Happiness and public policy: an institutionalist perspective

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1. Introduction

The aim of this paper is to discuss happiness, and the action required to achieve it, from an institutionalist perspective. Its aim is to draw insights from the literature originating from the Old Institutional Economics and from the contributions of authors such as H. Simon, A.O. Hirschman and A.K. Sen. It focuses on two issues that J. Friedman, A. McCabe (1996) raise in the introduction to a symposium on Tibor Scitovsky’s The Joyless Economy. Friedman and McCabe point out the dramatic implications of Scitovsky’s claim that people’s objective interests may differ from their preferences, thereby leading to inconsistent choices and unhappiness. Their argument may be summarised in terms of two paradoxes. The first one – which I shall refer to as the “means paradox” - is that precisely because people choose in an inconsistent way, they cannot be expected to choose a way out of their inconsistencies. According to Friedman and McCabe, this undermines the rationale for the market and democracy. Since these institutions provide people with what they desire – rather than with what they need and, ultimately, want – they are not the appropriate means to pursue and achieve happiness.

Although the means paradox raises a rather important issue, according to Friedman and McCabe the second paradox - which I shall refer to as the “ends paradox” – precludes it from being properly discussed. This second paradox is that, even though most economists are concerned with the unsatisfactory effects of the market and democracy, they are not willing to discuss them on the grounds that the market and democracy are – in their views - ends in themselves, independently of how people choose. The “ends paradox” reflects fear of elitist and paternalistic, if not authoritarian, alternatives but, as Friedman and McCabe argue, it leads to a dead end in terms both of theory and policy.

Before I discuss these issues in greater detail, it may be worthwhile to put them in a perspective by explaining if and why happiness may be a relevant topic. Happiness has become a theme in economic inquiry following Scitovsky’s (1976) above mentioned argument and Easterlin’s (1974) claim that happiness did not rise along with economic growth. Both contributions shed doubt on the appropriateness of the conventional market mechanism to achieve its goal. Economic growth is supposed to be a means to maximise the objective function of consumers but Easterlin leads us to the conclusion that it is unable to meet this requirement. As for consumers, Scitovsky warns us that they are not aware of what they are supposed to maximise.

Obviously, a range of explanations were provided to account for these inconsistencies (see Easterlin 2002). Typically, the conventional approach is to consider them as one more market failure, which, just like all the others, does not undermine the market’s potential allocative efficiency. What these inconsistencies do, however, is that they raise the question what the ultimate function of economic activity in general, and of the market in particular, is? Happiness may be a useful benchmark, compared to GNP, provided it is adequately defined. Is it?

According to Bruni (2006: 11) we can “distinguish between an ethical approach to happiness (the Aristotelian) and a purely subjectivist one based on psychological experience (the hedonic). In fact, the philosophical reference point for the hedonic approach is Bentham (or Epicurus), while Aristotle..."
is the father of the eudaimonic/ethical one.”. The subjectivist approach is concerned with whether individuals feel happy. This kind of happiness can be assessed by measuring specific types of neuronal activity. The ethical approach is concerned with whether individuals are happy. This is a rather more difficult matter because one may be happy even though she does not feel happy. She may be living an Aristotelian “good life” but that does not mean that she is in a constant state of neuronal excitement. Aside from measurement, a “good life” may involve a varied range of elements which may or may not be the same for all individuals. It is not clear whether any single concept may actually encompass all those elements.

Despite these drawbacks, happiness may be a useful shorthand for the end that an individual pursues. Actually, it may turn out to be a useful category precisely because it cannot be reduced to a single variable but encompasses different types of goals. In one case happiness may consist in living in Pinocchio’s Pleasure Island; in another it may consist in choosing to be Socrates dissatisfied rather than a pig satisfied, as Frank (1997) provocingly puts the matter. Either way, happiness would seem to be an exclusively individual matter in so far as only individuals know whether or not they are happy and they are also able to achieve their goal. It need not be an exclusively individual issue if even one of these conditions does not hold. This leads us to the central topic of the paper, in that the two paradoxes outlined above stress why these conditions generally do not hold.

The paper is arranged as follows. After a discussion of the two paradoxes in Section 2, Section 3 focuses on how individuals may understand what makes them happy. It suggests that people may actually be unable to distinguish their needs from their desires on account of their bounded rationality and incomplete information. It contends, however, that although taste cannot be disputed, arguments are possible over the meta-preferences – or values - that involve those tastes, so that, eventually, people may learn to distinguish what they need from what they desire. Section 4 discusses three types of constraint to the actual pursuit of happiness. They relate to the configuration of markets, their evolution and their potential inconsistency with societal values. The conclusion is that an individual who adapts to external market requirements may be unable to achieve happiness. Adaptation, however, need not be the only possible conduct. Section 5 discusses why, given the nature of learning processes, individuals may realise that the pursuit of happiness requires them not only to assess their meta-preferences but to change the economic, social and natural environment they live in. This leads to the conclusion that the pursuit of happiness cannot be restricted to individual action: it involves political choices, thus collective interaction. In this perspective, Section 6 discusses the scope for public policy. It stresses the importance of A. Sen’s notion of capabilities but it points out that, precisely because individuals may purposefully change their environment, thus also the economic and political balance of power underlying it, capabilities must also evolve in order to adapt to the new circumstances and to favour further change. Democracy, in this context, does not mirror preferences; it is the locus where meta-preferences are confronted. As for public policy, it is not the action that sets out the rules of a valueless game: it is a value-laden action in a conflict-laden environment.

