that ‘at times I feel like a failure’

Source: European Social Survey, 2006
4.6 Layard estimated that about 15 per cent of the British population suffers from depression. At 1 million, more people are now claiming incapacity benefit for mental ill-health than are claiming Job Seeker’s Allowance. In addition to the personal cost, depression also costs the economy in terms of days lost at work. While people prefer therapeutic to medicinal treatment, there is a large shortage of qualified therapists, and so GPs’ default option is to offer anti-depressant medication. In terms of days at work lost, the cost to the NHS of recurring depression and the cost of incapacity benefit, Layard estimated that the cost to society of depression was in the order of £17 billion, of which £9 billion consisted of benefit payments and reduced tax receipts.

4.7 Layard and the LSE’s Mental Health Policy Group formed proposals to roll out a series of psychological treatment centres staffed by experienced healthcare professionals retrained in cognitive behavioural therapy (CBT) techniques.

4.8 The plan proposed 250 psychological treatment centres, to be rolled out in tranches of 40 per year, which would require 5,000 more clinical psychologists and 5,000 more psychological therapists.³

4.9 In October 2007 the Secretary of State for Health announced an expansion of funding for psychological therapies at an annual commitment of £170 million per year by 2010-11. This should enable all GPs to refer patients for psychological therapy. By then 3,600 new therapists will have been trained and employed, while 900,000 patients will have been treated for depression and anxiety, with an estimated 450,000 to have been cured completely.

4.10 Layard also provided broader policy recommendations in his 2005 text:

- economic policy should be re-orientated to increase well-being rather than GDP. This would involve a re-orientation of the tax and benefit system, labour market policy, and macro-economic policy;
- the elimination of unemployment through ‘tough-and-tender’ approaches;
- support for community life through subsidy;
- greater sums to be spent on overseas aid;
- income tax should be increased for higher earners in order to redistribute income and discourage the self-defeating pursuit of high income which additionally provokes dissatisfaction in others. High earners should be encouraged to spend more time away from work undertaking more worthwhile activities, rather than be addicted to work and activities which do not increase well-being;
- attitudes to performance-related pay should be rethought given its tendency to exacerbate the ‘rat race’;
- prohibition of commercial advertising to children, as well as the removal of ‘pictorial advertising’ as a tax-exempt business expense;
- macroeconomic stability should be prioritised ahead of slightly higher growth: greater certainty over future incomes and employment prospects should have large beneficial effects in reducing personal risk and thereby increasing well-being;
- the adoption of family-friendly work practices – ‘more flexible hours, more parental leave and easier access to child care’, and finally,
education should be aimed more at understanding how to lead a ‘meaningful life’, the inculcation of empathy for others, emotional intelligence and the importance of service.\textsuperscript{5}

**Avner Offer and prescriptions from the *Challenge of Affluence***

4.11 The economic historian Avner Offer provides policy analysis in the concluding chapter of his 2006 text, the *Challenge of Affluence*. The text more broadly examines social trends undermining well-being, particularly inequality, status races, advertising, obesity, and family breakdown. He concludes that

> ‘in affluent societies, a moderate, regulated level of growth will do... Reported subjective well-being in most affluent societies is remarkably high. It would be very costly to nudge it up much further. A higher priority is to target more precisely the sources of ill-being’.\textsuperscript{6}

4.12 These include:

- the social stigma and deprivation associated with low social status;
- the erosion of intimacy, reciprocity, and regard;
- physical and mental disability; and
- excessive gambling, alcohol intake, and consumption of pre-processed food.

4.13 Given that a major source of ill-being is myopia and failure to exert self control, Offer suggests that new ‘commitment technologies’ are needed, as well as cognitive and personal skills, and a personal and social repertoire of good habits which prevent us from being our own worst enemies. There are also strong arguments for redistribution of income, both within and between countries.\textsuperscript{7} However, Robert Frank’s suggestion of a consumption tax on luxury goods, intended to reduce status competition, is criticised as liable to be captured and applied regressively. A more productive strategy was likely to be targeting of mental health: depression, anxiety, and schizophrenia are widespread, increasing and disabling, while treatment difficult to obtain: ‘there is hardly a household that is not touched by it at one time or another’.\textsuperscript{8}

4.14 Other suggested interventions include:

- Family-friendly policies, particularly for mothers, to support attachment and well-being of children for the long term;
- Provision of after-school clubs for the young;
- Support for cultural norms of moderation, humility and service to others; and
- Securing pension provision through mandatory participation, public management, and an explicit social contract.

\textsuperscript{5} Layard, Happiness, pp. 233-234.
\textsuperscript{7} Offer, *The Challenge of Affluence*, p. 368.
\textsuperscript{8} Offer, *The Challenge of Affluence*, p. 370.
Maximising National Well-being?

4.15 The Swiss economist Bruno Frey is a leader in the field of public choice and well-being. With his colleagues, he has made a number of additions to the literature on individual determinants of well-being – for example, that commuting tends to lower well-being. In addition they have investigated how policy-makers should use data on well-being, and whether it should be pursued explicitly as an end. They find that people do not only care about outcomes, but also whether they have been achieved justly. They call this procedural utility and suggest that it is an important source of well-being: ‘it is not only what, but also how, that matters’. The processes and institutions under which people live and act are independent sources of well-being. Good procedures also provide an important reinforcement of selfhood, and of due respect.

4.16 There is a good deal of evidence to show that procedural fairness matters even in the marketplace. Consumers can feel exploited if prices are increased sharply following a sudden increase in demand, and choose to boycott, even though they fully understand that this is how the market works. Differential pay within an organisation can upset norms of fairness, while it is well-known that workers resist nominal pay cuts even if they accept real pay cuts, because of what the former symbolises.

Box 4.A: Well-being and Civic Engagement

‘Psychologists have identified three such psychological needs [of self-determination] to be essential: autonomy, relatedness and competence. The desire for autonomy encompasses the experience to self-organize one’s own actions or to be causal. The need for relatedness refers to the desire to feel connected to others in love and care, and to be treated as a respected group member within social groups. And the need for competence refers to the propensity to control the environment and experience oneself as capable and effective’.


4.17 Frey and colleagues provide three interesting empirical examples of how the democratic or user-engagement process can affect outcomes and well-being:

- They examined the effect on well-being of differences in opportunities for civic engagement, using data from 6,000 interviews with Swiss residents. Citizens in Switzerland can express their political preferences through initiatives and referenda as well as elections, and the scope for this differs substantially across cantons. They found that the effect on well-being from more extended political participation rights was sizeable. Both citizens and foreigners without these rights living in jurisdictions with more direct democracy reported greater well-being. Notably, this positive effect was smaller for non-citizens, who were excluded from the actual process: the effect on citizens’ well-being was about three times greater.

