

Frey, Bruno S.

Working Paper

Happiness and Public Policies: Fundamental Issues

CREMA Working Paper, No. 2012-16

Provided in Cooperation with:

CREMA - Center for Research in Economics, Management and the Arts, Zürich

Suggested Citation: Frey, Bruno S. (2012) : Happiness and Public Policies: Fundamental Issues, CREMA Working Paper, No. 2012-16, Center for Research in Economics, Management and the Arts (CREMA), Basel

This Version is available at:

<https://hdl.handle.net/10419/214520>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Happiness And Public Policies: Fundamental Issues

Working Paper No. 2012-16

International Expert Working Group on Wellbeing and Happiness

Appointed by the King of Bhutan for the United Nations.

A New Development Paradigm

11 October 2012

*HAPPINESS AND PUBLIC POLICIES:
FUNDAMENTAL ISSUES* *

by

Bruno S. Frey

University of Warwick, United Kingdom, Zeppelin University, Germany,

and

CREMA – Center for Research in Economics, Management and the Arts, Switzerland.

Research on happiness or subjective well-being has recently received considerable attention from inside and outside academia. The findings are of direct relevance for economic development. In particular, the effect of income growth on happiness is of utmost importance. Some prominent authors – notably Richard Easterlin – have argued that a rise in income does not raise happiness due to adaptation and comparison effects. This is called the “Easterlin paradox”. If it held true – the finding is challenged by other happiness researchers – development policy would have to change. The main goal would no longer have to consist in raising real per capita income in poor countries. Rather, different objectives would have to be considered – but which ones?

Even if the “Easterlin paradox” was not true, the problem would remain. It is difficult to find any serious happiness researcher who claims that happiness grows linearly with per capita income. Happiness research has clearly established that there are diminishing marginal returns to higher income in terms of subjective well-being. At the same time, research has established that there are other crucial determinants of happiness that are relevant in the process of economic development. Personal health and social relatedness are examples at the individual level, while political participation rights and decentralized decision making structures are important determinants at the aggregate level. Unemployment is relevant both at the individual and at societal level because even persons holding a job fear losing it when the general unemployment rate is rising.

· E-mail: bruno.frey@econ.uzh.ch.

This report is based on recent work by the author and co-workers on the political economy of happiness policy, in particular Frey and Stutzer 2009, 2012, Frey 2011a, Frey and Gallus forthcoming a) and b). These publications provide extensive sources supporting the statements made in this report.

Governments have paid great attention to the results of happiness research, thus marking one of the rare instances when politicians actually react to insights from academia. A “happiness policy” has been explicitly proclaimed in countries such as Great Britain, France, Germany, and even China. The Kingdom of Bhutan was a forerunner in this respect. The objective of government policy is no longer taken to be development in terms of a growing Gross National Product (GNP), but it rather consists in raising, if not maximizing, a *National Index of Happiness*.

This report analyses whether such an aggregate or National Happiness Index is a better guide to development than GNP or other indices of development – such as the “Human Development Index”. I argue that *when the National Happiness Index becomes the official goal of policy, it will be distorted by political interests*. The respondents to surveys will resort to strategically answering the questions posed. Even more importantly, the government in power will manipulate the Index so as to further its own interests. As a result, the National Happiness Index will lose its informational quality and will therefore no longer serve as a reliable measure of happiness in the process of development.

The present report deals with five specific issues:

1. Government has considerable incentives and possibilities to distort the National Happiness Index;
2. Existing material indicators of economic development (such as GNP) are less subject to such distortions;
3. There exist various means to reduce the distortions of the Happiness Index, especially at the constitutional level of decision making; however, the politically induced distortions cannot be fully eliminated;
4. The National Happiness Index should be in competition with other happiness indices provided by other groups in society that are independent of government. It is mistaken to assign an exclusive role to the National Happiness Index.
5. The various happiness indices should be used in conjunction with existing material indices of development.

As should have become clear, this report does not compare the construction of the various subjective and material indices of development as such. There is an extensive literature devoted to this task already. Rather, the focus will lie on the indices from the point of view of *political economy*, an approach that has so far largely been disregarded.

Section I shortly discusses the incentives and possibilities of individuals to strategically misrepresent their preferences when asked in happiness surveys. Section II is devoted to the ~~more important~~ influence exerted by government when manipulating the National Happiness Index. The following section considers the possibilities to mitigate such manipulation of the National Happiness Index. Section IV concludes by suggesting what index or indices should be used to analyse development and to formulate adequate policies.

