Does Freedom Lead to Happiness?
Economic Growth and Quality of Life
Stavros A. Zenios
Professor of Finance and Management Science
Rector, University of Cyprus
Senior Fellow, The Wharton School, USA

and

Nina Gorovaia–Zeniou
Assistant Professor of Management, Frederick University
Nicosia, Cyprus

NINJA Lessons

In his ironic novel *Blindness*, José Saramago tells the story of a man who succumbs to a mysterious “white blindness” while waiting in his car for the traffic light to change. He visits an ophthalmologist who does not know what to make of the case—and goes blind himself as he is studying his textbooks. This marks the beginning of a blindness epidemic. The government interns the blind and those who came in contact with them in a lunatic asylum to contain the epidemic, but to no avail. A utopian organization of the community of the blind is developed where all familiar norms of behavior break down—until people start to see again, as suddenly and unexpectedly as they went blind. Life returns to normal—but does it really?

An epidemic of blindness might equally well explain the financial collapse of 2008 and the economic crisis it provoked; the worst since World War II. How could nobody see the dangers lurking when something as noble as a mortgage-backed security—a financial instrument that allowed banks to raise capital and give out mortgage loans so people could put a roof over their heads—mutated into NINJA loans and caused a housing bubble to grow and then burst?

NINJA, in this case, is not the team of anthropomorphic mutated teenage turtles of Mirage Studios and Nickelodeon. NINJA stands for “No Income, No Job, No Assets” and refers to mortgage loans given to individuals that had no income, were unemployed, and had no assets
to put up as collateral. These loans were highly risky, of course, and when issued in large quantities provided cheap credit that fueled a housing market bubble. When the bubble burst, the banks found themselves with large portfolios of “subprime” loans: loans for a house worth much less than the value of the loan itself. Several prominent institutions worldwide were driven into bankruptcy, or were bailed out using taxpayers’ money. The magnitude of the bailout strained several national economies and increased budget deficits or national debts to unsustainable levels. In the most severe case of national distress, Iceland saw all three of its major commercial banks go into bankruptcy, the stock market index dropping by 76%, and the krona declining more than 35% against the euro. (Extensive accounts of the crisis are given in Krugman 2009 and Roubini and Mihm 2010.)

What are the mechanisms at work that could lead to such catastrophes? The process starts with a set of loans given out to individual homeowners. A prudent bank will ask for collateral of, typically, 20% of the value of the property. A homeowner who wants to purchase a 100,000 USD house has to put down 20,000 USD and get a loan for the remaining 80,000 USD. The down payment serves several purposes. First, it holds the borrower responsible for the property, as the house is bought in part by his or her savings. Second, it provides a security cushion for the bank. That is, if the market prices drop and the homeowner stops paying the mortgage loan and walks away from the house, there is still enough value in the property to recover the amount of the loan. Only if prices drop by more than 20% will the bank lose its own money.

But the story does not stop here. Banks do not hold these loans on their balance sheets. They pool loans together, securitize them in what are known as mortgage-backed securities, and sell these securities to investors such as pension funds, insurance companies, investment banks, and so on. The investors receive interest on these securities equal to the interest paid by the homeowner on the loan (minus the banker’s service fee), and also benefit from any market-price appreciation in the value of the security. By selling the loans the bank now raises more capital and can give out more loans. These noble ideas originated in the U.S., especially with agencies such as Fannie Mae and Freddie Mac, and successfully financed the American dream of home ownership (Zenios 2007, Fabozzi 1988).

But the story does not stop here either. Investment banks, who bought some of these mortgage-backed securities, realized they could extract more profits out of them by first
pooling several securities together and then slicing them up into tiers, or *tranches*, of different riskiness: a low-risk tranche receives priority payments from all the mortgages in all the pools, while a high-risk tranche has low priority. There is usually a tranche of intermediate riskiness, known aptly as *mezzanine*. Hence, if a few mortgage-holders default, the low-risk tranche will still receive all its payments. Of course the risky tranche will lose every time a homeowner defaults, and hence it is more risky than the average mortgage-backed security. These tranches are known as *toxic products*. With this slicing the investment banks would allow investors in mortgages—based on their appetite for risk—to assume more or less risk than the average mortgage in the pool by buying the high-risk, mezzanine, or low-risk tranches, respectively.

Nothing wrong so far. These financial innovations fueled a significant growth in the mortgage market and allowed home ownership in the United States (and other countries that adopted similar innovations) to be much higher than in countries where no such facilities were available. These are noble goals indeed. They were made possible by using advanced financial engineering models (such as those described in Zenios 2007) to design these products, successful marketing from the banks, and absence of government regulation that would restrict such innovations (Allen and Gale 1994).

But then things did go wrong. The thinking was that banks would keep the toxic products on their own balance sheets, and so would have an incentive to monitor the underlying mortgage loans closely for their riskiness. However, the banks found out that they could offload these products to investors as well, simply by offering a high enough rate of return. Once this was done, all the risk from the original mortgage loans was passed on to investors outside the bank. The banks lost any incentive to monitor the risks, and focused on maximizing the revenues from originating loans. How do you do this? By giving out more loans. If the loans pay back, you win; if they default, someone else loses. Voilà—a recipe for unlimited profits! The alchemists of Wall Street had discovered the philosopher’s stone. The banks started going after every possible borrower, giving NINJA loans and offering a no-payment startup period, conveniently known as a “teaser,” to overcome the resistance of even the most hesitant borrower. (There were other innovations involved in bringing about a crisis of such magnitude, such as excessive leverage, unregulated shadow banking, and unsuitable
CEO compensation policies, but the essence is captured by what we have described so far. (A
detailed account can be found in Roubini and Mihm 2010.)

