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# What Good is Happiness?

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## Abstract

In this paper we examine whether, and how, welfare economics should incorporate some insights from happiness and satisfaction studies. Our main point, based on the principle of respecting the individuals' judgments about their own lives, is that one should not focus on reported satisfaction levels but on the ordinal preferences reported by individuals over the various dimensions of life. We illustrate with data from the Russian Longitudinal Monitoring Survey (RLMS) how to retrieve this information from happiness surveys.

Keywords: happiness, satisfaction, preferences, welfare economics, psychology.

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## 1 Introduction

Happiness studies are shaking the routine of welfare economics. For decades practitioners have been content with the traditional – if contested – tools of cost-benefit analysis, while

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theorists explored a variety of other approaches (social choice, fair allocation, capability approach), but they all worked within a relative consensus about the view that interpersonal comparisons of utility were deeply problematic. This consensus involved two different ideas, most of the specialists endorsing at least one of them. First, interpersonal comparisons of utility had no sound empirical basis, as argued by the advocates of the ordinal approach such as Robbins and Samuelson. Second, even if interpersonal comparisons of utility could be made, subjective utility was not considered the proper metric for the evaluation of the distribution of social advantages. The critique of welfarism by Sen (1985) was very influential in spreading this normative judgment among economists.

The success of happiness studies has toppled the consensus on the first idea. With the mass of data accumulated on happiness and satisfaction and the development of their econometric exploitation, subjective utility seems more measurable than ever. Truly enough, the possibility to relate happiness and satisfaction to personal characteristics and features of the social and economic environment does not necessarily enable the analyst to evaluate the distribution of happiness, due to individual effects which may mar interpersonal comparisons. But many publications do not stop at this difficulty and readily compute the average level of happiness or satisfaction for a group of respondents. There are, moreover, good reasons to trust the existence of sufficient regularity in human psychology, so that interpersonal comparisons appear feasible with some data.

These new developments have triggered a revival of welfarism as well. If utility can be measured after all, why not take it as the metric of social welfare, as was advocated by Bentham? Several authors have taken this line (Kahneman et al. 2004b, Layard 2005). On the other hand, none of the recent developments in the field of measurement directly undermine the arguments that were raised against welfarism in the philosophical debates of the previous decades. The fact that something becomes easier to measure does not give

any new normative reason to rely on it. So: where should welfare economics go?

Our aim in this paper is to assess whether, and how, the development of happiness studies can be helpful for making progress in welfare economics. In a nutshell, our thesis will be that these data can help us obtain information on individual preferences about the various dimensions of life, in particular the dimensions which are not directly connected to economic activity. But we will argue against the welfarist use of such data on the ground that this is unlikely to respect individual preferences on what makes a good life. Although this line of argument may sound paradoxical at first glance, because welfarism is usually associated with respect for preferences, we will show how a thorough examination of psychological results on satisfaction supports our argument. In particular, economists have hastily identified the answers to happiness questionnaires with “utility”. But “utility” is a Benthamite construct that does not quite fit the richness of human psychology. If welfare economics takes psychology seriously, it cannot go back to Bentham.

This paper belongs to a stream of critical literature which interrogates the implications of happiness studies for welfare economics, and includes Burchardt (2006), Frey and Stutzer (2007), Nussbaum (2007), Schokkaert (2007). Our work has much in common with these papers, but our line of argument is more formal and, we hope, more precise in the positive part of the proposal.

The paper is structured as follows. Section 2 introduces in more detail the open questions that we want to address in this paper. Section 3 presents the basic concepts and the formal framework of our analysis. Section 4 derives the core argument against welfarism from axioms expressing the requirement to respect individual preferences over the dimensions of life. Section 5 shows how one can make use of happiness and satisfaction surveys in order to derive relevant information about individual preferences. Section 6 concludes.

## 2 Questions and puzzles

Mostly because of its inability to deal with subjective utility, welfare economics has often confined its analysis to material sources of social welfare, with real income as a proxy for individual welfare, and GDP as a proxy for the welfare of nations. There can be no doubt that happiness studies have been very helpful in broadening the ethical scope of welfare evaluation. They stress the importance of status and social relations, the harm done by unemployment or by competitive struggles among individuals, the benefits brought by good health and family ties, and so on. Individual autonomy appears to be a key aspect of satisfaction with one's life, which includes but is much broader than access to material resources. In this light, one must probably admit that National Happiness would be a much more sensible goal of public policy than National Income.

This being said, the criticisms of welfarism stand as convincing as ever, and the data on happiness can be suspected of ignoring relevant aspects of well-being as well as of being polluted with irrelevant aspects. Going back to Sen's (1985) critique, one can indeed worry about what Sen calls "physical-condition neglect": utility is only grounded on the mental attitude of the person, and does not sufficiently take into account her real physical condition. Two examples are particularly illustrative. One is the case of expensive tastes, in which a higher level of aspiration may dampen an individual's satisfaction although this hardly seems a sufficient reason to consider him to be really worse-off. The other is the case of persons who adapt their aspirations to their objective circumstances: "A person who is ill-fed, undernourished, unsheltered and ill can still be high up in the scale of happiness or desire-fulfilment if he or she has learned to have 'realistic' desires and to take pleasure in small mercies" (Sen, 1985, p. 21). In such examples aspirations appear to play too big a role in the reported satisfaction while the real conditions of life are insufficiently recorded. A second important problem identified by Sen is what he calls

“valuation neglect”. Valuing a life is a reflective activity in a way that “being happy” or “desiring” need not be (Sen, 1985, p. 29). An acceptable approach to well-being should explicitly take into account this valuational activity by the persons themselves. This is a key insight which resonates in recent work in psychology and will be central to our analysis.

The non-welfarist approaches can stand firm on their critique of welfarism, but they are also vulnerable to criticism when it comes to concrete proposals. The objective-list approaches, in which a list of items is proposed for the measurement of well-being, generally tumble on the question of computing a synthetic index in which the various items will be weighted. Any set of weights that does not reflect individuals’ views on their own life can be accused of paternalism or perfectionism, of “playing God”<sup>1</sup> and imposing an external definition of the good life. This is famously known as the “index problem”, and it is usually considered that it raises a dilemma in which one has to choose between welfarism and paternalism.

We will definitely side with those who consider that one must rely on individual preferences in order to weight the various dimensions of life. In fact, no author, even from the non-welfarist circles, claims that preferences should play no role at all. It would certainly be utterly absurd to evaluate individual situations without any connection to human needs and goals. But most non-welfarist authors have abandoned any hope of catering to each and every individual’s preferences in the evaluation of his own situation. We do not accept this negative conclusion. Quite the contrary, the central message of this paper will be that *it is in fact possible to respect each individual’s preferences without falling back into welfarism*. This means that there is a way out of the dilemma. One can

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<sup>1</sup>Layard (2005) rebuts the adaptation critique by arguing that the alternative is ominous: “If we accept the Marxist idea of “false consciousness”, we play God and decide what is good for others, even if they will never feel it to be so.” (p. 121)

refrain from paternalism without falling back into welfarism. In fact we will even offer an argument against welfarism that is precisely based on the respect of preferences. It is somewhat different from the “physical condition neglect” and the “valuation neglect” criticisms, although it can be viewed as an extension of both.

The intuitive core of our argument is the following. Consider the famous discrepancy between the evolution of satisfaction over time, which is rather stable for most countries in the long run, and the growth of GDP. It is usually interpreted as meaning that income growth, at the national level, does not really improve satisfaction in the long run.<sup>2</sup> Although this interpretation serves as a powerful (and welcome) tool of propaganda against the materialistic view of social welfare, it sounds exaggerate to claim that people do not really care about material resources. Consider the following thought experiment. Propose to people in the 1960s to double their real income and to have access to mobile phones, internet, low-cost air transport and the rest, in combination with an increase in life expectancy of about ten years. Make sure they understand that it is not their relative standing that will rise but the whole society. Would they not see this perspective as particularly attractive? Symmetrically, ask people living in the 2000s to imagine all of them going back to the standard of living of the 1960s, with the corresponding reduced life expectancy. Would they consider it a minor sacrifice?