I. Indices and Strategic Misrepresentation

The material development indices such as the Gross National Product (GNP) or the Human Development Index are constructed on the basis of *objective* data. An outside person, such as a statistician, can observe and measure these data. In the case of the most important measure of development, national income or GNP, the data are derived from market interactions. It is defined as the total turnover (the quantity of goods and services consumed and invested times their respective prices, which in equilibrium reflect marginal utilities) minus the costs

necessary to produce these goods and services. The total value added corresponds to the GNP. While there are other parts of the GNP that cannot be observed on the basis of market transactions (in particular the value added by the public sector), GNP measures the preferences or utilities revealed by individuals through their behaviour. Individuals have little incentive to misrepresent their consumption or investment behaviour because this would impose costs on them. They would then no longer consume or invest in those goods and services that maximize their own utility. The measure of the components of the GNP based on market transactions therefore truthfully reflects the utilities of the individuals in society. In contrast, happiness data are based on the responses of individuals in representative oral surveys. It is well established that these answers are reliable (see e.g. Frey and Stutzer 1999, Diener 2009, 2011). The respondents truthfully reveal their state of happiness. They have little incentive to falsely report it. As a result, the subjective answers correspond well to what most people associate with a particular state of happiness. Thus, happy persons smile more in interactions with other persons, they are more open and optimistic, they are considered to be more agreeable work colleagues, they sleep better and they are in better health and live longer (Diener and Chan 2011, Frey 2011b). Conversely, unhappy persons have more problems at their work place, they seek more psychological treatment and they are more prone to commit suicide. Moreover, the happiness level they indicate tends to correspond to the one that close relatives and friends would attribute to them.

The truthfulness of the subjective happiness levels stated in representative surveys changes dramatically *once National Happiness has become an official policy goal of the government in power*. When this is the case, individuals have an *incentive to misrepresent their happiness level* for strategic reasons: they become motivated to support or to punish the politicians in power. Assume that an individual with a left-wing ideology living under a right-wing government is asked how happy she is. As happiness has become an official goal of that government, she is inclined to state that she is less happy than she actually is. She therewith signals her disapproval of the politicians in power. Conversely, a right-wing person living under a right-wing government has an incentive to state that he is happier than he actually is. He therefore wants to signal that he approves of the politicians in power. The individuals asked can misrepresent their state of happiness at low cost because their true state of happiness remains hidden. The cost of misrepresentation consists at best in the moral qualms of having stated a wrong happiness level. It can well be assumed that most people are little bothered by these moral costs, so that the cost of misrepresenting their happiness level is nil. Introducing happiness as an official government goal therefore systematically biases the stated happiness levels. However, it is not a priori possible to see in what direction the National Happiness Index is therewith distorted. This depends on the extent of the upward or downward misrepresentation by individuals as well as on the size of the various groups engaging in such misrepresentation.

II. Manipulation by Government

Once National Happiness has become an official policy goal of the government, the politicians in power have a strong *incentive to manipulate economic indicators* such as the rate of unemployment, the rate of inflation, the level and growth rate of national income, the current budget deficit and the size of the public debt¹. They do so because they are aware that it is not only the actual experiences that count for the citizens when they vote. A typical citizen has only very limited direct experience with respect to these economic factors. He

¹ See, e.g., Dafflon and Rossi 1999, Forte 2001, Koen and Van den Noord 2005, Milesi-Ferretti 2004 and von Hagen and Wolff 2006.

therefore has to use perceptions about the state of the economy. These perceptions are considerably influenced by the media, which propagate the official statistical figures provided by government.

It is not rare that governments manipulate the statistics that are released and engage in “creative accounting” – in particular when trying to hide undesirable economic facts (see, e.g., Balassone et al. 2007, Buti et al. 2007, *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* 2009 and *European Commission* 2010). For instance, governments rarely communicate the implicit public debt, which includes future expenditures that have formally been promised (e.g. health benefits). Moreover, they can hide part of the public debt by outsourcing it to bodies that do not directly belong to government. Yearly budget deficits have also been considerably understated in some countries’ public accounts (for instance in the case of Italy and Greece); a fact that has become particularly visible during the present financial and economic crisis. In California, such accounting tricks have repeatedly been used to obscure the yearly budget deficit, thus allowing the state to meet the constitutional requirements (*The Economist* 2012a). Likewise, the long-term unemployed are excluded from many statistics. This allows governments to publish unemployment rates that are lower than they are in actual fact (see e.g. Gregg 1994 and Webster 2002). Inflation figures can be manipulated in a similar vein, as has been revealed for example in the case of Argentina (*The Economist* 2012b): while the official rate of inflation lies at 9.7%, the real rate amounts to approximately 24%. As concerns the important measure of national income, it has been pointed out that some governments have resorted to including parts of their country’s shadow economy – yet, the extent to which this has happened is still unknown (see, e.g., Schneider and Enste 2002, Torgler et al. 2010 and Schneider 2011).