Table 1 tells the story in numbers. In the period from 2001 to 2006, subprime loans grew to
20.1% of the total mortgage originations; 80.5% of these loans were securitized. The result of
loose credit in the mortgage market was the bubble in housing prices, as reflected in the
S&P/Case-Schiller U.S. National Home Price index (figure 1).

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Mortgage Originations (Billions)</th>
<th>Subprime Originations (Billions)</th>
<th>Subprime Share in Total Originations (% dollar value)</th>
<th>Subprime Mortgage-Backed Securities (Billions)</th>
<th>Percent Subprime Securitized (% dollar value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$2,215</td>
<td>$190</td>
<td>8.6%</td>
<td>$95</td>
<td>50.4%</td>
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<tr>
<td>2002</td>
<td>$2,885</td>
<td>$231</td>
<td>8.0%</td>
<td>$121</td>
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<tr>
<td>2003</td>
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<td>$335</td>
<td>8.5%</td>
<td>$202</td>
<td>60.5%</td>
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<tr>
<td>2004</td>
<td>$2,920</td>
<td>$540</td>
<td>18.5%</td>
<td>$401</td>
<td>74.3%</td>
</tr>
<tr>
<td>2005</td>
<td>$3,120</td>
<td>$625</td>
<td>20.0%</td>
<td>$507</td>
<td>81.2%</td>
</tr>
<tr>
<td>2006</td>
<td>$2,980</td>
<td>$600</td>
<td>20.1%</td>
<td>$483</td>
<td>80.5%</td>
</tr>
</tbody>
</table>

Table 1: Mortgage originations and the growth of the subprime loan market from 2001
to 2006 (data quoted in Franke and Krahnen 2008).
Figure 1: S&P/Case-Schiller Home Price Index. (Dotted line indicates the estimated path of the index without the 263 billion USD subprime mortgages that were eventually written off.)

Note the bubble inflating after 2000 and the burst starting in 2007. If we calculate the growth in subprime mortgages from 2001 to 2006 at about 300%, using the data from table 1, and notice the growth of the twenty-city composite index during the same period by 190%, we infer a growth of 0.6% in the housing index per 1% increase in the subprime loans. What happens when these risky loans start defaulting? During the period 2007–2008 there was a write-off of 263 billion USD in bad subprime loans, which is about 45% of the originated loans. A 45% default on subprime loans would then translate to a $263 \times 0.6 = 27\%$ drop in the housing index from its peak of 206 to 150. The twenty-city index stabilized to almost 150 by 2010. That is where it should have been without the bubble caused by the subprime loose-credit policy. The lesson from this simple calculation is this: the value added by the subprime loans was eroded with the default of the loans, and the subprime loans appear to have been the major factor explaining the growth and decline of the housing market.

After the fact, of course, everything is clear. Saramago’s blind characters all of a sudden recover their vision. But while the market may have stabilized, the burst of the bubble did
cause considerable harm, as manifested by the global financial crisis that it provoked, through
contagion effects on the worldwide economy. Iceland, a country at the top of the U.N. Human
Development Index in 2007, and ranked by the Organization for Economic Cooperation and
Development as the fifth richest nation on earth per capita, was facing bankruptcy.

How come nobody saw it coming? And why was nothing done to prevent the bubble from
growing and bursting?

Some writers did see it. Still others, with a history of crying wolf, at last saw themselves
vindicated. We shall refrain from commenting on who was right and who was a crybaby, and
stick to the fact that nothing was done to prevent the crisis. Perhaps nothing could be done.
Major bubbles have a remarkable ability to reappear in different forms, as soon as the
collective memory forgets the traumatic experience of the previous bubble. This is about once
every fifty years, that is once every two generations (Perez 2002). The fascinating book by
Charles Mackay, Extraordinary Popular Delusions and the Madness of Crowds (MacKay 1841) records
many such bubbles: the Mississippi Scheme, the South Sea bubble, the Year of Panic 1825, the
Great Railway Mania of the 1840s, the Tulipomania, and of course the Great Crash of 1929. And
while some notable authors did see it coming, and warned extensively about it (Gray 1998
and Paul Krugman in many editorials; see Krugman 2009), no mechanisms were in place to protect
the market from going astray. Whether the bubble was fuelled by foolish investors, or whether
people foolishly followed the bubble over the abyss, is a question that economists are still
trying to understand.

While all the facts may be obvious ex post, there is a disturbing lesson to be drawn: namely
that the increased “freedom of transaction” brought about by the financial innovation of
mortgage securities only temporarily brought increased prosperity and happiness through the
ownership of a home. In the long run it caused a financial crisis, a global economic crisis, high
unemployment levels, and increased unhappiness. Should these freedoms have been curtailed?
And is there a flaw in Amartya Sen’s famous argument that instrumental freedoms are both
the primary ends and the principal means of development (Sen 1999)?

Knowledgeable students of Sen’s work will point out that the NINJA example violates one
of Sen’s instrumental freedoms: There were no transparency guarantees in the process of
securitization and resecuritization. Hence, we emphasize at the outset that this paper does not
set out to argue against freedom. Instead, we will argue, as the NINJA lessons taught us, that
freedom does not always lead to happiness. Care must be taken to understand the conditions under which adverse effects of free choice may be manifested. Whether we would opt for a “dictator” to impose these conditions by curtailing some freedoms, or take other steps to ensure that the right conditions exist so freedom does lead to happiness, is up to us.

