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## DETERMINANTS OF WELL-BEING AND WELFARE

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**Summary:** People tend to think that money is the most important factor that make them happy. But not only do economic factors influence our happiness. There are lots of socio-demographic, ecological, cultural or psychological factors that determine our well-being and welfare. However, the problem with happiness is that the same actions can make one person happy but not another. This article presents in what ways all the aforementioned factors can determine our well-being, welfare and influence our happiness. Except for a pure educational use, this knowledge can be very useful for government while deciding about economic changes.

**Keywords:** happiness, well-being, welfare, economy of happiness, behavioural economics.

### 1. Introduction

People sometimes consider what makes them happy. Many of them think that more money would solve all their problems. But is well-being really connected with welfare?

Well-being is rather a psychological term and means the state of being contented, healthy, happy, etc. It is sometimes mixed with the term “welfare” which is closer to prosperity and has a rather economic background. Both of them are connected, determine each other and lead to subjective happiness, which means the feeling or showing pleasure or contentment.

*Homo oeconomicus*, who is considered in the majority of economic theories, is based on the rule that he or she has no emotions. But who is *homo oeconomicus* in fact? It is just a human being. According to psychological theories, every man has feelings and emotions. Thus, it is impossible to make decisions, also economic decisions, and feel nothing. Even satisfaction of a well done job like making a decision is a kind of feeling. Consequently, the idea of *homo oeconomicus* is far from reality.

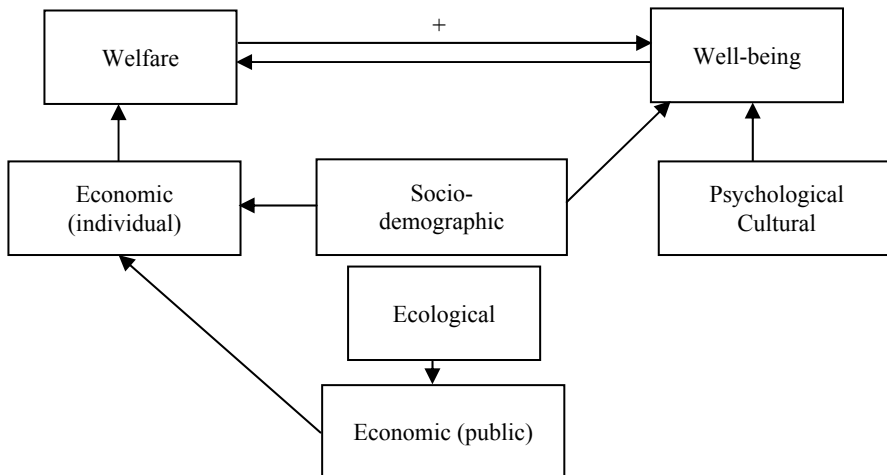
Knowing this, we can consider the true impact of psychological well-being on economic welfare and vice versa. We can also check how they influence the personal feeling of happiness. The part of economy that deals with this problem is called “economy of happiness” and was firstly described by Richard Easterlin [1974] in his article “Does economic growth improve the human lot?”.

The main idea of that trend was that not only economic factors influence our happiness. There are lots of socio-demographic indexes (like life expectancy, democracy, health care, education level, crimes, social pathologies), ecological indexes (like environmental protection, sources of clear water, urbanization), cultural or psychological indexes (like consumers optimism, life quality, personality). All of them show what the determinants of personal happiness and well-being are. Economic factors can be divided into two groups: individual (personal income) and public (GDP, inflation, public goods, rate of exchange, rate of taxes, entrepreneurship).

Frey and Stutzer [2000] distinguished three groups of determinants of happiness:

- personality and demographic factors,
- micro- and macroeconomic factors,
- institutional conditions.

Among them, they use variables that can describe the influence on happiness. In the first group, these are age, gender, citizenship, formal education, family setting and employment status. In the second group, these are unemployment and the income situation of the household. And in the last one: index for direct democratic rights and index for the extent of local autonomy [Frey and Stutzer 2000, pp. 918-938]. Considering these groups of factors, we can see how they influence well-being and welfare.