2. The two paradoxes

The starting point for Friedman and McCabe is Scitovsky’s (1976) claim that there is a difference between objective needs and desires/preferences. They argue that, although people would probably choose the former if they were to appreciate the difference, it is precisely this appreciation that is most unlikely: “it remains possible that people will not or cannot achieve the self-awareness necessary to transcend their unhappy preferences. As soon as objective needs – the empirical conditions of happiness – are logically separated from subjective desires, there is conceptual space for people ‘really’ to want what truly is not in their interest.” (Friedman and McCabe: 479:53). But if people want the wrong things, how can we rely on the market and on democracy to provide a

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1 This issue emerges when authors close to the Aristotelian approach try to qualify their view of what a good life should consist of. Cf. Nussbaum.
solution? Precisely because these institutions are supposed to be the economic and political means whereby people actually pursue what they want, it is intrinsic to how they function that they cannot prevent people from making the wrong choice. This leads us to what I referred to as the means paradox: “if we step back from the question of what policies should be adopted within liberal societies and consider social systems as wholes, both the democratic and the capitalist dimensions of liberal society appear to be threatened by Scitovsky’s analysis. Democracy and capitalism are similar in – ideally – giving people whatever they want, whether in the way of governance or of other ‘goods’ (cf. Scitovsky 1976, 269). Yet Scitovsky’s argument emphasizes that what people want may be bad for them.” (Friedman and McCabe 1996: 475:49).

Does this suggest that we should question both the market and democracy? The problem, here, is that these institutions are generally assumed to be ends in themselves. This leads us to the “ends paradox”. If the market and democracy are the ends, it is pointless to discuss the quality of the choices that people make when they resort to the market or to elections. On the other hand, if the real ends are what people pursue - and what people pursue is wrong - then the market and democracy should not be accepted a priori, i.e. anti-capitalist and/or paternalistic alternatives should not be dismissed from the very beginning.

The two paradoxes are somewhat overstated. The drastic conclusions of the paradoxes depend on three strong implicit assumptions in Friedman and McCabe’s paper. The first one is that it is practically impossible for (most) people to choose according to their needs rather than according to their desires. Truly, according to Scitovsky, this is what actually happens. The question, however, is whether this depends on institutional circumstances that can be somehow changed or on the inability of most human beings to understand what the issues at stake are. Only in this second instance would the radical conclusions of the paradox persist.

The second assumption is that the market and capitalism coincide. A market is an institutional device that coordinates the allocation of resources mainly by means of the information provided by relative prices. Capitalism generally includes this type of device but it generally complements it with other types of devices such as, e.g. households and the welfare state. These, too, coordinate the allocation of resources but, rather than on contracted exchange, they are based on criteria such as reciprocity and redistribution. Individuals do not make their economic choices on the market alone.

The third assumption is that democracy is tantamount to voting. This is a rather restrictive view of democracy. Democracy may well – and generally does - involve a more or less intense exchange – among people - of observations, opinions and ideas concerning how society is arranged as a matter of fact and how it could, and/or should, be arranged. This need not mean that votes are well thought; it does mean that the degree of interaction among voters is likely to affect how they vote.

Despite these qualifications, the paradoxes should not be neglected. The “means paradox” raises a major issue, i.e. whether the inconsistencies in people’s behavior may be overcome by improving the way the market and democracy function or by actually redefining the overall role that these two institutions play in society. The “ends paradox” raises the issue of the relation between the market and democracy on the one hand and freedom of choice on the other.

3. The individual’s search for what happiness is

Is it really impossible for individuals to choose what they need rather than what they desire? This question, which makes sense only when we acknowledge that individuals are not perfectly informed optimisers, raises a range of issues? First, how do people choose? Second, where do they choose, in the market or elsewhere? If all their economic needs and desires determine their preferences and all their preferences are reflected in relative prices, they can rely on the market alone. In such a case, relative prices are a general metric that allows agents to choose from a single choice context. If, on the contrary, some choices transcend the market, how do the corresponding metrics relate to each other?
Let us consider the first issue. It is now fairly straightforward for all economists that information is all but perfect. Moral hazard, adverse selection and other such concepts are now rather standard theoretical tools that emphasize how imperfect information affects individual choices within specific contexts. Despite this acknowledgement, the assumption that preferences are given tends to persist. This seems to imply that, although an individual does not - and cannot - fully understand what kind of economic and social environment she is living in, she is nonetheless perfectly aware of how she wants to situate herself in that same environment. This paradoxical outcome presumably depends on the assumption that individuals are boundedly rational – so that they cannot find out how to gather the information they lack – but optimisers nonetheless.