The kingdom of Bhutan opted in part for the former approach in pursuing a policy of improving Gross National Happiness (Bok 2010:3). This paper expects to contribute to the latter approach. We start from the beginning, and the next section outlines our argument.

**Introduction**

The question in the title is an old one. John Stuart Mill, in his 1859 treatise *On Liberty*, devoted a chapter to individuality as one of the elements of well-being. Mill’s inspiration came from the utilitarian theories of Jeremy Bentham. Bentham had articulated the opinion that liberty is a good that—even though it is not a fundamental value—reflects the greatest-happiness principle: that is, freedom produces the greatest amount of happiness for the greatest number of people.

Our paper offers to this long-standing debate a novel narrative. We link research carried out over the last couple of decades on freedom as the primary end and the principal means for development (Sen 1999) with the findings of research on the economics of happiness (see Bok 2010). We use the economy—within which freedom is practiced and where happiness is experienced—as the medium to link the two concepts of the title. Our narrative is constructive: it not only identifies cases where freedom does not lead to happiness, such as the NINJA example above, but it also offers suggestions on what needs to be done so that this (apparent) paradox can be avoided.

Our methodological approach is also a prime illustration of what the Onassis Foundation’s “Athens Dialogues” could achieve. What we have in this paper is a dialogue between two contemporary ideas of broad impact: development as freedom and the economics of happiness. When the effective ranges of these two powerful ideas (their “horizons”) intersect, a tension, or potential conflict, arises. This paper contributes to “broadening the horizons” of these two ideas—to use Gadamer’s famous phrase. This broadening of horizons is a purpose of dialogue (Gadamer 1975), and this is pursued by the narrative of this paper.
At the same time, the tension created between these two ideas needs to be managed, that is diverted towards useful ends. We need to give meaning to the area of overlap of the two horizons, and this is the constructive part of the paper. Giving meaning to the world, and creating something new in order to bridge any gap or conflict arising at the borders, is Freire’s main thesis in *Pedagogy of the Oppressed* (Freire 1972), and this is pursued by the prescriptive part of the paper.

A summary of our argument is as follows:

Sen’s *Development as Freedom* argues that the main end and the primary means of development is the expansion of instrumental freedoms and the ability of individuals to act as free agents. A summary of these arguments will be given in the next section: “Freedoms and Happiness.” At the same time, recent studies of the economics of happiness have shown that people cannot always choose what makes them happy in the long run, and that the increase in economic prosperity of the last several decades has not led to greater well-being and happiness. A summary of this line of inquiry is also given in the next section. When we put these two arguments together—and study some examples where the expansion of economic freedoms has not increased happiness, and even caused unhappiness—then it appears one can make a case against freedom, and this is addressed in the section “Some Evidence Against Freedom.” This is where the narrative part ends, but it is not the conclusion of this paper. This must be clear from the outset: we are not arguing against freedom. The following section, “What Needs to Be Done,” is the prescriptive part of the paper and addresses the question raised in the previous section: that is, can we avoid the conflicts suggested there without curtailing freedoms, while at the same time following Bentham’s greatest-happiness principle? A short epilogue suggests as a topic for discussion what Greek classical thought had to say about these very modern issues.

Before we proceed to the next section, we need to inquire into the contemporary context of our discussion. How are these issues relevant today, in the context of current economic development?

First, the currently prevailing system of liberal democracy and free markets has increased people’s freedoms substantially. In addition, the model of economic development through consumption urges consumers to use these expanded economic freedoms. Production and consumption together create a “virtuous” cycle of economic growth, whereby production
leads to increased employment, increased employment provides income and expands consumers’ capability for consumption, increased consumption leads to greater demand for production and therefore employment, and the process goes on and on (Galbraith 1996). And just in case a consumer is reluctant to run the treadmill of consumption, the art of marketing will take care of it. As Galbraith put it earlier (1958:124–125): “a man on arising each morning [is] assailed by demons which instill in him a passion sometimes for silk shirts, sometimes for kitchenware, sometimes for chamber pots and sometimes for orange juice....” And he reaches the incisive conclusion: “Production only fills a void that it has itself created.”

Second, technology has empowered the individual agent for action. In all walks of economic life new technology-enabled institutions or instruments, or the technological innovations per se, expand our freedoms and our capabilities. We can get loans with convenient terms or invest the surplus of our labor in any activity we choose through international markets. (A relevant example for our discussion is the possibilities offered by “vice investing,” that is the investment strategy that targets companies selling products related to human vices, such as alcohol, tobacco, gambling, and weapons.) At the same time globalization has made the impact of our free-will choices wider and deeper than in times past. A characteristic comment on the power of technology is that of Jody Williams—the 1997 Nobel Peace Prize laureate for her work against antipersonnel mines—when asked how she managed to coordinate 1000 NGOs for her fight. Her one-word reply is revealing: “Email.”

Third, and this is relevant to the happiness side of the debate, the current state of economic growth in the developed world placed most of us beyond the need to satisfy some basic physical needs and the need for safety. Modern economies, as a result of automation mainly, produce in abundance some basic consumer products such as food, clothing, and shelter. Hence individuals seek to satisfy emotional needs, and the quest for happiness is becoming dominant.

It is within this general framework that we now develop our arguments.
Freedoms and Happiness

Freedoms

We will focus on the concept of freedom as articulated in Development as Freedom (Sen 1999). All references to the work, unless specified otherwise, are from the first Anchor Books edition, August 2000.

