

Some Comments on the *Legatum Prosperity Index* from Happiness Economics

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November 3, 2009

Why Broader Measures of Well Being are a Good Thing

- In recent years, a whole new branch of economics has challenged standard assumptions in economics, both about the extent to which homo economicus is indeed a rational actor and about the extent to which the underlying assumptions about income and happiness hold
- Standard economics relies on revealed preferences – e.g. as gauged by consumption choices – to measure well being. But there are a number of questions which cannot be answered by revealed preferences approaches, either because individuals do not have the capacity to make the choices that they want to make OR because they are not making optimal choices
- Two lines of questions which are very relevant to the Prosperity Index come to mind: a) the welfare effects of institutional arrangements that individuals are powerless to change, such as inequality or macroeconomic volatility or poor governance on the one hand, and b) perverse welfare choices that are driven by norms (low expectations among the poor), or addiction or self control (obesity, smoking, etc)
- Survey research, which relies on expressed versus revealed choices allows us to get around this problem and assess the welfare effects of all kinds of things, including what kind of country people live in – a la the Prosperity Index

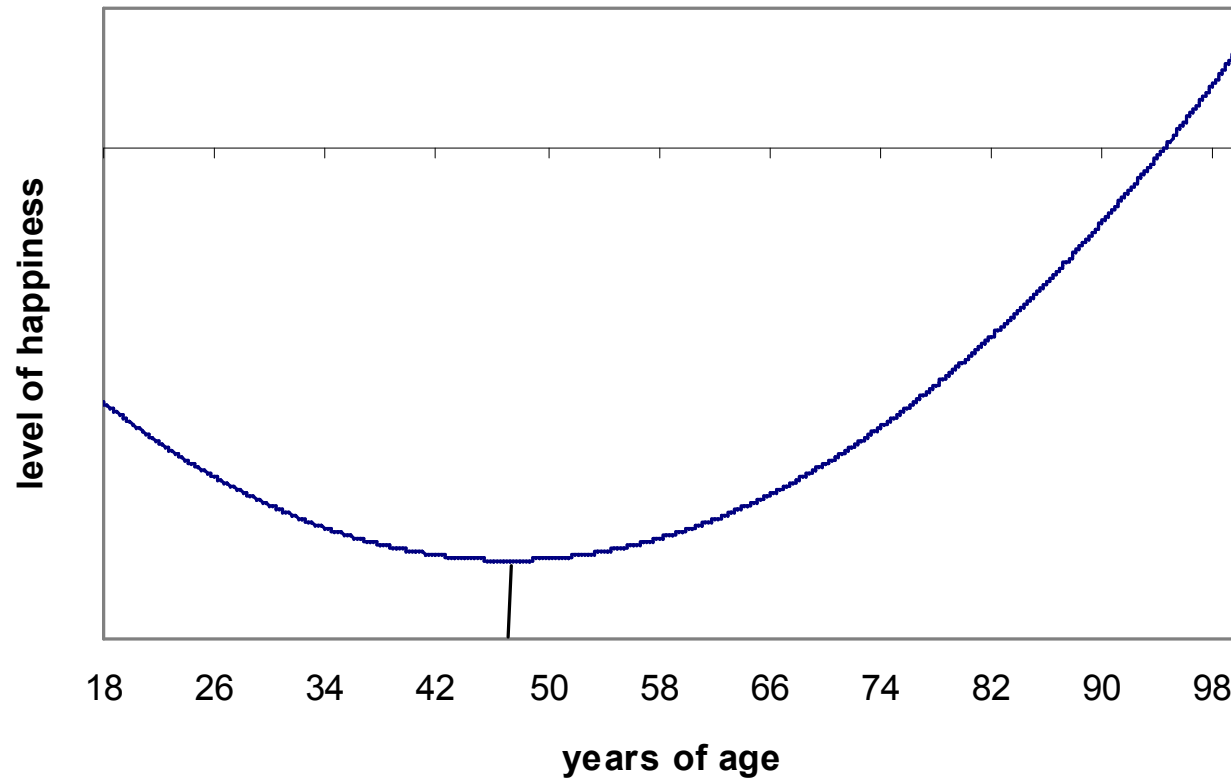
This is capturing national and international attention

