The Economics of Happiness

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Most of us, I think it is safe to say, would like to be happier, and to hold the "keys to happiness." For centuries this subject was the exclusive preserve of philosophers and theologians, who speculated and offered prescriptions on "the good life." Only fairly recently has it come into the domain of social science, first in psychiatry (where the inverse of happiness, depression, was the object of concern), and then, since around 1950, in the mainstream social sciences. The impetus for social science research in the last half century has been the development of population surveys inquiring into people's feelings of well-being. A very simple survey question, for example, might ask a respondent "In general, how happy would you say you are – very happy, pretty happy, or not so happy?" Another question might be, "How satisfied are you with your life as a whole – very, somewhat, so-so, not very, or not at all?" Each of us, I imagine, could readily respond to such queries on our overall feelings of well-being, as do survey respondents generally.

Over the years a substantial methodological literature has developed on the value of the answers to such questions. The professional consensus is that the responses, though not without their problems, are meaningful and reasonably comparable among groups of individuals. Although there are subtle differences between happiness and life satisfaction, I will treat them for the present purpose as interchangeable measures of overall feelings of well-being, that is, of *subjective* well-being. My focus will be on what we are learning from the survey data on the causes of subjective well-being, and, based on this, what we might do, as individuals, to improve it.

As I go along I shall discuss two prominent and contrasting theories of well-being, one in psychology, one in economics. These are what one might call the "central tendency" currently in each discipline; needless to say there is nothing like unanimity.

In psychology, "set-point theory" has gained increasing attention in the last decade or so. Each individual is thought to have a fixed setpoint of happiness or life satisfaction determined by genetics and personality. Life events such as marriage or divorce, loss of a job, and serious injury or disease may temporarily deflect a person above or below this setpoint, but in time each individual will adjust to the new circumstances, and return to the given setpoint. Psychologists call this adjustment process "hedonic adaptation." One setpoint theory writer states flatly that life circumstances have a negligible role to play in a theory of happiness. If this is correct, then there is little that you or I can do to improve our well-being, and public policies aimed at making people better off by improving their social and economic conditions are fruitless.

In contrast, economics places particular stress on the importance of life circumstances to well-being, particularly one's income and employment situation. The view that money makes you happier finds ringing endorsement in economic theory. The implication is that one can improve one's life satisfaction by getting more money, and that public policy measures aimed at increasing the income of society as a whole will increase well-being.

I shall argue that the accumulating survey evidence indicates that neither of these theories is correct. Contrary to setpoint theory, life events such as marriage, divorce, and serious disability or disease do have lasting effects on happiness. Contrary to what economic theory assumes, more money does not make people happier.

Sources of happiness

My discussion is guided by what people themselves say about what makes them happy. In the early 1960s, social psychologist Hadley Cantril carried out an intensive survey in fourteen countries worldwide, rich and poor, capitalist and communist, asking open-ended questions about what people want out of life – what they would need for their lives to be completely happy. I would like to stress the open-ended nature of Cantril's survey. There have been many surveys of people's values and goals, but almost all present the respondent with a list predetermined by the interviewer. Cantril, in contrast, let each respondent speak for him or herself.

Despite the enormous socio-economic and cultural disparities among the countries, what people said was strikingly similar. In every country, material circumstances, especially level of living, are mentioned most often. Next are family concerns such as a happy family life. This is followed by concerns about one's personal or family health. After this, and about equal in importance, are matters relating to one's work (an interesting job) and to personal character (emotional stability, personal worth, self-discipline, etc.). Concerns about broad international or domestic issues, such as war, political or civil liberty, and social equality, are rarely mentioned. Abrupt changes in these latter circumstances do affect people's sense of well-being at the time they occur, but ordinarily they are taken as a given. Instead, it is the things that occupy most people's everyday life, and are somewhat within their control, that are typically in the forefront of personal concerns – especially making a living, marriage and family, and health. The universality of these concerns helps explain why comparisons of happiness among groups of individuals are meaningful. Although the survey questions leave it open for each individual to define happiness and life satisfaction for him or herself, most people are basing their judgments of well-being on essentially the same considerations.