**Figure 1.** Determinants of well-being and welfare

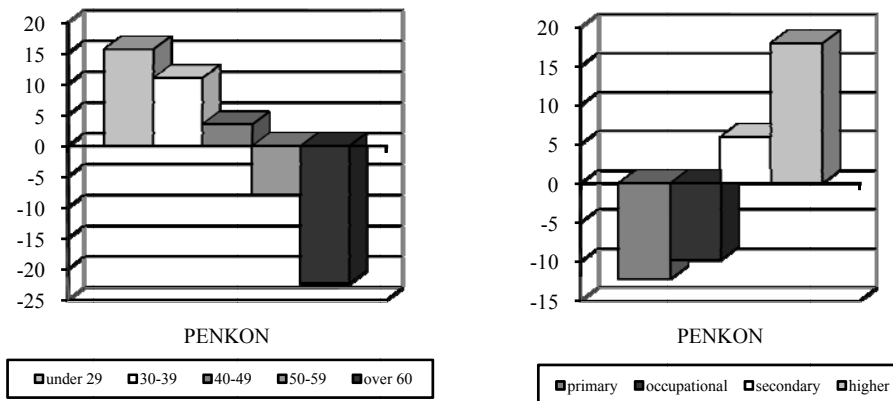
Source: Author's own study.

Economic determinants are directly connected with welfare as a more economic idea. Ecological factors influence welfare non-directly as they are strongly determined by public finance. Socio-demographic factors usually determine the economic

situation of individuals and the way that they influence welfare. Welfare determines well-being, which is mostly determined by psychological and cultural factors and, in some part, by socio-demographic ones. There are also some surveys confirming that well-being determines welfare.

## 2. Non-economic determinants of well-being

Socio-demographic factors affect both welfare and well-being. Age, education level or place of living can decide about somebody's income, but they can also cause differences in perception of stimuli and life satisfaction. As it was proved, young people are generally happier than old people, people from cities are happier than those from villages, etc. A survey taken by PENTOR strongly confirms this relation.



**Figure 2.** Age and level of education vs. PENKON<sup>1</sup>

Source: [*Barometr nastrojów...* 2010].

This relation was also confirmed in Czapiński and Panek [2009]. They found that the most important factor determining psychological well-being is age, then marriage, friends, gender and education level. All these factors are socio-demographic and after them there is an income per person as a determinant of well-being. This means that social life is the most important for building personal good feeling and money are used rather for fulfilling needs. Having them leads to unblocking the happiness potential [Czapiński and Panek (eds.) 2009, pp. 156-157].

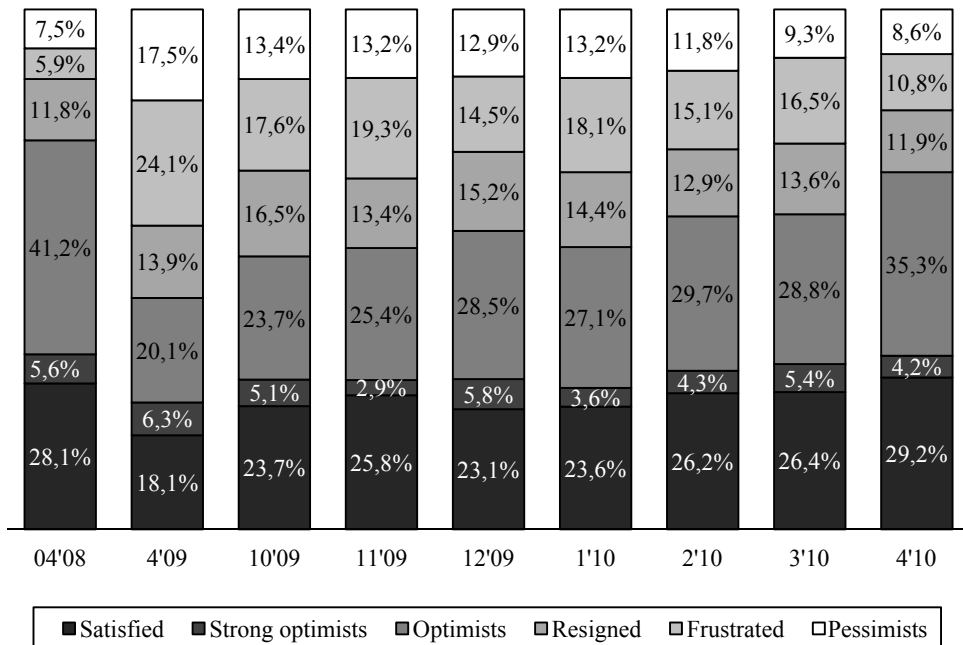
<sup>1</sup> PENKON is an index of consumers' climate and shows the average value of perception of country economic situation index (PESK) and index of financial condition of household (OGD). It can vary between -100 and +100. The index shows general consumers' economic mood connected with perception of economic situation of the country and financial condition of households. The higher the index, the more positive and optimistic is the consumers' climate [*Barometr nastrojów...* 2010].