- The increasing use of surveys in our dismal science has skyrocketed in recent years; one reason is the very consistent patterns that we find in the determinants of well being across populations, cultures, and countries around the world – happiness and age, for example (figure)
- While psychologists have been using such surveys of well being for years – and with real methods for validating their links to psychological measures of well being
- Earth to economists – there is more to happiness and quality of life than income! Why did it take us so long?
- There is still visceral debate over whether or not there is an Easterlin paradox, for example (why average happiness levels do not increase as average GDP increases over time, even though richer people are happier than poorer ones within countries) (figure)
- Despite the debate, a revolution of sorts – all KINDs of indices of this kind, from the happy planet index to the HDI to the Stiglitz commission and Sarkozy proposal to replace GNP with happiness indicators
- The Prosperity Index is the first to focus on prosperity as opposed to poverty, and on the creation of conditions that allow entrepreneurship and individual freedom to flourish
- It is also VERY well done – robust to the highest research standards
- I congratulate the authors!

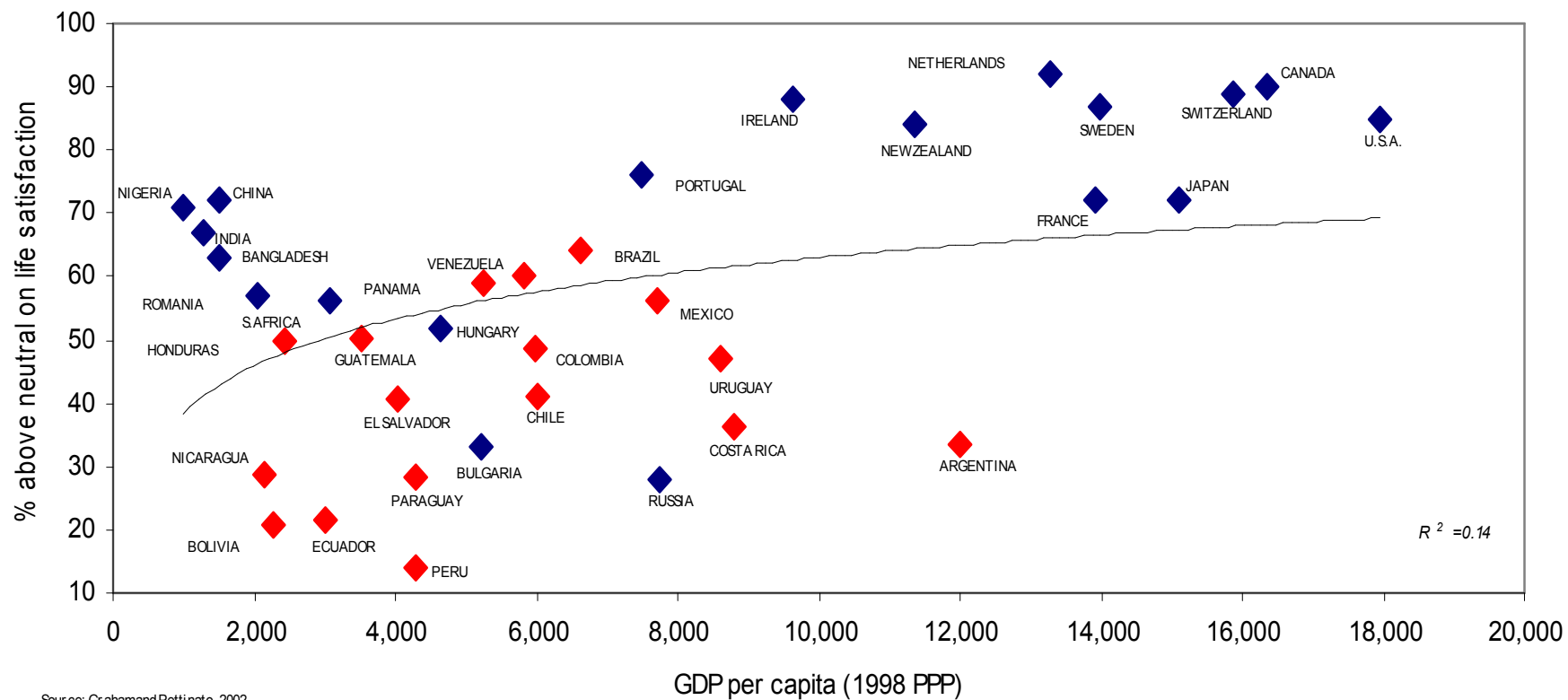
Happiness and Age: Pattern conforms World-wide!