In what follows I shall discuss the evidence on the relation to happiness of the three circumstances most often named by people as their sources of well-being – material living level, family circumstances, and health. I will focus throughout on average relationships. Needless to say, what is true on average is not necessarily true for each individual; but it is important to be clear on what is typical.

Usually, I'll be reporting the results of survey data – some, but not all, from my own research -- that show how life events affect well-being as people progress through the adult life cycle, from early adulthood through middle age to their retirement years. Most of the generalizations in the social science literature on subjective well-being are based, not on life cycle, but point-of-time studies. As shall be seen below in regard to money and happiness, point-of-time relationships are not always replicated over the life course. Even in those studies that do try to follow the same individuals over time, the period covered is rarely more than a year or two; hardly ever are data representative of the national population as a whole available for as long as five or ten years. The life cycle approach that I use here employs the demographers' technique of birth cohort analysis and covers a much longer segment of the life course. Annual surveys are used to track the experience as they become older of a group of individuals born in a particular year or decade, a "birth cohort." Although the same individuals are not interviewed in each successive year, we do have a nationally representative random sample of the same *group* of individuals. The special advantage of this approach is that we can follow birth cohorts in American data on happiness for almost three decades.

Health and happiness

Let me start with health. The critical issue is whether significant changes in health have a lasting effect on happiness. One might suppose, on the one hand, that a serious accident or major disease would permanently reduce one's happiness. On the other, people may bounce back from such occurrences, especially if helped by medications and health devices such as wheelchairs, and by a support network of friends and relatives.

Indeed, the psychologists' setpoint theory sees people as adapting fully, and returning to the level of happiness that they had before the adverse turn in health. The seminal article, repeatedly cited in the psychological literature as evidence of complete adaptation, is a 1978 study of 29 paraplegics and quadriplegics by psychologist Philip Brickman and his collaborators. The principal conclusion of this study is that the accident victims, when compared with 22 others, taken as comparable in all respects except that they had not experienced serious disability, "did not appear nearly as unhappy as might have been expected." As a careful reading of this statement makes clear, the study does not actually assert that there was complete adaptation. Indeed, the statistical finding is that the accident victims were significantly less happy than the comparison group.

There have been a number of studies since, some continuing to claim complete adaptation, others, contradicting it. To my knowledge the most comprehensive investigation is a 1990 American inquiry that compares the life satisfaction of large national samples of disabled and nondisabled persons. The conclusion is that the life satisfaction of those with disabilities is, on average, significantly *less* than those who report no disabilities. Even more telling is the finding that when persons with disabilities are classified in several different ways – according to the severity of the disability, whether the respondent suffers from one or multiple conditions, to what extent the respondent is limited in daily activities, and whether close others are thought to perceive the respondent as disabled -- life satisfaction is less for those with more serious problems on every single one of these dimensions.

It is highly unlikely that these systematic differences in life satisfaction by seriousness of disability arise because those with worse problems simply haven't had enough time to adapt. The more straightforward conclusion is that, on average, an adverse change in health permanently reduces happiness, and the worse the change in health, the greater the reduction in happiness. The results do not mean that no adaptation to disability occurs. But the evidence does suggest that even with adaptation, there is, on average, a lasting negative effect on happiness of poor health.

Let me turn from evidence relating to a point in time to some over the life cycle. As we all know, among adults real health problems increase as people age. But what do people *say* about their health? If people adapted completely to adverse changes in health, as setpoint theory asserts, then there should be no change in self-reported health over the life course, because people would continuously adjust to worsening health. Is it true that self-reported health doesn't change?

The answer is no, self-reported health declines throughout the life course. If one follows Americans born in the decade of the 1950s over the 28-year segment of the life span for which data are available, one finds a clear and statistically significant downtrend in their average self-reported health. This downtrend in self-reported health as people get older is also true of people born in earlier decades as far back as reliable data go.