First, what does he mean by development? The word “development” seems to be taken for granted in this work. After all, the book was the by-product of a series of lectures given as a Presidential Fellow at the World Bank in 1996, and “development” is part of the World Bank’s set of core values that were ingrained in everybody in the audience. The word does not even appear in the book’s “index by subject.” Nevertheless, the preface talks about the “persistence of poverty and unfulfilled elementary needs, occurrence of famines and widespread hunger, violation of elementary political freedoms as well as basic liberties, extensive neglect of the interests and agency of women, and worsening threats to our environment and to the sustainability of our economic and social lives…. Overcoming these problems is a central part of the exercise of development” (Sen 1999:xii). We take this to be his definition of development.

Second, what is the main argument in the book? There are two tightly interlinked lines of reasoning:

1. Development is a process of expanding the real freedoms that people enjoy. The narrower view of identifying development with the growth of GNP or with rising personal incomes, or with industrialization, or with technological advance, or with social modernization, is ignoring the point that all these are nothing but the means to expanding the freedoms enjoyed by the members of the society. Important as they may be, growth in GNP or personal income is nothing but the means to an end, and the end of expanding freedoms depends on other determinants, such as social and economic arrangements as well as political and civil rights. Access to facilities for education and health are used as examples here, together with the freedom to participate in public discussion and scrutiny. Clearly, in the author’s view, an increase in personal income that does not come with improved access to health care or education is not contributing much to the exercise of development (Sen 1999:3–4). This is one of the two reasons why freedom is central to the process of development, and the author calls this the evaluative reason. That is, progress has to be assessed primarily in
terms of whether the freedoms that people have are enhanced. This line of reasoning views freedom as the primary end of development, and is the “constitutive role” of freedom in development.

2. Freedom is the principal means of development. Freedoms have an “instrumental role” in development, since development is thoroughly dependent on the free agency of the people (Sen 1999:36). When people are deprived of some freedoms then their capabilities are restricted, and their effectiveness in the exercise of development is curtailed. The author calls this the effectiveness reason (1999:4), and a good part of the book (especially chapter 1) is devoted to providing empirical support for this argument. Seen from this perspective, freedoms not only contribute to the process of development, but they also contribute to the strength of free agencies of other kinds, thus creating positive multiplier effects on the development process.

Third, what are the instrumental freedoms that contribute to the success of development? Instrumental freedoms contribute directly or indirectly to the overall freedom people have to live the way they would like to live. The instruments involved are quite diverse, but Sen finds it convenient to identify five distinct types of freedom that are particularly worth emphasizing, and appear in the empirical part of the analysis. These are (1) political freedoms, (2) economic facilities, (3) social opportunities, (4) transparency guarantees, and (5) protective security (Sen 1999:38). One particular type of freedom that is of interest to our work, that of market transactions, falls under the category of economic facilities, and we turn our attention to what the author has to say on this.

Fourth, what is the role of markets? Sen argues that markets should be valued not only for their contribution to economic growth—for which they are already acknowledged in the literature. Quoting Adam Smith, he argues further that markets should be valued for providing freedom of exchange and transaction that is itself part and parcel of the basic liberties that people have reason to value (Sen 1999:6). He also argues that the freedom to participate in the labour market is one of the ways of avoiding keeping people in bondage and captivity. Hence the freedom to enter markets can be in itself a significant contribution to development, aside from whatever the market mechanism may or may not do to promote economic growth or industrialization (1999:7). In chapter 5, “Markets, State and Social Opportunities,” the author
examines the results that markets ultimately generate, but also makes the more immediate case for the freedom of market transactions as an important freedom itself. In this paper we examine the effect on happiness of economic facilities and the freedoms provided by the markets.

One final argument is needed before we can use Sen’s work as the building block for our own arguments on happiness. In particular, we need to expand his definition of development to include the pursuit of happiness. Maslow’s theory of human motivation of (Maslow 1943) provides the missing link. The basis of Maslow’s theory is that human beings are motivated by unsatisfied needs, and that certain lower physiological needs need to be satisfied before higher needs can be addressed (figure 2). According to this theory, there are general needs which have to be fulfilled before a person is able to act unselfishly: these are the so called “deficiency needs.” While people are motivated to fulfil these basic desires, they continue to move toward growth, and eventually self-actualization. We note now that Sen’s definition of development, as outlined above, refers to the base of Maslow’s hierarchy of human needs. Indeed, Sen refers to “unfulfilled elementary needs” independently of Maslow’s hierarchy. (If Sen was aware of Maslow’s work, it does not seem to have played any role in his arguments, and Maslow is not cited in the book.)

Can we apply Sen’s arguments to the pursuit of other needs as part of the development exercise? Or is his work restricted to overcoming only those problems described in his definition of development? Nowhere in his argument is the evaluative aspect of freedom is restricted to the freedom to satisfy specifically safety needs, or any needs for that matter. It is a main end of development, and hence we can deduce that Sen’s arguments apply independently of any hierarchy of needs, Maslow’s or anybody else’s. The instrumental aspect of freedom contributes “to the expansion of the ‘capabilities’ of persons to lead the kind of lives they value—and have reason to value” (Sen 1999:18). Indeed, the notion of “capabilities” and the “agency aspect” of individuals to help themselves and influence the world are central to Sen’s work. Freedom is seen as the instrument of expanding capabilities and strengthening the agent. There is no reason we know of to restrict the application of capabilities only to the satisfaction of the lower-level needs, and hence we take it that Sen’s development process applies to the incremental satisfaction of a hierarchy of needs. (Seeing no reason is not a proof
that no such reason exists. To be rigorous, one would have to work out the details of Sen’s thesis within a broader definition of development.)