- A further empirical finding relates to the question of overcoming NIMBY concerns regarding proposed construction projects. Traditional economics suggests that the most appropriate way to dissolve NIMBY protest is to tax those benefiting from a

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9 According to economic theory, people should commute just as far as they benefit from living in a cheaper or larger house further away from work, or a better-paid job further away from home, when a charge for commuting time and hassle is imputed. However, Frey and Stutzer find from the well-being data that people systematically live or work ‘too far away’ because they underestimate how costly and unpleasant commuting will be, and overestimate the attractions of the bigger house or better job. See B. Frey and A. Stutzer, ‘Stress That Doesn't Pay Off: The Commuting Paradox’, IZA Discussion Paper No. 1278, September 2004.


project and to distribute the revenue to those losing from it. However, ‘the procedure based on the price system indeed rarely, if ever works... Bribing disregards people’s sense of self as decent citizens’. In one example of a proposal to introduce a nuclear power station, the offer of compensation in fact reduced support for the project. However, it should be noted that there is a relative paucity of evidence in this area.13

- Individuals seem to experience greater well-being when they are more respectfully treated in the taxation process, and are thus more willing to pay their taxes.14

4.18 However, Frey and Stutzer have strong warnings for the naive use of well-being data by policy-makers as directly undermining procedural utility:

‘[it is] tempting to pursue the old dream of maximizing aggregate happiness as a social welfare function. Improvements in individual well-being are claimed to be measured directly and politics is seen as taking up advice and implementing it with suitable interventions in the political process’.15

4.19 They cite several problems with this approach:

- First, given that people adapt to changing circumstances, and that aspirations increase when circumstances improve, it is difficult to judge how welfare can be maximised if it only falls or rises in the short-term. Furthermore, should people who are more materialistic and aspirational be compensated more for their loss of well-being when there is an economic down-turn, than others who have learned how to moderate their expectations? Instead of aiming for unattainable perfection, society should instead try to deal with what habitation and the aspiration treadmill involve, through its collective decision-making processes.16

- Secondly, the policy-maker’s aspiration to maximise well-being by technocratic means involves a side-stepping of the existing institutions and processes which judge what society’s choice of well-being is to be. Even if acting altruistically this involves ‘benevolent dictatorship’. This is neither how society should operate, nor how it in fact operates: there are instead constitutionally-designed rules and institutions, which allow citizens to reveal what they consider the good life to be, and to provide politicians with incentives to produce it, if they want to win executive office. Therefore ‘the maximization of a social welfare function as such is an intellectual exercise’.17

- Thirdly, any explicit target to raise the level of national well-being would lead to incentive distortions, and change the way the relationship between Government and society operates. Once aggregate well-being becomes a politically-important


13 Frey and Oberholzer-Gee offered interviewees a putative $2,175 to $6,525 per person per year to accept a nuclear waste facility being constructed in their area, holding their survey one week before an actual referendum on amendments to the canton constitution regarding construction of nuclear waste repositories. They found the amount of compensation had no significant effect on the level of acceptance. Interviewees who rejected the offer were then made a higher offer (e.g. increasing the offer from $6,525 to $8,700). Only one respondent changed their mind. Frey and Oberholzer-Gee also cite a similar US study which rejected the possibility that the offers were simply too small. Richard Titmuss famously outlined this crowding-out hypothesis in his analysis of why people might willingly donate blood but refuse to do so for payment – see R. Titmuss, The Gift Relationship (London, 1970). Other work suggests that people willing to do a task or accept a responsibility gratis might be sensitive to compensation when it is large enough – a ‘pay enough or don’t pay at all’ effect. See U. Gneezy and A. Rustichini, “Pay Enough or Don’t Pay At All?”, Quarterly Journal of Economics, 115/2 (2000), pp. 791-810.


15 Frey and Stutzer, ‘Should We Maximize National Happiness?’, Conference on New Directions in the Study of Happiness, October 22-24, 2006, University of Notre Dame, p. 18.

16 Frey and Stutzer, ‘Should We Maximize National Happiness?’, p. 12.

17 Frey and Stutzer, ‘Should We Maximize National Happiness?’, p. 13.
Developments in the economics of well-being

In addition, survey respondents, knowing that their answers are politically influential, may begin misrepresenting their well-being to ‘play the system’.  

4.20 These criticisms do not mean that explicitly maximising GDP is preferable. Instead “the quality of the political process is key to people’s happiness and that the legitimacy of political action finally rests on the voluntary agreements of the citizens involved. Individuals’ sovereignty should not be reduced to self-reports of one’s well-being’.  

4.21 The role of policy is instead to establish the best framework to allow politicians and policy-makers to respond to people’s interests, both commonly-held and their individual ones. It may turn out that what people want is not to be happy so much as to support ‘loyalty, responsibility, self-esteem, freedom or personal development’ - whatever their conception of the ‘good life’ is. As often repeated, the US Declaration of Independence did not seek the right to happiness but the right to pursue happiness.  

4.22 However, Frey and Stutzer do provide examples of where happiness research has provided important insights which can be used in the policy-making process:  

- Exhibiting the link between mandatory retirement and schooling on well-being;  
- The importance of work norms and birth control rights on women’s well-being;  
- The impact of tobacco taxes on smokers’ well-being; and  
- The relation between working time regulation and people’s subjective well-being.  

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18 Frey and Stutzer, ‘Should We Maximize National Happiness?’, p. 16.  
19 Frey and Stutzer, ‘Should We Maximize National Happiness?’, p. 17.  
20 Frey and Stutzer, ‘Should We Maximize National Happiness?’, p. 17.
5.1 The second part of the paper looks at the developments in the economics of well-being from a central government and Treasury perspective.

5.2 This chapter examines firstly the new analytical tools arising from well-being research and secondly how well-being analysis can be incorporated into policy formulation. Chapter six looks more broadly at whether the Treasury should be concerned about the economics of well-being.

**Analytical tools**

5.3 Two key analytical tools are highlighted by the well-being analysis. On a macro level the use of alternative measures of progress to GDP and on a micro level happiness cost benefit analysis.

(i) Alternative progress measures

5.4 Some advocates of well-being have proposed that the Government look again at how it assesses progress. Their view is that while economic growth is necessary there is also a need to focus on ‘objective’ well-being. They argue that ‘objective’ measures of well-being provide alternative measures of assessing progress. Whilst sustaining well-being may require a constant level of growth the impact of achieving this growth should also be taken into account in terms of the difficult to measure, and sometimes invisible, costs which it imposes (e.g. unemployment, stress, long hours at work, inequality, damage to the environment, etc).

5.5 Easterlin’s findings and the subsequent research it stimulated suggest that measuring progress by the growth of Gross Domestic Product does not pick up all of the variables which contribute towards quality of life.