The obvious answer is that the former would heartily accept the change while the latter would strongly resist it. One interpretation of such answers is that people are mistaken about what really matters to them, about what really affects their satisfaction. We believe that there is some truth in this interpretation, but that it is not the whole story, not even the main part of the story. Even when one forecasts that, by adapting one’s aspirations, one’s satisfaction will remain stable in the long run, one can still have

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<sup>2</sup>See Easterlin (1995), Oswald (1997). While this is a long-standing finding in the happiness literature, it is still matter of debate, as suggested by some recent publications, e.g. Stevenson and Wolfers (2008).

definite preferences for a longer and more affluent life. Such preferences are not proved to be mistaken when one comes to adapt to one's current conditions and to consider them as the frame of reference when answering satisfaction questionnaires.<sup>3</sup>

Here is another example in the same vein. Consider a rich and a poor person. The former person could be, say, an average inhabitant of Iceland with a university degree, a life expectancy of 81.5 years and an income of \$36,510 (PPP-corrected); the latter could be, say, an average inhabitant of Sierra Leone with no schooling, a life expectancy of 41.8 years and an income of \$806 (PPP-corrected).<sup>4</sup> Suppose now that, because of adaptation to their current situation, both these persons provide similar answers about their happiness and satisfaction. Suppose that we can interpret their answers as revealing that their satisfaction is indeed about the same. In spite of this, it is still very well possible that both the rich and the poor have a strong preference for the former's life as against the latter's and could defend such preferences with good reasons. In fact, it is highly unlikely that the person from Iceland would prefer to move to Sierra Leone - it is very likely that the person from Sierra Leone would prefer the Icelandic environment.

And here comes our argument: it is precisely when one wants to respect individual preferences that one should *not* use the level of happiness or satisfaction as the measure of well-being. Doing so would lead to the conclusion that, above a relatively low threshold of affluence and comfort, "little matters in the long run" because happiness and satisfaction are quite stable, human beings being able to adapt to many variations in their living

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<sup>3</sup>Another possible interpretation of the stability of satisfaction curves in the long run is that while some aspects have improved (income, life expectancy), others have worsened (social relations, economic risk). If that were the case, then, people should declare indifference to our hypothetical questions if the way of life of the two epochs were described in a sufficiently complete way. We doubt that this would be their answer.

<sup>4</sup>The data are from the Human Development Report 2007/2008.



conditions. This is not a conclusion that the individuals themselves would accept, even knowing about the adaptation phenomenon. People have definite and strong preferences for various aspects of their living conditions and we should seek to respect these preferences (when they are well informed).

### **3 Satisfaction and preferences**

The delicate part of our argument is to explain that the level of satisfaction and the preference ranking can fall apart. Modern psychology sides with us, however. Due to the influence of utilitarianism, economists are naturally attracted to the idea that there is a core object that underlies answers to happiness and satisfaction questionnaires, and they call it “utility”. But this is not how psychology sees it.<sup>5</sup> As is emphasized, e.g., in Diener (1994) and Diener et al. (1999), utility, if there is such a thing, is an irreducibly multidimensional phenomenon. An essential distinction is between affects and cognition. And in addition, affects come in many colors and shapes, with a sharp divide between positive and negative affects.

The distinction between affect and cognition is the key element for our analysis. In the cognitive part of their satisfaction, individuals cast a judgment over their life. This judgment is an active exercise that is made whenever they want to make an assessment of their situation (for instance, when a happiness surveyor asks them to do so). It is not a quantity that stands in their brain permanently. In contrast, affects flow constantly when they are awake. Among them are feelings of pleasure, joy, excitement, pain, sorrow, abatement, love, hate, pride, shame, and so on, most of these items being subdivided into finer categories.

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<sup>5</sup>J.S. Mill already criticized Bentham’s unitary concept of utility, blaming “the empiricism of one who has had little experience” (quoted in Nussbaum 2008).

We consider that what should matter for welfare evaluation is the judgment that individuals cast on their life, i.e., the cognitive part of their satisfaction. Their affects are also important, but only inasmuch as the individuals themselves consider them to be important in their life. In order to see the importance of judgment in the evaluation of affects, observe that while positive and negative affects can be easily distinguished, it is not always the case that positive affects are always welcome and negative affects always shunned. There are bad sources of pleasure; there are also certain sorts of grief that testify to the value of what is lost, certain fears that distinguish courage from recklessness.<sup>6</sup> Affects themselves are generally influenced by and mixed with judgments,<sup>7</sup> but they do not comprehend the global evaluation an individual makes of all the dimensions of life.

The cognitive part of satisfaction does not come in one piece either. In order to analyze it, a model can be helpful. Let  $f_i$  denote the vector of “functionings” (Sen 1985) that describes the life of individual  $i$  in some a priori relevant dimensions. Theoretically one could retain all dimensions of life in this vector, but more sensibly, if one thinks of applying this analysis, it is convenient to think of the various components of  $f_i$  as corresponding to the main factors shown in the happiness studies to matter, or to the main items in the objective lists proposed in the non-welfarist literature. Not surprisingly, these two kinds of lists tend to be quite similar. It is best also to think of  $f_i$  as including the affects and feelings that characterize the individual’s subjective states in his life. In contrast, the evaluative judgment that he may cast on his life is not part of  $f_i$ . In this respect, we assume that each individual  $i$  has an ordering over the vectors of functionings, that reflects his judgment about what makes a life good or bad. We call it the “valuation ordering”, and denote it by  $R_i$ . The expression  $f_i R_i f'_i$  means that  $i$  weakly prefers the life described by  $f_i$  to the life described by  $f'_i$ . Let  $f_i P_i f'_i$  denote strict preference.

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<sup>6</sup>This point is made in Nussbaum (2008).

<sup>7</sup>See Kahneman (1999).

To prefer a life to another is not the same thing as having a greater “hedonic score”, i.e., a better balance of positive affects and negative affects, because individuals may have complex views about the relative importance of various affects, and may value other things than affects and feelings in their life. Affects are just subdimensions of life vectors  $f_i$ , and one must allow for a great variety of possible valuation orderings of life. It appears rather implausible that individuals would care only about their hedonic subjective states. The literature often recalls the Benthamite argument that happiness is the only thing that is intrinsically valuable because all other valuable things derive their value from their contribution to happiness.<sup>8</sup> This argument is a sort of tautology if happiness is understood as the evaluation of one’s life — obviously, a thing is valuable only insofar as it contributes to a good evaluation — but it is unacceptable if happiness is understood as a hedonic state.

To prefer a life to another is, also, not the same thing as being more satisfied in that life, because the satisfaction judgment is not just an ordering of various lives. It also involves the evaluation of one’s life with respect to a frame of reference, in particular certain aspirations. Let  $A_i$  denote the vector of variables which determine  $i$ ’s frame of reference. From the happiness literature one knows that such variables include in particular the past history of  $i$ ’s life and the situation of his group of reference.<sup>9</sup> The satisfaction level of individual  $i$ , denoted  $\sigma_i$ , can then be described as determined by a function

$$\sigma_i = \sigma(f_i, R_i, A_i). \tag{1}$$

For instance, a simple possibility is when satisfaction depends on the comparison between

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<sup>8</sup>This argument is taken up recently in Layard (2005). Diener (1994) attributes it to Aristotle. See, however, Nussbaum (2008) on Aristotle’s conception of happiness.

<sup>9</sup>See in particular Van Praag and Ferrer-i-Carbonell (2007), Clark and Oswald (2002), Clark et al. (2008).

a level of achievement and a level of aspiration. But many other possibilities are allowed by this model.