Figure 2: Maslow’s hierarchy of needs.

Happiness

In his ethical work, Aristotle addressed the issue of living a successful life. The notions of eudaimonia and makariotita—translated as ‘happiness’ or ‘blessedness’, respectively (Barnes 1995:199–205)—feature in his works. Buddha, in the earliest known work ascribed to him, the Dhammapada, expresses the view that what we are is the result of what we have thought, and concludes that “If one speaks or acts with a pure thought, happiness follows one, like a shadow that never leaves.” These seem to be the earliest references to happiness, and they influenced significantly the development of both eastern and western thought. But it was the enlightenment in the eighteenth century, and Jeremy Bentham’s work on felicific calculus—the algorithm that allows one to calculate the amount of pleasure a specific action is likely to cause—that moved happiness from the abstract realm of philosophical ideas to the pragmatic domain of policy-making. Felicific calculus would allow a society to pursue the greatest-happiness principle and produce the greatest amount of happiness for the greatest number of people. Bentham pronounced this as the overriding aim of government (Burns and Hart 1996).

The writings of political philosophers of the Benthamite school, like John Stuart Mill, influenced political action. Paraphrasing a phrase by Locke, the Declaration of Independence of July 5, 1776 proclaimed “life, liberty and the pursuit of happiness” as among the unalienable rights bestowed upon all men by their Creator. The French constitution of June 24, 1793
declared the goal of society to be general happiness. Thus happiness acquired the status of a real good that can be identified, measured, and accumulated. It became a constitutional right, and a government’s obligation to guarantee. (Although Bentham [1748–1832] gained enduring fame for the creation of the utilitarian school, it was when Bentham was one year old that Ludovico Antonio Muratori published a book entitled Della pubblica felicitá, and introduced the word “public happiness” (quoted in Dixon 1997:1812).

Readers interested in the history of happiness may consult McMahon 2006. In our work we are concerned with the contemporary issues relating to happiness, and in particular the research findings of the last decades on the “economics of happiness”; for an extensive book treatment see Bok 2010. We turn our attention to the major findings of the last thirty years of research that are relevant to our thesis.

Research on this topic, virtually nonexistent before 1970, has grown rapidly since then. While some authors talk about “happiness,” others talk of “well-being” or “life satisfaction.” The following comprehensive definition seems to cover the essence of what all the authors mean: “a person is said to have high [well-being or happiness] if she experiences life satisfaction and frequent joy, and only infrequently experiences unpleasant emotions such as sadness or anger. Contrariwise, a person is said to have low [well-being or happiness] if he or she is dissatisfied with life, experiences little joy and affection, and frequently feels unpleasant emotions such as anger or anxiety” (Diener et al., as quoted in Bok 2010:9–10).

Can happiness or well-being, thus defined, be measured? Psychologists and social and political scientists answer affirmatively. Lately economists have joined the group. Psychologists find it natural to ask people how they feel. “Not too happy,” “pretty happy,” or “very happy” are the available choices in the General Social Survey in the U.S. The Eurobarometer asks respondents to rate their life-satisfaction with answers ranging from “not at all satisfied” to “very satisfied.” An alternative approach followed by some researchers is to ask individuals about their feelings at different times during the day. One issue raised in the psychology literature is whether such measures are reliable and valid. The consensus is affirmative, and self-reported measures have been demonstrated to be correlated with objective characteristics such as unemployment, recall of positive or negative life experiences, assessment of one’s happiness by friends and family members, physiological responses to stress and psychosomatic illnesses such as headaches and digestive disorders,
electroencephalogram measures of prefrontal brain activity, and duration of so-called Duchenne smiles—the smiles that occur when two sets of facial muscles fire simultaneously, and are considered genuine smiles. An overview of the psychology literature on the reliability and validity of happiness measures is given in Blanchflower and Oswald 2004.

The findings of numerous research investigations address a wide range of diverse questions. Researchers look not only for categorizations, but also for trends in the data, as well as linking happiness measures with objective characteristics or events in one’s life.

For instance, surveys rate nations by their citizens’ average satisfaction with life, or by “quality life years,” which is a composite index of quality of life times life expectancy (Bok 2010:24–25). The distribution of life satisfaction, on a scale of 1 (unhappy) to 7 (very happy), shows an “optimistic” bias, with the majority of the population and their average being above the midpoint. Figure 3 summarizes the data for Britain, but similar findings hold in almost all advanced industrial nations (Bok 2010:25–26).

![Figure 3: The distribution of life satisfaction in Britain, where 7 is “completely satisfied” (from Oswald 2009:4).](image)

Happiness for different age cohorts has a U shape, with happiness levels declining from our teenage years until our mid thirties, but after that people tend to grow happier well into old age. Tracking events such as marriages, employment, childbearing, etc. reveals that married people tend to be happier than unmarried people, divorce causes unhappiness for three years before and after the event but people eventually bounce back, children do not appear to be
causing any significant increase in happiness, and unemployment makes people very unhappy. Experience sampling has allowed Kahneman and his colleagues (Kahneman et al. 2004) to study the effect of specific activities on happiness. Table 2 is interesting in its own right and will be useful to our arguments later on.

