

CHAPTER 6

How Many Do You Want It to Be?

OUTPUT, INCOME AND HAPPINESS

WHEN: Sometime in the 1930s

WHERE: The office of the Gosplan, the central planning authority of the USSR

WHAT: Interview for the post of the chief statistician

The first candidate is asked by the interview board, ‘What is two plus two, comrade?’ He answers: ‘Five.’

The chairman of the interview board smiles indulgently and says: ‘Comrade, we very much appreciate your revolutionary enthusiasm, but this job needs someone who can count.’ The candidate is politely shown the door.

The second candidate’s answer is ‘Three.’ The youngest member of the interview board springs up and shouts: ‘Arrest that man! We cannot tolerate this kind of counter-revolutionary propaganda, under-reporting our achievements!’ The second candidate is summarily dragged out of the room by the guards.

When asked the same question, the third candidate answers: ‘Of course it is four.’ The professorial-looking member of the board gives him a stern lecture on the limitations of bourgeois science, fixated on formal logic. The candidate hangs his head in shame and walks out of the room.

The fourth candidate is hired.

What was his answer?

‘How many do you want it to be?’

Output

Gross Domestic Product, or GDP

Output figures are rarely ‘manufactured’ blatantly, even in socialist countries, except in the most extreme political situations – such as the early days of Stalin’s rule or the Great Leap Forward under Mao Zedong in China. Still, it would be wrong to think that we can measure economic output, or any other number in economics for that matter, in the way we measure things in natural sciences, such as physics or chemistry.

The economists’ favoured measure for output is **Gross Domestic Product**, or GDP. It is, roughly speaking, the total monetary value of what has been produced within a country over a particular period of time – usually a year, but also a quarter (three months) or even a month.

I said ‘roughly’, because ‘what has been produced’ needs definition. In calculating GDP, we measure output – or product – by **value added**. Value added is the value of a producer’s output minus the intermediate inputs it has used. A bakery may earn £150,000 a year by selling bread and pastries, but if it has paid £100,000 in order to buy various **intermediate inputs** – raw materials (e.g., flour, butter, eggs, sugar), fuel, electricity and so on – it has only added £50,000 of value to those inputs.

If we didn’t take away the value of the intermediate inputs and simply added up the final outputs of all the producers, we would be double-, triple- and multiple-counting some components, inflating the actual output. The baker bought its flour from a milling company, so if we simply added up the output of the baker and the miller, the flour that the baker bought would be counted twice. The miller bought the wheat

from a farmer, so if we added the output of the wheat farmer to those of the baker and the miller, the portion of the wheat output that the farmer had sold to the miller and then was sold on to the baker would be counted three times. Only by counting the ‘added’ value can we measure the true size of the output.*

What about the ‘Gross’ bit in GDP? It means that we still have *not* taken away something that could have been removed from the picture, as when a can of tuna specifies gross weight and net weight (that is, the weight of the fish without the oil or brine). In this case, that something is the used-up parts of **capital goods** – basically machines, so we are talking the baker’s ovens, dough mixers and bread slicers. Capital goods, or machines, are not ‘consumed’ and incorporated into the output in the same way in which flour is to bread, but they experience reduction in economic value with use – this is known as **depreciation**. If we take away the wear and tear of machines from GDP, we get **Net Domestic Product**, or NDP.

Net Domestic Product, or NDP

As NDP accounts for everything that has gone into producing the output – intermediate inputs and capital-goods inputs – it provides a more accurate picture of what the economy has produced than GDP does. But we tend to use GDP instead of NDP because there is no one agreed way of estimating depreciation (suffice it to say here there are several contending ways), which makes the definition of N in NDP quite tricky.

Then how about D in GDP? ‘Domestic’ here means being within the boundary of a country. Not all producers in a country are its own citizens or companies registered in it. Seen from the other side, not all producers produce in their home countries; companies run factories abroad, and people get jobs in foreign countries. The number that measures all the output produced by your nationals (including companies), rather than the output produced within your border, is called **Gross National Product**, or GNP.