Happiness by Age Level

Latin America, 2000



Happiness and Income Per Capita, 1990s



Source: Graham and Pettinato, 2002.

So why is this NOT a great thing?

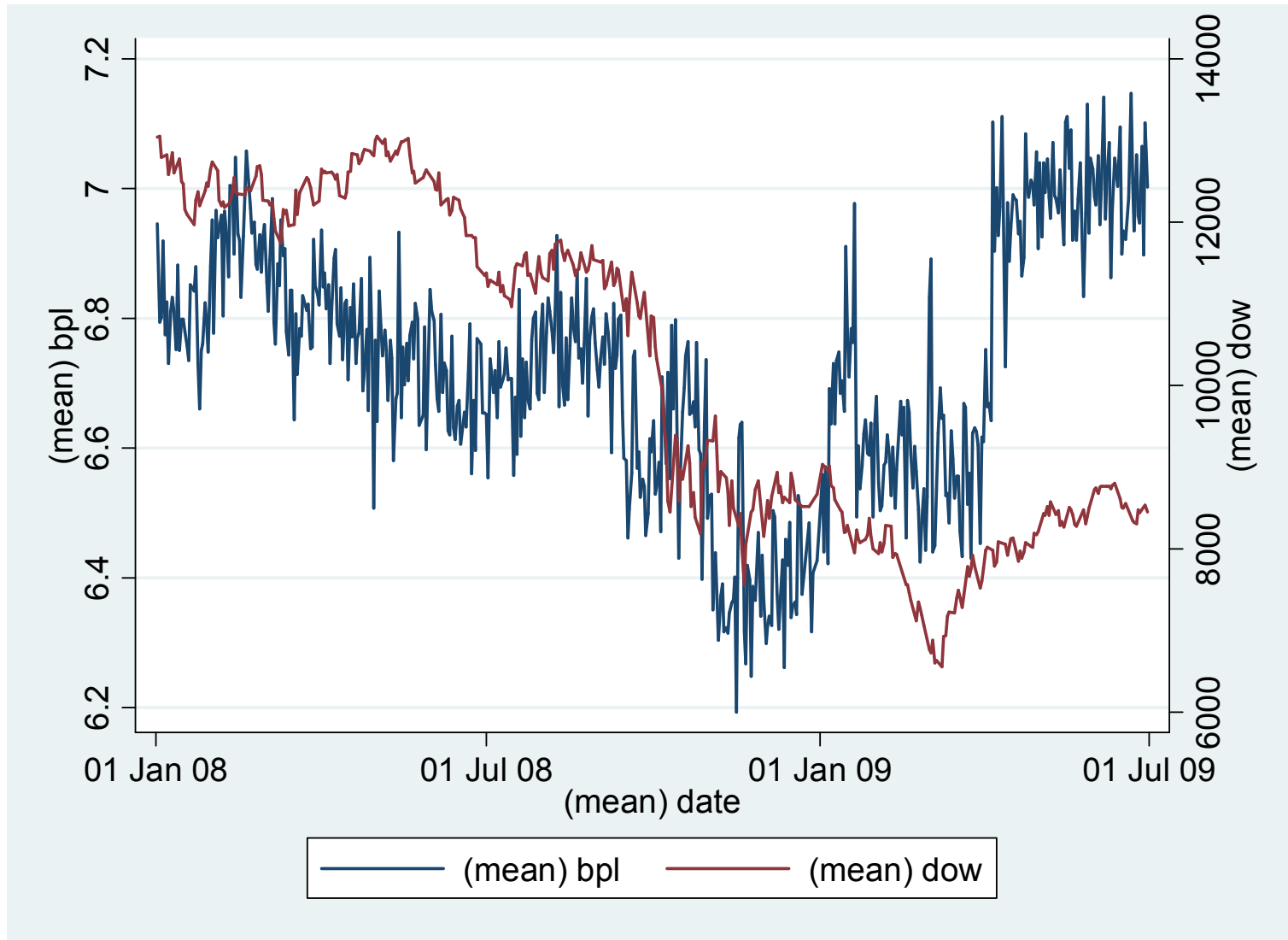
- I would argue that it is BUT some important caveats before we apply these measures directly to policy
- Some examples from my forthcoming book, *Happiness around the World: Happy Peasants and Miserable Millionaires* (Oxford University Press, Dec 2009)
- Cardinality versus ordinality
- The definition of happiness and other well being questions (open ended versus imposed definitions, among others)
- The happy peasant versus frustrated achiever/miserable millionaire problem
- The paradox of unhappy growth (slide)
- Adaptation, even to crisis (slide)