Finally, there is the answer to a question such as “Taking all things together, how satisfied are you with your life as a whole these days? Are you very satisfied, satisfied, not very satisfied, not at all satisfied?”. We cannot expect individuals to give an answer that is exactly faithful to their true  $\sigma_i$ . Therefore, one can only write the expressed satisfaction,  $S_i$ , as determined by a function in which a disturbance term  $d_i$  appears:

$$S_i = S(\sigma_i, d_i). \quad (2)$$

Disturbance comes from the fact that individuals are not given enough time to reflect properly and the fact that their judgment can be tinted by the mood of the day, by the good looks of the surveyor or by their feeling a duty to give a rosy (or a not too rosy) answer. Moreover, some questionnaires make “happiness”, and even current happiness rather than long term satisfaction, a salient feature of the question, and one should expect that this may make answers provide more information about affects than about the cognitive aspect of satisfaction. The fact that happiness and satisfaction questionnaires usually give similar statistical results in the literature suggests that both suffer from an insufficient clarification of the object of the question, leading respondents to give a confused answer mixing affects and cognitive evaluation, possibly in different proportions for different respondents.

Our thesis is that welfare economics should evaluate people’s lives on the basis of their valuation rankings  $R_i$ , not their satisfaction  $\sigma_i$ . With this model, it is easy to understand why one’s satisfaction is not necessarily in line with one’s judgment over one’s life. It is indeed possible to have  $\sigma(f_i, R_i, A_i) \leq \sigma(f'_i, R_i, A'_i)$  even though  $f_i P_i f'_i$ . This can happen if the adaptation of aspirations overshoots, for instance because the reference group undergoes a better improvement than  $i$ . Then the individual feels less satisfied in his new

life, even though he considers it better than his former life. This theoretical possibility is perhaps not often obtained in practice. More relevantly, however, the model shows that one should be cautious to interpret stable satisfaction as a quasi indifference. A more plausible understanding of human psychology is that affects and satisfaction judgments tend to oscillate in a small range of “normal” mental functioning,<sup>10</sup> even when individuals have strong preferences about their living conditions. Variations in observed satisfaction reveal a mixture of compensating differences in evaluations and in aspirations.

One may still ask why we argue for the use of  $R_i$  in welfare economics rather than  $\sigma_i$  or the “happiness” affects featuring in  $f_i$ . It should now appear clearly that this is a matter of “individual sovereignty” – a term that we prefer over the more traditional but more restricted notion of “consumer sovereignty”. We strongly feel that the well-being of individuals should be evaluated on the basis of their (cognitive) view on what is a good life. If a rich life  $f^{**}$  is preferred to a poor life  $f^*$  by two individuals  $i$  and  $j$  having the same views about life,  $R_i = R_j$ , it can happen that  $\sigma(f^{**}, R_i, A_i) = \sigma(f^*, R_j, A_j)$  when the rich “suffers” from high aspirations whereas the poor has adapted his aspirations to his situation. To conclude that the two lives are equally good because  $\sigma_i = \sigma_j$ , however, would go against these individuals’ own unanimous judgments and would be, in some sense, perfectionistic. What matters to people, and is therefore relevant under the principle of individual sovereignty, is not simply their satisfaction in life or their affects, but the dimensions of  $f_i$  as weighted by the valuation ordering  $R_i$ . This is their own judgment and any other judgment betrays their views. To return to the example given before: if the citizen from Iceland and the citizen from Sierra Leone both agree that they prefer the situation in Iceland over the situation in Sierra Leone, it is unacceptable to state that the

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<sup>10</sup>The normal range varies across individuals as a function of personal temperament, which appears to be a key factor of interindividual differences (see Diener 1994, Diener et al. 1999).

two situations are equally good.<sup>11</sup>

We do not claim that the individual valuation orderings are always respectable. Individuals may suffer from imperfect information or be conditioned by questionable social customs. We only claim that *if* there is no reason to attribute flaws to these orderings, they should be respected. And if there are reasons to think that they are flawed, using subjective satisfaction measures as the ultimate criterion is not the best way to laundering preferences.

## 4 From individual sovereignty to equivalence

In the rest of the paper we examine two questions. In this section, we study the implications of individual sovereignty for welfare economics and in particular for defining a proper way of making interpersonal comparisons. In the next section we explore how to retrieve valuable information about  $R_i$  from the happiness surveys.

In order to determine how to make interpersonal comparisons, we will adopt a setting

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<sup>11</sup>An important part of the happiness literature (Kahneman 1999, Kahneman et al. 1997, 2004a,b) has made the interesting point that hedonic states form an “objective” sort of happiness that is not well understood and memorized by the individuals themselves. As a consequence, specific methods are needed to measure it. This literature initially endorsed the Benthamite view that the aggregate quantity of objective happiness should be maximized, in spite of the paradox that this is not what people recall and care about (this objection is raised in Hausman 2007). Kahneman and Krueger (2006) have qualified this view, noting that the happiness data are not so reliable, especially for interpersonal comparisons, because of strong adaptation effects and substantial cultural variations. As a consequence they propose a different index that measures the amount of time that individuals spend in negative mood. This index is less sensitive than average happiness to scaling errors. Diener 2000 also notes that time spent in positive or negative mood is a better predictor of people’s own recording of happiness. Still, we consider it implausible that most individuals would globally evaluate their own lives in this way. All the variants of hedonism suffer from this problem.

that is as favorable as possible to the welfarist approach. That is, we will assume that the valuation ordering  $R_i$  is perfectly sound and respectable and that  $S_i$ , viewed as a function of  $f_i$ , is a correct numerical representation of  $R_i$  (in particular, the variables  $A_i$  and  $d_i$  are assumed to be fixed). Let this function be denoted  $U_i$  :

$$U_i(f_i) = S(\sigma(f_i, R_i, A_i), d_i). \quad (3)$$

The general problem of interpersonal comparisons consists in finding a ranking over individual situations summarized by the pair  $(f_i, U_i)$ . The vector  $f_i$  describes the various dimensions of life and  $U_i$  measures the corresponding satisfaction, in a way that is by assumption faithful to  $R_i$ , the valuation ordering. We will show that the possibilities for making interpersonal comparisons are seriously restricted by the principle of individual sovereignty.

Let the ranking over pairs  $(f_i, U_i)$  be denoted  $\succcurlyeq$  (with strict preference  $\succ$  and indifference  $\sim$ ).<sup>12</sup> Our guiding principle is individual sovereignty: when – as assumed in this section – there is no reason to correct  $R_i$  for any flaw, we should respect it. To fix ideas, we assume that there are  $m$  dimensions of life and that  $f_i$  can take any value in  $\mathbb{R}_+^m$ . We also assume that  $R_i$  is continuous and that it is weakly monotonic, i.e., that  $f_i \geq f'_i$  implies  $f_i R_i f'_i$  and  $f_i \gg f'_i$  implies  $f_i P_i f'_i$ . Let  $\mathcal{U}$  denote the set of continuous real-valued functions defined on  $\mathbb{R}_+^m$  and representing continuous and weakly monotonic orderings. For any given function  $U_i$ , let  $R(U_i)$  denote the valuation ordering it represents.

The most important and most immediate application of the principle of individual sovereignty is to respect  $R_i$  over comparisons concerning only  $i$ .

**Pareto Principle:** For all  $i \in N$ , all  $f_i, f'_i \in \mathbb{R}_+^m$ , all  $U_i \in \mathcal{U}$ ,  $(f_i, U_i) \succcurlyeq (f'_i, U_i)$  if and only if  $U_i(f_i) \geq U_i(f'_i)$ .

We can extend this principle to comparisons between individuals having identical

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<sup>12</sup>The rest of this section is inspired by Fleurbaey (2007).

preferences.

**Same-Preference Principle:** For all  $i, j \in N$ , all  $f_i, f_j \in \mathbb{R}_+^m$ , all  $U_i, U_j \in \mathcal{U}$ , if  $R(U_i) = R(U_j)$ , then  $(f_i, U_i) \succcurlyeq (f_j, U_j)$  if and only if  $U_i(f_i) \geq U_j(f_j)$ .