Gross National Product, or GNP

In the US or Norway, GDP and GNP are more or less identical. In Canada, Brazil and India, with many foreign firms inside their borders and few domestic firms producing abroad, GDP could be more than 10 per cent bigger than GNP. For Sweden and Switzerland, which have more of their national firms operating abroad than foreign firms operating within their borders, GNP is bigger than GDP, around 2.5 and 5 per cent respectively as of 2010.

GDP is more frequently used than GNP, since, in the short run, it is the more accurate indicator of the level of productive activities within a country. But GNP is a better measure of an economy’s long-term strength.

A country may have a higher GDP (GNP) than another, but that may be because it has a larger population than the other. So, we really need to look at GDP or GNP figures **per capita** (per head, or per person, if you like) if we want to know how productive the economy is – it is actually somewhat more complicated than that, but we can leave this aside; if you are interested, read the footnote.*

Limitations of GDP and GNP measures

A critical limitation of GDP and GNP measures is that they value outputs at market prices. Since a lot of economic activities occur outside the market, the values of their outputs need to be somehow calculated – ‘imputed’ is the technical word. For example, a lot of farmers in developing countries engage in subsistence farming in which they consume most of the food they produce. So we need to estimate that quantity and impute market values to what those farmers produced but did not sell in the market (and

consumed themselves). Or, when people live in houses they own, we impute the value of the ‘dwelling services’ involved, as if the house-owners are paying the rents at market rates to themselves. Unlike outputs exchanged through markets, the imputation of market values to non-marketed outputs involves guesswork, imparting inaccuracy to the numbers.

Worse, there is a particular class of non-marketed output whose value isn’t even imputed. Household work – including cooking, cleaning, care work for children and elderly relatives and so on – is simply not counted as part of GDP or GNP. The classic ‘joke’ among economists is that you reduce your national output if you marry your housekeeper. The standard excuse is that it is difficult to impute values to household work, but it is a very weak defence. After all, we impute values to all sorts of other non-marketed economic activities, including living in one’s own house. As the vast bulk of household work is done by women, women’s work is grossly under-valued as a result of this practice. Many estimates put the value of household work to be equivalent to around 30 per cent of GDP.

REAL-LIFE NUMBERS

Why do you need to know ‘real-life numbers’?

Despite the common impression that it is a ‘numbers’ subject, economics as it is taught today is rather short on numbers. It is common that someone with an economics degree does not know some ‘obvious’ economic numbers, such as the GDP or the average working hours of her own country.

There is no way anyone can remember more than a handful of those numbers. Indeed, in this internet age, you don’t have to remember any of them, because you can easily look them up. But I believe it is important that my readers familiarize themselves with some of these ‘real-life numbers’, even just to know what numbers to look up. More importantly, they need to develop a sense of what our economic world looks like in reality: when we talk about China’s GDP, are we talking hundreds of billions or tens of trillions of US dollars? Are we talking 15 per cent or 30 per cent when we say that South Africa has one of the highest unemployment rates in the world? When we say that a high proportion of people in India live in poverty, do we mean 20 per cent or 40 per cent? Thus, in this and all subsequent chapters, I provide a selection of the most important real-life economic numbers.

Most of world output is produced by a small number of countries

The world GDP in 2010, according to the World Bank data, was around \$63.4 trillion. The five largest economies by GDP were the US (22.7 per cent of the world economy), China (9.4 per cent), Japan (8.7 per cent), Germany (5.2 per cent) and France (4.0 per cent).^{*} Thus these five economies accounted for half of world output.

In 2010, the ‘high-income countries’ in the World Bank classification (countries with above \$12,276 per capita income) had collective GDP of \$44.9 trillion.[†] They accounted for 70.8 per cent of the world economy. The rest of the world, or the developing world, collectively had a GDP of \$18.5 trillion, or 29.2 per cent of world GDP. But two-thirds (66.6 per cent) of this \$18.5 trillion was accounted for by the five largest developing economies, China, Brazil, India, Russia and Mexico.^{*} The rest of the developing world, with a collective GDP of \$6.3 trillion, accounted for just under 10 per cent of the world economy.