The paradox of unhappy growth

The relationship between income per capita, economic growth, and satisfaction	122 countries	
	GDP per capita	Economic Growth
Life Satisfaction	0.788 ***	-0.082 ***
Standard of living	0.108 ***	-0.018 ***
Health satisfaction	0.017 *	-0.017*
Job satisfaction	0.077 ***	-0.006
Housing satisfaction	0.084 ***	-0.006

- OLS regression; dependent variable is average life satisfaction per country, growth rates are averaged over the past five years. N=122
- GDP per capita: The coefficients are the marginal effects: how much does the satisfaction of 2 countries differ if one has 2X the income of the other.
- Economic Growth: How much does an additional % point of growth affect satisfaction
- The life satisfaction variable is on a 0 to 10 scale; all others are the percentage of respondents that are satisfied.
- Graham and Chattopadhyay find similar effects for Latin America, based on individual data rather than country averages

Best Possible Life and the Dow



Adapting to good and bad times

- An anecdote: my tires were stolen in Washington, not in Lima.....
- Friendships/social capital matter to well being
- Friendships play particularly strong role in Latin America, and particularly for the poor – safety nets? Strong or weak ties? (Figure)
- Trust matters to well being, but it matters much less if there is less of it, as in Afghanistan. Afghans are relatively happy but have unusually low levels of trust; those that trust others are happier than the average, and also much less educated (pollyana effect?)
- Democracy matters to well being; but democracy and freedom matter more if there is more of it
- Crime and corruption matter to well being (negatively) but they matter less when they are more common; findings from Latin America, Africa, Afghanistan (tables)

Variance in Health Norms: Evidence from Health Satisfaction Across and Within Countries

- National average health satisfaction is only weakly correlated with GDP per capita, and is negatively correlated with the economic growth rate; it is weakly and positively correlated with life expectancy at birth BUT ALSO with the IMR rate! Variables that capture cultural differences matter more to health satisfaction than the expected indicators do
- Within countries, the rich are clearly more satisfied with their health than are the poor, but the gaps between their attitudes are much smaller than the gaps between their outcomes; optimism bias among the poor (happy peasants versus frustrated achievers, again....)
- On average for the 20 countries in LAC, the health satisfaction gaps between the richest and the poorest quintiles are only seven percentage points, while gaps between objective health indicators, access to health care, and incomes across quintiles MUCH greater.
- Within the US, meanwhile, I find that the negative well being effects of obesity are mediated by how much obesity there is in your socioeconomic and professional cohorts: WalMart versus Wall Street
- Thus individuals can adapt to almost anything, including very bad health, and report to be satisfied or happy

Why would should cautiously forge ahead....

- Despite all the caveats, this whole line of work has allowed us to learn more about human well being than income measures alone could have told us
- They have told us, for example, that people need income to be well off, but that rapid growth and the uncertainty that it produces can undermine even that levels effect
- They have told us that expectations and aspirations play as much of a role in determining well being as income gains do
- They have also told us that lack of expectations and adapting to adversity can help preserve individual psychological well being, but can result in collective tolerance for bad equilibrium
- They are allowing us to explore the well being effects of a host of phenomenon, ranging from inequality to cell phone ownerships to smoking and obesity to the environment and commuting time
- They highlight how uncertainty in the income and health arena can undermine even very high levels of income and good health care, precisely because people cannot adapt to uncertainty
- They have helped us understand how rational and irrational behavior together underlie economic and other behaviors, which in turn helps us understand unexpected reactions to public policy
- They are allowing us to compare these things across countries and cultures, and to *complement but not replace* GNP measures with broader measures of well being and quality of life
- The Prosperity Index is a model of both best practice and creativity combined in one index: KUDOS!!!!!!