These examples suggest that the manipulation of particular economic indicators is widespread. It may even be argued that it is the rule rather than the exception (although that is of course denied by governments).

Politicians have an even stronger *incentive* to manipulate the *National Happiness Index* in their favour than they have in the case of the economic indicators just mentioned. After all, it represents the self-declared unique goal of policy to which all policies are subservient. Citizens therefore focus on the development of that index and so will the media. It is to be expected that the political discussion will be dominated by changes in that index, which purports to capture the overall well-being of the population. The government will hence make a great effort to manipulate it in its favour. It is strongly motivated to prevent a decline in the National Happiness Index. To this end, it can undertake policies improving actual conditions – for instance by reducing the rate of unemployment – and therewith raising the Index. Yet, it can also endeavour to manipulate the Index without improving the actual well-being of the population. The government can even actively try to push up the Index to indicate a happiness level that in reality does not obtain. The *possibilities* to do so are manifold.

This is primarily the fact because the National Happiness Index is based on subjective evaluations of respondents to surveys. These can be manipulated more easily than indicators based on more objective data, such as the Gross National Product. For instance, the responses can be influenced by the order of the questions (Deaton 2011). Previously asking respondents about the political situation can for example lead to an average reported happiness score that is lower than it would otherwise be. Furthermore, “outliers” reporting extremely low levels of happiness can easily be excluded, arguing that they have not been serious when confronted with the questions (Simmons et al. 2011). Such subjective data also incite even more outright cheating on the part of government. The deletion of extremely low responses and the invention of some more responses that indicate high levels of happiness can hardly be detected.

It may be concluded that if people's subjective well-being, as captured by the National Happiness Index, is declared the unique goal of policy, the government in power has a strong incentive – and a broad set of possibilities – to manipulate this National Happiness Index in its favour. As a result, the Index will no longer serve as a reliable indicator of the population's well-being.

III. Improving the Reliability of the National Happiness Index

The discussion has so far assumed that the government is unconstrained: it has the power to undertake all possible manipulations of the National Happiness Indicator that it considers to be in its interest. This condition holds for a dictatorial or authoritarian political system and is therefore relevant for many economically less developed countries. But even these governments to some extent need the support of their population. Dictators, for instance, are restrained in their actions by the risks of either a political uprising or passive resistance by the population. The economic base on which such regimes rely in order to subsist is also threatened by an exodus of the economically most productive and creative members. History shows that it is exactly authoritarian governments that use the most intensive propaganda to cajole their citizens. This fact has been well captured in Huxley's *Brave New World* (1932). Such governments will therefore put extreme effort into manipulating the National Happiness Indicator in their favour.

Politicians in democratic countries may possibly be as power-ridden as authoritarian rulers, but they are more constrained by constitutional rules. Their power is limited by an open society based on the rule of law, free media, and a civil society in which individuals may form their own organizations and groups, including political parties. In a democracy, the government's means of manipulating the National Happiness Index are limited. Attentive and independent *media* have an incentive to reveal instances when the government manipulates the Index in its favour. However, as argued above, there are still many possibilities to influence the National Happiness Index, some of which are difficult or even impossible to detect.

Another constraint on the government's possibilities to influence the National Happiness Index may be exerted by *experts* – in so far as they are independent of the government. Free universities serve this function. But again, not too much can be expected. While academics might have the possibility to find out to what extent the government manipulates the Index, they may refrain from doing so in order to not compromise their own careers. If they criticize the government for having manipulated the Index, they may receive less government funds for their research and they may not be offered attractive policy positions anymore.

