

CONTROVERSY

ECONOMICS AND HAPPINESS*

Editorial Note

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In 1749, Ludovico Antonio Muratori, published a book titled *Della Pubblica Felicità* that introduced the use of the word ‘public happiness’. He saw public policy as seeking to find the best economic means to achieve the ‘public happiness’. Other contemporary Italian economists¹ developed the link between the theory of value (based on the individual’s calculus between pleasure and pain) and the theory of public policy based on ‘public happiness’. The historical foundations of the modern economic model of individual choice were largely utilitarian. Many neoclassical economists in the late 19th and early 20th century would have considered themselves to be utilitarians: Edgeworth, Jevons and Wicksteed to name a few. For such economists, ‘utility’ was a word that referred to something substantial, a mental state which might someday be measured. Edgeworth named the as yet uninvented machine to measure utility the ‘Hedonometer’. This view was by no means universal: Marshall was one of the most notable critics of the utilitarian viewpoint in his *Principles*, at least in its more extreme hedonist version.

However, since the Second World War, the conventional view has been that there is no place for utility in this substantial sense. ‘Utility’ is just a number given to possible outcomes that can in some sense explain or predict choices. The reasons for this switch were quite compelling. First, the rejection of the notion that utility was in principle measurable. Since satisfaction/pleasure and happiness are purely subjective, the idea of an objective scientific measure of utility is put into question.² Secondly, the development of ordinal utility theory showed that cardinal utility was unnecessary for economics, even for much of welfare economics. Since it was both suspect and unnecessary, the utilitarian foundations of choice theory were rejected, although the vocabulary lived on. Together, these arguments have proven persuasive to most of the economics profession for the last half-century.

Things may, however, be changing. This controversy brings together three economists from different backgrounds who all believe that happiness should

* I would like to thank Andrew Clark for helping me to set up this controversy, and Massimo Paradiso for informing me about the early Italian utilitarians.

¹ The most notable examples being the Neapolitans Antonio Genovesi and Giuseppe Palmieri writing in the 1760s.

² However, it is not precluded. Hot and cold were for most of human history purely subjective sensations, subject to many ambiguities and seeming paradoxes. That has not meant that we have been unable to develop an objective measure of temperature that is closely related to the subjective.

take a more central role in economics once again.³ They all share the view that it makes some sense to talk of ‘measuring’ utility. This is done not by placing electrodes on the heads of people (although that may come), but by asking people questions. Whilst this may well not be an exact way of measuring an individual’s well-being, the answers to such questions from a large number of people can be used as a guide to what factors in general make people feel happier. In particular, we can certainly use this sort of data to explore some of the basic maintained hypotheses of economics: for example, the notion that utility is an increasing function of income at the individual and aggregate level.

Andrew Oswald opens the controversy with a paper that focuses on the empirical side of what we can find from existing data on happiness and its relation to economic performance. He presents several findings which he draws from the data. One of the first economists to take a look at these data was Richard Easterlin in 1974. He formulated the hypothesis that well-being depends on relative income, not absolute income: this arose from the consideration of cross-country comparisons, and within country time-series. Oswald argues that using US data, there is a very small tendency for happiness to be increasing over the post-war period: the results are similar but much more mixed in Europe. For Oswald, the evidence is quite clear that whilst money might buy a little happiness, it does not buy very much. On the other hand, there are certain factors which do seem to influence overall well-being: for example, happiness is U-shaped in age with a minimum in the early thirties, unemployment makes people very unhappy and so on. There is clearly plenty of data available on well-being, and it should – Oswald argues – be used by economists.

Bob Frank explores in some detail the policy implications of the Easterlin hypothesis. He draws the conclusion from the data that relative consumption determines well-being (this was an idea also put forward by Fred Hirsch and Tibor Scitovsky in the mid-1970s, among others). If every one in a society seeks to maximise their own welfare, then there is an externality present: an increase in my own consumption makes me better off relative to you, and hence my consumption decreases your utility. The end result is that the equilibrium in society is inefficient: we all end up consuming more than is socially optimal. Since consumption uses up resources, we can all gain if we consume less: with lower average consumption across the population, utility would not be reduced. However, the real resources released from the production of consumer goods (including durables and housing) would be released for other uses (education, health and leisure), which could make everyone better off. This is a very simple argument, but it has powerful and clear policy implications. Frank himself argues strongly for a consumption tax as a practical implication of his analysis.

Yew Kwang Ng approaches the problem from the perspective of a traditional welfare economist. He argues very strongly against the orthodox

³ Of course, one might accept that one can measure well-being to some degree of accuracy, yet still reject the notion of a utilitarian social welfare function or moral system. The arguments for and against utilitarianism as a moral system are perhaps as extensive as they are inconclusive.

view that cardinal notions of utility should be rejected. Whilst he accepts that there are measurement problems, he believes that it makes sense to talk about cardinal utility, and that it is certainly more in tune with common sense than the pure ordinalist's view. If we accept this, then the whole focus of welfare economics (and indeed economics as a whole) should shift towards a science of promoting well-being and happiness. Conventional measures of welfare such as *per-capita* GDP are highly misleading if this is our objective. Like Frank, he argues that great increases in well being can be achieved if we take happiness seriously.

Perhaps more 200 years after Muratori argued for founding public policy on the notions of private and public happiness, it is time for economists to re-evaluate the foundations of their prejudices. Perhaps by excluding notions of well-being and happiness from economics, we have created an artificial limitation which precludes economics from answering some of the most important questions. Whilst the Hedonometer may take some years to be invented, you can reach your own conclusion after reading these three persuasive papers.

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