What seems more reasonable – and more consistent with H. Simon’s insights on rationality\(^2\) - is that, in order to choose what they need/desire, people must make some sense of the world they live in. They must learn about that world. Each individual is likely to have different learning requirements but everybody must be able to discern what they think is sensible from what is not. While this does not mean that someone can suspend her choice until she figured out what is going on, it does mean that she will need to do her best to be aware of the implications of her choice.

Truly, individuals do not learn from scratch. By the time they start asking questions, they have internalised a great deal of society’s knowledge, both directly – e.g. through education – and indirectly, through institutions. Society’s knowledge is neither homogeneous nor compact, however. Not only are there differences among individuals; inconsistencies exist even in the knowledge of single individuals, to the point that they are sometimes muddled in moral dilemmas they cannot solve. So individuals must try to identify what they deem relevant, which also involves understanding what relevance is all about.

Learning involves identifying what one should learn, which means drawing boundaries. It requires the choice of the heuristics that fit with the unknown circumstances to be studied. It also requires an aspiration level, to decide when to put a stop to an inquiry. However reasonable these choices may be, they are idiosyncratic: they reflect not only the actor’s biological heredity and social background but also the elaboration she has made of her previous individual experiences.

Precisely because learning has to do with what is not known, the individual who is learning can never be sure that beyond the boundary she has drawn there is something that was worth including in the inquiry. She cannot be sure that the heuristic she resorts to is better than any other. She would have to compare them in advance but the criterion to compare them with would still depend on what she knows at that moment. Finally, although an individual is likely to change the boundaries and the heuristics as the learning process goes on, a moment comes when she has to draw the line. Much like in the case of boundaries, the aspiration level does not warrant that something relevant has not been neglected.

Whatever we may think about overall progress in knowledge - i.e. whether it is cumulative and progressive or subject to revolutions that completely change the adopted perspective – no individual is ever able to understand everything. So people can make mistakes, i.e. they can make choices that, in a subsequent period, they will regret. A priori there is no criterion to identify those mistakes in advance.

Let us now consider where people choose, i.e. the metrics issue. A standard criticism of the view whereby the market provides an adequate metric to choose with is that there is a difference between Pinocchio’s Pleasure Island and merit goods such as books and education. Since, in general, you can understand how important education is only when you appreciate how it affects you, you have to be educated to appreciate it. If you are not, either someone who is educated chooses on your behalf or you may never know what you are missing and you may fail to achieve happiness. Unfortunately, it is not clear up to what point that someone should keep on choosing for you: Where does the educational threshold lie beyond which you are supposed to know enough to choose by

\(^2\) Simon, who originally introduced the concept of bounded rationality, stressed that this led to an altogether different perspective on behaviour: focus was on the process – hence the notion of “procedural rationality” rather than on some sort of constrained optimisation (Simon 1976).
yourself? Furthermore, there seems to be no criterion to assess that what the educated person chooses for you is what you would actually choose if you were educated. Apparently, we are stuck between patronising policies and Pleasure Island.

The above stalemate occurs because individuals are believed to prefer either one thing or the other, they cannot appreciate that what they prefer according to some criterion may not be appropriate from some alternative, yet relevant, perspective. A way out of this stalemate is provided by Sen (1977) and Hirschman (1984) who distinguish between preferences and meta-preferences, or values. Hirschman (1984: 89) argues that “men and women have the ability to step back from their ‘revealed’ wants, volitions, and preferences, to ask themselves whether they really want these wants and prefer these preferences, and consequently to form meta-preferences that may differ from their preferences.”. The key distinction, here, is that, while you cannot argue about a preference – there’s no accounting for taste - you can argue about a meta-preference. Thus, although Pinocchio is attracted by Pleasure Island, he may realise that school would be better. If he does not, the cricket may discuss the matter with him on grounds that may have little to do with taste, or even with economic convenience. Eventually, Pinocchio may change his mind. What all this leads to is that “When a change in preferences has been preceded by the formation of a meta-preference much argument has obviously gone on within the divided self; it typically represents a change in values rather than a change in tastes.” (ibid.: 90; emphasis in the original).

