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Globalization, Poverty, Inequality, and Insecurity

Some Insights from the Economics of Happiness

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Abstract

The literature on the economics of happiness in the developed economies finds discrepancies between reported measures of wellbeing and income measures. The 'Easterlin paradox', for example, shows that average happiness levels do not increase as countries grow wealthier. This article explores how the economics of happiness can help explain gaps between standard measures of poverty and inequality and reported assessments of welfare in countries in the process of integrating into the global economy. Most prominent among these discrepancies is that between economists' assessments of the benefits of globalization for the poor and those made by the general public. Survey research often highlights phenomena that are not typically captured by money metric measures, such as vulnerability to poverty among the near poor and distributional shifts at the local, cohort, and sector level. The article posits that the gaps between income measures and reported wellbeing may matter to development *outcomes*, based on evidence from the author's research on reported wellbeing in Latin America and Russia.

Keywords: welfare, wellbeing, happiness

JEL classification: I31, I32

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1 Introduction

Few issues have raised as much debate as the effects of globalization on poverty and inequality. Much of the debate among academics has focused on aggregate, money-metric measures of progress, such as per capita income growth and trends in the poverty headcount. These measures suggest that countries that integrate into the world economy do better at growing and reducing poverty than those that do not, although with a great deal of variation among them, depending on their initial factor endowments and institutional structures.[1] For the most part, however, such measures fail to capture phenomena which may have important effects on individuals' real and perceived welfare outcomes, such as vulnerability among the near poor, distributional shifts at the local, cohort, and sector level; and changes in the provision and distribution of public services, among others. These latter trends play a major role in determining public perceptions about the benefits and fairness of the globalization process.

Thus there is a major discrepancy between the academic assessments of the benefits of the process and the more negative assessment that is prevalent among the vocal critics of globalization. Some of this discrepancy has to do with a mismatch between the extensive data that are available to academics studying the process and the anecdotal evidence that is the basis for most public critiques of globalization. Yet some of it has deeper explanations and lies in the very different metrics that are used to benchmark progress.

While academics focus on internationally accepted poverty lines and measures of inequality, the average citizen experiencing the process tends to rely on country-level or even neighbourhood-level norms about what constitutes poverty, and on income differentials at the local and sector level rather than at the level of the national distribution. It is virtually impossible for internationally comparable measures, such as the US$1 or US$2 (PPP) a day poverty line, the Gini coefficient, and the 90/10 ratio, to adequately account for local norms and micro level trends. Nor do they capture *vulnerability* to falling into poverty, which is an extremely important component of welfare in developing economies as labour markets and other structures adapt to deeper integration in the world economy.

A related conceptual problem in the debate on globalization and poverty is a lack of distinction between basic needs definitions of poverty, and broader definitions, including that of near poverty or vulnerability. While alleviating extreme poverty is and should be a major goal of economic development, the first order policies required are distinct from those which pertain to countries' deepening integration into the global economy. The former include enhancing capacity to meet basic nutritional needs and investments in primary education, health, and public infrastructure such as water, electricity, and roads. The latter tend to focus on the function of labour and capital markets, trading systems, and regulatory and social welfare institutions. While both kinds of poverty can and do co-exist in many countries, and the problems and policies are not unrelated, they pose distinct analytical and policy challenges.

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1 For a fuller discussion of these issues, see Birdsall and Hamoudi (2002) and Collins and Graham (2004).

Establishing channels of causality related to globalization, meanwhile, is even more complex. The populations with the highest concentrations of extreme poor, meanwhile, such as those in Sub-Saharan Africa, tend to have minimal integration in the global economy.

This paper relies on surveys of subjective wellbeing or happiness, a relatively new tool for economists and other social scientists, to draw a broader picture of how the poor and the near poor in developing economies fare during the process of globalization. My research in Latin America and Russia, conducted jointly with several colleagues and discussed below, suggests that happiness surveys can tell us a great deal about how the *dynamics* of poverty and inequality affect wellbeing; they reveal many other elements of wellbeing which are not captured by income measures alone; and they can enhance our understanding of the effects of globalization on these processes. The picture is, by definition, a complex and incomplete one. Yet the hope is that these results, coupled with broader insights from the literature on the economics of happiness, can contribute to our understanding of the complex relationships between globalization and poverty and inequality.