5.6 A range of alternative indicators to measures well-being have therefore been developed using data on economic growth, social progress and environmental change. However, the absolute values (and hence determination of relative national rankings) of national well-being calculated by these ‘Quality of Life’ indicators are highly dependent on the choice of data sets the indicator comprises and the weighting system used and none of the alternative indicators available are without criticism (see table 5.A.).
Table 5.A: Problems with progress measures

<table>
<thead>
<tr>
<th>GDP</th>
<th>GDP alternatives (e.g. Index of Sustainable Economic Welfare)</th>
<th>Composite indicators of social trends (e.g. UN HDI)</th>
<th>Balanced Scorecard (e.g. UK Sustainable Development indicators)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not pick up all the variables which contribute towards the quality of life.</td>
<td>These types of indicator are built upon a series of valuations of components (e.g. cost of pollution or value of housework) where both the choice of indicators and the weighting given to them is subjective.</td>
<td>Choice of indicators and weighting given is via a subjective process.</td>
<td>Number of indicators risks obscuring message.</td>
</tr>
</tbody>
</table>

Partly sourced from: Donovan and Halpern 2002, p.36, box 2 (excluding column one)

5.7 The UK tends to perform slightly less well than its GDP per capita ranking both against measures placing an emphasis on social welfare variables and measures placing an emphasis on environmental variables. Such ranking should however be treated with caution. Firstly the relative weighting of the different elements will not necessarily be constant across countries. Different policy mixes consistently seen in some countries suggest the preferences of their population vary with regard to a number of the variables that contribute the indicators (eg measures of inequality.) Secondly (as noted above) the content and weightings of composite indices are fairly subjective and differ significantly. In addition as progress in one dimension may lead to less progress in another it is unclear which measure to attach most weight to. Finally it is just not possible to quantify some variables which make up well-being e.g. free speech.

5.8 Nevertheless, the variance of relative UK performance against the range of indicators currently available suggests that, in addition to growth, it may well be worth looking at alternative measures of progress. Such an approach will provide a broader framework with which to assess policy and spending choices and will be helpful in highlighting different areas of strengths and weaknesses. However, given the above caveats, the alternative measures should inform the policy debate rather than become targets themselves.

5.9 This analysis is in line with current government policy. Defra has introduced the UK Sustainable Development Index which consists of a set of 20 ‘headline’ performance indicators covering a range of areas with a particular emphasis on environmental protection and also including some provisional measures associated with well-being.

(ii) Evaluation methods

5.10 Consistent with suggesting objective measures of well-being as a measure of national progress it may also be possible to use subjective measures of well-being to evaluate individual policy measures.

5.11 Di Tella and MacCulloch1 (2006) summarise the standard approach economists have used to analyse the impact of policies on social welfare. They explain that traditionally economists have used a two-step process to measure how policies affect social welfare. First the policy is examined to see how it affects behaviour. Then a theoretical model is used to connect the policy impacts to welfare.

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5.12 Di Tella and MacCulloch highlight a common problem with this approach. Even when there is agreement on how a policy will affect behaviour, there is frequently no agreement on how the consequences of policy will affect welfare. This is particularly important for policy makers because a well-designed policy-making process, informed by relevant economic analysis, is central to shaping the appropriate policy response.

5.13 Happiness data offers an alternative approach which in principle could solve such ambiguities. Di Tella and MacCulloch use a number of examples including a tax on cigarettes (summarised in table 5.B) to illustrate and explain how happiness data can be used to evaluate policy.

Table 5.B: Happiness evaluation: example case studies

<table>
<thead>
<tr>
<th>Tax on cigarettes</th>
<th>Happiness evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Theoretical welfare implications</strong></td>
<td><strong>Gruber and Mullaianathan (2002)</strong></td>
</tr>
<tr>
<td>Empirical evidence suggests purchase of cigarettes falls as price rises but the effect on welfare is ambiguous.</td>
<td>matched happiness data from the US and Canada on people who were predicted to smoke and people who were not (assuming that cigarette taxes only affect the happiness of current and former smokers). They found that a 50-cent tax on a packet of cigarettes resulted in predicted smokers having the same level of happiness as those not predicted to smoke. This suggests that evidence from happiness surveys is consistent with the “psychological hyperbolic model”.</td>
</tr>
<tr>
<td>(i) “Rational addiction” model (Becker and Murphy (1988)) – the welfare of smokers falls as cigarettes, which they derive pleasure from, rise in price.</td>
<td></td>
</tr>
<tr>
<td>(ii) “Psychological hyperbolic” model (Laibson 1997) – the welfare of smokers rises. Smokers lack self-control: they want to give up smoking in the future, but lack the incentive to do so today. Tax provides an incentive enabling them to undertake a course of action they would not otherwise choose.</td>
<td></td>
</tr>
</tbody>
</table>


5.14 Di Tella and MacCulloch conclude that the use of happiness data to evaluate policy provides an alternative to conventional economic thinking, which analyses what people do (e.g. revealed preference techniques) rather than what they say about their feelings. However, such an approach (asking people how they feel about an intervention) is at possible risk of both respondent bias and the Hawthorne effect. Di Tella and MacCulloch warn that the results of happiness surveys should always be treated critically and with caution.

Incorporating well-being analysis into policy formation

5.15 This section looks at how policy makers might factor in developments in the economics of well-being when formulating policy. It looks first at the theoretical justification for intervention and then the considerations which need to be taken into account when deciding on the viability of any particular measure. Using this approach the remainder of the chapter discusses a range of existing and proposed policy measures which have arisen from the well-being debate.

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2 Analysis is based on purely on welfare of the individual and does not consider possible external benefits to society of a lower costs to the health service of a reduction in the number of people smoking.

3 The Hawthorne effect occurs when people who are participating in a survey change their behaviour as a result of being observed. The term originated from the Hawthorne works outside Chicago in the 1920s, where following research into worker productivity, it was noted that worker productivity increased briefly due to the process of having been observed.
Approach to evaluation

5.16 Following the analysis set out by Donovan and Halpern\(^4\) “[t]he case for state intervention needs to show that ... it will add to life satisfaction beyond that which will result from individual choices and actions.” Theoretically this will only occur where there are market failures preventing well-being maximisation (although intervention can also be justified on distributive grounds). The key question is whether the “free-market” for well-being allows individuals to maximise their own levels of well-being or whether “market failures” prevent this from happening.

5.17 If market failures exist there is a justification for the government to take action to alleviate the problem. Two main market failures can be identified:

- **Externalities**: Increases in individual income can have negative externalities leading to a loss in well-being in other less well-off contemporaries. Likewise conspicuous consumption can lead to similar feelings of envy. Positive externalities can be generated from becoming more involved in the community or building up levels of trust.