Note that the welfarist ranking  $(f_i, U_i) \succcurlyeq (f_j, U_j)$  if and only if  $U_i(f_i) \geq U_j(f_j)$  – respects the Pareto Principle but does *not* respect the Same-Preference Principle. This was precisely the point of the rich-poor example introduced in the previous sections. In our framework,  $f_i$  contains the relevant dimensions of life (including happiness affects), and the satisfaction level  $U_i(f_i)$  is not a dimension of life, it expresses a judgment over a life.

It is natural to seek to extend the application of the principle of individual sovereignty further for a world in which different individuals may have different preferences. This turns out to be far from trivial, however. Let us start from what seems an obvious idea, which is in line with the examples given before: if two individuals unanimously agree that  $f_i$  is "better" than  $f_j$ , then society should follow this ordering. More formally, this can be described as

**Consensus Principle:** For all  $i, j \in N$ , all  $f_i, f_j \in \mathbb{R}_+^m$ , all  $U_i, U_j \in \mathcal{U}$ , if  $U_i(f_i) \geq U_i(f_j)$  and  $U_j(f_i) \geq U_j(f_j)$  then  $(f_i, U_i) \succcurlyeq (f_j, U_j)$ .

Although this may seem surprising at first sight, the Consensus Principle is incompatible with the Pareto Principle and therefore cannot be retained. Consider the following example. Take  $f_i, f_j, f'_i, f'_j \in \mathbb{R}_+^m$  and  $U_i, U_j \in \mathcal{U}$  such that  $f_i \gg f_j, f'_i \ll f'_j, U_i(f_i) < U_i(f'_i)$ , and  $U_j(f_j) > U_j(f'_j)$ . Figure 1 illustrates this configuration in a two-dimensional case.

By monotonicity one has, for  $k = i, j$ ,  $U_k(f_i) > U_k(f_j)$  and  $U_k(f'_i) < U_k(f'_j)$ . The Pareto Principle implies  $(f_i, U_i) \prec (f'_i, U_i)$  and  $(f_j, U_j) \succ (f'_j, U_j)$  while the Consensus Principle implies  $(f_i, U_i) \succcurlyeq (f_j, U_j)$  and  $(f'_i, U_i) \preccurlyeq (f'_j, U_j)$ . By transitivity, one obtains  $(f_i, U_i) \prec (f_i, U_i)$ , which is impossible.



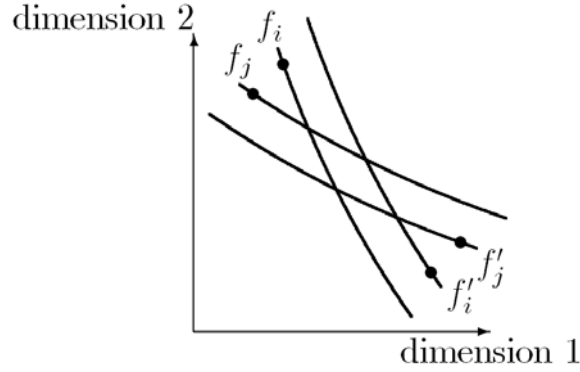


Figure 1: Incompatibility between Consensus and Pareto Principle

One could try to weaken the Consensus Principle and propose the Dominance Principle (which corresponds to Sen's intersection principle):

**Dominance Principle:** For all  $i, j \in N$ , all  $f_i, f_j \in \mathbb{R}_+^m$ , all  $U_i, U_j \in \mathcal{U}$ , if  $f_i \geq f_j$  then  $(f_i, U_i) \succ (f_j, U_j)$ .

However, the previous example shows that the Dominance Principle faces a similar problem as the Consensus Principle: it is incompatible with the Pareto Principle.<sup>13</sup> Both the Consensus Principle and the Dominance Principle imply that the ranking  $\succ$  is independent of  $U$ .<sup>14</sup>

We therefore have to seek something that is even weaker than the Dominance Principle and is compatible with the Pareto Principle. A rather natural solution consists in restricting the dominance idea to a certain region of the space. Let  $F$  be a given subset of  $\mathbb{R}_+^m$  that contains 0, is unbounded, and is arc-connected. We then state

**Subset-Dominance Principle:** For all  $i, j \in N$ , all  $f_i, f_j \in \mathbb{R}_+^m$ , all  $U_i, U_j \in \mathcal{U}$ , if

<sup>13</sup>On this issue, see in particular Brun and Tungodden (2004).

<sup>14</sup>The incompatibility with the Pareto Principle remains even if we consider the Strict Dominance Principle:

**Strict Dominance Principle:** For all  $i, j, f_i, f_j, U_i, U_j$ , if  $f_i \gg f_j$  then  $(f_i, U_i) \succ (f_j, U_j)$ .

The incompatibility of this axiom with the Pareto Principle is shown by the example of Figure 1.

$f_i, f_j \in F$  and  $f_i \geq f_j$  then  $(f_i, U_i) \succcurlyeq (f_j, U_j)$ .

The restriction to a region of the space makes a lot of sense in concrete applications. Consider for instance a simple world with only two functionings, health and wealth. Imagine two individuals such that one has slightly more wealth than the other, but both have a poor health. It is not obvious that the wealthier individual is better-off than the other when it happens that he cares more about health and would be willing to make a great sacrifice of wealth if this could alleviate his health problems. In contrast, when individuals are healthy it appears natural to rank them according to their wealth. This amounts to restricting the application of the Dominance Principle to the region of the space where individuals are healthy. We will see other applications in the next section.

Let us now first derive the consequences of requiring  $\succcurlyeq$  to satisfy the Pareto Principle in conjunction with the Subset-Dominance Principle. Let a monotone path be a family  $(f_\lambda)_{\lambda \in \mathbb{R}_+}$  such that  $\lambda \leq \lambda'$  if and only if  $f_\lambda \leq f_{\lambda'}$ . An “equivalence” ordering  $\succcurlyeq$  is such that there is a monotone path  $(f_\lambda)_{\lambda \in \mathbb{R}_+}$  for which one has  $(f_i, U_i) \succcurlyeq (f_j, U_j)$  if and only if  $\lambda_i \geq \lambda_j$ , where  $\lambda_i, \lambda_j$  are defined by  $U_i(f_i) = U_i(f_{\lambda_i})$  and  $U_j(f_j) = U_j(f_{\lambda_j})$ .

**Proposition 1** *The Pareto-Principle and the Subset-Dominance Principle imply that  $\succcurlyeq$  is an equivalence ordering.*

**Proof.** Let  $F$  denote the subset for which Subset-Dominance is satisfied. Consider two vectors  $f, f' \in F$  such that neither  $f \geq f'$  nor  $f \leq f'$ . One can then find  $U, U' \in \mathcal{U}$  such that  $U(f) > U(f')$  and  $U'(f) < U'(f')$ . By Pareto,  $(f, U) \succ (f', U)$  and  $(f, U') \prec (f', U')$ . By Subset-Dominance,  $(f, U) \sim (f, U')$  and  $(f', U) \sim (f', U')$ . By transitivity, one obtains a contradiction. This implies that for all  $f, f' \in F$ , either  $f \geq f'$  or  $f \leq f'$ . As  $F$  is assumed to contain 0, to be unbounded and arc-connected,  $F$  is a monotone path in  $\mathbb{R}_+^m$ . Let  $(f_\lambda)_{\lambda \in \mathbb{R}_+}$  be an indexing of  $F$  such that  $f_\lambda \geq f_{\lambda'}$  if and only if  $\lambda \geq \lambda'$ .

