
Happiness policy and economic development

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Abstract: Governments have paid great attention to the results of happiness research. In many countries, the object of government policy is no longer taken to be development in terms of raising GNP. Their focus has shifted to a *National Index of Happiness*. This paper analyses whether such an aggregate Happiness Index is a better guide to development than GNP or other indices of development. We 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 in order to further its own interests. As a result, the National Happiness Index will lose its informational quality and will no longer serve as a measure of true happiness in the process of economic development.

Keywords: happiness; subjective well-being; life satisfaction; policy; economic development; economic indicators; manipulation principle; political economy.

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1 Introduction

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 rising income on happiness is of utmost importance. Some prominent authors – notably Easterlin (1973) – have argued that rising income does not raise happiness due to adaptation and comparison effects. If this was the case – 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’ (see e.g., Clark et al., 2008), which states that rising incomes do not raise happiness, 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 decentralised 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 rate of unemployment is rising.

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 object of government policy is no longer taken to be development in terms of raising gross national product (GNP) but rather consists in raising, if not maximising, a *National Index of Happiness*.

This paper 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’ (HDI).¹ We 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 in order 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 measure of true happiness in the process of development.

The paper advances five specific claims:

- 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; the politically induced distortions cannot be fully eliminated, but this is a deficiency all indicators suffer from. Functioning democracies offer fewer possibilities for manipulation than do authoritarian regimes.
- 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. Such competition between indices will by itself be an incentive for politicians to propose correct indices if they want them to stand a chance of being observed by the public. This constitutes the first implication of a competition between different indices: it deters the creation of biased indices *ex ante*. There is also a second effect: the multitude of indicators, which compete against one another, makes it difficult – if not impossible – to manipulate the different indices *ex post*. Where only one happiness index exists, it is arguably much easier to be manipulated.
- 5 The various happiness indices should be used in conjunction with existing material indices of development.

As should have become clear, we do not compare the construction of the various subjective and material indices of development as such. There is an extensive literature devoted to this task and we see no need to repeat these contributions. Rather, this paper looks at the indices from the point of view of *political economy*, an approach that to our knowledge has so far been disregarded.²

Section 1 shortly discusses the incentives and possibilities of individuals to strategically misrepresent their preferences when asked in happiness surveys. Section 2 is devoted to the more important influence exerted by the government when manipulating the National Happiness Index. The following section considers the possibilities to mitigate such manipulation of the National Happiness Index. Section 4 concludes by suggesting what index or indices should be used to analyse development and to formulate adequate policies.

2 Indices and strategic misrepresentation

The material development indices such as the GNP or the HDI 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 maximise 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 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.

3 Manipulation by 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 debt.³ 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 the above-mentioned economic factors. He 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; 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; Schneider 2011; Torgler et al., 2010).

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).

Broader indicators of economic development, such as the HDI, also offer governments substantial possibilities for manipulation. It is, in particular, quite easy to distort the share of the population achieving some extent of education, as well as the average life span.

Politicians have an even stronger *incentive* to manipulate the *National Happiness Index* in their favour. 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 of 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.⁴

This is primarily the fact because the National Happiness Index is based on subjective evaluations of survey respondents. These can be manipulated more easily than indicators based on more objective data, such as the GNP. For instance, the responses can be influenced by the order of the questions (Deaton, 2012). 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.⁵ 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). Subjective data also incite even more outright cheating on the part of the 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 policy goal, 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, this index will no longer serve as a reliable indicator of the population's well-being. For the surveys on individual life satisfaction to remain informative and useful for policy conclusions, the incentives to manipulate their results need to be minimised. This can be done for example by having a multitude of indices of well-being, such that a manipulation of a single index is not worth the effort. The following section adduces further conditions that – when respected – explain why such subjective indicators can still be valid and reliable. Under these conditions, happiness indices provide an important basis from which policy implications can be derived, allowing to look beyond the purely economic facts and to adopt a more comprehensive perspective.

4 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 dictatorial or authoritarian political systems and is therefore relevant for many economically less developed countries. But even these governments to some extent need the support of their populations. Pure dictatorships for instance are restrained in their actions by the risks of either a political uprising or a passive resistance by the population. The economic base – which such regimes rely on in order to subsist – is also threatened by an exodus of the economically most productive and creative members. History shows that it is in fact 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 a favourable manipulation of the National Happiness Indicator.

Politicians in democratic countries may possibly be as power-ridden as authoritarian rulers, but they are more constrained by constitutional limits. 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 organisations and groups, including political parties. In a democracy, the government's means of manipulating the National Happiness Index are reduced. 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. Politically independent private and public 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 criticise 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 that it is possible to completely isolate a public institution from the political power play. Furthermore, statistical offices are used to working with objective data. They tend to refrain from dealing with subjective data.

A solution for overcoming the strong incentives and possibilities of the 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. A particular government will thus have to offer a qualitatively convincing indicator if it wants this indicator to be regarded by the public. In addition to this *ex ante* incentive effect, competition between various indicators also makes it less worthwhile for government to try to manipulate one of the indicators *ex post*.

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 is 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 maximise, 'the' national happiness corresponds to a technocratic view of society.

5 What indicators for development? Summary and policy conclusions

Economic and social development cannot be captured by one single indicator. Material indicators fall short of providing a comprehensive picture of a country's population's

well-being. However, the recent propagation of a National Happiness Index as the ultimate indicator of development is also mistaken. As argued in this paper, such a unique indicator will be even more strongly manipulated by governments than the existing main economic indicator, the GNP, or 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, the 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. Independent organisations that operate on an international level can help by providing benchmarks against which to compare the indicators propagated by the respective governments. To capture the state of development, it is 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 the government should construct a unique National Happiness Index so as to capture the level and development of well-being in society should also 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 a policy goal, academics and the wider public should support exactly the opposite: *many different happiness indices*, which are to be in competition with each other. This will enable the individual citizen to compare the different indices and to choose the one, or the ones, that one sees fit. These 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 the democratic setting.

The preferred solution is therefore that a country's institutions guarantee the possibility for organisations that are independent of government to propose their own happiness indices, which can then enter a competition and thus increase the general quality and reliability of the different indices – including the one propagated by government. Under competition, the single indicators will have a higher probability of being correct because, for instance, politicians who want to propose an indicator have the incentive of presenting a correct one if they want it to be regarded. Those who introduce an indicator will need to convince the public of their indicator's superiority with respect to the alternative indicators, i.e., they will have to convince with higher quality.

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Notes

- 1 The HDI was initially constructed so as to provide an alternative to the GNP as the principal measure of development. Although it has not replaced the latter, it has become its supplement and is frequently referred to.
- 2 For papers that integrate this perspective, albeit not in the context of development, see notably Frey (2011a) and Frey and Stutzer (2009).
- 3 See e.g., Dafflon and Rossi (1999), Forte (2001), Koen and Van den Noord (2005), Milesi-Ferretti (2004) and Von Hagen and Wolff (2006).
- 4 For a more detailed discussion, see Frey and Gallus (forthcoming).
- 5 As shown, e.g., by Vogel (2002), such strategic ordering can also be used in the case of objective data. While upholding the pretence of neutrality, the selection, ordering and presentation of objective data can implicitly convey normative messages by provoking the audience to make the desired linkages and draw specific conclusions.