Yet another possibility to restrain the government's influence on the National Happiness Index is to delegate its construction to an *independent Statistical Office*, instead of an office close to the president or prime minister. This solution resembles the idea that monetary policy should be undertaken by an independent central bank. However, experience shows that few, if any, national banks are in fact – and not just on paper – independent. The recent financial crisis reveals that even central banks that are formally independent tend to be subservient to the government's wishes. It is an illusion to think it was possible to completely isolate a public institution from the political power play.

A solution for overcoming the strong incentives and possibilities of government to manipulate the National Happiness Index must be sought on a more basic level; namely, the

constitutional setup of a democratic society. Such an approach fundamentally transforms the concept of a National Happiness Index.

In a democracy, each citizen has the possibility to influence the political process and the political outcomes in (free) elections. In direct democracies, citizens can even exert a direct influence – by expressing their preferences via popular initiatives and referenda. The discussion of economic and social issues is furthered by the competition among newspapers, radio and television, as well as by channels such as Facebook, Twitter and other Internet forums. The dominant position of the National Happiness Index produced by the government is undermined by additional happiness indices offered by civic interest groups, such as trade unions or environmental groups. If that occurs, competition between various happiness indices emerges and the monopolistic position of “the” National Happiness Index disappears. Each group that offers its specific index of social well-being is forced to argue why, and in what respects, it captures important aspects of people’s happiness.

The discussion has led us to a perhaps unexpected conclusion: the construction of “a National Happiness Index” is unwarranted in a democratic society. Rather, the construction of *many different happiness indices*, coupled with an intensive discussion of their strengths and weaknesses, is the adequate way to deal with the issue of happiness in a free society. The competition between various ways of capturing and aggregating the subjective well-being of individuals is the essence of democracy. In contrast, it is mistaken to believe that one single National Happiness Indicator was able to reflect the many different preferences and interests in an open society. Such an exclusive Index would be manipulated by government. To pursue, or even to maximize, “the” national happiness corresponds to a technocratic view of society.

IV. What Indicators for Development?

Economic and social development cannot be captured by one single indicator. The recent propagation by some governments of *one and only* National Happiness Index as the ultimate indicator of development is incorrect. As argued in this report, such a unique indicator will be even more strongly manipulated by governments than the existing main economic indicator, the Gross National Product, or the partial economic indicators such as unemployment, inflation, the budget deficit or the size of public debt. Due to the strong incentives and the extensive possibilities to manipulate the National Happiness Index, which is based on subjective survey data, an officially proclaimed National Happiness Index will lose much of its informational content. It will no longer reflect the state of subjective well-being in a society.

The manipulation of the National Happiness Index will be stronger in *authoritarian regimes* and even more so in dictatorships. In fact, such an Index will turn out to be close to useless. To capture the state of development, it is therefore important to use *many different social and economic indicators*, based on both objective and subjective data. This makes it more difficult for governments to effectively control the indicators. As a consequence, more trust can be put in the overall picture presented by the multitude of indicators.

In *democratic* countries based on an open society and the rule of law, the idea that government should construct a unique National Happiness Index so as to capture the level and development of well-being in society should be firmly resisted. In democracies, the respondents of surveys are induced to answer strategically, and the politicians in power have a strong incentive and considerable possibilities to manipulate the National Happiness Index. Instead of championing the introduction of one Index as the single policy goal, academics and

the wider public should support exactly the opposite: *many different happiness indices*, which are to be in competition with one another. This will enable the individual citizen to compare the different indices and to choose the one, or the ones, that she sees fit. The individual decisions can then be introduced into the political process and the social decision can thus be made using the constitutionally provided rules. Such an approach allows us to take into account the insights of happiness research and to embed them in a democratic setting.

