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Minding the happiness gap: Political institutions and perceived quality of life in transition

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ABSTRACT

Along with political and economic changes, the fall of the socialist regimes in Central and Eastern Europe and the former Soviet Union brought about fundamental institutional reforms. Several studies have examined the causes of the increasing unhappiness that accompanied the transition process, including deteriorating public goods, rising inequality, income volatility, stagnating labor market conditions and changing norms. However, few papers have sought explanations for the life satisfaction differentials between transition and non-transition economies. In this paper, I specifically examine the life satisfaction gap between post-socialist and advanced countries and the role of political institutions for explaining this gap. My results imply that both macro-economic factors and the rule of law explain the overall life satisfaction differential between the advanced and transition societies. The rule of law played an additional role in reducing the happiness gap in the 1990s and may have even reversed it in the post-crisis years. As institutions and macro-economic conditions continue to improve, post-socialist countries may complete their transformation processes and achieve quality-of-life levels comparable with those in the West.

1. Introduction

Beginning with the emblematic fall of the Berlin Wall in 1989, the transition process in the former Soviet Union (FSU) and Central and Eastern Europe (CEE) was a period of far-reaching socio-economic, political and institutional changes. The reforms included switching from a planned to a market economy, restoring private property as well as liberalizing prices and foreign exchange (EC, 2015a). Importantly, these fledgling democracies had to create the legal and institutional fundamentals that underpin democratic and capitalists states, including designing modern institutions of public finance, (central) banking and customs (Guriev and Zhuravskaya, 2009).

One of the lessons learned from these experiences is that while the design and introduction of institutions can happen relatively quickly, achieving a functioning institutional framework to support a modern democracy is a long-term process (EC, 2015b). Moreover, the build-up of new political and economic institutions in the transition region coincided with a decline in the quality of formal and informal institutions such as falling social trust and increasing corruption, weakened civil societies and an overall decline in social capital (see Bartolini et al., 2015 for a review).[1]

Several studies document a trend of unhappiness that accompanied the transition process and suggest that a persistent life satisfaction differential still exists between transition and non-transition countries. This paper examines the role of rule of law

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[1] Social capital formally refers to the "institutionalized norms of reciprocity and trust" that enable communities to solve collective action problems (Adsera et al., 2003, p. 446). The social capital gap between transition economies and the EU depends on the quality of formal political institutions and the level of development and may disappear once countries complete the transition process (Fidrmuc and Gërxhani, 2008).

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(RoL) in explaining the subjective well-being differentials between transition and advanced societies (i.e. the "happiness gap").[2] It finds that in addition to macro-economic factors, the conditional unhappiness gap may be accounted for by political institutions proxied by the RoL. This suggests that as institutional and market reforms continue, citizens in post-socialist economies may achieve the same quality of life as their counterparts in developed market economies.

Subjective well-being (SWB) metrics track positive and negative emotions, life evaluations and life purpose and have individual-, economic- and institutional-level determinants. Life satisfaction in particular is a perceived quality-of-life measure and is a cognitive reflective assessment of one's life as a whole. Because they trace both material and non-material aspects of life, SWB metrics furnish important complementary information to objective indicators such as income, employment and consumption. Furthermore, they are especially well-suited for studying the well-being implications of complex processes such as institutional reform or transition to democracy and a market economy. Given that it reflects both perceived and actual quality of life and as such is a broad welfare indicator, SWB has emerged as a key variable for economic and policy analysis. For example, SWB is linked with objective outcomes such as productivity, creativity, longevity and creativity (De Neve et al., 2013). Importantly, SWB may be relevant for the political process as voting behavior may be partly determined by SWB (Dolan et al., 2008; Liberini et al., 2014; Ward, 2015). Thus, studying how institutions and macro-economic conditions affect SWB and whether they can help transition countries on their way to prosperity is important for policy-makers at national and supra-national levels.

