

BY ALLEN R. SANDERSON

**Way back in 1971,** the Swedish Academy of Arts and Sciences awarded a Nobel Prize to the Russian-born economist Simon Kuznets of Harvard for one of the most significant contributions to economics in the 20th century: the construction of national income accounts, which made it practical to measure aggregate output and to begin to understand the nature and causes of economic growth. But even then, analysts were warning users that the accounts were conceptually flawed.

For example, GNP (or, GDP, its locationally focused equivalent in wider use today) was of limited value as a measure of output because it did not take account of the benefits flowing from leisure time and unpaid housework. By the same token, it did not include illegal and off-the-books transactions. But it did include some items that really didn't belong – expenditures that offset costs to society like crime prevention and outlays to clean up pollutants. With these cautions in tow, however, it was only a short (almost irresistible) leap to associate GNP with a country's well-being. More income, it was implicitly assumed, translated not only as a higher standard of living but also as more happiness for individuals.

While it is difficult to reconstruct the rise of criticism of this money-equals-happiness paradigm, some landmarks stand out. John Kenneth Galbraith's 1958 bestseller, *The Affluent Society*, pointed to inequalities of wealth in general and, more specifically, to overdependence on material possessions and an imbalance between the private and public

sectors. Then there was the boomlet in anti-materialism in the 1970s – the rise of a popular environmental movement (the first Earth Day was in 1970) and the publication of the British economist E.F. Schumacher's *Small Is Beautiful* in the spasm of soul-searching coinciding with the first global oil shock in 1973.

Perhaps the most poignant critique of GNP worship came earlier (in 1968) from the presidential candidate Robert F. Kennedy:

Too much and too long, we seem to have surrendered community excellence and community values in the mere accumulation of material things. Our gross national product ... if we should judge America by that – counts air pollution and cigarette advertising and ambulances to clear our highways of carnage. It counts special locks for our doors and the jails for those who break them. It counts the destruction of our redwoods and the loss of our natural wonder in chaotic sprawl. It counts napalm and the cost of a nuclear warhead, and armored cars for police who fight riots in our streets. It counts Whitman's rifle and Speck's knife, and the television programs which glorify violence in order to sell toys to our children.

Yet the gross national product does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or

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ALLEN SANDERSON is a senior lecturer in economics at the University of Chicago.



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the strength of our marriages, the intelligence of our public debate or the integrity of our public officials. It measures neither our wit nor our courage, neither our wisdom nor our learning, neither our compassion nor our devotion to our country; it measures everything, in short, except that which makes life worthwhile. And it tells us everything about America except why we are proud that we are Americans.

Early economists, including Adam Smith, Jeremy Bentham and John Stuart Mill, had surely thought about the uncertain link between income and happiness. But then the subject seems to have disappeared from economists' radar screens until the middle of the 20th century. Only in the last 40 years have economists returned to a territory staked out by psychologists, philosophers and social activists. Time will tell if they merit the claim.

It is hard to tell the players without a very large scorecard, but what follows is a "greatest hits" view of what one may term happiness research. At the moment, the objective measurement of subjective well-being is perhaps *the* hot topic among economists and psychologists (the intersection of the two fields is known as behavioral economics).

### **THE PIONEERS: MEASURED ECONOMIC WELFARE**

In 1972, William Nordhaus and the soon-to-be Nobel Prize winner James Tobin, both at Yale, developed the measured economic welfare (MEW) concept in an attempt to analyze whether conventional measures of growth were fundamentally misleading. In his principles textbook, Paul Samuelson, used the term Net Economic Welfare (NEW) with an appropriate bow to his Yale counterparts. MEW was designed to correct the income accounts for negative aspects of production and growth – hence the relevance of the "net" terminology.

While some of the factors included by

Nordhaus and Tobin – leisure time, nonmarket production and the flows of service from consumer durables like houses and cars – actually increased income measures, these were more than offset by the negatives (for example, the costs of urbanization, including commuting to work). The rate of economic progress was a bit lower when calculated as the change in MEW rather than the change in GDP because the aforementioned negatives were growing faster than the positives.

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The Human Development Index, created in 1990 by the United Nations, extended the logic driving the MEW revisions. The HDI is built around a conventional measure of per capita output, but leavens the index with other factors ranging from health to education to inequality. In broad terms, countries are divided into four categories ranging from "very high" to "low" human development.

