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CHAPTER

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Motivation and Happiness Bridge Social Psychology and Economics

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Over the past decade or so, social psychology and economics have established increasingly close interactions. In previous times, there were certainly some economists interested in integrating theories and concepts from social psychology into their own discipline but they had no impact on the field. The situation today is much different. *Economic psychology*, or *psychological economics*—or as it is also sometimes called, *behavioral economics*—has become one of the “hot” fields in economics and attracts scholars from the best universities. Accordingly, the state of knowledge has advanced, as indicated by several recent reviews (e.g., Frey & Stutzer, 2001; Mullainathan & Thaler, 2000; Rabin, 1998). The award in 2002 of the Nobel Prize in *economics* to the *psychologist* Daniel Kahneman gave an “official” stamp of approval, and high publicity, to this interdisciplinary endeavor.

I want to highlight this emerging new field by focusing on two areas—*human motivation* and *subjective well-being* or *happiness*—where the mutual gains of bridging the fields of social psychology and economics can well be illustrated. There are certainly other fields where this could also be done, in particular *behavioral anomalies* or *paradoxes*. The work of social psychologists—above all the seminal article by Kahneman and Tversky (1979) published in *Econometrica*—for some time received considerable attention from economists (e.g., Frey, 1999; Machina, 1987; Schoemaker, 1982; Thaler, 1992). But orthodox economics has not yet been sustainably affected by these scholars’ insights. I hope and expect that the inputs into economics from social psychology with respect to motivation and well-being will have a more lasting effect.

It seems to me that the converse flow—from economics into social psychology—has been less marked. Few contributions from economics seem to have entered the canon of social psychology. Important reasons may be that economists rarely publish in psychological outlets and that economists have the tendency to write their contributions in the very specific economic jargon. But there are indications that this will be different with respect to human motivation and subjective well-being.

HUMAN MOTIVATION

Economics has a generally accepted rational theory to explain human behavior. Individuals are assumed to maximize their own utility subject to a set of constraints, most importantly income. Preferences are taken to be constant. It follows that individuals react systematically to changes in relative prices. In particular, they reduce an activity (e.g., the consumption of a particular good or service) when its cost (or price) rises compared to other activities, keeping other influences constant (*ceteris paribus*). Economists accordingly predict changes in behavior by observing the measurable changes in costs. Thus, for instance, when the cost of polluting the environment rises (e.g., because a tax has been imposed on the exhaust of pollutants), individuals and firms are expected to alter their behavior so as to emit less pollution. They have a selfish incentive to change their behavior (in our case, to switch to a car or a production process with less pollution). Econometric analyses with many different real-life data have indeed demonstrated that this model of behavior applies under a wide set of conditions.

This model has successfully been extended to areas outside the economy. Economists have, for instance, made noteworthy contributions to decisions in the family, especially on marriage, the number of children, abortion, and divorce, on drug addiction, or on religious practice. This “economic” or “rational choice” approach to the social sciences (Becker, 1976; Frey, 1999, 2001; Lazear, 2000) has considerably influenced other social sciences, most notably political science (“public choice”), sociology, and jurisprudence (“law and economics”). One of the great advantages of this model of human behavior is that it is simple and robust and can therefore be applied to many conditions and areas of study. It provides an overarching, generally accepted theory to economics. In contrast, (social) psychology has identified a great number of detailed effects relating to human behavior. But it is, at least from the point of view of an economist, difficult to see which effect applies when, and what happens if the effects are contradictory. The absence of an overarching and generally accepted sociopsychological theory makes it difficult to determine which effect applies in one area but not in another one. Economists consider the use of a simple, and generally accepted, theory of human behavior a decisive advantage of their science, and it seems to me that social psychology could in this respect learn from economics.

The economic model of behavior is simple—sometimes *too* simple. Most importantly, it has been proved impossible to explain the empirical observation that individuals contribute considerably to a public good, even though withholding such contributions (i.e., free-riding) is the rational choice (at least under anonymity and in one-shot situations). For instance, the expected punishment for tax evasion in most countries is so small that even risk-averse individuals should cheat much more than is actually observed.

To solve such puzzles social psychology has proved to be of great help in the past and is likely to be so also in the future. Economists have long considered only *one* motivational force, namely, *extrinsic incentives*, often—but not necessarily—in the form of monetary rewards. Social psychologists have taught us that it is useful to also consider *intrinsic motivation*. A pertinent example is tax morale. But as long as the two motivations are independent of each other, no major problem arises for economic theory. The dynamic relationship between extrinsic and intrinsic motivation in psychology—often called “hidden costs of rewards” (Lepper & Greene, 1978) or “self-determination theory” (Deci & Ryan, 2000)—introduces a completely new element. When an external intervention strongly undermines intrinsic motivation, the relative price effect is counteracted and the outcome may be the *exact opposite* of the normal prediction by economists. This may be very relevant for economics. For instance, inducing employees to put in more effort by offering them higher compensation may backfire if the employees targeted are thereby also induced to reduce their work morale, a specific kind of intrinsic motivation (Frey & Osterloh, 2002).