- **Bounded Rationality**: Individuals may choose a course of action which is sub-optimal for well-being but rational given their own information set and decision-making matrix. A likely cause of such behaviour is imperfect information. Individuals are not fully aware of all the information available when making choices over well-being. For example they tend not to recognise the effects of adaption or social comparison. Furthermore, their cognitive resources may not be sufficient to take all the available information into account, so that people rely on rules-of-thumb instead, such as observing how others make similar decisions; or they choose to ‘satisfice’ rather than to continue searching for the optimal outcome. As a result their well-being is less than it might otherwise be.

5.18 In addition a range of measures have been proposed to enhance well-being where there is less evidence of well-being market failure. In these cases intervention will still require justification on market failure or distributive grounds. The role of well-being economics is then not to advance the case for intervention per se but rather, in areas where such a justification has already been made, to add to the cost benefit analysis.

5.19 However, identifying a case for intervention is a necessary but not sufficient condition for incorporating well-being into policy making. It will also be necessary to evaluate proposals against:

(i) the theoretical and empirical evidence base arising from well-being literature and surveys;

(ii) their impact on other government objectives, especially when there is an overt conflict, for example preserving the economic incentives that support a dynamic economy;

(iii) alternative well-being proposals taking into account the opportunity costs to well-being of the measure and the possible knock-on effects on other determinants of well-being; and

(iv) their affordability.

5.20 As an illustration we discuss a range of existing and proposed policy measures which have arisen from the well-being debate subdivided according to the theoretical argument for government intervention.

\(^4\) Donovan and Halpern, ‘Life Satisfaction’.

\(^5\) For a brief exposition of bounded rationality see: Tyson, C. Bounded Rationality:http://www.nuff.ox.ac.uk/users/tyson/documents/bin/bounded-rationality.pdf
Externalities

5.21 The following section discusses policies where it can be argued that government intervention would correct for externalities which, if not addressed, will result in a sub-optimal level of well-being. However, as noted above, satisfying this criteria provides a necessary but not necessarily sufficient case for a particular policy, as we explore further below.

Prioritising macroeconomic stability over the pursuit of slightly higher growth

5.22 It is argued that “happiness is an ultimate goal of life” (Frey and Stutzer, 2002). Once a minimum level of income (relative to one’s peer group) is achieved there are diminishing returns to well-being as GDP per capita increases. Achieving macroeconomic stability will deliver enhanced security over future income and employment prospects and hence should have large beneficial effects in reducing personal risk (e.g. worries about future employment) thereby increasing well-being. As a result proponents argue that economic policy should be re-orientated to prioritise macroeconomic stability above slightly higher growth.

5.23 Easterlin’s initial work – and repeated subsequent studies - found that subjective well-being has been more or less static in the majority of developed western economies since 1945 despite considerable increases in average income. However recent work by Veenhoven and Hagerty (2006) and Wolfers and Stevenson (2008) question this finding (paragraphs 3.44-3.52).

5.24 Empirical research has also shown a positive relationship between job satisfaction and life satisfaction with one of the main factors being job security. (Although given that this relationship is to be expected it is questionable whether it tells us anything about causality.) The ‘relative standards’ explanation of the income-happiness paradox (see paragraphs 3.11-3.23) also suggests that individual happiness is in part determined by whether individuals believe they will meet their income-based expectations. Concerns over future income are therefore likely to lead to a fall in happiness.

5.25 It is not clear that well-being presents any new perspective here. The evidence that greater stability will enhance well-being does seem plausible; however this would seem to support the government position as much as suggesting a change of thinking.

5.26 Current government policy implicitly and explicitly acknowledges the importance of achieving stable economic growth as a priority. In addition the proposal to prioritise stability above slightly higher growth is dependent on showing that the two are mutually exclusive whereas current macroeconomic policy is perhaps best characterised as stability being a pre-requisite for maximising growth.

Progressive taxation

5.27 Proponents of well-being argue that focusing on income maximisation ignores other determinants of happiness and overlooks the impact higher incomes and the instruments used to achieve this may have on social well-being. It is argued that progressive taxation - increasing income tax for higher earners – will redistribute income and discourage the self-defeating pursuit of high income which additionally provokes dissatisfaction in others. High earners should be encouraged to spend more time away from work undertaking more worthwhile activities, rather than having an addiction to work and activities which do not increase well-being.

5.28 Proponents of progressive taxation put forward various psychological explanations (need fulfilment and social comparison theories) of the income-happiness paradox (paragraphs 3.9-3.28) to justify their policy proposal. But the theoretical arguments are not clear-cut. Part of the rationale assumes individuals benchmark against people on high incomes, but it is also possible
that they may actually benchmark against those earning just above them in their own peer group who may or may not be high earners.

5.29 The viability of proposing a progressive tax on well-being grounds is subject to a number of criticisms. The most popular criticism is that such policy proposals inhibit personal freedoms, the expansion of which should be the primary aim of public policy. Individuals should be free to follow actions which are ‘bad’ for them, provided they do not interfere with the freedoms of others, without the state intervening. It is also proposed that the correct response to individuals exhibiting envy should be to tackle the envy not the cause of the envy. Finally reducing incomes of higher earners will only have a temporary effect on the happiness of relatively poorer people. Likewise the effects on the happiness of earners from encouraging them to spend more time away from work will also diminish over time. In addition the proposal is very narrow from a policy development perspective.

5.30 The Treasury does already take account of general well-being, through distributional analysis, when developing tax policy. But it also considers a range of other factors (overlooked by this proposal), which will contribute to achieving the government’s wider objectives, including impact on macroeconomic variables, impact on behaviour, legality and operational delivery.

Taxes and subsidies to improve the environment

5.31 Proponents argue that personal well-being can be partially determined by the social conditions that we inhabit. One of the ways the government can alter these conditions is through taxes and subsidies to improve the state of the environment.

5.32 Empirical evidence to support this proposition from a purely subjective well-being perspective is limited as Newton (2007) highlights and one where further research is required. There is however substantial second order evidence that both the natural environment and local environment can have an impact upon mental and physical health, the community in which we live and our personal safety, all of which have been found to have a significant effect on happiness.

5.33 Currently policy makers assess the value people place on a healthy and productive local, national and global environment (for example via revealed or stated preference techniques). They then make policy interventions to address identified market failures (most commonly externalities, e.g. pollution, global warming). Examples of such policies include the climate change levy and congestion charging. The Treasury’s 2002 publication, Tax and the Environment, sets out how the development of environment policy takes place within a principled framework. This framework sets out the criteria for deciding whether intervention through the tax system is the right action to take, one of these criteria being the need to take account of the impact of action on wider social and economic objectives – including maintaining sound public finances.