2 The economics of happiness

Central to the findings of much of the happiness literature in the developed economies are numerous discrepancies between reported measures of wellbeing and income measures. Richard Easterlin pioneered the economics of happiness in the mid-1970s.[2] He found that across countries and cultures, the way that most people spend their time is similar: working and providing for their families. The concerns they express when asked about happiness are similar. His finding—that wealthy people tend to be happier than poorer ones within countries, but that there is no such relationship among countries or over time—has since been supported by a number of subsequent studies, and is known as the 'Easterlin paradox' (Easterlin 1974).[3] More recently, Stefano Pettinato and I developed data for 17 countries in Latin America and found similar results.[4]

Yet while the Easterlin paradox—and happiness surveys more generally—provide us with important information and suggest new analytical approaches, they can also pose challenges when translated into direct policy recommendations. For example, at the same time that countries have grown wealthier over time, they have also made major

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2 Easterlin used thirty surveys from nineteen countries, including some developing countries. See Easterlin (1974; 1995; 2001 and 2003a). He also finds that health is a demographic variable with clear effects on happiness in all societies, a finding that other studies corroborate. For an excellent summary of many of these studies, see the 4 October 2004 issue of the *New Scientist* magazine.

3 Blanchflower and Oswald (2004: 1359-87) find that well-being in the US has trended slightly downwards, while in the UK it has trended slightly upwards. See also Diener (1984) and Frey and Stutzer (2002).

4 We find that average happiness levels are, for the most part, lower in the Latin American economies than in their wealthier OECD counterparts. Yet *within* the subset of Latin economies, there is a similar lack of relationship between per capita income and average happiness levels. See Graham and Pettinato (2002a).

improvements in other indicators, such as morbidity, mortality, and literacy rates.[5] Yet if the direct policy conclusion from the Easterlin paradox is that more money does not make people happier, then a related conclusion could be that long-term gains in health and education also do not make people happier.[6] Most development economists would find this extremely problematic.

Related to this, a prominent explanation for the Easterlin paradox is that norms and expectations adapt upwards at about the same rate as income increases, and thus after basic needs are met, income increases do not make people happier. The most extreme view of the adaptation thesis is the psychologists' 'set point' theory of happiness, which posits that all individuals have a set point of happiness, and that they adapt back to that set point even after major events like winning a lottery or getting divorced.[7] The rather uncomfortable message for policymakers might then be that after a certain point, there is nothing that they can do to make people happier.[8]

Yet that is in the extreme, and even if norms and adaptation play a major role in determining subjective wellbeing, there is also ample evidence that objective conditions—and changes in objective conditions—matter. Additionally, comparisons across countries, relying on aggregated, country-level responses have limited utility. In addition, country-level happiness scores can also be biased by idiosyncratic conceptualizations of wellbeing or happiness that are driven by language, culture, or other unobservable traits.[9] The most useful—and robust—comparisons are those across individuals *within* particular countries and over time, and/or across large numbers of individuals across countries, but including controls for unobservable country-level traits.

Within virtually all countries where such surveys are conducted, cross-section data show that wealthier people are happier than poor ones. Healthier people are also happier, as are more educated people, employed people, and married people. Conversely, economic and other forms of insecurity, such as high levels of crime, seem to have negative effects on people's happiness.[10]

This hardly supports the thesis that progress does not matter. Escaping abject poverty and having sufficient income seem to matter to people's happiness, but other non-income factors, such as stable employment, marital status and good health, play an equally important role. While across nations there are diminishing returns to increasing income, other things that correlate with national income, such as health,

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5 For an excellent review of the relationship between health and development (and the links or lack thereof to inequality) see Deaton (2003).

6 I thank an anonymous reviewer for making this point.

7 Easterlin discusses arguments in favour and against the 'set point' theory in Easterlin (2003b).

8 Gregg Easterbrook (2003) discusses this in detail.

9 One example of these is the consistently high ranking that appears for Nigeria in cross-country happiness studies.

10 For the negative effects of unemployment, for example, see Clark and Oswald (1994: 648-59); on income volatility, see Graham and Pettinato (2002a); and on crime, see Powdthavee (2004).

quality of government, and human rights, are correlated with higher happiness levels (Frey and Stutzer 2002; Diener 2004). In a recent cross-country study, for example, John Helliwell concludes that people with the highest wellbeing 'are not those who live in the richest countries, but those who live where social and political institutions are effective, where mutual trust is high, and corruption is low' (Helliwell 2003, quoted in Diener and Seligman 2004).[11]

The discrepancy between cross section and over-time country-level findings, meanwhile, is a paradox on its own. After minimum basic needs are met, respondents do not seem to factor in long-term, aggregate improvements in per capita income levels or in basic health and literacy standards as they assess their wellbeing. At the same time, at any point in time within individual countries, wealthier and healthier people are happier than are poorer and less healthy people; responses are also influenced by *changes* in both income and health status. And even if over-time gains do not affect people's answers to happiness surveys, if life expectancy is longer and disease incidence is lower, then these happier, wealthier, and healthier people will have more years to enjoy their lives.[12] More generally, the paradox between cross-section and over-time data highlights how wellbeing surveys can provide novel information and insights.