Pick any  $(f, U) \in \mathbb{R}_+^m \times \mathcal{U}$ . By continuity and monotonicity of the valuation orderings, and the fact that  $F$  is an unbounded monotone path containing 0, there is a unique  $f_0 \in F$  such that  $U(f_0) = U(f)$ . By Pareto,  $(f, U) \sim (f_0, U)$ . As a consequence, for all  $f, f' \in \mathbb{R}_+^m$ , all  $U, U' \in \mathcal{U}$ , one has  $(f, U) \succcurlyeq (f', U')$  if and only if  $(f_0, U) \succcurlyeq (f'_0, U')$ , where  $f_0, f'_0 \in F$  are defined by  $U(f_0) = U(f)$  and  $U'(f'_0) = U'(f')$ . This shows that  $\succcurlyeq$  is an equivalence ordering, for  $(f_\lambda)_{\lambda \in \mathbb{R}_+}$ . ■

Although an equivalence ordering is a rather specific approach to interpersonal comparisons – in particular, it is not welfarist – the class of equivalence orderings is large. It consists in all orderings which compare pairs  $(f, U)$  exclusively in terms of the corresponding indifference sets, and evaluate any given indifference set by the  $f_\lambda$  that it contains. A prominent example in this class is famous in economic theory, namely, the ray utility function, which takes a reference  $f_0$  and computes  $\lambda$  such that  $U(f) = U(\lambda f_0)$ . This function can be found in many references, e.g., Debreu (1959), Samuelson (1977), Pazner (1979).<sup>15</sup>

Given the great variety of equivalence orderings, one must ask how to go about the choice of the monotone path  $(f_\lambda)_{\lambda \in \mathbb{R}_+}$ . We do not have a complete theory for this, but the literature offers examples where some foundations for a special choice of path can be obtained by specifying some distributional judgments that are independent of individual preferences. We introduced already the health-wealth case. As an other example, in

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<sup>15</sup>One can extend the class of equivalence orderings and replace the monotone path by a collection of nested sets. An example is the money-metric utility function, which takes a reference price vector  $p_0$  and computes  $\lambda$  such that the maximum utility attainable with an expenditure equal to  $\lambda$  under the price  $p_0$  is equal to  $U(f)$ . This function can be found, e.g., in Samuelson (1974). Blackorby and Donaldson (1988) have criticized the money-metric utility function for failing to yield quasi-concave social orderings over allocations, and their criticism can be extended to apply to the ray utility function and similar constructs. The problem, however, disappears when the social aggregation relies on the maximin or leximin criterion, and is substantially alleviated when inequality aversion is put in the social aggregation.

Maniquet and Sprumont (2004), studying a public good economy with money, a particular path is deduced from the axiom that it is a social improvement to reduce the inequality in money transfers between any agent who contributes and any agent who is subsidized. All recent characterizations of social orderings based on equivalence rankings involve conditions of this sort, i.e., axioms specifying some distributive principle that does not depend on individual preferences.

In the next section, we provide a simple example of how a particular monotone path can be chosen. This is an extension of the health case. In this approach one picks reference values for the various functionings (except income). These reference values are chosen in such a way that it seems ethically acceptable to compare the well-being of the individuals in terms of their income, independently of their preferences, when they are at these reference values. The equivalence idea then implies that one looks for what we will call an equivalent income  $Y_i^*$  for each individual  $i$  which is such that the individual is indifferent between her actual functionings bundle (including her actual income  $Y_i$ ) and the bundle containing  $Y_i^*$  and all the other functionings at their reference levels. Interpersonal comparisons can then be relevantly made with these values  $Y_i^*$ .

## 5 With the data: Russia 2000

We now illustrate how the theoretical proposal in the previous section can be implemented based on the data from a satisfaction survey. The crucial challenge is to distinguish in the satisfaction (or happiness)-answers the part that is due to preferences from the part that is linked to aspiration levels. As soon as we have the preferences identified, we can compute the equivalent incomes.

We use the data from the Russia Longitudinal Monitoring Survey (RLMS) for this illustration. These RLMS-data have already been used to analyse happiness and life

satisfaction by Frijters et al. (2006), Graham et al. (2004), Ravallion and Lokshin (2001, 2002) and Senik (2004). We introduce the data and show results for the estimation of a standard happiness equation in the first subsection. We then discuss how the theoretical framework from the previous sections can be applied to the Russian data and we derive the estimates of the equivalent incomes. In this section, we restrict ourselves to a cross-section analysis. However, we are currently working to exploit the panel nature of the data in order to model in a better way changes in the aspiration levels.

## 5.1 The data: RLMS and life satisfaction in Russia

The Russia Longitudinal Monitoring Survey (RLMS) is a series of nationally representative surveys designed to monitor the effects of Russian reforms on the health and economic welfare of households and individuals in the Russian Federation. These effects are measured by a variety of means: detailed monitoring of individuals' health status and dietary intake; precise measurement of household-level expenditures and service utilization; and collection of relevant community-level data, including region-specific prices and community infrastructure data. Data have been collected thirteen times since 1992. In this section we analyse the data of round 9, i.e. for the year 2000. We use observations for 5340 individuals in 2646 households.<sup>16</sup>

The RLMS is an extremely rich dataset, containing a lot of information on the personal characteristics and the socio-economic circumstances of the individuals. It also contains a typical "satisfaction with life"-question, formulated in the following way: "*To what extent are you satisfied with your life in general at the present time?*", with answers on a five point-scale ranging from "fully satisfied" to "not at all satisfied". Figure 2 shows

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<sup>16</sup>In total, wave 9 of the RLMS has observations on 10,976 individuals in 4,006 households. However, we only include in our analysis the individuals for which all relevant variables are available.

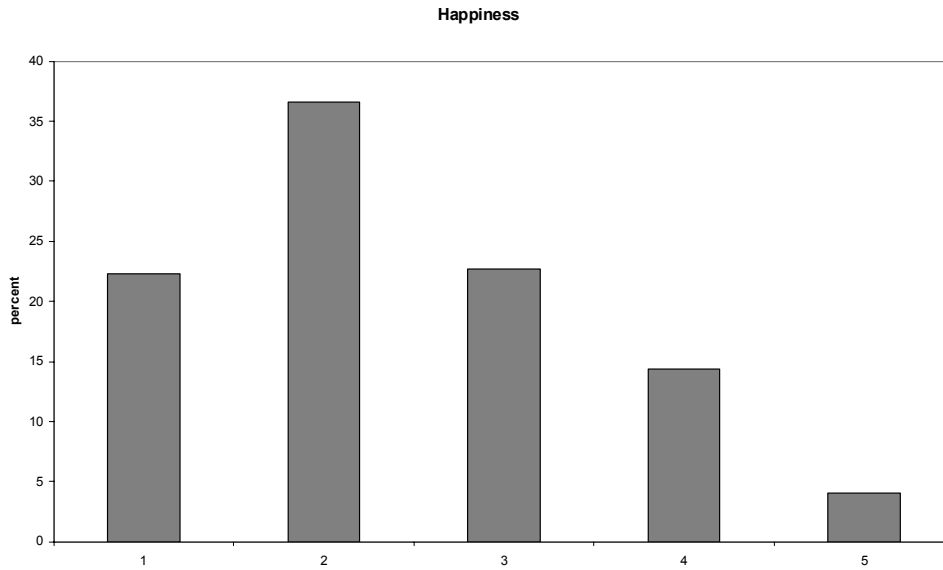


Figure 2: Life satisfaction in Russia (2000)

the distribution of the answers on that question: compared to most other life satisfaction studies, a large fraction of the Russian population was "less than satisfied" or "not satisfied" with their life in 2000.

As a starting point, we estimated a typical "happiness equation" as they have appeared in many recent publications. At this stage, we simply use OLS to regress life satisfaction  $S_i$  of individual  $i$  (measured with the five-point scale) on equivalized expenditures  $Y_i$  and a set of explanatory variables  $X_i$  - we come back to the interpretation of  $X_i$  later in this section. For the computation of equivalized expenditures, we have chosen as equivalence scale the square root of the number of household members. We work at the level of the individuals and correct the standard errors for clustering at the household level. After some experimentation with different specifications of the non-linear relationship between satisfaction and equivalized expenditures, we finally preferred the following

functional form:

$$S_i = \alpha + \gamma_1 Y_i + \gamma_2 \ln(Y_i) + \delta' X_i + d_i \quad (4)$$

with  $(\alpha, \gamma_1, \gamma_2, \delta)$  a vector of coefficients to be estimated. The results of estimating (4) are shown in the first column of Table 1. They are perfectly in line with what is usually found in the literature. Equivalized expenditures, housing and self-assessed health have a highly significant positive effect on life satisfaction<sup>17</sup>. Being unemployed has a significantly negative effect. Males are *ceteris paribus* more satisfied than females. We find the usual U-shaped pattern with respect to age, with the minimum level of life satisfaction reached in the age range 40-49 years. Being married or living as a married couple increases life satisfaction. Being a member of a minority group (i.e. having a non-Russian nationality) has a positive effect (at the 0.05 level). Education has no significant effect and the same is true for being religious. However, there are differences between the different religions - with the buddhists and the hindus significantly more satisfied than the other creeds. Nothing of this is surprising: these are basically the regularities that are found in most of the "happiness literature". The question now is: how to proceed from here?