5.34 There is little evidence that looking at such issues from a well-being perspective would alter this approach. It does offer the potential to enhance our ability to make such environmental evaluations but is unlikely to have a significant effect on policy choices themselves.

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7 Research has found that people are more likely to socialise if they have green spaces in their neighbourhood, resulting in stronger social ties (Kuo, Coley and Brunson, 1998) and community gardening is associated with better social interactions and a stronger sense of community (Dunnett and Qasim, 2000; Schmeizkopf, 1995; Mackenzie, Agard, Portella, Mahangear, Barol and Carson, 2000).
Bounded rationality

5.35 The following section analyses policies where the basis for any intervention would be to correct for situations where individuals exhibit bounded rationality. Again it is worth stating that this criterion provides a necessary, but not sufficient case for a particular policy.

Limit the freedom of manufacturers to advertise products which reduce well-being

5.36 The premise for putting limits on advertising certain products is that the existence of such adverts creates an informational bias and hence leads to a distortion in the market. Removing this market distortion will, it is argued, lead to an increase in freedom of choice resulting in individuals making decisions which are more likely to increase their well-being.

5.37 The empirical evidence from well-being to support this is however weak. There is no strong empirical evidence to link the consumption of any specific good directly to subjective well-being. Although there may well be second order effects for some products, for example unhealthy food and drink, to the extent that their over consumption leads to a reduction in level of health which has been shown to influence well-being.

5.38 A number of issues arise which question the viability of such policies. Firstly, policy prescriptions that seek to address the problem that collective and individual choices are ‘bad’ for us are confronted by arguments of individual liberty, and the proposition that advertising reduces freedom of choice is highly controversial. Secondly, the effect on well-being of reducing the level of information (in the form of advertising) available on particular goods and services is ambiguous. Thirdly, the assumption that individuals are more likely to choose alternative well-being friendly outcomes is questionable. Without additional information they may be just as likely to make decisions which are bad for their well-being.

5.39 In addition the policy takes no account of the government’s wider objectives in terms of health, where obesity is classified as a disease, not a life choice. Nevertheless where the recognised risk to health is substantial and long term the second order effect on well-being is not insignificant and the arguments for intervention stronger.

5.40 Government policy is in line with this analysis; tobacco advertising has been banned and there are restrictions on advertising of certain foods to children, notably those high in sugar, salt and fat.

Reduction in working week

5.41 The argument behind the proposal is that individuals will experience an increase in well-being if they are able to spend more time on leisure activities. Material belongings will enhance life satisfaction to a certain degree but for most individuals additional income does not add much to well-being. Rebalancing work-leisure balance more towards leisure will lead to a net increase in well-being, and as a result proponents suggest that the government should intervene because individuals lack either the freedom or the information to achieve the optimal work-life balance.

5.42 The empirical base (summarised by Donovan and Halpern9) shows that people who exercise, play sport or work in the garden are more satisfied than those who do not. Having friends and supportive relatives is also correlated with higher life satisfaction; this is partly due to the social aspects of these activities. However it is not clear that all non-work time activities enhance well-being. Figures for the UK10 show that average weekly working hours for the total

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9 Donovan and Halpern, ‘Life Satisfaction’.
labour force have reduced by approximately 8.5 per cent since 1971\textsuperscript{11} but subjective measures of happiness have remained unchanged. A possible explanation can be found in a break down of time use in the UK which shows that the most popular activities when not at work (or asleep) are the potentially more solitary activities of house work and watching television, followed by social life and sport.

\textbf{5.43} However using well-being as the main rationale for regulating the length of the working week raises a number of concerns. Firstly the net effect of a reduction in work time on well-being is more ambiguous than policy proponents argue. It will depend upon each individual’s income and non-work activities. For people on low incomes, or who spend little of their leisure time involved in sociable activities, a reduction in hours worked may actually lead to a fall in well-being (i.e. greater material loss from lower income than welfare gain from more hours leisure).

\textbf{5.44} Secondly individuals are currently free to choose (at least in the medium to long term) how much leisure they wish to enjoy and which activities to undertake during this time. They may be happier making different choices but they do have a free choice. The rationale for government intervention is therefore limited. The converse of this is, of course, that such limits would reduce personal freedoms and hence are subject to the criticisms set out in paragraph 5.38 above.

\textbf{5.45} Government policy implicitly acknowledges these concerns; improved work-place standards are already part of government policy, which is supportive of reducing hours and encouraging flexibility providing there remains sufficient choice for workers to work long hours if they wish to do so. In addition policy all takes into account wider government objectives by allowing employers sufficient flexibility to manage their operational business needs and requirements.

\textbf{Introduce more family-friendly work practices.}

\textbf{5.46} The argument behind this proposal derives from empirical evidence suggesting that family life has a very strong influence on happiness\textsuperscript{12} and that family break-up can often occur due to shortage of time. As a result it is suggested that more family-friendly practices at work (e.g. flexible working, entitlement to parental leave) should enhance family life and thereby raise the happiness of both parents and children. Individuals are making rational decisions within the current labour market regulations but this is sub-optimal for maximising their well-being.

\textbf{5.47} Empirical research has consistently found that married people are happier than those who have never married or who are divorced, widowed or separated.\textsuperscript{13} Conversely divorce, widowhood and separation all reduce life satisfaction.\textsuperscript{14} Subjective survey evidence showed people in the UK rated family as the third most important contributory factor (behind health and income) in contributing to current quality of life. It also found that it was the area of their life where they were most satisfied with 93 per cent expressing positive satisfaction levels.

\textbf{5.48} As with measures to limit the working week, the counter argument here is that people are already free to choose their working patterns. Indeed more labour market regulation might reduce the range of options on offer, restricting people’s ability to maximise their well-being (the UK has a far more varied set of working patterns than more regulated markets).

\textsuperscript{11} There are a range of reasons for the reduction in average weekly hours worked for the total labour force since 1970 including (i) the movement of employment from the manufacturing sector to the service sector; and (ii) an increase in part-time working (in the main due to an increase in the number of women in the labour force).


\textsuperscript{13} Donovan and Halpern, ‘Life Satisfaction’, p.27, para. 76.

\textsuperscript{14} Although there may be some selection bias here as it questionable that those who divorce would be as happy as those who remain married if they were compelled to remain married.
5.49 Policies on child-care, leave entitlements and flexible working have already been introduced by the current government (see paragraph 5.45). In addition a governmental review is currently underway looking at social mobility. The review will examine a range of issues including childcare and family support.

Enhancing the analytical base

5.50 The final section of this chapter looks at policies where there may be no explicit well-being market failure.

5.51 Such policies are in most cases already part of the government’s policy agenda, and are justified by other forms of market failure or on distributive grounds. Here the impact of well-being economics is not to justify a particular policy measure, but more to differentiate between competing spending priorities or to further strengthen ex-post consensus views on certain issues, for example democratic representation.

