Section 8: Well-Being and Economics

"I take that economics is concerned with the best way of promoting human satisfaction in a world of scarce resources" Jon Elster.

A key theme in behavioural economics is what is the best measure of welfare of individuals and countries. A huge literature has debated whether it is money that makes people better off or whether we need to look at an alternative measure.

Determinants of well-being

The most famous paper on this area is by Brickman, Coates & Janoff-Bulman (1978). The results showed that people who won the lottery and people who were rendered paraplegic by an accident initially experienced big changes in well-being in the expected direction but they expected to converge back to their base levels. Additionally, the lottery winners did not derive any more pleasure from everyday activities. This is in line with a big literature arguing that well-being is set to a fixed point determined by genetics, upbringing, disposition etc., and that it is not very malleable to changes in external factors like income.

Can we predict what events make us happy?

People like Kahneman and others have argued that the focusing illusion effect might come into play when we think of what life would be like after some external change. For example, Schkade & Kahneman (1998) showed that people think they would be happier if they lived in California (nice weather etc.,) but, in fact, Californians are no happier than New Yorkers (same working stresses etc.,). We think it would be nicer to live in California because we focus on the most salient piece of information that comes to mind when we think about it, e.g. the nice weather. More succinctly, Kahneman explains the focusing illusion by arguing that "Nothing In Life Is As Important As You Think It Is, While You Are Thinking About It". A more recent paper asks the question "would you be happier if you were richer?" again arguing that people overfocus on the benefits of money when making counterfactual judgments.

Conceptualisations of well-being

So life-satisfaction and emotional well-being seem to be tapping into two very different things. Most of the papers in the literature deal with levels of income rather than sudden once-off increases in income. It might be the case a that helicopter drop of money places so much exertion on the self-control of the beneficiary that it reduces their well-being, particularly if the person has no experience managing the various complexities (both social and financial) that accompany their new-found wealth.

In general, well-being can be conceptualised in a number of different ways. The standard concept is to think of utility deriving from consumption. In textbook microeconomics, individuals are assumed to have well-defined preferences and operate in well-functioning markets in conditions of strong information. Provided we make a set of assumptions about how people make decisions (known as the axioms of choice), then the behaviour of people in markets can be said to reveal their preferences and provide a measure of their welfare. A strong advantage of this approach is that it does not require us to make interpersonal comparisons of utility nor does it require us to directly measure well-being.

Measurements of wellbeing

WHO 5 WELL-BEING QUESTIONNAIRE

Please, indicate for each of the five statements which is closest to how you have been feeling over the last two weeks. Notice that higher numbers mean better well-being.

Example: if you have felt cheerful and in good spirits more than half of the time during the last two weeks, put a stick in the box with the number 3 in the upper right corner.

	Over the last two weeks	All the time	Most of the time	More than half of the time	Less than half of the time	Some of the time	At no time
1	I have felt cheerful and in good spirits	5 ☐	4 ☐	3 ☐	2 ☐	1 ☐	0 ☐
2	I have felt calm and relaxed	5 ☐	4 ☐	3 ☐	2 ☐	1 ☐	0 ☐
3	I have felt active and vigorous	5 ☐	4 ☐	3 ☐	2 ☐	1 ☐	0 ☐
4	I woke up feeling fresh and rested	5 ☐	4 ☐	3 ☐	2 ☐	1 ☐	0 ☐
5	My daily life has been filled with things that interest me	5 ☐	4 ☐	3 ☐	2 ☐	1 ☐	0 ☐

Fig 2. The WHO 5

Direct measurements of well-being take many forms. The most simple and widely used is the single-item global assessment of happiness (also called emotional wellbeing), which essentially asks people to rate their subjective happiness on a ten-point scale. This measure is simple and clear and has been included in many of the world's largest survey exercises and has been studied substantially. Fig 2 shows the World Health Organisation's measure for recent emotional well-being.

A more cognitive approach is to elicit subjective evaluation of one's position, generally conducted by asking life satisfaction on a scale of 1-10. You find this in many longitudinal data-sets; the NCDS, G-SOEP and World Values Survey all ask "*How satisfied are you with your life, all things considered*?" or something similar.

Happiness/emotional wellbeing and life satisfaction may seem similar and are indeed highly correlated, but they are measuring different facets of well-being. Happiness assesses an affective component and life-satisfaction a cognitive component. It is too restrictive to suggest that well-being is a uni-dimensional construct and there are many attempts to conceptualise the multi-dimensional nature of well-being. One of the most commonly used in the economics literature is the idea that one derives satisfaction in different life-domains such as finance, health, marriage and so on. As outlined by Van-Praag et al, overall welfare can be viewed as a sum of satisfaction in each of the life domains along with information about the relative weighting of each domain in the overall life satisfaction.