Ecological factors are usually chained with public finance, which are part of the public economic sphere. This sphere also influences private income by taxes level, by inflation, by exchange rates, etc.

Psychological and cultural factors are mainly connected with well-being. Things like mood, personality, way of making decisions, being under the influence of social groups, religions beliefs can decide about somebody's mood. But there are only a few surveys approving that these factors also influence welfare. The most popular explanation of this relation comes from the theory of making decisions, which is described in a further part of this text.

Personality is one of the psychological factors determining well-being. According to a survey taken by PENTOR, we can distinguish six groups of people, based on their attitude to the economic condition in Poland [*Barometr nastrojów...* 2010]:

- pessimists are people who positively evaluate the economic situation but expect it to be worse;
- frustrated are people who negatively evaluate the economic situation and expect it to be worse;
- resigned are people who negatively evaluate the economic situation but expect no change, neither worse or better;



**Figure 3.** People and their attitude towards the economic situation

Source: [*Barometr nastrojów...* 2010].

- optimists are people who evaluate the economic situation positively and expect it to be better;
- strong optimists are people who evaluate the economic situation negatively but despite this they expect it to be better;
- satisfied are people who evaluate the economic situation positively in general or partially and do not expect changes.

The data shows that the majority of people are rather satisfied with their economic situation or expect it to be better.

Another classification is based on the way that people take life happiness. There are two groups: hedonists and eudaimonists. "Hedonic treadmill means that aspirations increase along with income and, after basic needs are met, relative rather than absolute levels of income matter to well-being" [Graham 2008, p. 5]. Hedonists do not think what aims and in which way a man achieves. The most important thing is to be happy and have more joy than pain. Eudaimonists think differently. Happiness means achieving things that are worth it, things that give a sense of life despite suffering and disappointments [Czapiński and Panek (eds.) 2009, p. 163].

### 3. Economic determinants of well-being

The most important and the most often considered economic determinant of well-being is income. Economists find it quite obvious that there is a positive correlation between income ( $Y$ ) and happiness, which they call utility ( $U$ ), and it can be presented by the formula:  $U = U(Y)$ , and  $U' > 0$ ,  $U'' < 0$ .

The interpretation of this function is that the higher income is, the higher utility (happiness) becomes. But what about the well-known Polish proverb that "money does not give happiness"? It is almost the same as Richard Easterlin's sentence that "money does not buy happiness" [Frey and Stutzer 2002, p. 74; Maital (ed.) 2007, p. 296]. A survey taken by Brickman et al. (1978) on the winners of large sums of money showed that these people were only slightly happier (life satisfied) than others (4.0 vs. 3.8 on 5-point scale). Smith and Razzell (1975) found that people who became wealthy and left their jobs, broke their relationships and felt socially excluded. They were also under a heavy pressure because friends and family expected them to share money [Frey and Stutzer 2002, p. 73; Maital (ed.) 2007, p. 295]. This is connected with diminishing marginal utility of income. The rising utility is not linear, which means that each growth supplies smaller satisfaction and happiness. It can even cause harm when the sum of collected money is that big that needs special protection. A man then feels unsafe and thinks that people that are close to him or her want to take his or her money. Therefore, if the relation between income and happiness were like economists suggest, it would be obvious that people living in rich countries would be happier than these living in poor ones. And again, practical verification of this thesis shows that higher income raises happiness but only in developing countries.

In rich countries this effect does not appear [Frey and Stutzer 2002, p. 90; Maital (ed.) 2007, p. 312].

Most studies find that inflation and unemployment have negative effects on happiness, but effects of unemployment are stronger than those of inflation. Moreover, they find a strong positive correlation between happiness and preferences for democracy and that unemployed people are happier (or less unhappy) when unemployment rates are higher. It helps them believe that it is not their fault, their lack of qualifications or another disfunctions [Graham 2008, pp. 7-9].

Taxes are rather negatively connected with happiness, but there is some evidence that negative financial effect of non-direct taxes may be outweighed by positive self-control effects [Graham 2008, p. 8] and as A. Oswald claims: “higher taxes increase public joy by reducing envy” [Foorohor 2007].

Considering these factors for Poland, we can also find some correlations between economic indexes and happiness measured by the Consumers’ Optimism Index<sup>2</sup>.