## 5.2 Quality of life dimensions and satisfaction with life

We can link our typical happiness-equation (4) to the equations (1) and (2) in section 3. This comparison shows that the vector of explanatory variables  $X_i$  contains both

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<sup>17</sup>The RLMS-data contain a lot of information on housing characteristics: space in squared metres, availability of central heating, hot water, metered gas, sewerage, telephone, video and computer. They also contain information on the price of the house. We first estimated a hedonic price equation ( $R^2 = 0.55$ , all variables significant with the correct sign). To correct for household size, we then calculated for each individual an index of the housing quality as the value predicted by the hedonic equation after having substituted "equivalized space" for "space". More information about the estimation procedure and the results is available from the authors on request.

Table 1: Estimation Results

	(Model 1)		(Model 2)	
	coefficient	Std. Err.	coefficient	Std. Err.
expenditure	0.00000669*	0.00000342	0.00000659*	0.00000342
log (expenditure)	0.216***	0.0289	0.217***	0.0289
health	0.242***	0.0232	0.276***	0.0352
house	0.00000174***	0.000000312	0.00000173***	0.000000312
unemployed	-0.270***	0.0536	0.007	0.115
gender	0.0784***	0.0285	0.0791***	0.0285
householdsize	-0.00512	0.0123	-0.00420	0.0122
age_90	0.169	0.308	-0.447	0.340
age_80	0.0112	0.145	-0.592***	0.198
age_70	-0.265***	0.0988	-0.873***	0.168
age_60	-0.429***	0.0885	-1.054***	0.165
age_50	-0.488***	0.0869	-1.132***	0.168
age_40	-0.641***	0.0791	-1.302***	0.165
age_30	-0.501***	0.0790	-0.532***	0.0791
age_20	-0.279***	0.0696	-0.300***	0.069
higher education	-0.0586	0.0375	-0.323***	0.124
married	0.227***	0.0619	0.219***	0.0617
as married	0.311***	0.0847	0.297***	0.0847
divorced	0.0488	0.0746	0.0455	0.0744
widowed	0.0741	0.0764	0.0675	0.0760
religious	0.0623	0.0393	0.0613	0.0393
orthodoxy	-0.235	0.175	-0.247	0.177
catholicism	0.0918	0.260	0.074	0.261
protestantism	0.384	0.360	0.330	0.363
islam	-0.234	0.200	-0.245	0.202
judaism	-0.334	0.239	-0.351	0.235
buddhism	1.626***	0.436	1.555***	0.457
hindu	0.723***	0.205	0.720***	0.208
minority	0.145**	0.0610	0.142**	0.0607
jogged	0.149**	0.0755	0.167**	0.0752
young*health			-0.198***	0.0431
higher educ*health			0.0922**	0.0395
higher educ*unempl			-0.344***	0.126
constant	-0.144	0.331	-0.412	0.362
$R^2$ ( $N = 5340$ )	0.221		0.226	

Regional effects are included, but not shown; \*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$



indicators of  $f_i$  (the dimensions of the life or the functionings of individual  $i$ ) and variables measuring personal characteristics of  $i$ , that are related to interindividual differences in their frame of reference  $A_i$  and in their preferences  $R_i$ . Differences in the frame of reference (the aspiration levels) should not play a role in the overall evaluation of the living standard, differences in preferences should be respected. Therefore, to proceed we have to think explicitly about the interpretation of the different variables in the vector  $X_i$ .

The first and most important decision is the definition of the vector of relevant life dimensions. Many different lists of functionings have been proposed in the literature. They are to a large extent overlapping, however. As a matter of fact, everybody agrees that material welfare (in our equation captured by  $Y_i$ ) is relevant. Moreover, our vector  $X_i$  contains some of the other most important items, appearing in all of these lists: health, housing and employment. The latter variable is captured in a minimal way in our estimation, since the only indicator used is "being unemployed". It would certainly have been preferable to include richer information about the job characteristics of the individuals, but these are not available in our data. Yet, we can feel rather safe - and we are in line with most of the previous literature - if we partition the vector  $X_i$  as  $(F_i, Z_i)$ , where  $F_i$  contains the relevant dimensions of life apart from material welfare (i.e. health, housing, unemployment) and all the other variables are in  $Z_i$  and are interpreted as conditioning variables. The latter will influence the frame of reference of the individuals - or lead to differences in preferences.

Two remarks are important here. First, while it is an essential step in our approach, the distinction between life dimensions and conditioning variables is not as clear-cut as it may seem. To give an example: implicitly, we have taken being religious or not, and personal family situation (being married, divorced, as married or widowed) as conditioning variables and not as dimensions of life that should be taken into account in the evaluation

of living standards. Certainly in the latter case, one could take the opposite view and argue that "having harmonious personal relations" is a crucial feature of a good life. In our view, ultimately this boils down to an ethical question. We are looking for a concept of well-being that is useful for policy analysis. More specifically it should be of help in evaluating the desirability of redistributive policies. For this purpose, it seems reasonable to focus on the dimensions of life that are at the center of the attention of public policies, and to compare individual situations in these dimensions, at the exclusion of the life dimensions which are in the private sphere.<sup>18</sup>

Second, life dimensions will only play a role if they have an effect on satisfaction with life, as revealed in the surveys (see eqs. (1) and (2)). Remember that we argued that it would indeed be absurd to evaluate individual situations without connection to human needs and goals, as they are conceived by the individuals themselves. While this is clear in principle, it also raises some tricky issues. Consider the variable "education": sometimes level of education appears as such in lists of relevant dimensions of life, or, it is at least closely related to proposed functionings (or capabilities).<sup>19</sup> It turns out to have a negative (but insignificant) effect in our estimation and we did not include it in our list of life dimensions. However, it is possible that education is a true life dimension (i.e. that individuals prefer higher education), but at the same time also influences the frame of reference. It is impossible to distinguish these two effects in a cross-section analysis. That is why we want to exploit in the future the panel nature of the data.

When interpreted in terms of preferences and frames of reference, the limitations of the simple specification (4) become immediately clear. While it allows (for good reasons)

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<sup>18</sup>This is only a first step, and in some cases a more extensive analysis is defensible, e.g. if social circumstances make it impossible for individuals to have a normal family life.

<sup>19</sup>To give an example: one of the capabilities on Nussbaum (2000)'s list is "being able to think and reason in a way informed and cultivated by an adequate education".

for a non-linear relationship between equivalized expenditures and satisfaction with life, eq. (4) imposes that the preferences of different subgroups of the population are basically the same. A change in one of the conditioning variables will only shift the level of satisfaction upwards or downwards, without changing the marginal rates of substitution. Remember that such upwards and downwards shifts (leaving the indifference curves the same) are interpreted in our theoretical framework as changes in aspiration levels. It seems more realistic that different individuals (or groups of individuals) also have different preferences. To capture such differences we need a more flexible functional form.

The easiest way to introduce more flexibility in the specification is the inclusion of interaction effects. We therefore have experimented with the following (general) functional form:

$$S_i = \alpha + \gamma_1 Y_i + \gamma_2 \ln(Y_i) + (\vartheta + \lambda' Z_i)' F_i + \delta' Z_i + d_i \quad (5)$$

This expression contains a large amount of independent variables. We therefore simplified the model by keeping only the significant interactions which had a convenient theoretical interpretation. The resulting estimates are shown in the second column of Table 1. We observe that the preferences are different for the young and the old and for the highly educated and the non-highly educated. Health has a stronger effect on the life satisfaction of older and more highly educated respondents. Moreover, the negative effect of unemployment is very strong for the highly educated (and becomes insignificant for the others). All these results stand to reason.

