Quality of Governance Moderated the Effect of the Economic Crisis on Subjective Well-Being: Evidence from EU regions

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Abstract

During the recession of 2008, large regional differences in subjective well-being could be observed in Europe. In Mediterranean countries (Greece, Spain, Italy and Portugal), the decline in life evaluation was large and persistent during the years of recession (Figure 1). Beyond doubt, South Europe has experienced an enormous decline in subjective well-being[1] after 2008. At the same time, in West-European countries and in some countries of the east of Europe, the decrease in subjective wellbeing was only limited, in some cases neglectable. These large North-South divide has given rise to a literature which examines the drivers of the discrepancies (WHR, 2013; Gonza and Burger, 2016, Helliwell et al 2014; Bjornskov, 2013).

Figure1

What can explain these differences? On the one hand, the Mediterranean countries were disproportionally affected by the great recession. By 2012, unemployment rate had climbed to 24.5% in Greece, to 24.8% in Spain and to 15.8% in Portugal and in most areas of South Europe there has been an evident decrease in Gross Domestic Product (GDP) between 2008 and 2012. Other European economies were less volatile during the crisis. Most notably, Sweden and Denmark experienced only a small increase in unemployment rates, while in Germany the unemployment rate even decreased (Figure 2 and Figure 3). The effect of unfavorable macroeconomic conditions including increased unemployment, decreasing income and inflation on subjective well-being has been extensively examined in the happiness economics literature (e.g., Veenhoven, 1989; Winkelmann & Winkelmann, 1995; Di Tella et al., 2001; Wolfers 2003; Arampatzi et al., 2015). In this literature, it has been found that, in general, macroeconomic fluctuations are strongly associated with subjective well-being. Empirical evidence also shows that among other factors, unemployment has the most detrimental effect on subjective well-being.

Figure2

On the other hand, there is a longstanding debate on the effect of GDP growth which seems not to have a long-term relationship with happiness (Easterlin, 1974). However, more recent evidence shows that the effect of positive growth on subjective well-being is less manifest than

[1] The decline is consistent across surveys and different subjective well-being indicators including Life evaluation, Happiness and Life Satisfaction measures.

the effect of negative growth, indicating that subjective well-being is more sensitive to economic decline than economic growth (De Neve et. al 2015).

Despite that economic shocks and their consequent macroeconomic fluctuations have been consistently demonstrated as the source of large declines in subjective well-being, findings on the magnitude and intensity of their impact remain ambiguous. For example. Deaton (2009) uses an American sample and subjective well-being data from the Gallup World Poll to find that the macroeconomic changes including those in income and unemployment during the 2008 crisis, only predicted changes in subjective well-being at the short-term. At the same time, not all countries that experienced severe economic shocks, experienced considerable declines in subjective well-being. One year after the collapse of financial institutions and the bankruptcy that followed in Iceland, Gudmundsdottir (2013) found limited evidence on the negative effects of the crisis. She finds that unemployment and loss of income did not result to changes in happiness after the economic downturn. It is suggested that, on average, happiness was stable despite the crisis because good social relationships worked as protective factor against the economic downfall (Gudmundsdottir, 2013).

Unlike Iceland, it has been highlighted that during the most recent recession some European countries experienced much larger declines in subjective well-being than what would be explained or even predicted from losses in income and unemployment rates (WHR, 2015; Helliwell;)[2]. Literature shows that the unexpectedly large changes in subjective well-being are conditional on the economic and social environment. The diverse conditions are expected to alleviate or intensify the negative effects of recessions. Among the mitigating factors are unemployment support programs and employment protection legislation (Morgan, 2015). In countries where there is sufficient economic support and employment protection, the damaging consequences of a crisis are less severe. High institutional and social trust (Helliwell, 2014) and high social capital (Sabatini, 2015), have also a mitigating effect in presence of bad economic conditions. Trust promotes cooperation attitudes and social support which in turn creates a safer environment to cope with economic hardships. On the other hand, increased unemployment rate, high inequality as seen in the Gini indexes, and below average income amplify the negative effects of the economic crisis.

In the World Happiness Report of 2013 and 2015 an in-depth discussion of the circumstances that helped some countries to "navigate" the recession better led to the conclusion that "*the strength of the underlying social fabric, as represented by levels of trust and institutional strength, affects a society's resiliency in response to economic and social crises*" (Helliwell, J. F., Layard, R., & Sachs, (2015) p. 33. and that *"….should social institutions prove inadequate in the face of the challenges posed by the crisis, they may crumble further under the resulting pressures, making the happiness losses even greater, since social and institutional trust are themselves important supports for subjective well-being*" (Helliwell, J. F., Layard, R., & Sachs, (2015) p. 33..