One example of wellbeing surveys informing unresolved policy questions is the evidence that they provide, albeit mixed, that distributional outcomes matter to welfare. Experimental, firm- and region-level studies find that inequities in rank or in the distribution of particular rewards can erode the positive gains accrued from income.[13] Based on US data from the General Social Survey (GSS), Blanchflower and Oswald (2004) find that relative income differences matter to happiness even when absolute income is held constant.[14] My research, based on the Latinobarometro public opinion survey for Latin America in addition to the GSS for the US, finds that respondents who perceive the distribution of income in their societies as unfair are less happy, on average, than others. (This finding is merely suggestive, as the

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11 It is important to note that some critics of the findings of the social capital literature more generally have some genuine concerns about the robustness of these findings. See, for example, Durlauf and Fafchamps (2004).

12 I thank Andrew Oswald for a discussion of this point.

13 Experimental studies, such as the Ultimatum game, find that people are willing to turn down fairly large amounts of 'reward' money rather than accept a reward that is unfairly divided between two people. Oswald *et al.* (2003) finds that worker's place a higher value on rank in a firm—and how their salary compares to other co-workers, than to the actual amount of salary. Hagerty (2000) finds that, controlling for personal income, individuals living in higher income areas in the US were lower in happiness than those living in lower income areas.

14 They use two specifications as proxies for relative income. The first is the ratio of individual income to state income per capita (controlling for regional housing prices) and the second is a series of variables which measure income relative to the average level of income in each of the different quintiles of income within the person's state. In both instances, greater relative differences make people less happy, and in the latter instance, the greatest effects come from the ratio of individual income to income in the top quintile (see Blanchflower and Oswald 2004).

direction of causality is unclear: less happy people may be more likely to perceive disparities as unfair).[15]

Happiness surveys also show that macroeconomic conditions matter to wellbeing. Studies in the developed economies find that higher inflation and unemployment rates make respondents less happy, all else being equal.[16] My research with Pettinato corroborates these findings for Latin America, with high inflation being bad for happiness, and with unemployment rates having a negative effect.[17] Most economists and policymakers would be quite comfortable with the logical conclusion from these results: high inflation and unemployment are bad for wellbeing.

Yet in a more recent study of the costs of regional unemployment rates in Russia, Eggers, Gaddy, and I find that respondents that live in regions with higher unemployment rates are, all else held equal, happier than their counterparts in regions with lower rates (Eggers, Gaddy and Graham 2004). These results reflect the unusual nature of the Russian economy and its uneven transition to the market; a detailed interpretation is beyond the scope of this paper. The point is that the policy implications, taken at face value, are that high unemployment rates are good for wellbeing in Russia. Few analysts would find that useful or conscionable. Again, this demonstrates that wellbeing surveys can provide important and novel information, but that caution is necessary when drawing direct policy conclusions.

More generally, there seems to be a relationship between subjective wellbeing and many of the questions that are central to the work of development economists—and to the challenges faced by developing country governments. These insights complement but certainly cannot replace the valuable information and benchmarks of progress provided by income based measures. But they can be useful in helping explain policy puzzles such as differences among societies' tolerance for inequality and unexpected interruptions in social and political stability.

The point of this paper is to demonstrate how research on reported wellbeing or happiness can provide new insights into the complex process of development and how individuals fare—and/or perceive they fare—during that process, and how those fates—and perceived fates—are affected by the process of integrating into the global economy.

With a view towards shedding light on the discrepancy between economists' generally positive assessments of globalization's benefits for the poor and the more negative ones which are typical of the general public, the paper reviews the general approach taken in the economics of happiness and then presents some results from our studies in Latin America and Russia. In particular, our results highlight the extent to which vulnerability to falling into poverty, temporary poverty spells, and uneven

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15 See Graham (2003a).

16 See Di Tella, MacCulloch, and Oswald (2001).

17 On inflation, see Graham and Pettinato (2002a); on unemployment, see Eggers and Graham (2004). The unemployment finding is significant at the 5 or 10 per cent level, depending on the specification. One explanation for the mixed results is the large proportion of the population in the informal sector, and therefore not directly affected by the unemployment rate.

rewards to different educational and skill cohorts can erode the overall benefits and possibly even the sustainability of the process.