On similar grounds, Tool (2001) distinguishes between ends and ends in view. Here, too, an individual may choose in relation to two different perspectives, which may or may not be consistent. While she can “see” the end in view, she may at the very least “foresee” the end. The end may be her education; it may also be a different (better) world to live in. In the latter case, she may not know what that world is actually going to look like, but she may choose to act in a procedurally rational way to achieve it, by directing change towards approximations of what she thinks the world “ought to be”. This view is similar to Hirshman’s in that it assumes that a value system exists that is distinct of preferences. Its specificity lies, however, in its emphasis on a choice that remains instrumental but may transcend a given moment and a given place.

Ultimately, both authors suggest that, on theoretical grounds, the Pleasure Island-merit goods dilemma can be overcome by acknowledging that different metrics exist. These different metrics may or may not be mutually consistent, so people may actually have to deal with a concrete dilemma. If there is only one metric, then only one coordinating instance – e.g. the market – is required. When more than one metric exists, this may not be true. This issue will be discussed further on.

The conclusion of the above discussion is that, owing to idiosyncratic knowledge, the only one who can decide how to be happy is the person involved. Since information is incomplete and rationality is not substantive, it is most likely that individuals are unaware of the difference between their needs and their desires. Although human imperfection cannot be overcome, it must be respected: people can eventually succeed in their attempt to identify happiness, or whatever they deem worth living for, only if they can learn through trial and error. This freedom to choose does not mean, however, that all choices are on the same standing. But, subject to qualifications that will be presented in Section 6, only they can establish possible hierarchies. No elitist philosopher or patronising religious authority can show the way, although dialogue may help better to understand what the issues are.

4. The individual’s pursuit of happiness

Supposing an individual has identified what happiness means to her, how can she pursue it? The conventional view would be that she can resort to the market as a means to coordinate her pursuit of

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3 This suggests that although “biological heredity and social background (institutionalized behavior norms)” (Gordon 1990: 880) matter in the determination of an individual’s values, there is more to the process.

4 Tool refers to the “continuity of human life and the noninvidious re-creation of community”.

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happiness with the pursuit of happiness by others. In other terms, the market ensures that a consistency is achieved among the desires of all individuals, given a set of external constraints such as the techniques of production and factor endowments. The market, in this view, is only a coordinating instance. Provided some requirements are satisfied, it operates independently of value judgements or sectional interests. Agents only have to adapt to economic constraints. As far as economic issues are concerned, agents do not need to worry about anything else.

Three issues deserve to be discussed, here. They have to do with the actual configuration of a capitalist economy, its evolution and its potential inconsistency with the values of the society it is a part of.

Let us consider the configuration issue. Actors do not choose in an institutional and cultural vacuum. They operate within a more general legal-economic nexus that affects the way they view their reality and, accordingly, behave: “Institutions constrain, but they also shape what people see and want, as well as liberate and empower individuals to act. Laws help shape preferences, procedures, and habits. Laws help define what is regarded as progress (growth) and productive. Law, in specifying ideals, can sometimes affect behavior toward these ideals and toward other people, even when explicit incentives and sanctions cannot be administered.” (Samuels, Schmid, Shaffer 1994: 97).

The legal-economic nexus determines the distributional rights of all actors, i.e. the assignment of property rights. This is not only a technical but a political issue, since even the notion of efficiency depends on what priorities the institutional context defines5. Consequently, “If registered and valorized costs are in part a function of whose interests are made a cost to someone else, through rights, then prices are, insofar as, in Joseph Schumpeter’s expression, they are coefficients of choice, also a function of whose choices are registered and valorized, through rights. Both prices and costs are a function of whose interests count.” (Samuels, Schmid 1997: 225).

Does “whose interests count” matter to individuals who pursue happiness? We may conceive of two possible approaches. The first one is that individuals act as conventional economic agents. Consequently, they take the choices of policy makers as given and merely adapt to the ensuing conditions of the market, which they consider as exogenous constraints. The second one is that they realise that distribution matters, e.g. it could be more advantageous to them. In this case, while they may still adapt to the extant conditions of the market, they may also choose to act in order to change distribution. We will get back to this issue in the next section.

The second issue relates to the evolution of the market. Tsuru (1993) provides the following thought experiment. Consider a situation where everybody uses public transport. One day, someone chooses to buy a car because it is faster and more comfortable. Other people eventually follow but, as they do, traffic congestion increases, thereby reducing the speed and comfort of private transport and increasing the consumption of fuel and air pollution. In the meantime, since traffic has increased, public transport is slower than before so that less people choose to use it. As a result, per capita costs of the public transport company rise, so that it will either operate at a loss or push its prices up. If the company is shut down on efficiency grounds, everybody will have to resort to private transport. If its prices rise, some people will give up public transport anyway. Either way, private transport, along with its negative effects will increase. What is interesting about this thought experiment is that what people choose may have cumulative effects which turn out to be