Most developing economies produce tiny – I mean tiny – fractions of what the richest countries produce

The typical GDP of very poor small developing countries (5–10 million people), such as the Central African Republic or Liberia, is in the region of one or two billion dollars, or \$0.001 trillion to \$0.002

trillion. These are not even 0.01 per cent of the US GDP, which was \$14.4 trillion as of 2010.

The thirty-five low-income countries according to the World Bank classification (countries with less than \$1,005 per capita GDP in 2010) collectively had a GDP of \$0.42 trillion. This is 0.66 per cent of the world economy or 2.9 per cent of the US economy.

Even the larger middle-income developing countries (30–50 million people), such as Colombia or South Africa, may have GDP of \$300–400 billion. These are only as large as the GDP of a mid-sized US state, such as Washington or Minnesota.

In terms of GDP per capita figures, we have a huge range. Since these figures are similar – actually identical in theory, although not necessarily so in practice – to income per capita figures that we discuss shortly, suffice it to say here that we are talking about differentials over 500 times.

Income

Gross Domestic Income, or GDI

GDP may be seen as a sum of incomes, rather than outputs, as everyone who is involved in the production activity is paid for his/her contribution (whether the amounts paid are ‘fair’ is another matter). Going back to the baker’s example, having paid for flour, eggs and other intermediate inputs, the bakery will divide up its value-added between wages for its workers, profits for its shareholders, interest payments for the loan it may have contracted and the indirect taxes that are automatically included in the revenue that it generates (that is, value added tax (VAT) or sales tax).

The sum of these incomes is known as **Gross Domestic Income**, or GDI. In theory, GDI should be identical to GDP, as it is simply a different way of adding up the same thing. But in practice it is slightly different, as some of the data used in compiling the two of them may be collected through different channels.

Gross National Income, or GNI, and per capita GNI

Like GNP is to GDP, **Gross National Income**, or GNI, is to GDI. GNI is the result of adding up the incomes of a country’s citizens, rather than the incomes of those who are producing within its border, which gives us GDI. The World Bank publishes GDP and GNI, rather than GNP and GDI. This is presumably on the reasoning that income, as a measure of earnings, is better measured according to the nationality of those who claim it, while product, as a measure of outputs, is better measured according to where the production activities are happening.

Per capita income, usually measured by GNI (or its product equivalent, GNP) per capita, is considered by many people to be the single best measure of a country’s living standard. But saying that it is the best does not mean that it is good enough.

One obvious problem is that GNI per capita only measures the average income. But the average may conceal a much greater variation among different individuals and groups in one country than in another. To give a simple numerical example, Countries A and B may both have \$5,000 per capita income and ten people (therefore GNI of \$50,000 each), but A may consist of one person with \$45,500 income and nine people with \$500 each, while B may consist of one person with \$9,500 income and nine people with \$4,500 each. In this case, \$5,000 per capita income will be a relatively accurate description of the standard of living in Country B but will be completely misleading for Country A. To use a more technical

term, you would say that the average income is a more accurate indicator of the living standard for a country with a more equal distribution of income. (More on this in [Chapter 9](#).)

Adjusting for different price levels: purchasing power parity

One important adjustment that is often made to the GNI (or GDP) figures is that for different price levels in different countries. The market exchange rate between the Danish krone and the Mexican peso may be around one krone to 2.2 pesos, but with 2.2 pesos you can buy more goods and services in Mexico than you can with one krone in Denmark (I will explain shortly why). So the official exchange rate between the Danish krone and the Mexican peso under-estimates the actual living standards in Mexico.

The problem is that market exchange rates are largely determined by the supply and demand for *internationally traded* goods and services, such as the Galaxy phones or international banking services, while what a sum of money can buy in a particular country is determined by the prices of *all* goods and services, including those that are not internationally traded, such as eating out or taking a taxi.¹

To deal with this problem, economists have come up with the idea of an ‘international dollar’. Based on the notion of **purchasing power parity** (PPP) – that is, measuring the value of a currency according to how much of a common set of goods and services (known as the ‘consumption basket’) it can buy in different countries – this fictitious currency allows us to convert incomes of different countries into a common measure of living standards.