3 What are standard measures missing?

An obvious question is what are our traditional measures missing and does it matter to development outcomes? Respondents' assessments of their own welfare often highlight factors which are not adequately captured by income measures. Examples of these are real and perceived insecurity as rewards and incentives systems adapt to structural changes; the state of essential public services, such as education, health, and crime prevention; and norms of fairness and justice. Even the trends that can be measured in income terms, such as poverty and inequality, have broader dimensions—as well as dynamic elements—which are not captured by traditional income-based measures, such as poverty headcounts and Gini coefficients.

While the gap between economists' and the public's assessments of the effects of globalization may be exaggerated by the vocal opponents or proponents of globalization, it may also reflect trends—and broader dimensions of welfare—that standard income measures are not capturing. Few development economists dispute the notion that growth is a necessary but insufficient condition for poverty reduction. It should come as little surprise, then, that measures of poverty and inequality which only capture income and expenditure trends do not provide a complete picture of the many and broader dimensions of poverty and inequality, much less fully depict how they are affected by the complex process of globalization in the developing world.

Gini coefficients, for example, are static, aggregate measures that do not change very much over time, and usually do not reflect distributional shifts among regions and/or among age or skill cohorts. Poverty headcount studies based on cross-section studies conducted every few years often miss short-term movements in and out of poverty.[18] Such movements are common in developing countries and create widespread insecurity among the middle class as well as the poor.[19] This phenomenon is not typically highlighted in discussions of the links between globalization and poverty. Panel data which measure income mobility are better suited to capturing shifts among cohorts and short-term poverty movements. Yet these data are rare and only exist for a few developing countries.[20] Fixed international poverty lines, such as the US$1 or US$2 per day lines, meanwhile, while useful for intra-country comparisons, often

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18 In the first three years of the financial crisis in Indonesia of the late 1990s, 20 per cent of the population was below the poverty line at any given point in time. Yet 50 per cent of the population was in poverty at some point during the three year period. See Pritchett, Suryahadi, and Sumarto (2000).

19 For a discussion of the extent of drops into poverty during financial market crises, for example, see Cline (2002). For a discussion of insecurity among the middle class, see Birdsall, Graham, and Pettinato (2001).

20 Even then they usually cover short time periods—say 1 to 3 years—and are rarely nationally representative samples.

have very little to do with public conceptions of poverty within particular countries and regions.

A related issue is public tolerance for inequality. Years ago, in a classic article, Albert Hirschman (1973) compared public tolerance for inequality in the development process to a traffic jam in a tunnel. He noted that when one lane moves forward, it gives those in the stalled lanes hope, as it provides a signal or information about where they might be going in the future. But if only one lane continues to move and the others remain stalled for a long period of time, then those in the stalled lanes become frustrated and are tempted to revert to radical behaviour such as jumping the median strip. Note that the frustration and radical behaviour come after a period of growth and development (albeit unevenly shared), not at a time of overall stagnation. There is nothing in our standard measures of growth or inequality that allows us to gauge the timing of such frustration and how the tolerance threshold differs among societies. Nor can they tell us how or if that threshold is affected by globalization-related phenomenon, such as increased information flows, which can alter norms of equity and fairness, and adjust consumption standards upwards.

The more important question, however, is whether this gap between economists' assessments and broader measures of wellbeing matters to *outcomes* in poor countries. Surely the bottom line or minimum requirement for economic development is economic growth. Will understanding broader, and surely more difficult to measure, dimensions of welfare contribute anything at all to the already complex challenges of economic development? And if there is merit in pursuing these broader concepts of welfare, how can we better measure what traditional tools do not capture? At the least, the economics of happiness provides some new tools with the potential to contribute to answering these questions.

4 Evolution and relevance of happiness research

The study of happiness, or subjective wellbeing (terms which are used interchangeably), is a fairly new area for economists, although psychologists have been studying it for years. Some of the earliest economists, such as Jeremy Bentham, were concerned with the pursuit of individual happiness. As the field became more rigorous and quantitative, however, much narrower definitions of individual welfare, or utility, became the norm. In addition, economists have traditionally shied away from the use of survey data because of justifiable concerns that answers to surveys of individual preferences—and reported wellbeing—are subject to bias from factors such as the respondents' moods at the time of the survey and minor changes in the phrasing of survey questions, which can produce large skews in results.[21] Thus traditional economic analysis focuses on actual behaviour, such as revealed preferences in consumption, savings, and labour market participation, under the assumption that individuals rationally process all the information at their disposal to maximize their utility.

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21 For a summary of the critiques of the use of survey data, see Bertrand and Mullainathan (2001).