5 The non-neutrality of efficiency was clearly pointed out by K.W. Kapp (1985/1976): “Despite the fact that farming could be a net energy-producing sector of the economy – by capturing the energy of the sun – and despite the energy crisis, we continue to measure efficiency in farming in terms of output per hour of labour or per acre instead of measuring it in terms of output per unit of energy.” (147). In a footnote, Kapp drew attention on the fact that, while a Chinese wet-rice farmer would get a return that was 50 times the energy he expended, in the US the return was only one fifth. He concluded by citing M. J. Perlman: “On the basis of these two ratios, Chinese wet rice agriculture is far more ‘efficient’ than our own system” (147, n. 2).
irreversible. Thus, when the people involved realise that their original choices have led to undesired consequences, it may be too late to go back.\(^6\)

In order to make up for the negative consequences of undesired changes, innovation may occur both in terms of the goods that the market provides and in terms of institutional change. Faster and more comfortable cars or the construction of wider streets may give the impression that there is a way to compensate the inconveniences of traffic congestion but, in so far as they enhance private transport, they aggravate the above process and determine an expenditure that merely raises the cost of living with no actual influence on well-being. Paradoxically, the very pursuit of social justice may worsen the quality of life, if it enhances cumulative processes such as the one depicted by Tsuru. This point was stressed by Hirsch (1976), who noted that the congestion determined by opulence may be enhanced by “reluctant collective” policies that aim to provide everybody with the same opportunities.

The issue, again, is whether the pursuit of happiness involves dealing with institutional changes that affect the way the market coordinates exchange. Just as with distribution, the conventional view would focus on how actors adapt to these changes. This may not be the best way to look at the matter. Before we discuss this issue let us discuss the third issue: the inconsistency of market values with societal values.

Kapp (1950) argued that business determines social costs by shifting its private costs onto workers or by depleting the environment. While the conventional view would conceive of these social costs as externalities, i.e. failures of the price mechanism to properly reflect the use of resources, Kapp stressed that they are the outcome of explicit action by firms who seek all ways to bypass the price mechanism. In other terms, following Veblen’s claim that business is not concerned with output as such but with money profit, Kapp argued that it is only sensible for firms to avoid incurring some costs by simply shifting them over to others.

Kapp’s insight is that social costs arise because of the different metrics underlying business conduct and society. It can be traced back to Veblen’s (1921/2001) contrast between the engineers and the price system. It is consistent with K. Polanyi’s (1957) view whereby either the economy may be embedded in a society – in that it allows the material reproduction of society in a manner that is consistent with values of that society – or, quite to the contrary, it is a society that is embedded in the economy, in the sense that society’s values are subsumed by economic values. It ultimately contends that, in a capitalist market economy, the money profit goal, which underlies business decisions, may be inconsistent with societal values involving the dignity of human life, the cultural and ethical values established through time in a given community and even the material reproduction of society.\(^7\)

The conclusion of the above discussion is that a range of circumstances that affect living conditions – thus, the quality of life and the happiness of people – transcend individual actions in the market. There is no clear-cut boundary between economic and societal – thus also political – values and choices. This would suggest that actors who merely react to what goes on in the market may not succeed in achieving happiness. Whether this is actually the case, however, requires a preliminary discussion of how individuals behave. This is the topic of the section that follows.

5. Adaptation and change

It is inevitable for any economic inquiry to isolate some phenomena in order to avoid dispersion. It would be wrong, however, to consider the ensuing boundaries as an actual part of reality, i.e. to

\(^{6}\) Myrdal (1944; 1957) and Minsky (1982) provide detailed accounts of how processes of cumulative causation such as the one pointed out here may occur in entirely different contexts, such as poverty, economic development and finance. The relevance of cumulative causation in institutionalist thought is highlighted by O’Hara (2007).

\(^{7}\) It may be appropriate to stress that societal values may be consistent with – and therefore favour - economic activity: typically ethical rules may enhance trust in business transactions. However, owing to different metrics – thus, because of different priorities – this consistency need not always hold.
conceive of the economy – more specifically, of the market – as systemically semi-closed (Auyang 1988). This is precisely what the automata of conventional theory are expected to do. They must, at the very least, learn to adapt to external circumstances. This is no trivial simplification. The implicit assumption underlying it is that there is a clear-cut separation between economic – in the restrictive sense of the market – and societal conduct8. Given the insights of the authors discussed in the previous section, a more appropriate approach is to follow Hirschman’s (1984) suggestion to complicate the economic discourse in order to adequately understand the economy. This applies to scholars; it also applies to individuals who try to make sense of the world they live in.

Recall that the choice of a meta-preference may be the outcome of a troubled learning process and that, owing to the idiosyncratic features of knowledge, an individual who tries to make sense of what goes on around her may achieve one out of many views of the world. The outcome is neither unique nor given once and for all. As a result of this process she may conceive of herself as a conventional economic agent, i.e. one that only needs to adapt to the (exogenous) circumstances of the market. Alternatively, she may appreciate the interdependence among different sections of reality or, as (Simon 1981) would name it, reality’s near decomposability. In this case she may acknowledge that economic choices do not involve a mere adaptation to (market) constraints that she cannot remove but actions to actually modify the environment and its constraints. From this perspective, she will have to conceive of change as a multi-tier concept (Ashby 1971; Watzlawick, Weakland, Fisch 1973).