The result of the conversion is that PPP incomes of countries with expensive service-sector workers (the rich countries, excluding a few with a lot of cheap immigrant labour, such as the US and Singapore) are significantly *lower* than their market-exchange-rate incomes, while those of countries with cheap service workers (the poor countries) tend to become much *higher* than their market-exchange-rate incomes.*

Sticking to the Denmark–Mexico comparison above, Danish PPP per capita income in 2010 is around 30 per cent lower than its market-exchange-rate income (\$40,140 vs. \$58,980), while the Mexican PPP per capita income is around 60 per cent higher than its market-exchange-rate income (\$15,010 vs. \$9,330). So the income gap of over six times (\$58,980 vs. \$9,330) is reduced to the living standard gap of under three times (\$40,140 vs. \$15,010) after the PPP adjustments.

PPP adjustment is very sensitive to the methodology and the data used, not least because it relies on the rather heroic assumption that all countries consume the same basket of goods and services. And we are not talking about minor differences. By changing its method of estimating PPP incomes in 2007, the World Bank reduced China’s PPP income per capita by 44 per cent (from \$7,740 to \$5,370) and increased Singapore’s by 53 per cent (from \$31,710 to \$48,520) overnight.

Income figures do not fully represent living standards, even with PPP adjustments

Even with PPP adjustments, income figures, such as GNP per capita and GNI per capita, do not fully represent living standards. There are a number of reasons for this.

One obvious but important point is that we don’t live by monetary income alone. We want political freedom, vibrant community life, self-fulfilment and many other things that money cannot buy. The increase in monetary income does not guarantee increases in these things and may even undermine them. For example, if higher income is gained at the cost of working longer and with greater intensity, we may have less time and energy for community life or self-fulfilment.

Another is that, as pointed out above, income figures do not reflect household work (including care work), which to a substantial part of the humanity – children, the elderly and the sick – are the most important things.

Even regarding things that can be bought with money, we often make poor decisions as consumers (recall [Chapter 5](#)). Influenced by advertising or in our desire to ‘keep up with the Joneses’ (or the Zhangs, the Patels, the Castros, or whoever, depending on where you live), most of us have bought things that we never knew we needed. Beyond providing the fleeting joy of purchase itself, these goods add little to our well-being.

Even if we are totally rational as consumers, the existence of **positional goods** makes income an unreliable gauge of true living standard (or happiness, satisfaction or what you will).² Positional goods are goods whose values derive from the fact that only a small proportion of potential consumers can have them.* Even if our personal income rises, we may still be unable to acquire things like houses in prime locations, Rembrandt’s paintings or elite education that gives access to top jobs, if others have also become richer and are able to stump up even more money than we can. This problem is more severe in richer economies, as the finer things in life tend to be positional goods, while essential goods are usually not.

These limitations don’t mean that income is unimportant in measuring living standards. Especially in the poorer countries, a higher income is largely a positive thing. In those countries, even a slightly higher income can make all the difference between eating properly and starvation, between working in a dangerous, back-breaking job and having just a hard job, and between having your child die at the age of one and seeing it grow up. In the richer societies, the positive impacts of a higher income on living standards are less certain. But even there, higher incomes will help people have higher standards of living, if they are used well. For example, a higher income will allow a country to reduce working hours and thus enable people to have more time with family and friends or get more adult education, while maintaining previous levels of material consumption.

REAL-LIFE NUMBERS

What are the income figures like in the real world? Here we will look at income per capita figures, given that we have already talked a lot about overall output figures, such as GDP and GNP, that are identical to overall income figures in theory and are very similar to them in practice.

Countries that we typically know as the richest countries have over \$40,000 per capita income

According to the World Bank, in 2010, the country with the highest income (GNI) per capita in the world was Monaco (\$197,460), followed by Liechtenstein (\$136,540). However, both these are tax havens with tiny populations (33,000 and 36,000 respectively). So, if we exclude countries with a population of less than half a million, Norway, with a per capita income of \$85,380, is the richest country (that is, it has the highest per capita GNI).

A selection of the richest countries is listed in [Table 6.1](#). They are mostly in Western Europe and Western offshoots. A few Asian countries belong to this group, with Japan and Singapore firmly in the upper league. South Korea, together with a couple of Eastern European countries, are there too – only just.