Trend analyses show how the happiness levels of various groups change with time. The major finding was the so-called Easterlin paradox. In a seminal paper, Easterlin (1974) studied time-series data on the happiness level in the United States since 1946. His conclusion that “higher income was not systematically accompanied by greater happiness” (Easterlin 1974:118) sparked a controversy, as it seemed paradoxical that increased prosperity would not make a nation happier on the average. Many explanations have been offered for the paradox. Perhaps the most notable is that growing GDP does not make one better off relative to all his neighbors, and as people are comparison animals, the increased prosperity of all increases the happiness of none. Inconsistencies in the time-series data were also used to explain the paradox, with Oswald (1997) pointing out that the longest consistent set in Easterlin’s data shows a marked increase in the percentage of Americans reported as very happy, with a comparable decrease in the percentage of those reporting as not very happy. Oswald’s finding in the same paper (1997:1818) that “happiness with life appears to be increasing in the United States, but the rise is so small that it seems that extra income is not contributing dramatically to the quality of people’s life” gives us a weak version of the Easterlin paradox.

<table>
<thead>
<tr>
<th>Activity</th>
<th>Hours spent per day</th>
<th>Effect of activity on happiness (on a scale from 1 to 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intimate relations</td>
<td>0.2</td>
<td>4.74</td>
</tr>
<tr>
<td>Socializing after work</td>
<td>1.2</td>
<td>4.12</td>
</tr>
<tr>
<td>Dinner</td>
<td>0.8</td>
<td>3.96</td>
</tr>
<tr>
<td>Relaxing</td>
<td>2.2</td>
<td>3.91</td>
</tr>
<tr>
<td>Lunch</td>
<td>0.5</td>
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<td>Exercising</td>
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<td>Praying</td>
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<td>Socializing at work</td>
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<td>3.75</td>
</tr>
<tr>
<td>Activity</td>
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<td>Minutes</td>
</tr>
<tr>
<td>--------------------</td>
<td>-------</td>
<td>---------</td>
</tr>
<tr>
<td>Watching TV</td>
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<td>3.62</td>
</tr>
<tr>
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<td>3.49</td>
</tr>
<tr>
<td>Napping</td>
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<td>Shopping</td>
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<td>2.96</td>
</tr>
<tr>
<td>Child care</td>
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<td>2.95</td>
</tr>
<tr>
<td>Evening commute</td>
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<td>2.78</td>
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<tr>
<td>Working</td>
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<td>2.65</td>
</tr>
<tr>
<td>Morning commute</td>
<td>0.4</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Table 2: The effect of specific activities on happiness (Kahneman et al. 2004:429).

Some Evidence Against Freedom

Given the current state of knowledge on happiness as outlined above, can we infer that freedom leads to happiness, or is there evidence to the contrary? If we identify cases where freedoms have been expanded while happiness has decreased, that would be an argument for not answering positively to our question. We use one type of instrumental freedom, that referred to by Sen as “economic facilities,” and in particular the freedoms afforded by the markets, and use economic indicators as proxies for market freedoms. If we identify cases where economic indicators have improved while happiness has decreased, that too would be an argument against a positive answer.

Note that a non-positive answer is not the same as a negative answer. While some statistics may show that a freedom has been expanded while happiness has decreased, there may be other factors depressing the happiness levels: some freedoms were curtailed as others were increased, the increased freedom had an inadvertent negative effect on other freedoms, the expanded freedoms did not improve the capabilities of all the population, the population did not make use of the expanded capabilities they acquired with the expanded freedoms. These are some potential explanations. Nevertheless, any evidence against freedom questions whether we can pursue freedom and happiness simultaneously.

Some may already see the Easterlin paradox as evidence against freedom. This would be true if increased prosperity were accompanied by a decrease in happiness, instead of non-
increasing happiness. But this is not the case. The strong version of the Easterlin paradox would lead to the conclusion that freedom is irrelevant to happiness. The weaker version, as articulated by Oswald and quoted above, suggests that freedom has a marginally positive income on happiness. However, more recent work—using more reliable and extensive time series of data and more refined mathematical regressions—found a significant negative trend of happiness over time. According to Blanchflower and Oswald (2004) “America is becoming systematically less happy (in the eyes of the Americans themselves),” with a negative time trend estimated at −0.0027, and a sufficiently large t-statistic to reject the hypothesis that the time trend is zero. Hence, the increase in prosperity brought about by increased freedoms in the U.S. over the last quarter of the twentieth century brought about a decline in happiness.

Hence, expanded economic facilities and market freedoms reduced happiness levels, and this would be evidence that freedom does not lead to happiness. However, other evidence than time series analysis tells a different story: richer people tend to be happier than poor people. Some evidence for this is found in table 3.

<table>
<thead>
<tr>
<th></th>
<th>Lowest-income quartile people</th>
<th>Highest-income quartile people</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very happy (%)</td>
<td>18.8</td>
<td>28.4</td>
</tr>
<tr>
<td>Pretty happy (%)</td>
<td>54.5</td>
<td>58.5</td>
</tr>
<tr>
<td>Not too happy (%)</td>
<td>26.7</td>
<td>13.1</td>
</tr>
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This table does not provide rigorous evidence, however, that higher income implies higher levels of happiness. To test the hypothesis that money buys happiness, we compare the average happiness of the population of two sets of countries: the EU-27 countries with per capita GDP above the median (wealthy), and those with per capita GDP below the median (not so wealthy). We use Eurostat data measuring GDP per capita in Purchasing Power Standards (PPS). The USA, Japan, Turkey, Norway, Iceland, and Switzerland are also included in the sample. Happiness data were obtained from the ASEP/JDS databank. The level of happiness is measured using the “happiness index,” which is defined as the percentage of those declaring themselves “very happy” or “quite happy,” minus those declaring themselves “not very
happy” or “not at all happy,” plus 100. This index ranges from 0 to 200, with the happiest countries going to 200 and the less happy countries going to 0. One hundred is the midpoint value for countries that have similar rates of persons “quite” or “very happy” and those “not very” or “not at all happy.” Our regression analysis of the happiness index as a function of GDP found a statistically significant positive coefficient of 0.367. The same story is confirmed when we compare the mean happiness of the wealthy with the not-so-wealthy group. The not-so-wealthy group has a mean happiness index of 151.97, while the wealthy group has a mean of 184.07, and the difference is significant using the t-test.

