



# Give me liberty and give me control: Economic freedom, control perceptions and the paradox of choice



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## ABSTRACT

We explore the relationship between individual control perceptions and the degree to which a country's institutions and policies are consistent with the principles of economic freedom. Using data from the World Values Surveys (WVS) and the Economic Freedom of the World (EFW) index, we find that people living in more economically free countries are more likely to perceive greater control over their lives. This effect is not diminishing at higher levels of economic freedom. One possible channel that explains this relationship is the perception of procedural fairness and social mobility. Decomposing the EFW index, we further find that the area of sound money is what drives the results.

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## 1. Introduction

Over the past several decades, numerous studies in behavioral psychology have documented overwhelming evidence that the extent to which people *believe* that they have freedom of choice and control over their environment is critically important to the way in which they cope with stress, engage in challenges, work towards success, or even enjoy life. Many of these studies are part of a literature that focuses on the effects of locus of control, also known as “internal-external control,” which is a measure of personality first developed in the 1950s by psychologists at Ohio State University.

The locus of control construct is based on the idea that people vary in the degree to which they believe they are in control of their own lives (Rotter, 1966). On the one hand, people who believe that their trajectory in life depends on controllable factors such as effort and skill have internal locus of control. On the other hand, people who believe that the outcome of their actions depends on uncontrollable factors such as destiny or luck have external locus of control.

The important lesson from the literature on control perceptions is that even after controlling for socio-economic background and intelligence, people with internal locus of control are more successful in multiple domains of life. People who believe that

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they have greater control over their life, for instance, are more likely to persevere in the face of adversity, to pursue achievement related behavior, engage in morally relevant action, and are less susceptible to group pressure.<sup>1</sup> These tools of coping with life's challenges ultimately leaves people with higher control perceptions more satisfied with their lives.

While the personality traits that affect individuals' locus of control are often believed to be genetically determined, a large number of experimental studies, starting with the seminal work of *Maier and Seligman (1976)* on learned helplessness, suggest that these personality traits can be influenced by the environment in which individuals live and hence can be learned.<sup>2</sup> Previous studies, for example, attribute the development of such traits to factors such as family upbringing, socio-economic background, cultural stability, and experiences of effort that lead to rewards (*Lefcourt, 2014*). Far less is understood about the macroeconomic and institutional determinants of control perceptions. Are more economically free countries more likely to produce individuals who believe that their actions matter? And are people who live in more economically developed societies more likely to perceive higher levels of control over their lives? The answers to these questions are important for policy analysis and have far reaching consequences for health, wealth, and happiness.

In this study, we build on this line of research by exploring to what extent the institutional environment in a country influences people's perception of control. All choices require a degree of freedom, and institutions consistent with the principles of economic freedom—personal choice, voluntary exchange, freedom to enter markets and compete, and security of privately owned property (*Gwartney et al., 2014*)—allow people to freely choose, learn, innovate, and exert control over their environment. Economic freedom therefore allows individuals to pursue the type of lives that they value the most while maximizing their autonomy and developing their talents. By raising the cost of discrimination, economic freedom also maximizes cooperation and enhances people's sense of relatedness, especially in the work and market places.

More importantly, societies with a high degree of economic freedom are characterized by automatic feedback mechanisms, including the price system and profit and loss accounting, which act to coordinate economic activity and allow people to learn that their choices have consequences (*Hayek, 1945*). A large literature in economics shows that countries with institutions consistent with the principles of economic freedom tend to experience higher growth rates, less unemployment, and higher investment in human, physical, and social capital.<sup>3</sup> Consequently, people who live in countries with greater levels of economic freedom are more likely to associate their efforts and productive activities (e.g., obtaining a higher education or starting a business) with higher economic and social rewards (*Baumol, 1990*). Thus, we expect that higher levels of economic freedom will be linked to greater perception of procedural fairness and social mobility, which in turn will lead to higher perception of control and subjective well-being.

Higher levels of economic freedom may, however, lead to more restlessness, higher material aspirations, and decision paralysis as more responsibility is placed on the individual to make the right choice in a world with more options and uncertainty. The so called “paradox of choice” hypothesis argues that more freedom of choice leads to lower perception of control and ultimately to dissatisfaction (*Schwartz, 2004*). Numerous studies also find that economic development improves subjective well-being, but only up to a point (e.g., see *Easterlin et al., 2011*). If the paradox of choice hypothesis is correct, then we should expect to see diminishing returns from economic freedom and/or development.

To test our hypotheses, we merge data from the widely used Economic Freedom of the World (EFW) index with the latest release of the World Values Survey (WVS) integrated longitudinal dataset. This provides a pooled cross-sectional dataset containing >190,000 individual observations representing 84 countries spanning the period 1981–2012. Using multi-level OLS econometric models that control for a large set of individual characteristics and macroeconomic variables as well as country and year dummies, our results provide support for the hypothesis that individuals living in countries with higher levels of economic freedom are more likely to perceive greater control over their lives. The relationship is robust and, if causal, our estimates suggest that, all else equal, a unit increase in EFW is associated with a 0.167 to 0.257-point increase in control perceptions (on a 10-point scale). The magnitude of this effect is economically significant as the gain in control perceptions from a one-unit increase in EFW is enough to offset the loss in control associated with individual unemployment.

The positive relationship between economic freedom and control perceptions does not appear to be diminishing at higher levels of economic freedom and does not appear to be conditional on the level of economic development. In this sense, we do not find evidence supportive of the “paradox of choice” hypothesis. We also decompose the EFW index to examine how the five areas of the index correlate with control perceptions. The results suggest that the area of sound money is the primary driver of the main results.

Finally, we explore how economic freedom is related to perceptions of procedural fairness and social mobility and find that, consistent with our main hypothesis, people who live in countries with higher levels of economic freedom are more likely to believe that everyone has a chance to escape poverty and that if people are living in need, it is because of their own efforts as opposed to social injustice. They are also more likely to believe that the proper role of government is to preserve freedom.

Although the results support our hypotheses, they should be treated with caution due to the cross-sectional nature of the data. Specifically, challenges related to omitted variable bias and reverse causality are potentially problematic in the absence of experimental data, which is unfeasible for this type of study. First, it is possible that omitted variables which influence both economic freedom and control perceptions bias the estimates. Although we cannot completely control for unobserved heterogeneity, we

<sup>1</sup> For a comprehensive review of this literature, see *Lefcourt (2014)*.

<sup>2</sup> See *Bouton (2007)* for a contemporary review of the various learning and behavioral theories, including learned helplessness.

<sup>3</sup> For a recent review of the empirical economic freedom literature, see *Hall and Lawson (2014)*.

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