Enhancing good governance, reducing corruption and increasing democratic involvement\(^\text{15}\)

5.52 Good governance is central to determining national well-being, both in terms of the process of government and the outcomes it achieves.

5.53 Firstly, looking at process, Frey and Stutzer (paragraph 4.17) point out that people not only care about outcomes but also whether they have been achieved justly. To that extent, it has been argued (following Donovan and Halpern\(^\text{16}\)) that corruption by public or elected officials will greatly reduce people’s expectations, trust of one another and consequent life satisfaction. This proposition is supported by empirical evidence where the quality of country’s governance (including stability, control of corruption and the rule of law) have all been found to help explain national differences in well-being, after other factors are taken into account.

Improving the health and well being of children and young people

5.54 The DCSF Children’s Plan (2007) expressed the aim to make England the best place in the world for children and young people to grow up. The Children's Plan set a series of goals for 2020 including for ‘all young people to be participating in positive activities to develop personal and social skills, promote well-being and reduce behaviour that puts them at risk’. The 2007 Comprehensive Spending Review set a public service agreement for the Department for Children, Schools and Families (DCSF) to promote health and well-being supported by five indicators related to breastfeeding, school meals, childhood obesity, mental health and parents’ views of services for disabled children. Related to this the Every Child Matters agenda sets out five broad outcomes for child well-being (being healthy, staying safe, enjoying and achieving, making a positive contribution and achieving economic well-being), together with a range of measures of how to achieve this aim. These include the improvement and integration of universal services, the involvement of children and young people when assessing and planning service provision, and more specialised help to allow early intervention when problems arise. In complementary work the Department for Culture Media and Sport (DCMS) working with DCSF have set out a PE and Sport strategy\(^\text{17}\) for young people with the aim of raising participation levels.

\(^{15}\) Paragraphs 5.52 and 5.53 reproduce in shortened format the analysis and summary of empirical evidence set out by Donovan and Halpern, ‘Life Satisfaction’, para. 105.

\(^{16}\) Donovan and Halpern, ‘Life Satisfaction’.

Developments in the economics of well-being

5.55 Evidence on the well-being of children in the UK is mixed. Subjective surveys of children in the UK\(^{18}\) shows that the large majority of children in the UK are happy (although 60 per cent also said they were worried about something). However the 2007 Unicef child well-being report\(^{19}\), using six criteria (material well-being, health and safety, educational well-being, family and peer relationships, behaviours and risks and subjective well-being), reported the UK as the lowest of the 21 countries participating (although the usual caveats apply to such measures). Data from the Eurobarometer survey show decreases in subjective measures of happiness from about the age of 10 until the early twenties, before rising slightly until a further decline in middle age. Research from Feinstein, Bynner and Duckworth\(^{20}\) also suggests a number of positive outcomes as a result of children participating in sports/community centres at age sixteen.

5.56 As with alternative measures of progress (paragraphs 5.4-5.9) it is not clear which of the Unicef well-being measures to apply most weight to, or whether policies to achieve any one of these goals may have negative impacts on another. It would also seem counterintuitive that the UK should exhibit high levels of subjective child well-being but lower scores on objective criteria when many of these (e.g. health, economic well-being, family relationships) have been found to be key determinants of subjective well-being. This analysis would seem to support DCSF’s approach to child well-being of looking at a range of indicators.

5.57 The disparity between the high subjective scores and low objective scores for the well-being of children in the UK does however suggests that there may be scope to raise overall well-being by concentrating more on the causes of unhappiness, rather than trying to raise the level of happiness.

Direct intervention to address the sources of unhappiness, e.g. mental health

5.58 This proposal is based on survey evidence suggesting that mental illness is possibly the largest contributor to unhappiness amongst the population of western countries\(^{21}\). In addition, it plausible to argue that the systematic targeting of ill-being will achieve a higher marginal return than targeting well-being and therefore will be a more efficient way of raising the average level of well-being. Proponents recommend that a higher priority be given to targeting the main sources of ill-being (e.g. poor mental health).

5.59 In the empirical evidence reviewed in Chapters Two and Three, the Eurobarometer registered high levels of subjective well-being in the UK, with only 11 per cent of UK residents describing themselves as dissatisfied. Likewise the UK scored high absolute values in the majority of objective measures of quality of life surveyed. At such high levels of happiness - as the ‘need fulfilment’ explanation of the Easterlin paradox explains (paragraph 3.9) - incremental gains in needs satisfaction begin to taper off.

5.60 In contrast the empirical evidence showed good health to be one of the most important contributory factors to subjective well-being (irrespective of income level). The 1999 Eurobarometer survey showed UK residents rated health as the most important factor contributing to their current quality of life. According to Layard’s ‘Effects on happiness’ table (Table 3.A, paragraph 3.70), severe reductions in health register as approximately three times more significant than a reduction in family income by a third and in some cases the effects will

\(^{18}\) TellUs2 Survey


Developments in the economics of well-being

5.61 Although it is too early to draw firm conclusions the evidence does appear to support the case that intervention to address health issues, and in particular mental health problems, will increase well-being. However, it is important to balance this against the opportunity cost to well-being of reductions to expenditure on alternative measures.

5.62 This is consistent with the broad conclusions of a Foresight Project on Mental Capital and Wellbeing recently undertaken by the Government Office for Science, which reported in October 2008. The project surveys the scientific and economic evidence available and proposes a range of evidence-based policy interventions designed to improve mental capital – a person’s cognitive and emotional resources – and mental wellbeing. It concludes that it is important to shift aggregate levels of mental capacity and well-being across the population.

5.63 This is not necessarily inconsistent with the idea of targeting ill-being. Despite the potential benefits being high, the evidence on the economic impact of such interventions is comparatively weak at present, particularly when mental wellbeing is targeted, and more research is needed. The areas where there is clear evidence of very good value for money – for example, help for those with mental illness to work, and depression treatments of the kind advocated by Layard – will fall in the ill-being dimension of welfare (see paragraphs 4.5-4.9).

5.64 Hence, while there is clearly a case to be made for raising well-being across the population, evidence to date suggests that in the first instance the greatest returns may be achieved by specifically targeting the causes of ill-being.

Conclusions

5.65 The analysis suggests that in conditions of market failure, or to address distributional concerns, there are good arguments for the government to consider intervening to try and increase well-being. However, identifying a case for intervention is a necessary but not sufficient condition for incorporating well-being into policy making. It will also be necessary to evaluate proposals against: (i) the theoretical and empirical evidence base arising from well-being literature and survey; (ii) their impact on other government objectives, especially when there is an overt conflict, for example preserving the economic incentives that support a dynamic economy; and (iii) alternative well-being proposals, taking into account the opportunity costs to well-being of the proposed measure, and the possible knock-on effects on other determinants of well-being. In addition, as with any government policy, it will be necessary to consider whether it is affordable and offers value for money.