If change occurs within different spheres of reality, the actions required to deal with change need not be restricted to market transactions; other types of action may be required. These actions may have to do with how the market as a whole is organised, with how the economy – thus, not only the market - is organised, and/or with how society is organised. From this perspective, the actor would have to conceive of herself not just as a conventional economic agent but as a full fledged member of society.

This may seem to be a rather trivial contention. The above argument apparently reasserts the distinction between political and economic action or, following New Institutionalist Economics, between devising the rules of the game and playing the game (North 1990). The point of the argument, however, is that the distinction does not imply separation. For instance, in order to improve their relative position on the market, self-interested actors are likely to change the rules of the game as they play it (Ramazzotti, Rangone 2002). Thus, while it is true that the polity and societal values influence the economy, the obverse is just as possible. Furthermore, if individuals can distinguish their preferences from their meta-preferences and their ends-in-view from their ends, there is no reason to claim that self-interested behaviour and what Williamson (1998) refers to as “economising” are what the game is all about. The game may well be that of living a good life within all the interdependent domains of an individual’s environment. This would imply that the rules of the game must allow the pursuit of this end across the different domains.

The latter approach implies that actors may refer to societal – as opposed to mere market - values when they make their economic choices. In this respect, they may choose neither simply to adapt to the conditions of a given market nor to change those conditions alone, e.g. through constraints on economic conduct such as incentives or norms. They may choose to affect the very nature of economic interaction by determining the extension of the market within the economy, thus which activities may be carried out through the pursuit of money profit and which domains may be assigned to the welfare state, to the family, to non-profit organisations, etc., the end being neither

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8 “Treating costs as given or absolute, in order to generate unique determinate optimal equilibrium results, is both a cause and a reinforcing consequence of the ergodic view that the economy is a transcendent and independent process, thereby marginalizing institutions, rights, and collective action (in Common’s sense).” (Samuels, Schmid 1997: 285-6).
growth nor profit per se but some notion of social justice. To this end they may assign public policy the task to devise the division of labour among different forms of integration.

This shifts the issue of happiness from a strictly individual sphere to a more collective one. If the pursuit of happiness crosses the traditional boundaries of the market, the economy and society, and may require actions that change these institutional setups, people must somehow agree on common goals and collective action. The above mentioned game is not strictly economic anymore: it is not concerned only with the achievement of the material reproduction of society. It has to do with how and for whom production and distribution is to be carried out. But, although each individual may be entitled to voice her preferences and meta-preferences on these issues, the relevant choices involve society as a whole: they are collective choices.

The previous section argued that a range of circumstances may prevent people from achieving their happiness goal through passive adaptation to market conditions. This section argued that the cognitive capabilities of single individuals allow them to transcend the boundaries of the status quo and to envisage actions that cross the boundaries of the market, the economy, and society. The conclusion this leads to, however, is that this more extensive view of action and change implies that individual actors somehow interact with the polity and especially with public policy. In this perspective it is important to deal with what the scope for public policy is.

6. Public policy and democracy

The conventional role assigned to public policy is that it must make up for all market failures either by changing the market in order to make it more efficient – e.g. by removing rigidities - or by complementing it, e.g. with the provision of public goods. This approach is rather restrictive in the light of the above discussion. Actors are likely to be concerned not only with how the market works but with its very boundaries. Consider a typical case, that of externalities. Following Coase (1960), New Institutionalism contends that externalities exist when some costs are not accounted for because the market cannot provide them with a price. The suggested solution consists in devising the institutions that will allow the market to measure social costs in price terms. The implicit assumption is that economic choice is a price-based choice, which ultimately depends on a monetary metric. In order for economic choice to be efficient, the devised institutions must allow choice to encompass both price-based and hitherto non price-based knowledge.

What New Institutionalists tend to disregard is that the identification of social costs is not a purely technical matter. Pollution, for instance, may appear to be fairly intuitive but the question is: what pollution do we refer to? Is it just any amount of a toxic substance or only those amounts that exceed some threshold? What determines the level of the threshold: the probability of any minor affection or the probability of serious illness? Are only human affections taken into account or should other forms of life be considered? What are the relevant probability intervals to decide when there actually is a risk? Under these circumstances, who - and how – is to decide over these matters is a critical issue.