This finding assesses adaptation in terms of self-reported health, not life satisfaction, as in the disability analysis. Perhaps health might get worse, but people do not feel unhappy about it. However, this is not the case -- people who report poorer health also say they are less satisfied with their health, and that they are less happy generally. At a point in time among adults of all ages reported happiness is always less, on average, the poorer the state of self-reported health. The negative impact of poorer health on happiness is due in part to loss of income, but more importantly to nonpecuniary effects such as the unhappiness caused by limits on one's usual activities. It seems clear from comprehensive survey evidence that, contrary to the psychologists' setpoint theory, adverse health changes have a lasting negative effect on happiness, and that there is less than complete adaptation to deteriorating health.

Marriage and happiness

Let me turn to the effects of marriage and marital dissolution. One might suppose that establishing close and intimate relationships of the sort represented by marriage would typically make the partners in such a relationship happier and more satisfied with life in general. Correspondingly, the loss of a partner and consequent dissolution of such relationships, through widowhood, separation, or divorce, would affect happiness negatively. Some of the initial pleasure of a new union would be expected to wear off in time; similarly, persons who have lost a partner might adjust somewhat to single status. But, on average, the close relationships embodied in marriage would be expected to have a lasting positive effect on one's happiness, and the loss of such relationships, a permanently negative effect. (I am using marriage here as a proxy for the formation of unions. These days marriage is sometimes preceded by a period of cohabitation, and the real "union" consequently takes place some time prior to marriage.)

The psychologists' setpoint theory would argue, however, that adaptation to marriage and marital dissolution is complete. Indeed, there is a recent empirical study of the German population claiming to support this conclusion. Around the time of marriage, happiness increases briefly during what might be called a "honeymoon period," but after one year of marriage it returns to the level that prevailed more than one year before marriage. Widowhood takes a somewhat longer time for complete adaptation to occur, eight years; separation and divorce are not included in the study.

American data, however, contradict the results of the German study, and suggest enduring effects of the formation and dissolution of unions. As young Americans, in the period from ages 18 through 29, increasingly get married, the average happiness of those who marry is consistently higher than the unmarried, and quite constant.

This result is counter to that for the German population which finds only a "honeymoon period" elevation of life satisfaction. If young Americans were simply experiencing a temporary increase in well-being when they married, then the happiness of *married* persons should start out at its highest value at ages 18 to 19 when those married are all in the honeymoon period. Then, happiness should progressively decline after age 19 as the honeymoon happiness of those newly marrying is increasingly offset by the return to their setpoint level of those who were married first. In fact, throughout the first decade of marriage the happiness of young married persons remains constant at a higher level than the unmarried.

The American results also contradict another argument, namely that the higher happiness of the married group stems from a "selection effect," that is, that those getting married were happier to start with. If those who marry were happier to start with, then the life satisfaction of the *combined* group of married and unmarried persons would not increase as more and more persons marry. But contrary to the selection effect argument, the happiness of the group as a whole, married and unmarried, does increase as the proportion married rises from ages 18 through 29.

Beyond the early adult years the survey evidence continues to suggest lasting effects on happiness associated with marital status. The happiness of married persons remains significantly greater than that of the unmarried throughout the life cycle. Persons who *re*marry are just as happy as those still in their first marriage, and even after 35 years of marriage, the happiness of those still in their first marriage continues to be significantly greater than their unmarried counterparts.

Results consistent with these are reported by American sociologist Linda Waite and her collaborators in a nationally representative study that follows 5,000 married Americans over a five year period. At the end of the period, the happiness of those still married is virtually unchanged, while the happiness of those who separated, or divorced and did not remarry, is significantly below that of those who are married. *Re*marriage reverses the effect of divorce -- the happiness of those who divorced and then remarried is about the same as those who stayed married. The lesson is clear: on average, marriage brings greater happiness, marital dissolution, less.