Hence, GDP data do not paint a conclusive picture. While having the freedom and the capacity to place oneself in the group of wealthy countries improves happiness, the improvement in GDP of a country over time does not improve happiness, and in one study was even found to reduce it. The best explanation offered for this is that happiness is driven by comparisons, and a tide that raises all boats does not make anyone relatively happier. But overall it seems that wealth and happiness live happily together.

Exhibit 1. Problems, however, seem to be lurking below the surface of a happy symbiosis between GDP and happiness. We compare the use of drugs in the two sets of wealthy and not-so-wealthy EU countries. (Data on drug use is taken from the European Monitoring Centre for Drugs and Drug Addiction.) When it comes to lifetime prevalence in the percentage of the population who use either cannabis or cocaine, the wealthy countries had more users, on average, than the not-so-wealthy countries. At the 95% confidence level, the use of cannabis by citizens of wealthy countries is between 3.8% and 18.1% higher than by citizens of not-so-wealthy countries. When it comes to the use of cocaine, the difference is between 0.4% and 4.0%, again at the 95% confidence level.

Hence, expanded freedoms for these countries may have led to increases in GDP and the purchasing power of their citizens, but part of this power has been used on activities that only in the very short run make one feel happy.

Exhibit 2. Blanchflower and Oswald’s analysis (2004) includes some interesting findings for subgroups of the U.S. population. While the population at large is becoming marginally unhappier with economic growth from 1972 to 1998 (coefficient -0.0027), there are stronger trends for subgroups. The coefficient of their regression model for women is -.0062, and this is statistically significant. Over the period of testing, the percentage of American women
considering themselves very happy dropped from 36% of the population to 29%. Similar
evidence is provided by the British data. The authors’ conclusion (2004:1381) is a direct answer
to our question: “Whatever the consequences of anti-female discrimination policy elsewhere
in society, it has apparently not been successful in either country in creating a feeling of rising
well-being among women.” We hasten to add, though, that evidence in the same paper shows
that differences in well-being of racial groups in the United States have narrowed over time.
Blacks have made up ground, and became happier during the period of Blanchflower and
Oswald’s study.

Exhibit 3. Some compelling evidence that people cannot choose for themselves what makes
them happy is provided when we study how Americans spend their free time, as reported in
Bok 2010:76. From 1965 to 2003, both men and women saw their leisure time increase.
Depending on the definition of leisure used in the studies, this increase ranged from 5.6 to 8
hours for men, and from 3.7 to 6.8 hours for women. How was this extra time used? Watching
television increased by 7.4 hours per week, while the number of hours devoted to reading
dropped by 3.1 hours and the time spent socializing with friends by 3.9 hours. If we refer now
to the data in table 2, we observe that people did not use the extra free time on those activities
that according to them brought them more happiness. While their self-reported data show that
socializing brings them the most happiness, they reduced their socializing time to watch
television, which gives them much less happiness. No surprise then that Blanchflower and
Oswald find the population becoming less happy during most of Bok’s period: while their
income may have grown and so did their free time, they spent their expanded freedoms in
front of the television.

Exhibit 4. The report of the Commission on the Measurement of Economic Performance and
Social Progress set up by President Sarkozy is full of statements that point to underlying
problems even as freedoms are expanded (Stiglitz et al. 2010). We quote a few:

“In Russia, declining life expectancy suggests there are underlying problems, even if GDP
per capita is increasing” (page xix). This observation comes at a time when Russia has seen
its freedoms significantly expanded through democratic reforms in the postcommunist
era.
“There may be an increasing disparity between average income and median income (the income of the representative individual); one may be increasing while the other is declining” (page xxi). Hence, while the average freedoms are expanded, the capabilities of the average Joe and Jane are restricted.

“A developing country that sells a polluting mining concession with low royalties and inadequate environmental regulation may see GDP increase but well-being decrease” (page xxii). This is a real situation in many developing countries, and the freedom to manage their own natural resources does not always leave them better off.

“For a poor developing country to be told that its GDP has gone up may be of little relevance. It wants to know whether its citizens are better off” (page 29). The report provides data for Ireland, showing that disposable income there declines relative to the country’s GDP, as a result of profits that are repatriated by foreign investors. Interestingly, according to an OECD study Ireland is one of the few countries that has reduced its expenditures on education during this period.

What is the overall conclusion from the evidence we have provided? If there is evidence that freedom sometimes leads to a decrease in happiness, are we to conclude that freedom does not lead to happiness? And hence, if we take the pursuit of happiness as the paramount value, then should freedom be curtailed? The first question can be answered with logical inferences; the second requires a value judgment.

On the first question: the evidence shows that expanded freedoms do not necessarily lead to happiness. Hence, it is not enough to expand freedoms and then expect a society to progress upward through Maslow’s hierarchy in pursuit of happiness. Something more seems to be needed.