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22 It is possible that mental illness is equivalent to well-being in which case it may not be possible both to have high levels of well-being and suffer from mental illness.

23 To the extent that people with poor physical health are on low incomes looking at the aggregate picture may risk overstating the argument, as such individuals may experience a much larger marginal return to well being from increases in income than assumed (i.e. they are towards the bottom of the income-happiness curve).

24 In the Foresight Project, ‘mental capital’ refers to the totality of an individual’s cognitive and emotional resources including their cognitive capability, flexibility and efficiency of learning, emotional intelligence (e.g. empathy and social cognition), and resilience in the face of stress. The extent of an individual’s resources reflects his/her basic endowment (genes and early biological programming) and their experience and education, which takes place throughout the life course.

25 In the Foresight project, ‘mental well being’ is a dynamic state in which the individual is able to develop their potential, work productively and creatively, build strong and positive relationships with others, and contribute to their community. It is enhanced when an individual is able to fulfil their personal and social goals and achieve a sense of purpose in society.
5.66 Although it is too early to draw firm conclusions from the literature on well-being, the analysis presented does suggest that there is a case to be made for policies to enhance good governance and democracy and that the new analytical techniques will provide an additional dimension to policy analysis. There is also reasonably strong empirical evidence to suggest that reducing unemployment, supporting the family and tackling mental health will enhance well-being.

5.67 Evidence to support many of the specific policy measures themselves is less strong - both for the critical drivers of well-being, and their likely effectiveness. In addition, some measures put forward conflict with achieving other government objectives, or are philosophically controversial.
Chapter Six considers why the Treasury might be interested in the economics of well-being. It discusses whether the Treasury should factor well-being into policy thinking, and the extent to which it has the policy capacity to do so. The final section discusses the pros and cons of possible policy intervention for the government as a whole on both a generic and specific level.

**Should the Treasury be concerned about the economics of well-being?**

Well-being as a concept is closely related to the Treasury’s objectives, as the Treasury aim explicitly states:

“To raise the rate of sustainable growth, and achieve rising prosperity and a better quality of life with economic and employment opportunities for all.”

Although many issues in the economics of well-being remain unresolved — not least Easterlin’s happiness-income paradox — there are a number of arguments for the Treasury being concerned about well-being. Firstly, the research appears to have some validity. The empirical evidence base summarised in Chapters Two and Three shows that life satisfaction can be reliably measured, and its causal determinants identified. Evidence also shows that survey evidence is closely related to other indicators. Well-being analysis offers a potential opportunity to provide a more succinct definition to what exactly is meant by quality of life.

In addition it puts a new perspective on policy, providing policy-makers with two new analytical tools:

- "Objective" measures of well-being — these provide an opportunity to assess progress against a measure other than GDP and thus give a different perspective with which to assess policy progress and outcomes. UK rankings against objective well-being indices can be compared both with GDP per capita and with other developed countries. This can highlight performance outcomes which are not picked up by GDP, although any such international comparisons should be treated with caution (see paragraphs 5.5-5.6).

- Life satisfaction approach to policy analysis - Subjective measures of happiness provide a potential complementary approach to policy analysis that in principle should enable policy makers to discriminate between competing explanations for empirical findings in behaviour.

**Available policy levers**

In theory the Treasury is in a position to build upon the analysis presented in the well-being literature. The evidence reviewed suggests that, in addition to genetic and personality factors, well-being is also affected by social, economic and institutional factors. These factors can all be influenced by government action, which suggests that incorporating the findings of well-being research into the analysis framework might provide a relevant new dimension when developing policy.
6.6 Current policy reinforces this point. Treasury objectives include expanding economic and employment opportunities, and improving the quality of the public services. As meeting these objectives will affect, for example, unemployment levels and standard of health (both of which have been shown to have a significant impact on well-being), it follows that the Treasury is in a position where consideration of well-being issues in policy development is potentially non-nugatory.

6.7 However this analysis should be set in the context of Easterlin’s findings which, although now coming under increased scrutiny, leave open the question of how effective any resulting policy levers might be on overall well-being. If Easterlin is correct, and well-being has remained unchanged despite steady GDP growth, this suggests that although individual policies may be able to impact positively on well-being, the overall policy mix is ‘well-being’ neutral (in so far as aggregate happiness has remained unchanged).

Arguments for and against government intervention

6.8 It is possible to make a case both for and against policy intervention on a generic or aggregate level.

6.9 It could be argued that the current policy stance is sub-optimal. A change of policy stance to place a greater emphasis on subjective well-being might in theory lead to an increase in net well-being. However, this need not necessarily mean a rebalancing of policy away from targeting growth to targeting well-being. It could equally imply maintaining growth policies but tackling offsetting negatives.

6.10 Likewise aggregate survey evidence also suggests there may be scope for intervention. Subjective measures of well-being suggest two possible reasons:

- Relative performance: Although absolute levels of happiness in the UK are high, and the UK performs more strongly than France or Germany, in subjective measures of life satisfaction it is below a number of other EU countries including Ireland, Sweden and Denmark. This suggests there may still be scope for intervention to raise aggregate well-being.1

- Levels of dissatisfaction: Approximately 11 per cent of the UK population judge themselves as dissatisfied with life (a measure which has remained relatively steady over time). Hence there may still be scope for intervention to reduce levels of unhappiness. However, such action would have to consider the well-being costs to the other 89 per cent of the population.

6.11 There are several arguments against intervening to affect well-being. Firstly, there are philosophical objections: the implicit assumption that well-being should be the ultimate objective of public policy conflicts with the conclusions of many political philosophers (and more latterly, Amartya Sen), who have maintained that the preservation and expansion of personal freedom (or ‘capabilities’) should be the primary aim of public policy, not utility maximisation. Freedom has traditionally been defended as a higher goal of public policy on the grounds that it allows people to pursue their own conception of the good life. This may include maximising their subjective happiness, but could equally encompass altruism, religious obligations etc.

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1 It is possible that the UK is behind other countries due to a consequence of fixed country effects (for example Danish people might have propensity to give more positive survey responses). For it to be possible to enhance the relative position of the UK it must be possible for countries to enhance their position as a result of policy choices.
6.12 Moreover, a strict utilitarian approach to policy-making could also jeopardise individual rights if/when these were perceived to conflict with collective social objectives. For example, proposals to limit the working week could be seen as removing free choice from individuals as to how much they would like to work.