Evidence of people's desires for a "happy marriage" also contradicts the notion that people adapt completely to their marital circumstances. I think it is reasonable to say that women over 45 years old have quite low prospects for remarrying if they are widowed, divorced, or separated; hence one might expect them to be fully adjusted to their status as single women, and have largely dismissed marriage from their minds. Yet, when asked about their conception of the good life as far as they personally are concerned, six in ten cite a happy marriage. Even more remarkable are the responses of women over age 45 who have never married. Among these women more than four in ten cite a happy marriage as part of the good life. Perhaps some have adapted, and doubtless some never wanted to marry in the first place, but a sizeable proportion of these women, who have been single their entire lives, have not fully adjusted to their unmarried status, and continue to wish they were married.

These are substantial reasons, I believe, for concluding that adaptation with regard to marital status is less than complete, and that the formation of unions has a lasting positive effect on happiness, while dissolution has a permanently negative effect. This does not mean that no adaptation occurs after unions are formed or dissolved, but the adaptation that does occur is less than complete. If the psychologists' setpoint model is correct that life circumstances are of negligible importance to long run happiness, then it is hard to see how one can reconcile it with the bulk of population survey evidence on either marriage or health.

Let me briefly mention, finally, two pieces of survey evidence other than that on health and marriage that are difficult to square with the setpoint model. Throughout the life cycle blacks in the United States are, on average, consistently less happy than whites. One would be hard put, I believe, to argue that this difference by race is due simply to different setpoints given by genetics and personality, and that differences in the life circumstances of the two races are of little importance. Second, beyond age 60 the life cycle excess of female over male happiness is reversed. Clearly, this cannot be explained by genetic and personality factors; rather an important life event – the much higher incidence of widowhood among women than men – is chiefly responsible.

Money and happiness

I'd like to turn now to the source of happiness that is mentioned most often by people – one's material living level, or standard of living. Does more money make people happier? To judge from survey responses, most people certainly think so, although there is a limit. When asked how much more money they would need to be completely happy, people typically name a figure greater than their current income by about 20 percent. Indeed, if happiness and income are compared at any point in time, those with more income are, on average, happier than those with less.

But what happens to happiness as income goes up over the life cycle – does happiness go up too? The answer is no; on average, there is no change. Consider, for example, Americans born in the 1940s. Between the years 1972 and 2000, as their average age increased from about 26 to 54 years, their average income per person – adjusted for the change in the price of goods and services – more than doubled, increasing by 116 percent. Yet, their reported happiness in the year 2000 was no different from that 28 years earlier. They had a lot more money and a considerably higher standard of living at the later date, but this did not make them feel any happier.

Consider, further, two subgroups of persons born in the 1940s, those with at least some college education, and those with only a secondary education or less. At any given age, the more-educated are happier than the less-educated. This is consistent with the point-of-time relation between happiness and income just mentioned, the more-educated being, on average, more affluent and happier.

But what happens over the life course to the two educational groups? As one might expect, the income of the more educated increases more than that of the less educated. If happiness were moving in accordance with the income of each group, then the happiness of both groups should increase, with that of the more-educated increasing more, and the difference between the two groups widening. In fact, happiness remains constant over the life course for both educational groups, and the happiness differential, unchanged. Although those fortunate enough to start out with higher income and education remain, on average, happier than those of lower socio-economic status, there is no evidence for either group that happiness increases as their income grows.

These results – both point-of-time and life cycle – hold as well for persons born in the 1950s, 1930s, and 1920s. Although the point-of-time result seemingly confirms the economists' assumption that more money makes you happier, the life cycle result contradicts it.

Why this paradoxical pattern? A simple thought experiment brings out the basic reason. Imagine your income increases substantially while everyone else's stays the same – would you feel better off? The answer most people give is yes. But now, let's turn the example around. Think about a situation in which your real income stays the same, but everyone else's increases substantially – then how would you feel? Most people say that they would feel less well off, even though their real level of living hasn't, in fact, changed at all.