On the second question: if we subscribe to Bentham’s opinion that liberty is a good that is not of fundamental value in itself, but its value is that it reflects the greatest-happiness principle, and if our evidence has shown that freedom does not always reflect the greatest-happiness principle, then we should be ready to make freedoms subordinate to happiness. This route is pursued by regimes that suppress democratic liberties until such time that the economic development of the country can afford it. However, if we value freedom as something of fundamental value—which is the evaluative part of Sen’s arguments, contrary to
Bentham’s statement—then we are faced with the difficult question of what to do when the expansion of freedom and the pursuit of happiness are at odds with each other. Recognizing that conflict is unavoidable part of human affairs, we turn in the next section to a search for ways to minimize the conflict.

Recognizing that the proof by example we have given so far is not a rigorous one, we provide a final argument to strengthen this section:

*Exhibit 5.* We point out that the exhibits we have presented thus far are examples of the dilemma of a “paretian liberal,” as analyzed in Sen’s impossibility theorem (Sen 1970). Without going into the technicalities of the weak and strong forms of the impossibility theorem, Sen has shown that it is impossible for a society to make social choices that satisfy simultaneously Pareto efficiency of the final state and the conditions of individual liberty. If we consider, in our case, social choices that relate to happiness, then Sen’s theorem would state that it is impossible to find a state of society where nobody could be happier unless someone else is made less happy, while respecting the liberty of individuals. We would have to accept suboptimal happiness conditions if we guarantee individual liberties for some. Interestingly, in his definition of “some,” Sen requires that at least two people should have their liberties guaranteed, for if only one person is left in this set then we would have a dictatorship. Even with this definition of minimal liberalism—which is an oligarchy—we have an impossibility. Obviously the impossibility theorem holds true in the more general case discussed here, where we do not guarantee the freedoms of only a chosen few.

**What Needs to Be Done?**

Are there any solutions to resolving the conflict between freedom and happiness we have outlined in the previous section?

*Education.* One answer can be obtained from Sen’s own conclusion on what to do with the impossibility of the Paretian liberal: “The ultimate guarantee for individual liberty may rest not on rules for social choice but on developing individual values that respect each other’s personal choices” (Sen 1970:155). Hence education has to play an important role. But education should not be restricted to developing values that respect each other’s personal choices, following Sen’s conclusion. In addition, we argue that education should be broad enough so that individuals are capable of judging the impact of their choices on
their happiness. We do not expand here upon the kind of education that is needed, but two concrete points can be made:

Blanchflower and Oswald’s analysis shows that education introduces a positive coefficient in the happiness equations. What is even more important, though, is that this positive effect is independent of the earnings effect. That is, while education contributes positively to one’s earnings, and wealthy individuals are happier than not-so-wealthy individuals, the positive effect of education on happiness remains even when we control for increased earnings. Education is playing a role independently of income. We surmise that the role it plays is in guiding people to use their expanded freedoms in ways that improve their happiness—for instance, by deciding to spend any extra free time they may receive socializing with family and friends or relaxing with a good book, rather than watching more television.

Education must be broad, as a narrow focus on specialized skills that help only to improve one’s income are not sufficient to increase happiness. Thus the arguments that people in the humanities have been making for their disciplines over the years gain renewed weight (see Nussbaum 2010). To participate efficiently in the production-consumption cycle, it is not sufficient merely to have an educated population. The population must be in a position to reflect effectively on “producing” those things worth “consuming,” such as a functioning, efficient, and compassionate democracy; critical thinking; and a creative imagination for the arts and literature.

Well-being audits. A second answer can be obtained by looking at the way society has been dealing with the environmental consequences of our economic activity. Once it was recognized that our free-will choices had an inadvertent impact on the environment, regulations were enacted and procedures were put in place to carry out environmental audits for major new projects.

A similar approach is needed in dealing with a society’s well-being and happiness. Regulatory discussions on specific activities should take into account the effect of these activities on happiness. To this end, standards must be developed for well-being audits, in the same way the professions gave us standards for environmental audits. It is only through proactive audits that we can discover the inadvertent effects of some free-will choices we make in instituting major projects.
Susan George uses the term “boomerang” to describe how the third-world debt is harming the developed nations (George 1992). Policies that we thought were positive for us had a negative effect on others and eventually acted like a boomerang. In a globalized world we cannot expect to dump our waste in our neighbor’s back yard and expect that the filth will not touch us. Happiness audits should search in advance for such boomerang effects so that informed decisions can be made.

Well-being metrics. The third answer comes from the report of the Stiglitz Commission: the need to develop appropriate metrics for measuring our lives. The metrics we use dictate our actions. The commission makes four recommendations that, if adopted, will give a more balanced view of what we measure when we seek to assess material well being. But, most importantly, it makes a fifth recommendation that income measures should be broadened to include nonmarket activities.

It is through the realization that well-being is multidimensional, coupled with metrics and regulations to monitor these dimensions, and improved knowledge of the multiple dimensions and their interactions, that we can exercise the capabilities freedom gives us in the pursuit of happiness. For as long as we fail to do this effectively, the tension between freedom and happiness we have described will remain a paradox.

Epilogue: Greek Classical Thought

What do the classical Greek philosophers have to say about these very modern questions? Can we use their wisdom to advance contemporary understanding? We leave these questions to be addressed by more knowledgeable participants at the Onassis Foundation’s “Athens Dialogues.”

Bibliography


