

Frey, Bruno S. and Alois Stutzer (2002). *Happiness and Economics*. Princeton and Oxford: Princeton University Press. 220 pp. \$24.95. ISBN 0-69 1-06998-0.

The publication of this book is a welcome sign that the study of happiness has reached the threshold of respectability in economics. With the advent of the so-called 'New Welfare Economics' in the 1930s, the economics profession began taking a turn away from consideration of subjective states such as happiness and toward a focus on objective variables that, reinforced by the work of Samuelson and others on revealed preference in the 1950s, came to represent the mainstream. Ironically, this movement probably strengthened economics more as a descriptive, rather than prescriptive, science. With few exceptions, such as Easterlin (1974), Ng (1978) and van Praag and Kapteyn (1973), economists neglected research that takes seriously efforts to quantify human welfare. This left economics in a weak position with regard to policy recommendations: most judgments rely on the Pareto Principle with its limited practical applicability or on the Compensation Principle with its stronger and more questionable ethical assumptions. Perhaps this book, in addition to the numerous other significant contributions to the happiness and economics literature it reviews, heralds a new age in which economic theory and policy are informed by research on psychological and subjective states.

Although the current swell of interest by economists in happiness dates only to the mid-1990s, these recent studies have been significant both in number and in impact. Themselves important contributors to this literature, Frey and Stutzer do an excellent job of organizing and synthesizing not only the classic and newer scholarship but also the expansive research conducted throughout the past thirty years by other social scientists, disproportionately psychologists, on happiness (or *subjective well-being*, in

the more typical and inclusive nomenclature of psychology). The first section consists of three chapters that provide an overview of the subject matter and of the book (chapter 1), a review of concepts and measures of well-being in psychology and economics (chapter 2), and a discussion of non-economic correlates of subjective well-being, namely, personality and socio-demographic factors (chapter 3). Here and throughout the book Frey and Stutzer focus on self-reported subjective well-being (or SWB), measured in different survey instruments that seek to capture happiness, feelings, emotions, moods or satisfaction with life. These types of measures, which are employed by almost all SWB researchers, reflect the choice of a simple and empirically based definition for the meaning of happiness in the absence of more compelling subjective measures (e.g., spousal reports) or objective indicators (e.g., electroencephalograms) that are subject to their own drawbacks.

The second section reviews the economic determinants of happiness that have been most thoroughly investigated, which turn out to be the three variables that traditionally figure most prominently in macroeconomics: income (chapter 4), employment (chapter 5) and inflation (chapter 6). On the first variable, Frey and Stutzer note the typical findings that reported happiness (or life satisfaction) and income are uncorrelated over time within countries, positively correlated at a point in time within countries and uncorrelated across countries (save in poor nations where increasing income raises SWB). Building on various economic and psychological theories, they account for these patterns by relating happiness to relative income, i.e., one's income relative to that of a comparison group or to aspirations, both of which may change over time. The apparent importance of relative, and not absolute, income implies that even Pareto improvements may not lead to greater individual or aggregate happiness. On the other two macroeconomic variables, Frey and Stutzer report studies showing that higher levels of both unemployment and inflation reduce SWB. In this regard, they cite the interesting study of Di Tella MacCulloch and Oswald (2001), which estimates the impact of a one percentage point change in the unemployment rate to be about 70% greater than that of an equivalent change in the inflation rate, thereby suggesting that the so-called Misery Index, which simply sums the unemployment and inflation rates, understates the importance of the former.

The third section of this book comprises three chapters that review the literature on happiness and political economy, an area in which the authors' own contributions are particularly notable. Chapter 7 examines the relationship of satisfaction to politics within a given constitutional framework and identifies favorable effects of political stability, mixed evidence on social expenditures, no effect of real economic growth and differential importance of ideology (left-wing persons are happier with liberal governments and lower unemployment relative to inflation). Chapter 8 considers the impact of different political institutions on happiness and finds SWB benefits from democracies relative to dictatorships and from federalist (decentralized) structures over centralized political systems. Chapter 9 expands on the institutional question by focusing on role of process versus outcome. Drawing largely on studies of Switzerland (including their own), Frey and Stutzer conclude that more direct political participa-

tion rights confer benefits both because of the more favorable *outcomes*, e.g., political decisions conform better to the wishes of the people, but more importantly because of the *procedural* satisfaction derived from the very existence of more inclusive political processes. The fourth and final section consists of chapter 10, which summarizes the findings and contains a thought-provoking commentary on the broader place of this literature within economic theory, method and policy.

*Happiness and Economics* presents a comprehensive and balanced account of its subject matter, and its conclusions are persuasively argued. It stimulates a number of questions for further research that, given the youth of this literature, have not yet been fully addressed. For example, the conclusions of Frey and Stutzer regarding the favorable effects of a more participatory political process are consistent with the finding of psychologists that happiness is positively related to greater individual control. In Switzerland, they associate this with decentralized political systems and more direct democracy. One wonders whether these claims are robust to other countries. In the US, for instance, states' rights have often been defended in order to maintain exclusionary measures, such as Jim Crow laws, and critics of the ease with which propositions are placed on California ballots often argue that the vote on these propositions reflects less the informed will of the electorate than the financial resources opposing camps are able to marshal for political advertising. It is possible that additional institutional constraints must be considered with other political systems to determine whether more decentralized and direct political decision making translates into greater and improved participation rights.

Probably the most important open question in happiness research, however, pertains to measurement issues, where, I believe, this field is most vulnerable. This is not a criticism of Frey and Stutzer, who employ the available data adroitly, rigorously and often with clever inventiveness. Rather, it is an important matter for all of us who use self-reported SWB. The fact that even standard economic variables are also subject to measurement error is not particularly comforting. Subjective measures do contain an additional layer of potential error over objective measures in that they are, by definition, not interpersonally observable. On the other hand, in deciding whether to use these data, this concern is more than offset by other considerations. It is now well established that reported happiness regularly correlates with myriad objective variables that we plausibly expect to influence SWB. Moreover, reported happiness is one step closer than objective variables like income or goods to what we (should) care about: the subjective states real people experience. Even the committed ordinalist would have a hard time arguing for more goods if it could be demonstrated that providing them would make people less happy. In order to advance our knowledge of happiness as well as to maintain credibility with skeptics, I believe happiness researchers should, as Frey and Stutzer do, readily acknowledge the fact that available happiness data are flawed, perhaps more in certain respects than most economic data, while seeking to develop better measures. But they should unapologetically utilize these data given that they are meaningful, and, most importantly, too important to ignore. *Happiness and Economics* skillfully presents fascinating and compelling arguments and evidence in

favor of that case, and it should be on the reading list of every economist and SWB researcher.

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