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Editorial

Institutions and well-being

> "*The tools that the new economic historian inherited from the economist were not intended to deal with long-run economic change… The economist not only accepted tastes, technology, and population as given, but also he accepted equally the current basic ground rules within which both market and non-market decisions were made. For that matter, the theory did not recognize the possibility of making economic decisions via the political process. Information was assumed to be perfect and costless.*"

Douglas North (1971).

1. Introduction

The goal of this special issue, which we dedicate to the late Nobel Laureate Douglas North, one of the most prolific and influential economists of the twentieth century, is to encourage new socio-economic research on the relationship between institutions and well-being. North passed away on November 15, 2015, days after his 95th birthday, but his legacy in the field of economics will long be remembered. He popularized an innovative way of thinking about the big questions in economics—e.g., what makes some countries rich and others poor—by emphasizing the essential role of institutions in shaping economic and political incentives and human interactions. For him, the ultimate explanation for many economic and social phenomena is found precisely in the type of factors that many economists before him took for granted. In the spirit of Douglas North, this special issue is dedicated to the study of institutions, or as he defined them "the humanly devised constraints that structure political, economic and social interactions." We believe that having a special issue on the topic of "Institutions & Well-being" is timely and relevant for at least three reasons.

First, institutions matter. While it is by now clear that achieving economic growth and prosperity depends on the complex interaction of many factors—policy, culture, geography, legal origins—perhaps even a fair amount of luck, development economists increasingly refer to institutions as one of the most important and "deep" determinants for sustained economic prosperity (Acemoglu et al., 2005a, 2005b; Economides and Egger, 2009). Some economists even suggest that institutions are now at the forefront of mainstream economic theory (Jones and Romer, 2009). Institutions, as North (1990, p. 111) suggests "shape the subjective mental constructs that individuals use to interpret the world around them and make choices. Moreover, by structuring the interaction of human beings in certain ways, formal institutions affect the price we pay for our actions." In that sense, institutions play a vital role in reducing transaction costs and shaping the appropriate incentives that drive long-run economic growth and development. The ideologies that people have can also influence how they interact with each other and ultimately determine their subjective experiences and satisfaction with various aspects of their lives.

Second, most of the previous research in the field has focused on establishing the relevance of institutions to economic outcomes such as growth in GDP per capita and individual income. Well-being, however, is a multidimensional concept that requires looking not merely at the health of the economic system, but also at a variety of other human experiences and conditions such as civic engagement, community values, health, education, social networks, safety, freedom, or psychological well-being and its many sub-domains; including life satisfaction, positive and negative emotions, meaning, self-esteem, optimism, or positive engagement. Many of these well-being dimensions are strongly correlated with economic development. But there are also striking discrepancies, especially when it comes to how people perceive their lives are going (Stiglitz et al., 2009). Oil-rich countries in the Middle East, for instance, have some of the highest levels of GDP per capita in the world, yet they lack some basic human freedoms and significantly lag behind with regard to human rights, education, and other important well-being dimensions. While good institutions are an end in themselves, studying the relationship between different types of institutions and these well-being dimensions can significantly enrich our understanding of the consequences of institutions and help instruct public policy.

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This is particularly important today because in recent years the measurement of socio-economic progress has started undergoing a fundamental change. Starting with the seminal work of the Commission on the Measurement of Economic and Social Progress in 2009 (Stiglitz et al., 2009), a variety of initiatives around the world have been launched that aim to provide a more complete picture of socio-economic progress. The OECD, for example, is now tracking individual well-being in eleven distinct quality of life categories using both objective and subjective indicators—from material standards of living and work-life balance to subjective indicators of health and life satisfaction. Gallup is now collecting data on human thriving and happiness in more than 140 countries. A World Happiness Report that tracks not only the level of happiness, but also its distribution, has been published annually since 2012. The New Economic Foundation (NEF) is collecting data on national well-being for 22 European countries on multiple aspects of subjective well-being such as life evaluation, emotions, vitality, autonomy, meaning, trust, supportive relationships, resilience, self-esteem, optimism, and positive functioning. An increasing number of countries, including leading economies such as the UK, now have distinct national well-being accounts.[1] The World Bank now reports, as part of the World Development Indicators, estimates of genuine investment which captures the evaluation of intertemporal social welfare (Dasgupta, 2009; Fleurbaey, 2009). This shift is now quickly gaining momentum.[2]