[2] Indeed, cross country comparisons show that the international differences in subjective well-being during the Great Recession are explained by other factors rather than economic outcomes per se (WHR, 2013).

Building on the narrative provided in the World Happiness Report, this article shows how quality of governance moderates the negative effect of the most recent economic crisis on life satisfaction. More specifically, we assess whether regional differences in quality of governance drive the variation in the way European regions responded to the economic downturn in terms of life satisfaction.

Given the complexity that characterizes the term “good governance” and the plethora of factors that capture it, we opt to focus on two core indicators; quality of governance as suggested by Kauffman that captures a large variation of the governance spectrum, and a perceptions measure related to trust in government. That will allow us to explore the sensitivity of two distinct measures of “governance” and capture any potential differences in their development during the crisis. We also have the opportunity to explore whether perceptions, such as institutional trust drive general dissatisfaction or whether it is the objective deteriorating conditions of quality of governance that shapes the unhappiness function.

We expect that individuals living in countries with high quality of governance are able to cope more easily with economic downturns in terms of subjective well-being, while individuals living in countries with low or decreasing quality of governance are expected to demonstrate unanticipated declining levels of subjective well-being during the crisis.

Previous literature has focused on the indirect links between good governance and subjective well-being (Gonza, Sabbatini), mainly via economic growth and interpersonal and institutional trust that thrive in its presence. However, the direct positive association between quality of governance and subjective well-being has been highlighted, net of its influence on social and economic factors (Alvarez-Diaz et al, 2010; Helliwell et al, 2014). Good governance entails numerous characteristics widely linked to subjective well-being. Inclusive law-making and institutions ensure that policy-making procedures are fair (Frey and Stutzer, 2000; Helliwell et al 2015), political participation and voting eliminate exclusion and strengthen public awareness. Another element of good governance, lack of corruption, is also strongly linked to higher well-being. Lack of exposure to corruption increases perceptions about reliability of governments and their respective responsiveness and effectiveness of the services. Good governance can also signal that the ability of governments and their institutions to handle and cope with adversities is evident. It is therefore expected that the beneficial outcomes of good governance are even more important during economic downturns The idea that high quality of governance has a mitigating effect during economic hardships questions the negative universal effect of bad economic conditions and challenges the debate on the specific circumstances that can prove to be beneficial for social progress during economic crises.

We use individual-level data taken from Eurobarometer for 28 European Union countries for 2010 and 2013, combined with regional unemployment, GDP and inflation data from Eurostat and regional data on Quality of Governance (EQI). We employ several logistic regression models including interaction terms to test Quality of Governance as a moderator.

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Figure 1

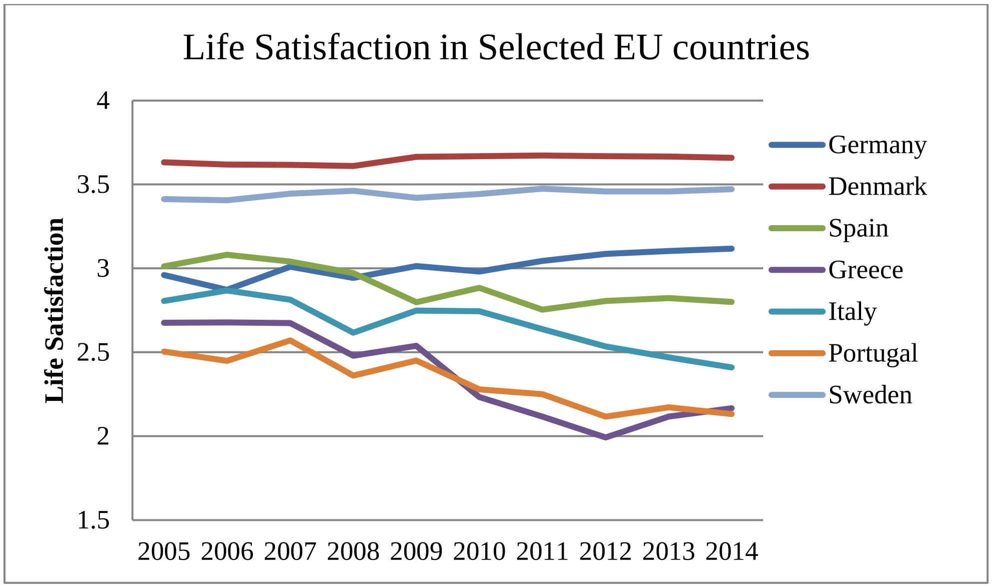

Figure 2