The average person in the poorest four countries doesn’t even earn \$1 a day

At the other extreme, Burundi, with \$160 per capita income, was the poorest country in the world in 2010. In several of the poorest countries, the average person did not even earn \$1 of income per day (\$365 per year).

Countries with less than \$1,000 per capita income are officially classified as ‘low-income’ countries in the World Bank classification (the World Bank cut-off line is \$1,005), or as **least-developed countries** (LDCs) by various international treaties and organizations.

[Table 6.2](#) lists a selection of LDCs. It shows that most of them are in Africa, with a few in Asia (Nepal, Bangladesh, Cambodia, Tajikistan, Kyrgyz Republic) and only one in Latin America (Haiti).

INCOME RANGE	COUNTRIES (FROM THE RICHEST TO THE POOREST IN EACH GROUP)
\$50,001 and above	Norway (\$85,380), Switzerland (\$70,350), Denmark (\$58,980)
\$45,001 – \$50,000	Sweden (\$49,930), the Netherlands (\$49,720), Finland (\$47,170), the USA (\$47,140), Belgium (\$45,420)
\$40,001 – \$45,000	Australia (\$43,740), Germany (\$43,330), France (\$42,390), Japan (\$42,150), Canada (\$41,950), Singapore (\$40,920)
\$30,001 – \$40,000	The UK (\$38,540), Italy (\$35,090), Spain (\$31,650)
\$20,001 – \$30,000	New Zealand (\$29,050), Israel (\$27,340), Greece (\$27,240)
\$15,001 – \$20,000	South Korea (\$19,890), Czech Republic (\$17,870), Slovakia (\$16,220)

Table 6.1
 Incomes of the richest countries (GNI per capita, 2010)
 Source: World Bank, *World Development Report, 2012*.

INCOME RANGE	COUNTRIES (FROM THE POOREST TO THE RICHEST IN EACH GROUP)
\$300 and below	Burundi (\$160), Democratic Republic of Congo (\$180), Liberia (\$190)
£301 – \$400	Malawi (\$330), Eritrea (\$340), Sierra Leone (\$340), Niger (\$360), Ethiopia (\$380), Guinea (\$380)
\$401 – \$500	Mozambique (\$440), Togo (\$440), Central African Republic (\$460), Zimbabwe (\$460), Uganda (\$490), Nepal (\$490)
\$501 – \$600	Tanzania (\$530), Rwanda (\$540), Burkina Faso (\$550), Mali (\$600)
\$601 – \$800	Bangladesh (\$640), Haiti (\$650), Benin (\$750), Cambodia (\$760), Tajikistan (\$780)
\$801 – \$1,000	Kyrgyz Republic (\$880)

Table 6.2
 Incomes of the poorest countries (GNI per capita, 2010)
 Source: World Bank, *World Development Report, 2012*.

INCOME RANGE	COUNTRIES (FROM THE RICHEST TO THE POOREST IN EACH GROUP)
\$8,001 – \$10,000	Chile (\$9,940), Russia (\$9,910), Turkey (\$9,500), Brazil (\$9,390), Mexico (\$9,330), Argentina (\$8,450)
\$6,001 – \$8,000	Malaysia (\$7,900), Costa Rica (\$6,580), Bulgaria (\$6,240), South Africa (\$6,100)
\$4,001 – \$6,000	Colombia (\$5,510), Ecuador (\$4,510), Algeria (\$4,460), China (\$4,260), Thailand (\$4,210), Tunisia (\$4,070)
\$3,001 – \$4,000*	Angola (\$3,960), El Salvador (\$3,360)
\$2,001 – \$3,000	Indonesia (\$2,580), Egypt (\$2,340), Sri Lanka (\$2,290), the Philippines (\$2,050)
\$1,001 – \$2,000	Bolivia (\$1,790), India (\$1,340), Ghana (\$1,240), Vietnam (\$1,100), Pakistan (\$1,050)
\$1,000 and below*	Least Developed Countries (LDCs)

Table 6.3

Incomes of selected developing countries (GNI per capita, 2010)

Source: World Bank, *World Development Report, 2012*.