We can illustrate the working of the model with the indifference curves that are implied by it. Some examples are shown in Figure 3 and 4. Figure 3 compares the indifference map in the health-expenditures space for young and old Russians without higher education. The larger weight of health in the preferences of the old is immediately clear. Figure 4 in addition introduces the distinction between highly and non-highly

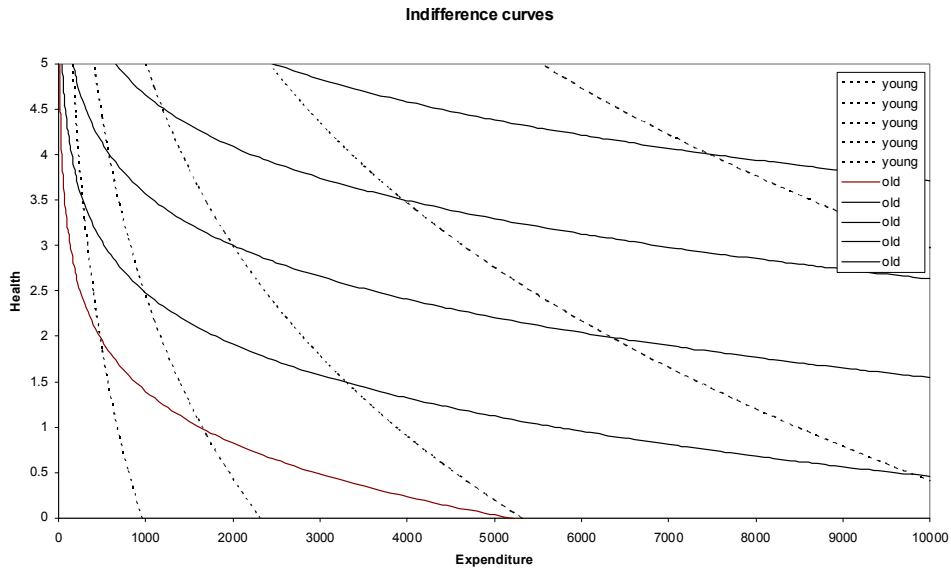


Figure 3: Indifference curves implied by model (5) of a young and old Russian without higher education.

educated respondents: note the very flat curve for the highly educated elderly.

### 5.3 Results: equivalent incomes and life satisfaction

In the previous subsection we have shown how one can start from estimations of the happiness equation to derive information about the preferences of the individuals - and how one can approach the issue of preference differences. The indifference curves in Figure 3 represent the preferences  $R_i$ . The conditioning variables  $Z_i$  play two roles. First, they influence the marginal rates of substitution between different functionings. This preference effect has to be taken up in the welfare evaluation. Second, they have a direct effect on welfare - this is interpreted as being linked to differences in the frame of reference. A welfarist approach would take up this latter effect in the evaluation of the welfare of individual  $i$ , but we do not. The same is true for the disturbance term  $d_i$ , which we also

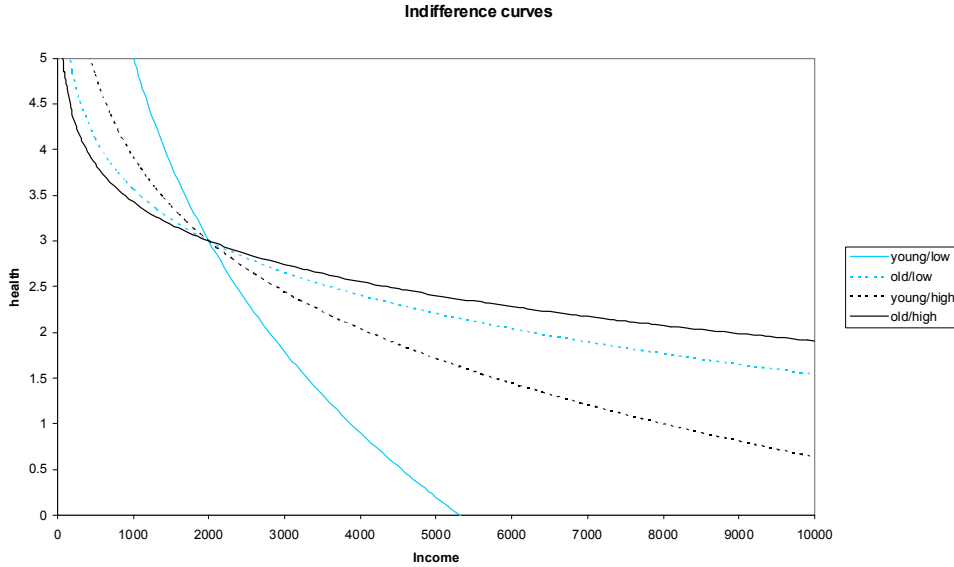


Figure 4: Indifference curves implied by model (5) of a young, low educated; old low educated; young highly educated and old highly educated Russian.

interpret as linked to the frame of reference.

Let us now apply the ideas from the previous section to derive an overall indicator of the quality of life for the individuals in our sample. We first have to choose a monotone path  $(f_\lambda)$ , which will allow us to derive a relevant equivalence ordering. The most straightforward way to do so is to pick reference values for all the dimensions of life, except material welfare. Let us denote these reference values for the life dimensions by  $\bar{F}$ . We can then calculate the "equivalent income"  $Y_i^*$ : this is the level of equalized expenditures that makes individual  $i$  indifferent between the bundle of functionings  $(Y_i^*, \bar{F})$  and his actual bundle  $(Y_i, F_i)$ . We will then say that the well-being of individual  $i$  is larger than the well-being of individual  $j$  if  $Y_i^* \geq Y_j^*$ .

There still remains the crucial question of the choice of the reference values  $\bar{F}$ . This is ultimately an ethical choice: we have to fix the reference values in such a way that

they lead to acceptable distributional judgments. This raises deep issues, but for our illustrative purposes, we propose the following choices:

- as argued before, for *health* it is natural to take perfect health as the reference. If two individuals are equally healthy, we can rank their quality of life on the basis of their material welfare.
- a similar argument can be put forward with respect to *employment*: here also we choose as reference value the best possible situation, i.e. not being unemployed. This means that "not being unemployed" is the natural social reference point for a comparison of well-being, in that if two individuals are employed we can rank them on the basis of their expenditures only. It would be strange to compensate one of the two if she claims that she cares less than the other about being employed.<sup>20</sup> However, take two unemployed individuals with a different income. In that case it makes sense to check if one of the two suffers more from the social and psychological stigma related to unemployment, implying that a ranking in terms of expenditures would not suffice. Note that we are not taking a position on psychological feelings of happiness here, our aim being to respect individual preferences and views about the importance of life dimensions.
- *housing* raises more difficult issues, because it is not obvious what is the natural point of reference. In our empirical work, we will use the median value of housing.

With the values for  $\bar{F}$  fixed in this way, we can immediately calculate for each individual her equivalent income  $Y_i^*$  by solving the following implicit equation:

$$\gamma_1 Y_i^* + \gamma_2 \ln(Y_i^*) + (\vartheta + \lambda' Z_i)' \bar{F} = \gamma_1 Y_i + \gamma_2 \ln(Y_i) + (\vartheta + \lambda' Z_i)' F_i \quad (6)$$

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<sup>20</sup>With the proviso mentioned before that our data do not allow us to include a rich set of job characteristics.

Note that the conditioning variables  $Z_i$  only appear in eq. (6) in so far as they influence the preferences of different individuals - but that the direct effects on the level of satisfaction (captured by  $\delta$  in eq. (5)) are considered as irrelevant for the welfare evaluation. The same is true for the idiosyncratic disturbance term  $d_i$ . Solving eq. (6) for all individuals gives a complete vector with the equivalent incomes of all individuals in the sample.