References

- Balassone, Fabrizio, Daniele Franco and Stefania Zotteri (2007). The Reliability of EMU Fiscal Indicators: Risks and Safeguards. *Banca d'Italia Working Paper* 633.
- Buti, Marco, João Nogueira Martins and Alessandro Turrini (2007). From Deficits to Debt and Back: Political Incentives under Numerical Fiscal Rules. *CESifo Economic Studies* 53(1): 115 - 152.
- Dafflon, Bernard and Sergio Rossi (1999). Public accounting fudges towards EMU: a first empirical survey and some public choice considerations. *Public Choice* 101(1-2): 59-84.
- Deaton, Angus S. (2011). The financial crisis and the well-being of Americans. *Hicks Lecture*. Oxford. May 2011.
- Diener, Ed (ed.) (2009). *The Science of Well-Being – The Collected Works of Ed Diener*. Dordrecht, Heidelberg, London, New York: Springer.
- Diener, Ed (2011). The Validity of Life Satisfaction Measures. *Mimeo*. Department of Psychology, University of Illinois and The Gallup Organization.
- Diener, Ed and Micaela Y. Chan (2011). Happy People Live Longer: Subjective Well-Being Contributes to Health and Longevity. *Applied Psychology: Health and Well-Being* 3(1): 1-43.
- European Commission (2010). *Report on Greek Government Deficit and Debt Statistics*. Brussels.
- Forte, Francesco (2001). The Maastricht “Excessive Deficit” Rules and Creative Accounting. In: Mudambi, Ram, Pietro Navarra and Giuseppe Sobbrino (eds). *Rules and reason: perspectives on constitutional political economy*. Cambridge: Cambridge University Press.
- Frey, Bruno S. (2011a). Subjective Well-Being, Politics and Political Economy. *Swiss Journal of Economics and Statistics* 147(4): 397-415.
- Frey, Bruno S. (2011b). Happy People Live Longer. *Science* 331: 542-543.
- Frey, Bruno S. and Jana Gallus (forthcoming a). Political Economy of Happiness. *Applied Economics*.
- Frey, Bruno S. and Jana Gallus (forthcoming b). Happiness Policy and Economic Development. *International Journal of Happiness and Development*.

Frey, Bruno S. and Alois Stutzer (1999). Measuring Preferences by Subjective Well-Being. *Journal of Institutional and Theoretical Economics (JITE)* 155(4): 755-778. Tübingen: Mohr Siebeck.

Frey, Bruno S. and Alois Stutzer (2009). Should Happiness Be Maximized? In: Amitava K. Dutt and Benjamin Radcliff (eds). *Happiness, Economics and Politics*. Cheltenham, UK, and Northampton, USA: Elgar: 97-126.

Frey, Bruno S. and Alois Stutzer (2012). The use of happiness research for public policy. *Social Choice and Welfare* 38(4): 659-674.

Gregg, Paul (1994). Out of the Count: A Social Scientist's Analysis of the Unemployment Statistics in the UK. *Journal of the Royal Statistical Society, Series A* 157: 253-250.

Huxley, Aldous (1932). *Brave New World*. London: Chatto and Windus.

Koen, Vincent and Paul Joseph Van den Noord (2005). Fiscal Gimmickry in Europe: One-off Measures and Creative Accounting. *OECD Economic Department Working Paper* No. 417.

Milesi-Ferretti, Gian Maria (2004). Good, bad or ugly? On the effects of fiscal rules with creative accounting. *Journal of Public Economics* 88: 377-394.

Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2009). *Die Zukunft nicht aufs Spiel setzen*. <http://www.sachverstaendigenrat-wirtschaft.de/jahresgutachten-2009-2010.html> (Last accessed June 18, 2012).

Schneider, Friedrich (ed.) (2011). *Handbook on the Shadow Economy*. Cheltenham, UK, Northampton, MA, USA: Edward Elgar.

Schneider, Friedrich and Dominik Enste (2002). *The Shadow Economy: Theoretical Approaches, Empirical Studies, and Political Implications* Cambridge (UK): Cambridge University Press.

Simmons, Joseph P., Leif D. Nelson and Uri Simonsohn (2011). False-Positive Psychology: Undisclosed Flexibility in Data Collection and Analysis Allows Presenting Anything as Significant. *Psychological Science* 22: 1359-1366.

The Economist (2012a). California – Not quite Greek, but still weak. *The Economist*. June 16th, 2012.

The Economist (2012b). Official statistics – Don't lie to me, Argentina. *The Economist*. Feb. 25th, 2012: 12.

Torgler, Benno, Friedrich Schneider and Christoph Schaltegger (2010). Local autonomy, tax morale, and the shadow economy. *Public Choice* 144(1): 293-321.

Von Hagen, Jürgen and Guntram B. Wolff (2006). What do deficits tell us about debt? Empirical evidence on creative accounting with fiscal rules in the EU. *Discussion Papers* 148, SFB/TR 15 Governance and the Efficiency of Economic Systems, Free University of Berlin, Humboldt University of Berlin, University of Bonn, University of Mannheim, University of Munich.

Webster, David (2002). Unemployment. How Official Statistics Distort Analysis and Policy and Why. *Radical Statistics* 79/80.