6.13 Finally it may be the case that the current policy stance is optimal for maximising well-being. There are a number of policies that have a positive influence on subjective well being already in place. If the policy stance were changed to place a greater emphasis on subjective well-being, there is no guarantee that the final outcome will actually lead to an increase in happiness, and there is a risk that it might even reduce well-being. For example, changing from targeting economic growth to targeting well-being could result in second-round negative effects on well-being via reduced unemployment or slower technological advances, which might outweigh the benefits of the well-being policies introduced in their place. Further research in this area would be welcomed.

6.14 Given the inconclusive nature of the debate, intervention decisions are probably best made on an individual policy basis. Three reasons for intervention were identified in Chapter Five: market failure resulting from externalities; market failure resulting from individuals exhibiting bounded rationality (possibly caused by imperfect information); and for distributive reasons.

6.15 If an argument for policy intervention can be identified, then each measure should be assessed on its own merits within a policy framework that attaches appropriate weights to the benefits from higher well-being, and the potential costs of a particular policy intervention.

**Conclusion**

6.16 To summarise the analysis in this chapter, academic research on well-being provides a new framework with which to measure progress and analyse policy. It suggests the government has the potential to benefit from these new analytical tools and should consider using them in addition to current techniques to examine the current balance of policies. However, any specific policy suggestions require exogenous justification for government intervention, and should be evaluated in terms of their impact both on well-being and the Government’s (ultimately society’s objectives) for income growth, living standards, and wealth and income distribution.
Conclusion

7.1 Well-being – both subjective and objective – is an important issue. It provides a new framework with which to measure progress and analyse policy, providing new evidence for policy makers to assess how material welfare affects well-being.

7.2 However, it is important to be careful about intervening explicitly to influence well-being. Consideration will have to be made of other objectives alongside well-being, notably the effect on economic incentives (as they will impact on current and future prosperity). Whilst international evidence shows UK happiness levels are below some other western counterparts, in absolute terms happiness levels in the UK are already very high, and there is no guarantee that a change in policy stance would have a net positive effect on well-being.

Political economy

7.3 The Easterlin Paradox and related research highlights that income is not the sole determinant of well-being. However, Easterlin’s findings are now coming under increasing challenge, and in any case do not refute the view that income is an important element of well-being. The challenge for Government policy is to create an environment in which individuals can efficiently trade-off their personal preferences between income and other sources of well-being, and in which the social costs and benefits are balanced.

7.4 Well-being research highlights where those trade-offs lie. In principle, cost-benefit analysis provides a way for policy to capture these trade-offs but in practice, the full costs and benefits are often difficult to measure with the necessary degree of precision. Therefore formal quantitative exercises may be of limited use, and the evaluation may need to be framed in more qualitative terms.

7.5 The political process is one way in which the social preferences for well-being and income are expressed. Examples where well-being objectives are already factored into government policies include: environmental policy (clean air and water); health and safety legislation; consumer protection measures and security to name a few.

7.6 To determine the efficacy of any particular policy aimed at increasing well-being, it is necessary to consider whether there is justification for intervention, as opposed to letting the free market decide. Then for each relevant policy, first its impact on other policy objectives should be considered, and secondly whether this is the best way of raising well-being, taking into account the opportunity costs to well-being of the measure, and the possible knock-on effects on other determinants of well-being.

Policy suggestions

7.7 Well-being research has identified proposals for new analytical techniques and a wide range of specific policy measures to increase national well-being.

7.8 New analytical techniques offer an alternative subjective measure of well-being to assess how a particular policy will impact on individual welfare. There is also a strong case for measuring progress against a variety of indicators in addition to GDP growth.
7.9 In terms of specific policies, measures to enhance good governance and involvement in the
democratic process are relatively uncontroversial, and there is good evidence to suggest they will
increase, although not maximise, well-being.

7.10 But despite evidence that happiness in the UK has remained unchanged over the past five
decades as the economy has grown (exemplified by Easterlin’s income-happiness paradox),
arguments to support changing policy priorities from prioritising economic growth to prioritising
well-being are still inconclusive - the more so given the recent challenges to Easterlin’s findings.

7.11 A number of possible psychological explanations have been put forward to explain the
income-happiness paradox and may all be true to an extent. Need fulfilment theory suggests a
tapering of satisfaction growth at higher income levels, whilst social comparison and adaption
theories argue that it is not possible to significantly increase average and individual satisfaction,
respectively, through growth alone.

7.12 The behaviours which these theories are seeking to explain could be caused by market
failures (imperfect information, externalities and a need for collective action). This results in
a sub-optimal (for the individual and/or society) prioritisation of increasing consumption at the
expense of other, better drivers of well-being and hence presents an argument for
government action.

7.13 The form this action could take has been manifested in a range of policy proposals. They
aim to increase well-being by attempting to tackle either (a) inequality in consumption or (b) the
motivations/behaviours to emulate others’ higher consumption (education, advertising controls,
restricting working hours, etc). However, the evidence to support such policies measures - both
for the critical drivers of well-being and the effectiveness of government measures - is weak, and
some of the measures themselves are philosophically controversial. In addition, any such policy
proposals need to be evaluated alongside other government objectives where there may be a
conflict of interest.

7.14 Taking into account what is known about the drivers of self-reported life satisfaction and
well-being, the evidence points to the continued need for growth, but also highlights particular
priorities: alleviation of chronic illness, including mental illness; reducing unemployment and
promoting macro-economic stability; and strengthening relationships and social capital. These
policies are already reflected in Government policy.

Policy development and delivery

7.15 From a practical point of view it is not desirable or even possible for government to reduce
people to happiness metrics, and to promise a magic bullet to deliver well-being, even if as
individuals we often believe that there are short cuts to our well-being. Instead it is more
pragmatic to support the right democratic institutions and mechanisms which allow
Government to respond to what people want regarding improvement of their self-control.

7.16 Recent examples of this already happening include the roll-out of emotional education
through the SEAL and SEBS programme in schools; the extension of after-school clubs; the
extension of maternity and paternity leave; the banning of smoking in places of work; tightening
of advertising to children; tighter control of selling alcohol to under-18s; and clearer information
on nutritional content on food packages.

7.17 Such reforms have often been in response to real problems and consensus over the need
for reform, rather than having arisen due to policy-makers chasing happiness metrics. An
effective programme for well-being, may therefore of necessity be more piecemeal, bottom-up
and responsive, and requires a due process of consultation and review of inherently difficult and
complex issues.
Further research

7.18 Finally, further research into well-being should be encouraged particularly to advance new analytical techniques and to get a better understanding of the relationship between subjective individual well-being (happiness) and objective national well-being (Quality of Life); longitudinal studies of well-being which can help identify the direction of causality; the importance of relative income for subjective well-being and the sources of status for individuals and the relationship between subjective well-being and the environment.


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