It is instructive to compare the results of our approach with three alternative approaches to measuring welfare. The first is using equivalized expenditures as such, i.e. considering only material welfare. This is probably still the most common approach in applied work, partly because of the operational difficulties in implementing ethically richer and more attractive approaches. The second is the welfarist alternative, which has gained so much popularity since it has become feasible to measure subjective satisfaction (and/or happiness) with survey questions. The third is self-assessed health. This is added mainly for comparison purposes, although it is interesting on its own, because it is very often used as the single indicator in the work on equity in health.<sup>21</sup> Tables 2-4 show the cross-tabulations of  $Y_i^*$  with equivalized expenditures  $Y_i$ , subjective satisfaction  $S_i$  and self-assessed health respectively. Table 5 summarizes this information in terms of Spearman rank coefficients. It is obvious that the different concepts lead to different rankings. Both the cross-tabulations and the Spearman rank correlation coefficients show that equivalent incomes are far from perfectly correlated with health and with equivalized expenditures. And the correlation with subjective satisfaction is even very low.

We give some further information about the differences between the different approaches in Table 6. This table sketches a portrait of the individuals in the lowest quin-

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<sup>21</sup>Fleurbaey and Schokkaert (2007) argue that an evaluation of equity in self-assessed health requires considering the whole vector of life dimensions and propose an approach in terms of equivalent incomes.

Table 2: Cross-tabulation of  $Y_i^*$  and equivalized expenditures.

equivalized expenditure	10 quantiles of $Y_i^*$										total
	1	2	3	4	5	6	7	8	9	10	
1	284	137	90	76	90	36	20	3	3	0	739
2	155	174	105	84	81	119	50	19	0	0	787
3	122	137	117	75	80	93	98	49	19	0	790
4	61	87	128	93	89	77	111	96	33	5	780
5	47	62	111	118	72	100	114	89	67	14	794
6	53	68	96	88	64	100	75	122	82	32	780
7	29	42	63	106	92	69	81	135	150	46	813
8	21	36	42	77	111	69	86	104	156	86	788
9	9	33	22	45	78	77	67	103	156	198	788
10	4	8	12	21	29	43	83	64	119	403	786
total	785	784	786	783	786	783	785	784	785	784	7845

Table 3: Cross-tabulation of  $Y_i^*$  and subjective satisfaction

subjective satisfaction	10 quantiles of $Y_i^*$										total
	1	2	3	4	5	6	7	8	9	10	
1	363	247	212	164	180	155	140	103	88	63	1715
2	266	326	340	358	294	317	268	261	240	207	2877
3	89	122	148	162	187	180	205	232	220	198	1743
4	44	67	70	75	90	104	137	145	175	227	1134
5	9	14	9	16	27	21	27	34	57	83	297
total	771	776	779	775	778	777	777	775	780	778	7766

Table 4: Cross-tabulation of  $Y_i^*$  and self-assessed health

Health	10 quantiles of $Y_i^*$										total
	1	2	3	4	5	6	7	8	9	10	
1	188	33	6	3	2	3	0	1	0	0	236
2	398	334	132	79	40	31	26	22	13	17	1092
3	194	395	602	642	600	518	436	371	271	238	4267
4	5	22	46	56	138	214	310	367	453	441	2052
5	0	0	0	3	6	17	13	23	48	88	198
total	785	784	786	783	786	783	785	784	785	784	7845



Table 5: Spearman rank correlation between the welfare concepts

	equi. expenditures	$Y_i^*$	health	satisfaction
equi. expenditure	1			
$Y_i^*$	0.5932	1		
health	0.1227	0.6394	1	
satisfaction	0.2323	0.3312	0.2155	1

tile of the distributions for the different welfare concepts. Who is considered to be deprived? The differences between the results for the welfarist satisfaction measure and for our equivalent incomes are especially striking. The least satisfied individuals have much larger expenditures, a better health and a nicer house than those with the lowest value of well-being in our approach. Moreover, the proportion of unemployed is slightly lower among the least satisfied. Clearly, subjective satisfaction does not capture deprivation on the dimensions of life. The larger correlation between equivalized expenditures and our concept of well-being also shows up in this table. The main difference is with respect to health: health is valued strongly in our well-being concept, certainly for a large fraction of (educated and older) people. This effect is of course not taken up in equivalized expenditures. The same is true (to a much smaller extent) for the non-monetary cost of being unemployed. Table 6 clearly shows that the choice of concept used for the welfare evaluation does indeed matter - and we have the impression that our well-being concept gives quite reasonable results.

## 6 Conclusion

The recent happiness literature suggests that interpersonal utility comparisons are to some extent possible. Yet this does not in the least undermine the basic philosophical criticism

Table 6: Portrait of lowest quintile of different welfare concepts

	equi. expenditures	$Y_i^*$	satisfaction
expenditure	1088	2096	3409
$Y_i^*$	187	31	762
health	2.96	2.26	2.85
happiness	2.02	1.93	1
house	64056	64722	75131
unemployed	12.9%	14.4%	14.2%
male	39.8%	35.6%	40.4%
householdsize	3.09	2.73	3.22
age	48	60	47
higher education	55.3%	61.1%	64.4%
married	43.3%	51.0%	51.1%
as married	10.1%	8.2%	8.3%
divorced	8.7%	8.5%	8.5%
widowed	19.8%	27.7%	16.8%
religious	72.3%	75.0%	71.8%
minority	14.4%	13.1%	14.4%

on utilitarianism (or, more generally, on subjective welfarism). A focus on subjective utility may lead to a relative neglect of the real conditions of life. Moreover, valuing a life is a reflective activity that should not be reduced to the evaluation of hedonic states. In fact, the psychological literature has also argued that "utility" is a multidimensional phenomenon and that it is crucial to distinguish affects and cognition. Therefore it is to be hoped that we will not witness in the near future a revival of primitive utilitarianism. At the same time, however, the empirical work on happiness has drawn attention to the importance of the non-material dimensions of life - a welcome shift away from the exclusive focus on material consumption.

We have argued that an adequate normative approach should indeed focus on the vector of "functionings" that describes the life of the individual in a priori relevant dimensions. The list of dimensions may include affects and feelings in addition to the objective

circumstances of life. In fact, subjective happiness can be one of its items. In aggregating these different dimensions, one should respect the individual's well-informed ordinal preferences, reflecting their opinion about what is valuable in life. Such respect for preferences does not imply subjective welfarism. Quite the contrary, it is precisely when one wants to respect individual preferences that one should not use the level of happiness or satisfaction as the measure of well-being, as these happiness levels are influenced by adaptation and by changes in the aspiration levels.

Since we discard "happiness" or "satisfaction" as an adequate aggregator of the different dimensions, we are confronted with a difficult indexing problem when different individuals have different preferences. We describe one promising approach to that problem, which consists in calculating equivalent incomes. These correspond to the hypothetical incomes that would put individuals at the same welfare level, i.e. on the same indifference curve, as in their actual situation, if they were at well-defined reference levels for all other dimensions. The reference levels are chosen in an ethically attractive way. Equivalent incomes fully respect individual preferences. To calculate them, we need knowledge about these preferences. While this knowledge can be obtained from different sources, one possibility is to start from the answers on the questions about happiness or life satisfaction. We have described how the traditional happiness equations can be used to recover the information which is needed for the calculations of equivalent incomes. We illustrate the method with RLMS-data for Russia. It turns out that the picture of well-being obtained with equivalent incomes is very different from the picture that is obtained by focusing either on material consumption or on subjective welfare.

The main problem with our approach lies in the need to distinguish preference shifters and conditioning variables. Until now we restricted ourselves to an analysis of the cross-section data of one wave of the RLMS. Exploiting the panel nature of the data would

make it possible to tackle the crucial problem of adaptation of aspiration levels in a more adequate way (Burchardt, 2005; Frijters et al., 2006). This does not in the least change our basic theoretical structure, but it allows for a more refined way of distinguishing differences in preferences from changes in the frame of reference. We are currently working at this needed extension.

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