The Easterlin Paradox

The biggest development of the view that economic growth does not imply well-being is that of the demographer Richard Easterlin. Easterlin first documented the Easterlin paradox (1974), a decoupling of well-being from economic growth particularly at higher levels of income. This paradox has been hotly contested in the literature and its ramifications are, of course, staggering. A recent paper by Stephenson and Wolfers (2013) calls the Easterlin Paradox into question. Using the global Gallup world health and well-being survey, they find strong evidence that economic welfare and well-being are strongly related, even at very high levels of income. The strength of their results led one commentator on the paper (Alan Kreuger) to suggest that the Easterlin paradox be renamed the Easterlin conjecture.

Eastern & Angelescu (2009) hit back strongly at these results, arguing that they confuse the implications of the original argument. They restate the Easterlin paradox starkly as: "Simply stated, the happiness-income paradox is this: at a point in time happiness varies directly with income, but over time happiness does not increase when a country's income increases" (p2). Furthermore, they argue strongly that the Stephenson and Wolfers paper commits a logical fallacy: "As will be seen, the dissenting view appears to be largely the result of failing to distinguish between the short- and long-term temporal relationship between happiness and income. Over the short-term, when fluctuations in macroeconomic conditions dominate the relationship, happiness and income are positively related. Over the long-term, happiness and income are unrelated" (p2).

Individual determinants of well-being

A recent review by Dolan, Peasgood and White provides a detailed review of the literature on the determinants of well-being. They highlight poor health, separation, unemployment and lack of social contact as factors that are substantially negatively associated with well-being. Their review also highlights the considerable evidence against income being a strong driver of well-being beyond a certain level.

Hsee and colleagues argue that money contributes to happiness to the extent that it can contribute to the purchase of what he calls "inherently evaluable" goods, which are goods that contribute to some basic primary need e.g. the need for basic social interaction, shelter, food, freedom from pain and so on. These are distinct from "inherently inevaluable" goods, where the consumption experience depends on the relative desirability of the good. The authors give the example that people need to learn that a higher karat diamond is more valuable than a lower karat one; it is not something they innately understand. Most financial improvements are evaluated relative to social benchmarks and many are subject to phenomena such as hedonic treadmills, habituation and social reference effects.

Unemployment and wellbeing

A 2008 review by Blanchflower points to a negative effect of unemployment on well-being both at individual and aggregate level. Wolfers (2003) shows that both unemployment and inflation decrease well-being and also finds a volatility effect, with more volatility independently lowering well-being. In general, there does not seem to be papers that argue against a causal effect of unemployment on well-being but contact us if we've missed any.

Readings

Blanchflower (2008), International Evidence on Well-being, IZA Discussion Paper

Brickman et al. (1978), Lottery Winners and Accident Victims: Is Happiness Relative? Journal of Personality and Social Psychology

Daly & Wilson (2008), Happiness, Unhappiness, and Suicide: An Empirical Assessment, Working Paper

Dolan et al (2008), Do we really know what makes us happy? A review of the economic literature on the factors associated with subjective well-being, Journal of Economic Psychology

Easterlin (1974), Does Economic Growth Improve the Human Lot? Some Empirical Evidence, Nations and Households in Economic Growth

Easterlin & Angelescu (2009), Happiness and Growth the World Over: Time Series Evidence on the Happiness-Income Paradox, IZA Discussion Paper

Goodman et al. (2011), The long shadow cast by childhood physical and mental problems on adult life, PNAS

Knabe et al. (2010), Dissatisfied with Life but Having a Good Day: Time-use and Well-being of the Unemployed, The Economic Journal

Hsee et al. (2008), Wealth, Warmth and Wellbeing, Journal of Marketing Science

Kahneman et al. (2006), Would You Be Happier If You Were Richer? A Focusing Illusion ,Science

Stevenson & Wolfers (2013), Subjective Well-Being and Income: Is There Any Evidence of Satiation?, American Economic Review

Schkade & Kahneman (1998), Does Living in California Make People Happy? A Focusing Illusion in Judgments of Life Satisfaction, Psychological Science

Van Praag , Frijters & Ferrer-i-Carbonell (2003), The anatomy of subjective well-being, Journal of Economic Behaviour & Organization

Wolfers (2003), Is Business Cycle Volatility Costly? Evidence from Surveys of Subjective Wellbeing, NBER Working Paper

Further Readings on the Measurement of Wellbeing

Bylsma, Taylor-Clift & Rottenberg (2011). Emotional reactivity to daily events in major and minor depression. Journal of Abnormal Psychology

Dockray et al. (2010), A comparison of affect ratings obtained with ecological momentary assessment and the Day Reconstruction Method, Social Indicators Research.

Kim et al. (2012). Systematic comparison between ecological momentary assessment and day reconstruction method for fatigue and mood states in healthy adults, British Journal of Health Psychology

Miret et al. (2012). Validation of a measure of subjective well-being: an abbreviated version of the Day Reconstruction Method, PLoS ONE