Thus, the per capita income of the richest (Norway) is a staggering 534 times greater than that of the poorest (Burundi) as of 2010. Even if we take the less extreme cases of the US (no. 7 from the top with \$47,140) versus Ethiopia (no. 8 from the bottom, with \$380), the income differential is still 124 times.

There are poor countries and there are poor countries: gaps between developing countries

In between these extremes lie the vast majority of countries that are called middle-income countries in the World Bank classification. People, including myself, often call them developing countries or simply poor countries, but there is poor and there is poor.

[Table 6.3](#) provides per capita incomes of a selection of developing countries, to give the reader some idea of who belongs where and also the gaps that exist between developing countries themselves.

At the top of the developing country grouping are countries like Brazil and Mexico, with \$8,001–\$10,000 per capita incomes. These countries have per capita incomes that are fifty to sixty times higher than those of the poorest countries that we discussed in Table 6.2, when their own differentials with the richest countries are no more than ten times.

Countries that we typically think of when we hear the words ‘developing countries’ – such as Indonesia, Egypt, Sri Lanka, the Philippines, India and Ghana – are mostly found in the \$1,001–\$3,000 range of per capita income. Even these countries have per capita incomes that are five to ten times those of the poorest countries.

PPP adjustments show that gaps in living standards are not as severe as gaps in productivity

To more precisely learn about different countries’ living standards instead of their productivity, we need to convert their incomes (outputs) into PPP terms. This adjustment results in significant changes in the rankings of countries.

In PPP terms, Luxembourg, at \$63,850, becomes the richest country in the world, followed by Norway, Singapore, Kuwait, Switzerland and the US.* With PPP adjustments, per capita incomes of poor countries

rise in relative terms, as non-traded services (and some goods) are cheaper in these countries. In PPP terms, the Democratic Republic of Congo (DRC) (\$310), Liberia (\$330) and Burundi (\$390) are the three poorest countries in the world.[†]

With these PPP adjustments, the income differences between the rich and the poor countries are diminished, compared with the ones calculated in terms of market exchange rate incomes. The difference between the highest and the lowest GNI per capita is diminished from 534 times (Norway vs. Burundi) to ‘only’ 206 times (Luxembourg vs. the DRC).

Happiness

Not everything that counts can be measured, not everything that can be measured counts: can – and should – happiness be measured?

Recognizing the limitations of using monetary income to measure living standards, some economists have resorted to directly asking people how happy they are. These ‘happiness’ studies allow us to get around a lot of problems involved in measuring living standards: what needs to be included in the measurement; how we assign values to difficult-to-measure elements that affect our living standards (even though this has not stopped people from coming up with things like ‘political freedom index’); and what weight to give to each element. The best-known of this type of study are the Gallup Happiness Survey and the World Values Survey.

Many people question whether happiness can be, and indeed should be, measured at all. The fact that happiness may be conceptually a better measure than income does not mean that we should try to measure it. Richard Layard, the British economist who is a leading scholar trying to measure happiness, defends such attempts by saying, ‘If you think something matters you should *try to measure it* [italics added].’³ But other people disagree – including Albert Einstein, who once famously said, ‘Not everything that counts can be measured. Not everything that can be measured counts.’

We can try to quantify happiness, say, by asking people to rate their happiness on a scale of ten, and come up with numbers like 6.3 or 7.8 for the average happiness of Countries A and B. But such numbers are not even half as objective as \$160 or \$85,380 per capita incomes – and we’ve discussed why even the income numbers are not totally objective.

Adaptive preference and false consciousness: why we cannot totally rely on people’s judgements on their own happiness

More importantly, it is debatable whether we can trust people’s judgement on their own happiness. There are all kinds of **adaptive preferences**, in which people reinterpret their situations to make them more bearable. ‘Sour grapes’, namely, deciding that what you could not get is actually not as good as you had thought, is a classic example.

Many people who are oppressed, exploited or discriminated against say – and they would not be lying – that they are happy. Many of them even oppose changes that will improve their lot: many European women *opposed* the introduction of female suffrage in the early twentieth century. Some of them may even play an active part in perpetuating injustice and brutality – like those slaves who took a lead in the oppression of other slaves, such as Stephen, the character played by Samuel L. Jackson in the movie *Django Unchained*.