Now what this thought experiment is demonstrating is that as far as material things are concerned one's satisfaction with life depends not simply on one's own *objective* condition, but on a comparison of one's objective situation with a *subjective* (or internalized) living level norm, and this internal norm is significantly affected by the average level of living of the people around us. At any given time, the living conditions, or real incomes, of others are fixed, and happiness differences depend, therefore, only on differences in people's own, actual, income. This is the point-of-time relationship. Over time, however, as everyone's income increases, so too do the internal norms by which we are making our judgments of happiness. The increase in internal norms is greater for those with higher income, because as we go through the life cycle, we increasingly compare ourselves with those with whom we come in closest contact, and contacts are more and more limited to those of similar income. The increase over time in one's internal living level norm undercuts the effect on well-being of the growth of one's own, actual, income, and, as a result, happiness remains unchanged.

The subversive effect of rising internal norms also explains why people think that over the life course more money will make them happier, when, in fact, it doesn't. When people think about the effect of having more money, they implicitly assume that their own income increases while everyone else's stays the same, and hence conclude that they'll be happier. What actually happens, of course, is that when their own income increases, so too does that of everyone else. This means the internal living level norms used to evaluate happiness also increase. In thinking about the effect of future higher incomes on well-being, people fail to factor this prospective increase in their internal norms into their judgments of how well-being will be affected, and hence mistakenly conclude that more money will make them happier. But it does not – happiness stays the same as their income, and everyone else's, goes up. Here, at last, we seemingly have a validation of the psychologists' model – in the material goods domain there does appear to be complete hedonic adaptation.

Implications

The survey evidence indicates that over the life cycle family and health circumstances typically have lasting effects on happiness, but more money does not. What do these empirical results imply for the possibility of increasing one's happiness?

Each of us has only a fixed amount of time available for family life, health activities, and work. Do we distribute our time in the way that maximizes our satisfaction? The answer, I believe, is no, for a reason that has already been suggested. We decide how to use our time based on a "money illusion," the belief that more money will make us happier, failing to anticipate that in regard to material conditions the internal norm on which our judgments of well-being are based will rise, not only as our own income grows, but that of others does as well. Because of the money illusion, we allocate an excessive amount of time to monetary goals, and shortchange nonpecuniary ends such as family life and health.

As evidence of the perverse effect of the money illusion, let me cite, finally, a survey reported by sociologist Norval Glenn. In this survey Americans were asked about the likelihood of their taking a more highly rewarding job that would take away family time, because it would require both more hours at the office and more time on the road. Out of four response options, not one of the 1200 respondents said it was "very unlikely" he or she would take the job, and only about one in three said it was "somewhat unlikely." The large majority of respondents said it was either "very likely" or "somewhat likely" that they would take the job, each of those categories accounting for about one-third of the respondents. Most Americans, it would seem, would readily sacrifice family life for what they think will be greater rewards from their working life, not knowing that these rewards are likely to be illusory.

Although I have been critical here of two prominent theories of happiness in psychology and economics, I want to make clear that there is much valuable work in both disciplines, without which this article would not have been possible. Some may feel that I have given too little attention to genetic and personality determinants of happiness. This is so, but there is a reason for this. There is nothing one can do, at least at present, about one's genes, and very little that most of us can do about our personalities (except, perhaps, consult at considerable cost a psychologist). But all of us have the potential for managing our lives more efficiently to produce greater happiness.

In my discussion of life events, I have focused on the three – money, family, and health – that people cite most often as important for their happiness. There are, of course, other life circumstances that have enduring effects on happiness. Take friendships, for example. Is it not true that for many of us, there are certain people whom, when we see them, continue to evoke in us, year after year, special feelings of pleasure? And yet, how often do “work” commitments interfere with the enjoyment of such friendships? Each of us, I am sure, could name similar sources of satisfaction that we have sacrificed to the money illusion.

I have tried to summarize here what social surveys have to say about the sources of personal happiness. Could we make our lives happier? The tentative answer, based on the evidence at hand, I suggest, is this. Most people could increase their happiness by devoting less time to making money, and more to nonpecuniary goals such as family life and health.