No big surprises here, in large part because many of these factors correlate highly with per capita income. Norway, Australia and New Zealand rank one, two and three in the 2010 HDI, while Zimbabwe, the Democratic Republic of the Congo and Niger bring up the rear. But a look at the rankings might still raise an eyebrow or two, most likely because of the inclusion of education and quality-of-life variables. For example, South Korea comes out ahead of most of Western Europe,

while Greece trumps Britain and Italy, and Hungary tops superrich Qatar and Bahrain.

Perhaps the most rigorous attempt to follow up on MEW comes from a panel, the Commission on the Measurement of Economic Performance and Social Progress, created by Nicolas Sarkozy, the president of

line with the Human Development Index. But the report (downloadable free at <http://www.stiglitz-sen-fitoussi.fr/en/index.htm>) is less a step forward than a compilation of the vast challenges to moving forward in a disciplined fashion. Meanwhile, it's fair to say that much of the effort to second-guess the na-



France. The commission, headed by the Nobel laureates Joseph Stiglitz and Amartya Sen and the French academic economist Jean-Paul Fitoussi, summarized the shortcomings of conventional national income accounting. In particular, it pointed to a variety of weak links: the failure to account for household output, environmental goods and costs and a host of quality-of-life issues ranging from income inequality to personal income security to social mobility – in spirit, in

tional income accounts has been distinguished by ideology rather than scholarship.

The environmental economist Herman Daly, then at the World Bank, and the theologian John Cobb started the ball rolling in the late 1980s. They coined a new term, “sustainability,” that is now firmly entrenched in the language of public policy. In accounting for the costs associated with ecological degradation and depreciation of capital assets, the Index of Sustainable Economic Welfare not

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only yielded lower estimates of net output, but lower – sometimes even negative – growth rates. The ISEW was soon followed by the development of a larger, more comprehensive metric in the same spirit, the Genuine Progress Indicator, which enjoys a higher domestic and international profile.

This expansion of what counts in the accounts subsequently proved to be a very slippery slope. Consider the Happy Planet Index, created by the British New Economics Foundation, which describes itself “an independent think-and-do tank that inspires and demonstrates real economic well-being.” The HPI mixes the objective (life expectancy)

private sector via taxes and borrowing to produce “goods” that do not add to well-being. Thus, such production should be tallied as a cost on balance sheets, not as output.

### **SOMETHING ENTIRELY DIFFERENT**

There are lots of good reasons to maintain (and refine) national income accounts. Implicit in many variants, of course, is the assumption that the production of goods and services (properly defined) generates well-being. And, to a point, that isn't controversial: getting enough to eat and protection against the elements matter a lot to everybody. But in modern societies that provide at least the minimum for subsistence, it's not clear that

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with the less objective (life satisfaction and ecological footprint) to produce truly bizarre rankings. Costa Rica comes in first among 143 countries – a plausible choice, if life satisfaction has more to do with income equality and social justice than with average material well-being. But then it descends into Bizarro World: the Dominican Republic, Jamaica, Guatemala, Vietnam, Colombia, Cuba, El Salvador, Brazil and Honduras round out the Top 10. Wait, we're not done: Norway, Canada, Denmark, Australia and New Zealand fight it out with the likes of Belarus, Zimbabwe and both Congos near the bottom of the pecking order.

This, by the way, is a game the ideological right can play, too – though perhaps not as enthusiastically as the left. The libertarian economist Murray Rothbard introduced the Gross Private Product, calculated as GDP less all government goods and services. The rationale: governments siphon resources from the

more is always more. One eloquent frontal assault on material accounting comes from Arthur Brooks, now the president of the American Enterprise Institute. His book *Gross National Happiness: Why Happiness Matters for America – and How We Can Get More of It* infers from a variety of data that the happiest Americans are those with traditional values: religious faith, belief in hard work and stable families. By the same token, the roadblocks to happiness include secularism, reliance on the state to solve problems and a preference for security over individual freedom.

Brooks is a social conservative, and his conclusions fit his worldview. But the evidence of what makes people happy allows for plenty of ideological wiggle room. Derek Bok, a former president of Harvard (and a political progressive), has also gotten into the fray with his 2010 book, *The Politics of Happiness*. Bok acknowledges the limitations of the welfare state in making people happy. But he ar-



gues that government still has a substantial role to play in bridging the gap between production and subjective satisfaction.

