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MACROECONOMIC PERFORMANCE AND INSTITUTIONAL CHANGE: EVIDENCE FROM SUBJECTIVE WELL-BEING DATA

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The relationship between macroeconomic performance and institutional change is explored in member countries of the Organization for Economic Cooperation and Development (OECD). We first assess the effects of national income growth, unemployment and inflation on subjective well-being (SWB) in thirty OECD countries, and employ the relationships found to construct an index of macroeconomic performance in terms of SWB. Applying the index to the period 1990-2009, we find that macroeconomic performance has improved in OECD overall and in the majority of countries, and that there has been a convergence of performance within the OECD. We then present evidence that OECD countries' performance, as measured, is positively related to institutional change towards more trade openness and better institutional quality. We argue that both increased openness and improved institutional quality are correlates of economic and political integration and conclude that international integration has enhanced SWB by improving OECD countries' national macroeconomic performance.

JEL classification codes: F15, E61, I31
Key words: macroeconomic performance, institutional change, international integration, subjective well-being, OECD

1. Introduction

The past few decades have seen a wave of international economic integration and institutional reform, including the transition of Eastern European countries from socialism to capitalism and their accession to the European Union, the introduction

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of the euro as a common currency, the creation of the North American Free Trade Agreement, and the removal of trade barriers worldwide.

With respect to such developments, economists have emphasized the positive economic effects of trade openness (Sachs and Warner 1995, Frankel and Romer 1999) and improved institutional quality (Acemoglu et al. 2001, Rodrik et al. 2004), whereas social scientists and the general public have often been critical towards economic liberalization and "globalization". Especially, there has been concern about negative impacts on output and employment in developed countries due to competition from developing and emerging economies (see, e.g., Bauman 1998).

Against this background, this paper explores the relationship between macroeconomic performance and institutional change in member countries of the Organization for Economic Cooperation and Development (OECD) over the past two decades. As is well-established in the macroeconomics literature, we capture macroeconomic performance by the standard goals of GDP growth, low unemployment and price stability.[1] Institutional change is captured by indicators of trade openness, civil liberties, and the control of corruption.[2]

While the set of factors that constitute macroeconomic performance seems uncontroversial as such, it is not clear how these factors are to be integrated into an *overall* measure of macroeconomic performance, and it is this issue to which this paper also contributes. We do so by using a measure of subjective well-being (SWB) as an empirical indicator of welfare. Specifically, we run SWB regressions to study how the rates of growth, unemployment, and inflation prevailing in a set of thirty OECD countries affect citizens' well-being and use the results to construct a composite index of national macroeconomic performance.[3] This approach follows a recent trend of using subjective measures of well-being in economics analysis.

[1] These indicators reflect the common view of macroeconomic performance, as stated in one leading textbook: "a successful economy is an economy that combines high output growth, low unemployment and low inflation" (Blanchard et al. 2010: 27).

[2] These institutional indicators are not *direct* measures of economic institutions (like absence of trade barriers) or political institutions (like democracy). The measure of trade openness (imports plus exports as a fraction of GDP) is a *consequence* of the removal of trade barriers, and civil liberties and the control of corruption are measures of the *quality* of democracy and governance. All countries in our sample (OECD countries) are electoral democracies, but differ with respect to the quality of democracy, as captured by civil liberties.

[3] Unemployment is typically a factor that contributes to higher inequality, especially at business cycle frequencies. Therefore, our macro index leads to take into account distributive considerations that do not appear in an average measure like income growth.