While the large life satisfaction gap between transition economies and other nations at similar or different levels of development is well documented, few papers have explored its determinants. (Djankov et al., 2016; Gruen and Klasen, 2012; Guriev and Zhuravskaya, 2009).[3] This paper builds on and substantially extends previous studies in several ways. First, unlike other studies exploring the differences between transition and *non-transition* countries, this study explicitly examines the life satisfaction gap between transition and *advanced* countries. If the transition process entails reaching the level of development and material and non-material standards of developed countries, then I argue that advanced countries, and not non-transition countries in general, are the relevant comparison group.[4] Second, I look at the life satisfaction differentials in light of a previously understudied factor, namely the RoL. Since institutions can both improve the quality of the social fabric and enhance economic outcomes, I examine both the direct and indirect influences of institutions on the size of the SWB gap by controlling for a number of macro-economic variables. Third, I use variance decompositions to study the relative importance of macro-economic vs. institutional and socio-demographic factors for individual life satisfaction in transition, which to my knowledge has not been undertaken in this context before. Finally, I distinguish between EU and non-EU transition countries and observe whether EU membership and the institutional transformations entailed had a particular effect for post-socialist countries.

2. Life and unhappiness in transition

Fig. 1 shows the average life satisfaction levels for transition and advanced countries in the main analysis sample based on data from the last four waves of the World Value Survey (1994–2013). Using earlier WVS waves, other studies document that life satisfaction has a V-shape in transition economies (Easterlin, 2009, 2014; Guriev and Zhuravskaya, 2009; Sanfey and Teksoz, 2007). During the 1990s, life satisfaction dramatically fell in transition economies, mirroring GDP trends, and while it eventually began to recover in the late-1990s, it failed to do so commensurately with GDP (Easterlin, 2009). Using data from later years, I show that while there was a large life satisfaction gap between advanced and transition economies in the mid-1990s, this gap has recently started to close. Nonetheless, even in the last WVS wave, the unconditional happiness gap is about 1 on a scale of 1–10, which is substantial. According to Fig. 1, while life evaluations in advanced economies have remained relatively stable over the analysis period, those in transition countries started at relatively low levels in mid-1990s. Accordingly, this paper focuses on studying what underlies the life satisfaction differentials between transition and advanced nations.

The conclusion of the relatively large literature on unhappiness in transition is that people in post-socialist economies paid for these tectonic transformations with their SWB. While income is certainly part of the explanation of unhappiness in transition, it does not account for the entire puzzle (Bartolini et al., 2015). Other causes of declining happiness in transition economies could include the depreciation of education acquired under socialism, deteriorating public goods, income inequality (Guriev and Zhuravskaya, 2009), worsening social protection and stagnating employment conditions (Easterlin, 2009), as well as changing norms and volatility (Graham and Pettinato, 2002). Moreover, large-scale reforms such as privatization may have further lowered happiness in transition (Popova, 2014).[5]

Transition economies present an opportune case to study the well-being consequences of institutions for several reasons. First, these nations witnessed the formation of new institutions or the fundamental restructuring of old ones. Importantly, this experience has varied across the transition region, with some countries making substantial progress while others lagging behind (Askarov and Doucouliagos,

[2] The "happiness gap" in this paper is borrowed from Guriev and Zhuravskaya (2009). Note, however, that Guriev and Zhuravskaya (2009) examine the differences between transition and non-transition countries (including advanced and developing countries), while I study the gap between transition and advanced Western nations.

[3] Note that Djankov et al. (2016) work, which appeared after this paper was already in the editorial and publication process, focuses on Eastern Europe and uses cross-country panel regressions to argue that the happiness gap is explained by perceptions of government and corruption proxies.

[4] I use the list of advanced economies from the International Monetary Fund Appendix Table B (IMF, 2015), which includes: Austria, Australia, Belgium, Canada, Cyprus, Denmark, Finland, France, Germany, Hong Kong, Greece, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Spain, Sweden, Switzerland, Taiwan, the United Kingdom and the United States. The Czech Republic, Estonia, Latvia, Lithuania, Slovakia and Slovenia are considered advanced in the IMF's list, although we include them in the transition countries list.

[5] Factors such as increasing economic, political and social freedoms (Inglehart et al., 2008; Lelkes, 2006; Sanfey and Teksoz, 2007) and greater access to consumer goods (Guriev and Zhuravskaya, 2009) were arguably a positive channel affecting life satisfaction in transition. However, it seems that the negative experiences during transition associated with rapid political and economic change and fundamental socio-economic, social and institutional transformations dominated the transition experience.