A common answer to these objections is that it is individuals who deal with these matters, and they do so every day. For instance, practically everybody, in Western economies, drives an automobile. This implicitly involves a probability of an accident. So, the argument goes, we should just look at revealed preferences. Although this approach is appealing to a great many economists, it is based on a strong assumption, i.e. that individuals take the status quo for granted. Indeed, individuals who need to choose under specific circumstances of time and space can hardly change the social and technological arrangements that determine those probabilities. This assumption, however, is less reasonable if those same individuals are allowed to transcend those specific circumstances and formulate their preferences not with respect to existing risk but to the social and

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9 The conventional view would point to a trade off between efficiency and equity. The alternative view, discussed in the previous section, is that efficiency can only be defined in relation to specific priorities.

10 K. Polanyi (1957) pointed out three forms of integration: contracted exchange, redistribution and reciprocity.
technological arrangements that determine that risk. When this is the case, revealed preferences do not provide appropriate information on what risks individuals really want to incur.\footnote{With respect to Frank’s (1997) above mentioned remark, rather than being a satisfied pig, an individual may well choose to be a Socrates dissatisfied. He may also choose, however, that he wishes to change the terms of the alternative and be a Socrates that is not going to be forced, eventually, to drink poison. Isn’t this the choice that people who struggle against the authoritarian regimes of their countries make?}

Extending Hirschman’s (1984) discussion of preferences and values, it is reasonable to argue that, here too, people may step back and ask themselves whether the choice context they are facing actually is what they want to choose from. But this means that they are questioning the extant set of relative prices as well as the extension of the market with respect to other economic activities. In other terms, they are resorting to metrics that transcend the market.

Given these features of individual behaviour, it is misleading to believe that public policy should exclusively supplement the market. This type of action reflects only one out of the many possible priorities that can be assigned to public policy. A more reasonable one, in the light of the happiness goal, would be to enable individuals to choose how to conduct their lives or, in Sen’s (1987, 1993, 1999) terms, to provide them with as extensive capabilities as possible.

Since the pursuit of happiness cannot be restricted to the market, capabilities involve access to democracy. It is, however, important to point out that the nature of the required democracy – and the capabilities involved – depends on how we expect individuals to behave. If individuals adapt to conventional market conditions, what is relevant to them is their preferences alone. Democracy will, therefore, consist in a political system that reflects those preferences, and capabilities will consist of whatever allows actors to adapt in the best of ways: individual rights, private goods and public entitlements that enable them to choose how to conduct their lives.

If, on the other hand, individuals interact with their economic, social and natural environment in order to change it, freedom to choose how to conduct one’s life involves, as we mentioned above, choice of what to choose from: it involves choice of values. Individuals who live this way may intentionally change the environment that other people live in, thus also their lives. This is likely to lead to conflicts in terms of different values – meta-preferences – and in terms of interests. Democracy, in this context, should not just be conceived of as a voting system that reflects preferences; it should consist in the arena where these values are debated and where deliberation eventually becomes possible.

In this perspective, it is worthwhile to stress that, while it is true that the appropriateness of capabilities depends on how people behave, it is also true that individuals are likely to choose how to conduct their lives in relation to the capabilities they have. Whether actors merely adapt or not may be a matter of choice, i.e. of priorities that each person sets out in the course of her life. It may also depend on whether she can react to a range of impeding circumstances. Two examples deserve some attention. The first one, pointed out by Sen (1999), relates to people whose economic and social conditions preclude major changes in their material well-being. Under such circumstances an individual may resign herself to the status quo and restrict her pursuit of happiness on the grounds that “that’s how things are”. One reason for this behaviour is that the individual is unaware that the status quo could change. She is so accustomed to it that she is unable to think of any alternative. Another reason is cognitive dissonance: if she does become aware of possible alternatives but cannot accommodate them within her general beliefs, she ends up denying them.

The second consideration relates to conflicts of interest. When changes may affect vested interests in different ways, it is convenient for some people to guide or influence other people’s learning processes. Propaganda and advertising, for instance, affect people’s current decisions but, above all, they establish or reinforce enabling myths, i.e. more subtle and enduring habits of thought that support the status quo on emotional grounds.\footnote{An “enabling myth” may relate to gender, sex, race, religion, nationality. It may also underlie the resigned attitude of people, as in Sen’s example. It “is similar to propaganda, in that both are means of social control used by the powerful to control the powerless. However, enabling myth is far more permanent and penetrates far deeper into the culture of a people than the propaganda used by a particular political regime. In this respect, enabling myth is more like folklore, for}
are the indirect ones. Following the stage of their life when people receive a formal education, a
great deal of what they learn depends on their job and on how it is organised. Depending on
whether they have the opportunity to enhance their learning skills and improve their knowledge or
not, their capabilities change. But in most instances this depends on how the division of labour is
devised within firms (Braverman 1974, Marglin 1978, Ramazzotti 2004).