The Princeton/Obama administration economist Alan Krueger and his Nobel laureate colleague, the psychologist Daniel Kahneman, approach the puzzle from another angle. They use surveys to measure how people spend their time on everything from work to child care to channel surfing – and how pleasant or unpleasant the experiences are. While the National Time Accounting effort is in its infancy, it offers promise for comparing individuals and nations. In particular, the researchers focus on the “U-Index” of intensely unpleasant activities, which they argue allows the use of subjective reporting to make interpersonal comparisons of well-being.

All told, the jury is still out on whether efforts to improve on Kuznets’ national accounting approach to measuring society’s product represent net improvements. There is little doubt, though, that the endeavor has appropriately focused attention on (a) the degree to which happiness is derived from material well-being, and (b) the place of government in promoting happiness.

#### **THE EASTERLIN PARADOX**

In the 1970s, the demographer Richard Easterlin, now at the University of Southern California, discovered that there was no statistical correlation between a country’s material living standard and self-reported well-being, especially after some modest threshold level of income has been reached. (Recent research by Richard Layard of the London School of Economics

pegged this threshold at about \$15,000.)

But more recent re-examinations by Justin Wolfers and Betsey Stevenson of the University of Pennsylvania and Angus Deaton of Princeton have challenged this conclusion. They find that if one plots a proxy for happiness (“life satisfaction”) against per capita in-



come, then happiness appears to level off in the middle-income range (as Easterlin’s research suggested). But a closer look, with much richer data than Easterlin originally employed, suggests that subjective happiness is logarithmically correlated with income.

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That is, the impact of an extra dollar of income is less potent as income grows, but the relationship remains positive. Indeed, among rich countries, a given *percentage change* in income has considerably more impact on life satisfaction than among poor countries.

This debate is hardly over, however. Wolfers and company focused on cross-country comparisons at one moment in time. Easterlin's newest research, written with colleagues at USC, suggests that the correlation disappears when one measures happiness and income for one country over a decade or more.

Note that the Easterlin Paradox, if true, constitutes the equivalent of a "disruptive" technology – a proposition that upends much of the logic of modern economics. First and foremost, it raises questions about the purpose of economic growth beyond the levels already achieved by middle-income countries. If growth doesn't generate a net increase in personal satisfaction, what is the point? Or to put it another way: if growth doesn't lead to happiness, why should we ask people to delay material gratification by accumulating capital, or to strain the carrying capacity of the global environment to achieve it?

Then there is the question of progressive taxation. The justification for taking from the rich to give to the poor hinges in large part on the assumption that such redistribution enhances overall societal welfare. But can societal welfare be separated from the sum of individual welfare – which, by Easterlin's analysis, doesn't increase much as income reaches modest levels?

### **WHAT'S IT ALL ABOUT?**

Material output, we have been forcefully reminded, does not tell us all we need to know in order to assess the success of an economy in meeting the goals of its citizens. On the

other hand, it is highly unlikely that we will ever reach a consensus on an alternative metric that adjusts output for imperfectly definable concepts like sustainability or intangible ones like social justice. And few of us, I would suspect, would be prepared to live by the implications of the Easterlin Paradox.

In 1850, life expectancy in the United States and Western Europe was about 40 years; today it's close to 80, and the probability of living a long life is not nearly as closely tied to where one stands in the economic pecking order. A century ago, the United States was the richest country on earth (today, by the way, that honor probably goes to Norway). Yet at the dawn of the 20th century, few Americans had electricity or running water. None, of course, had access to antibiotics or could travel across the ocean in a few hours at little risk. What happened to the United States in the 19th and 20th centuries is being replicated in less developed countries, where the portion of the population living at (or below) subsistence has fallen drastically in just a few decades.

Many considerations other than income – family cohesion, social stability and the like – loom large in our collective sense of happiness. But if you could choose any time to be born in the long sweep of human history, the smart money is clearly on 2012. And while the residents of Europe and North America may have reached a standard of living that makes us question the value of further material gain, don't forget that this is a luxury not available to two-thirds of the planet's inhabitants. Perhaps someday, we'll be able to focus on indices of happiness rather than unemployment or growth or inflation. But for now, GDP and income per person may still be the best measures of well-being, if only because they correlate so strongly with access to the basics of a long and rewarding life. **M**