Finally, improving well-being is not only an important social-economic objective and something that most people strive for, it is also an individual and collective resource that can lead to many objective benefits and drive social progress. Healthier, wealthier, happier and more educated people can transform the social fabric of society, which can lead to higher levels of political participation, and in the long-run increase the likelihood of the development and persistence of good institutions (Lipset, 1959). More educated nations, for instance, are more likely to have higher levels of tolerance and trust, lower transaction costs and crime, and be more politically engaged (Lochner, 2011). Subjective well-being has also been linked to many objective benefits—from health and pro-social behavior to higher income and productivity (De Neve et al., 2013). In other words, pursuing well-being is both intrinsically and extrinsically valuable. We believe that a better understanding of the relationship between institutions and well-being can offer many unique insights into some of the vexing barriers to achieving sustained well-being and of the consequent conditions most conductive to improving quality of life.

The articles in this special issue contribute to our understanding of institutions and well-being along at least one of three margins described above. Section 2 provides a brief review of the literature on institutions and well-being, followed in Section 3 by a synopsis of the papers in this issue and how they contribute to this literature. Concluding remarks are offered in Section 4.

2. A brief literature review

Since the early days of economics as a distinct discipline, often associated with the release of Adam Smith's *The Wealth of Nations*, economists have sought to understand the fundamental causes of social progress and human prosperity. Classical economists such as Smith, John Stuart Mill, and David Ricardo stressed the importance of institutions, public policy, and the rule of law in shaping economic performance and human well-being. As economics became increasingly formalized throughout the twentieth century, and particularly with the development of neo-classical growth models, the explanation for differences in economic development and material well-being across the world began to focus on the accumulation of physical and human capital (Solow, 1956; Koopmans, 1965; Lucas, 1988). As Easterly and Levine (2001) recognized, however, factor accumulation is unable to explain the majority of the variation in income and growth differences in cross-country growth regressions. Easterly and Levine noted that the residual, often referred to as total factor productivity (TFP), has the most explanatory power, and called for economists to focus on the determinants of TFP as a means to better understand economic growth.

Most neoclassical growth models treat the production process as a "black box" in which quantities of labor, capital, and technology are somehow combined to produce goods and services, ascribing differences in these variables as the causes of economic prosperity. But why and how societies choose to invest in new technology or human capital is often left unexplained. Along these lines, North and Thomas (1973, p. 2) suggest that factors such as innovation, economies of scale, education, and capital accumulation "are not causes of growth; they are growth." Acemoglu (2009, p. 109) adds: "…any explanation [of growth] that simply relies on technology, physical capital, and human capital differences across countries is, at some level, incomplete. There must be other, deeper reasons that we will refer to as "fundamental causes" of economic growth. It is these reasons that are preventing many countries from investing enough in technology, physical capital, and human capital." In other words, variables such as technology and human and physical capital are only *proximate* causes of economic growth and prosperity, but are insufficient as fundamental explanatory causes. The experience of the transition economies at the end of the last decade furthermore suggests that factors of production are incapable of delivering growth without the appropriate institutional environment (Eicher and Garcia-Penalosa, 2006). The work of Nikolova (this issue), for example, shows that even the glaring happiness gap between transitioning and advanced economies is now closing, largely due to improvements in institutions such as the rule of law.

Increasingly, economists are interested in understanding the fundamental, long-run causes of economic growth and development. Spolaore and Wacziarg (2013, p. 325) provide a review of the burgeoning literature examining the so-called "deep roots" of economic development, which include a host of factors that "have been transmitted across generations over the very long run"

[1] The Office of National Statistics (ONS) published 41 measures of National well-being, organized by ten "domains" including health, what we do, and where we live. The measures include both objective variables such as the unemployment rate and subjective ones such as the percentage of people who felt safe walking alone at dark.

[2] There are a large number of other recent initiatives that attempt to go beyond GDP to track human progress, including the Legatum Prosperity Index, the Social Progress Index, the Happy Planet Index, the Sustainable Economic Development Assessment, and the Economist's "Where to Be Born" Index, among others.