**Table 1.** Consumers’ Optimism Index and economic determinants of well-being in Poland

	2004	2005	2006	2007	2008
Consumers’ optimism index [ <i>Wskaźnik optymizmu...</i> 2009, pp. 12-14]	+90	+95	+102	+113	+106
GNP (million PLN)	885 819	964 533	1 018 836	1 134 554	1 243 822
Inflation	104.3	102.4	101.1	103.2	105.2
Public deficit (million PLN)	41 417	28 361	25 063	15 956	24 346
Public debt (million PLN)	432 284	466 591	504 991	527 442	597 797
Exchange rate of 100 EUR to PLN	453.4	402.54	389.51	378.36	351.65
Income and wealth taxes (million PLN)	36 957	47 526	51 590	64 488	72 600
Unemployment rate	19.0	17.6	14.8	11.2	9.5

Source: [*Statistical Yearbook...* 2007, 2008, 2010].

In Poland the correlation analysis shows that a statistically significant relation of consumers’ optimism index is only between public deficit ( $r = -0.940$ ) and unemployment rate ( $-0.902$ ). Both correlations are negative, which means that consumers’ optimism rises when public deficit and unemployment fall. It was quite expected according to cited surveys. A quite strong correlation but statistically not significant is between COI and taxes ( $r = 0.869$ ,  $p = 0.056$ ), GNP (0.836), exchange rate ( $r = -0.816$ ) and public debt ( $r = 0.774$ ). Positive correlation between COI and taxes confirms Oswald’s thesis cited earlier. Very surprising is that COI is not correlated with inflation ( $r = 0.010$ ). These results may be connected with too short a time period taken under consideration.

<sup>2</sup> Its construction is based on 10 questions that 1000 people are asked.

## 4. Determinants of welfare

All these surveys present the impact of welfare on well-being, but there is also another direction impact – well-being determines welfare. As a psychological term, well-being is connected with personality and individual differences. One of its part is the way of making decisions. According to surveys taken on this topic, people can be divided into two groups: maximizers and satisfiers. Maximizers tend to look for the best option, while satisfiers want to find an object that fulfils expectations. There is a correlation between the way of making decisions and the subjective feeling of happiness, life satisfaction, depression and optimism. In factor analysis there four indexes were used: regret level, maximizing behaviour, buying behaviour and level of needs. A tendency of choosing the best option is positively correlated with regretting and depression, which means that maximizers more often feel regret after a decision and are depressed. At the same time, they rarely feel happy, satisfied and optimistic. Maximizers are sometimes perfectionists.

All these effects come probably from the fact that maximizers see their decisions as worse and it influences their mood and life satisfaction. Maximizers also have higher expectations that usually cannot be fulfilled. But except for the negative consequences of their functioning there is also a positive one – it is an adaptation function of such decision making [Lehman et al. 2002, pp. 1178-1197].

Survey taken by Diener et al. (2003) showed that people with a higher happiness level tend to have better effects in the labour market and higher income [Graham 2008, p. 6]. This shows that being more optimistic leads to more positive experiences and helps feel better, happier and so on.

## 5. Conclusions

The most important question connected with economy of happiness is what it is really needed for? Except for purely educational use, this knowledge can be very useful for government while deciding about economic changes, like raising taxes. As it was presented in the article, people consider different factors that let them feel better. Some of them are out of the control of government, like age or gender, but some of them are strongly controlled by it, like public deficit or taxes. Some factors can be influenced by government, like unemployment or inflation and in this way help people feel happier. Unfortunately, these relations are not so simple, because well-being and welfare are also determined by psychological factors that are generally very difficult to change. People are so individual that it is irrational to expect them to behave in the same, rational way as classical economists want. And this is the issue with happiness – the same actions can make one person happy while others not.

Thus, government should monitor social trends in this area and try to predict what the result of its activity would be and remember that, according to the surveys, happier people are people who achieve better effects on the market. These effects mean that the whole economy works better and have higher indexes.

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## DETERMINANTY DOBROSTANU I DOBROBYTU

**Streszczenie:** Ludzie zazwyczaj sądzą, że pieniądze są najważniejszym czynnikiem, który sprawia, że są szczęśliwi. Jest jednak cała gama innych czynników społeczno-demograficznych, ekologicznych, kulturowych czy psychologicznych, które mogą oddziaływać na nasze poczucie dobrostanu i dobrobytu. Jednak problem z uszczęśliwianiem ludzi polega na tym, że te same działania jedni będą postrzegali pozytywnie, a inni negatywnie. Niniejszy artykuł przedstawia, w jaki sposób wymienione czynniki mogą oddziaływać na dobrostan, dobrobyt i poczucie szczęścia. Wiedza ta ma wymiar nie tylko pogładowy, ale może być bardzo użyteczna z punktu widzenia władz podejmujących decyzje o zmianach natury ekonomicznej.