The systematic relationship between extrinsic and intrinsic motivation has been introduced into economics as “crowding theory” (Frey, 1997). It takes into account that there may be “crowding out” as well as “crowding in.” This import from social psychology has proved to be useful far beyond the analysis of pay for performance systems. An example is the siting of locally unwanted projects such as a nuclear plant where offering monetary compensation tends to *reduce*, rather than to increase, the willingness of the local population to accept it. Considerable empirical evidence has been collected for many different areas (see Frey & Jegen, 2001, for a survey). Such research should be of interest to social psychologists because the applications extend to important real life situations, which have so far not been treated by them. However, such transfer of results from economics to psychology seems to be rather slow, if it takes place at all.

SUBJECTIVE WELL-BEING

Macroeconomics, the analysis of economic variables such as production, employment, or inflation, works with highly aggregated data. The skillful reduction of the multiple dimensions of these variables into a single one, by using the monetary evaluation by market prices, has allowed economists to develop empirically testable theories of economic growth and fluctuations. Aggregate

income, or gross national product (GNP), has become a generally accepted measure of economic activity and aggregate social welfare used by virtually everyone dealing with economic affairs. This is no small achievement, which might serve as an example to social psychology.

Since the beginning of the 1930s, economists have used utility as a unit to be maximized but have also thought that the concept is immeasurable. Economic theory simply *assumed* that whatever individuals do is the result of maximizing their own utility. Following this approach, even suicide is a utility-maximizing act: It is *revealed* to be superior to any other alternative because otherwise this voluntary act would not have been undertaken.

Insights from social psychology have recently strongly changed this view. Evidence has accumulated that not all behavior is in the individual's own best interest. But to make progress, a measure of utility independent of behavior is needed. Psychologists have convincingly demonstrated that it is indeed possible to approximate individual utility in a useful way by surveys on subjective well-being or happiness (e.g., Kahneman, Diener, & Schwarz, 1999). This enables economics to leave the self-imposed straitjacket of solely revealed preferences and to analyze the determinants of well-being. This is of central importance for economics because it is agreed that the ultimate aim of economic activity is to promote individual happiness.

Research on happiness has become a truly transdisciplinary endeavor. What has been aimed at in many other areas of research has here been achieved in a natural way, serving as a shining example. Economists have above all learned that self-reported data present a most useful addition to the aggregate statistical data sets they normally use. They have, moreover, gained insights into how perceptions and expectations can be dealt with. An example is the rising aspiration level spurred by increasing income. Some of the results of happiness research support the conventional economic views, whereas others clearly contradict the standard assumption of economics (for a comprehensive survey, see Frey & Stutzer, 2002). The standard assumption that when an individual's income increases, utility rises but at a decreasing rate, conforms to standard theory. In contrast, the fact that over time per capita national income rises but reported subjective well-being stays about the same strongly contradicts conventional economics. Another instance refers to the evaluation of unemployment. Following the "new classical macroeconomics" as well as other parts of standard economics, unemployment is voluntary. People choose to leave employment because they find the burden of work and the wages unattractive compared to having leisure as an unemployed person and receiving unemployment compensation. In contrast to this view, but in line with much psychological evidence, happiness research has convincingly established that being unemployed causes significant stress and reduces well-being in a magnitude similar to divorce.

Although economics has profited greatly from social psychology, as far as I am aware this is less so for social psychology. For example, one finds very few references in the psychological literature to works on well-being written by

economists. One potential explanation for the prevalent "reception asymmetry"—for human motivation as well as for subjective well-being—may be the very existence of an overarching theory in economics and the lack thereof in social psychology: Once economists encounter behavior deviating from the standard rational choice prediction, it comes in useful to offer a scientifically well-founded rationale imported from psychology, rather than ad hoc speculation. Psychologists, on the other hand, have little incentive to cite works that—although in principle confirming the applicability of their effects to economic contexts—are reducing these to "aberrations" or "paradoxes" within a general rational choice theory of human behavior.

CONCLUSIONS

Human motivation and happiness research have been taken as examples to demonstrate the fruitfulness of the interaction between social psychologists and economists. These two areas are only examples, and there may be additional areas characterized by intensive interchange. With respect to both motivation and well-being, it appears that economics has learned more from social psychology than social psychology from economics. Economics has amended the relative price effect governing the theory of human behavior by taking into account intrinsic motivation. Even more importantly, it has been taken into account that intrinsic motives may be undermined or raised by external interventions (crowding theory), potentially leading to totally different results from standard economics. Economists have also learned from social psychology that individual surveys on well-being provide important insights. This allows economists to give up the self-imposed restriction that all behavior must by definition be utility-maximizing. It opens the door to a systematic study of deviations from individual rationality. Moreover, it enables identifying the economic determinants of happiness. According to my subjective evaluation, social psychology has not (yet) profited to the same extent from economics—potentially due to the lack of an overarching theory in social psychology—but there are indications that this will change in the future. In my view, there can be little doubt that a more equal flow of insights over the bridge linking social psychology and economics would be beneficial.

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