These examples lead to an important issue. If, provided some material conditions hold, people
could freely carry out their learning processes, their resulting views would simply reflect their
personal idiosyncrasies and value judgements. If, however, it is in the interest of some actors or
social sectors to affect those learning processes, what people want may depend on what they are
made to believe. The implication is that, although it is important that public policy remove material
constraints to the pursuit of happiness, such as lack of food, of decent housing and health
conditions, of education, etc., this may not be enough: social constraints such as those underlying
the organisation of economic activities and the division of labour may be just as important.

When these social constraints are believed to be essential for economic activity, it may not be easy
for public policy to change them and to enhance the participation of people. On the other hand,
when people change their beliefs, and conceive of ways to carry out social and economic change,
these social constraints can be removed. What would seem to be a dog chasing its tail is a further
implication of the issues discussed so far. As the pursuit of happiness leads people to transcend
specific fields of action such as the market and to focus on the general organisation of society,
public policy must favour change by extending people’s capabilities. This is not a one shot policy
measure, however. It is a continuous process that identifies capabilities in relation to what people
need and, in so doing, allows needs to evolve and to change the capabilities that are deemed
necessary.

In sum, contrary to the view that public policy should be the ancillary of the market, the pursuit of
happiness requires the provision of capabilities and their co-evolution with the learning processes of
the people involved. It requires, in other terms, action in favour of a deliberative democracy.

7. Conclusions

Happiness is an important topic in that it points out that the end of economic action lies – or ought
to lie - beyond economic ends in view. In this perspective it is consistent with a long tradition of
institutionalist analysis (Peukert 2005). In the perspective of this paper, happiness is viewed as an
end - rather than an end in view - which generally involves a complex process both to identify what
it consists of and, subsequently, to achieve it. The paper focused on these two aspects. Let us recall
them by going back to the two paradoxes we began with.

Contrary to the means paradox, people can become aware of their personal inconsistencies and
can pursue a way to overcome them. This does not mean that they always succeed: individual
idiosyncrasies and social and economic impediments may prevent them from achieving this
awareness. Awareness is nonetheless possible, because people can potentially distinguish their
preferences from their values, they can think about - and argue over - their values, and they can
eventually change their very preferences.

Contrary to the ends paradox, it is not people’s inconsistencies that undermine the rationale of the
market. Rather, the market may be inconsistent with people’s needs because of the peculiar
circumstances that characterise its configuration and its evolution, as well as because of the intrinsic
tendency of firms to shift their private costs onto the community. As for democracy, its rationale is
undermined not by people’s inconsistencies but by a narrow view of its function, that of reflecting
individual preferences rather than being the arena where deliberation follows confrontation over
different values (and value systems). The nature of such a confrontation remains, however, an open

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13 A detailed discussion of this issue is provided by Ramazzotti (2007).

both enabling myth and folklore penetrate deeply into culture and they both arise from deeply within culture.” (Dugger,
Sherman 2000: 70).
issue. Its realisation depends on mutual understanding and on the ability to transcend vested interests.

The measurement of happiness is also an open issue. The key issue is not that it is multidimensional: it is its dependence on what an individual chooses as an appropriate benchmark. Resignation may involve an overly optimistic and inappropriate assessment of happiness. Resignation, in turn, depends on circumstances that may well transcend the choice context and potential action of single individuals. The apparent inconsistency between paternalism and freedom of choice is, in this perspective, misleading. Although the former can reduce the latter, it is also a condition for its existence. People can become aware of their needs only through the provision of appropriate capabilities, i.e. capabilities that reflect their learning requirements, which in turn, depend on how they choose to relate to their economic, social and natural environment. Public policy may succeed or it may fail, much like a teacher may succeed or fail in making her students able to formulate independent judgements.

An individual may manage to be aware of what she needs and wants, but she must also be able to pursue it. Reliance on the specific features of a capitalist market may make such a task very difficult, when not impossible. Actors may have to extend their pursuit to other fields of action, involving the economy as a whole, society and nature. In general, the pursuit of happiness involves a trespassing of boundaries, from the economy to society. The reason is the systemic openness of the economy, i.e. the absence of clear-cut boundaries that divide economic relations and values from societal relations and values. This openness affects the way people behave: they choose in relation to their values as well as their preferences.

Systemic openness also affects the way policy makers behave: in order to be effective, public policy has to relate to people’s values as well as to their preferences. The implication for economic inquiry is that, much like the single actor discussed in Section 3, whoever carries out an economic analysis must decide what the relevant boundaries for the analysis are. But relevance basically depends on the goals pursued. In this sense, economics is of necessity a normative discipline.

Owing to the inseparability between economic action and societal organisation, a policy that focuses only on the efficiency of the market - and, relatedly, on efficiency-equity trade-offs – is not only a very restrictive one; it reflects a value judgement whereby the social and natural environment are taken as given and the legal-economic nexus must adapt to this status quo. This type of policy is not the only one available, however. The choice of policy and the outcome to be achieved are a matter of value judgement or, in more ordinary terms, of political choice.

References