These people think they are happy because they have come to accept – ‘internalize’ is the fancy word here – the values of the oppressors/discriminators. Marxists call these cases of **false consciousness**.

The problem that false consciousness poses for happiness studies has been most brilliantly illustrated by the Wachowski siblings' mind-blowing 1999 movie *The Matrix*. In the movie, we have those, like Morpheus, who think that a happy life under false consciousness is unacceptable. Others, like Cypher, would rather live in false consciousness than lead a dangerous and hard life of resistance in reality. And who are we to say that Cypher's choice is necessarily the wrong one? What right does Morpheus have to 'rescue' people only to make them feel miserable?

The issue of false consciousness is a genuinely difficult problem that has no definite solution. We should not approve of an unequal and brutal society because surveys show that people are happy. But who has the right to tell those oppressed women or starving landless peasants that they shouldn't be happy, if they think they are? Does anyone have the right to make those people feel miserable by telling them the 'truth'? There are no easy answers to these questions, but they definitely tell us that we cannot rely on 'subjective' happiness surveys to decide how well people are doing.

Happiness studies with more objective measures

Given these limitations of subjective happiness measures, most happiness studies now combine more objective measures (e.g., income level, life expectancy) with some element of subjective assessment.

One good – and quite comprehensive – example in this category is the Better Life Index, launched in 2011 by the OECD. This index looks at people's subjective judgements on life satisfaction, together with ten other more (although not completely) objective indicators, ranging from income and jobs to community life and work–life balance (and each of these indicators has more than one constituent element).

Even while a happiness index that includes more elements is conceptually more defensible, its numerical outcome is more difficult to defend. As we try to incorporate more and more dimensions of our life into the happiness index, we are made to include more and more dimensions that are very difficult, if not impossible, to quantify. Civic engagement and the quality of community life in the OECD index are such examples. Moreover, as the number of elements grow in the index, it becomes more difficult to assign a weight to each element. It is interesting to note that, in open recognition of this difficulty, the OECD Better Life Index website lets you make up your own index by varying the weights between different elements according to your own judgements.

REAL-LIFE NUMBERS

Happiness index numbers, whether they are completely subjective or combined with more objective indicators, are not really meaningful in themselves. You simply cannot compare different types of happiness indexes with each other. The only thing that you can reasonably do with them is track changes in happiness levels for individual countries according to one index or, less reliably, rank countries according to one index.

Different happiness indexes include very different elements. As a result, the same country can rank very differently depending on the index. But some countries – the Scandinavian countries (especially Denmark), Australia and Costa Rica – tend to rank highly in more indexes than other countries do. Some countries – such as Mexico and the Philippines – tend to do better in indexes with greater weight given to subjective factors, suggesting higher degrees of 'false consciousness' among their people.

Concluding Remarks: Why Numbers in Economics Can Never Be Objective

Defining and measuring concepts in economics cannot be objective in the way such exercises in physics or chemistry can be. Even such an exercise regarding what are seemingly the most straightforward of economic concepts, such as output and income, is fraught with difficulties. A lot of value judgements are involved – for example, the decision not to include household work in output statistics. There are many technical problems – especially in relation to the imputation of value to non-marketed activities and to the PPP adjustments. In the case of the poorer countries, there are also issues with data quality – collecting and processing the raw data require financial and human resources that these countries do not have.

Even if we do not dispute the numbers themselves, it is difficult to say that output/income figures correctly represent living standards, especially in richer countries, in which most people can meet their **basic needs** for food, water, clothing, shelter, basic health care and basic education. It is also necessary to make allowances for differences in purchasing power, working hours, non-monetary aspects of the standard of living, irrational consumer choices (whether due to manipulation or herd behaviour) and positional goods.

Happiness studies try to obviate these needs, but they have their own, even more serious, problems – the inherent immeasurability of happiness and the problem of adaptive preferences (especially of the false consciousness variety).

All of this does *not* mean that we should not use numbers in economics. Without having some knowledge of key numbers – like output levels, growth rates, unemployment rates and measures of inequality – an informed understanding of the real-world economy is impossible. But we need to use them in full awareness of what each number does and doesn't tell us.

Further Reading

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F. HIRSCH

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