In recent years, however, the strictly rational vision of economic decisionmaking has come under increasing scrutiny. One important innovation is the concept of bounded rationality, in which individuals are assumed to have access to limited or local information and to make decisions according to simple heuristic rules rather than complex optimization calculations.[22] A more recent trend has been the increased influence of behavioural economics, which supplements the methods and questions of economists with those more common to psychologists.[23]

Economists who work in the area broadly define happiness and/or subjective wellbeing as satisfaction with life in general. The three sets of terms are used interchangeably in most studies. Most are based on a very simple set of survey questions that typically ask respondents 'How satisfied are you with your life?' or 'How happy are you with your life?' Answers to this open-ended question obviously incorporate psychological as well as material and sociodemographic factors. Critics used to defining welfare or utility in material or income terms bemoan the lack of precise definition in these questions. Yet the economists who use these surveys emphasize their advantages in making comparisons across cohorts of individuals—in which they find a surprising consistency in the patterns of responses both within and across countries—rather than in evaluating the actual happiness levels of specific individuals. In addition, they find that the events that are known to have documented effects on happiness, such as illness, marriage, and divorce, are very much reflected in over-time responses to happiness surveys.[24] All of this suggests that errors pertaining to idiosyncrasies in the way individuals answer these surveys are relatively small in magnitude, and do not appear to affect aggregated responses. Psychologists, meanwhile, find a significant degree of 'validation' in subjective wellbeing surveys, wherein individuals who report higher levels of happiness actually smile more, as well as meet several other psychological measures of wellbeing.[25]

Despite the new attention that economists have given to happiness research in recent years, the Easterlin paradox remains somewhat of a puzzle. With economic growth and related improvements in living standards, such as reduced infant mortality and increased life expectancy, people are better off by any number of definitions. Yet these objective improvements do not seem to be captured in people's responses to the happiness questions. Easterlin explained this apparent anomaly by suggesting that absolute income levels matter up to a certain point—particularly when basic needs are unmet—but after that, relative income differences matter more. Decades earlier, Pigou (1920: 53) reasoned that because the rich derive much of their satisfaction from their relative, rather than absolute, income, satisfaction would not be reduced if the incomes of all the rich were diminished at the same time, justifying redistributive taxation.

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22 See, among others, Conlisk (1996); and Simon (1978).

23 A notable recognition of the behaviouralist approach was the awarding of the 2002 Nobel Prize in Economics to Daniel Kahneman, a psychologist.

24 See Easterlin (2003a and 2003b).

25 See, for example, Diener and Biswas-Diener (2000); and Diener and Seligman (2004).

As noted above, an additional explanation—which Easterlin and others have explored in later work—is that people's norms and expectations also adapt upward with economic progress. Thus the expected gains of income on happiness are mediated by the rising aspirations that accompany the income gains. Later empirical studies support this proposition, showing a much stronger relation between income and happiness at the lower end of the income scale.[26] The most extreme view of adaptation, meanwhile, is the psychologists' set point theory. Along the same vein, most country-specific poverty lines adapt upwards as per capita GDP rises over time.

Psychologist Ed Diener and his colleagues based their analysis on two samples: a cross-section of 18,000 college students in 39 countries (primarily developed economies), and a ten-year (1971-81) longitudinal study of 4,942 adults in the United States. They found a stronger relationship between income and happiness at the lower end of the income scale, and a flatter one at higher incomes that are well above subsistence levels. Across countries, they found a moderate relationship between affluence and life satisfaction (Diener *et al.* 1993). Their findings highlight the importance of relative differences but do not discount the importance of absolute levels of income for happiness, even after people have incomes above the subsistence level.

Easterlin's proposition about changing reference norms is supported by James Merton's well-known sociological work, based on Stouffer's analysis of the effects of promotions among US military men. Stouffer found that infantry men, for whom promotion was quite rare, were much more satisfied with promotions when they occurred than were air force men, for whom upward mobility was the norm rather than the exception.[27]

The importance placed on relative income and reference groups can lead to an ever-rising bar of perceived needs. In a classic work, *The Theory of the Leisure Class*, Thorstein Veblen posits that in affluent societies, spending—and in particular conspicuous consumption—becomes the vehicle through which people establish social position. Several decades later, Juliet Schor cites repeated surveys showing that more than half of the population of the United States, the richest population in the

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26 Some scholars also find an additional effect at the very top of the scale, which might be explained by greed or changing preferences resulting from high levels of wealth. See Argyle (1999: 353-73). Ruut Veenhoven (1991: 1-34), meanwhile, finds that the correlation between income and happiness is much greater in poor countries.

27 See Stouffer's account as summarized in Merton's *Social Theory and Social Structure* (1957). I thank George Akerlof for pointing me in the direction of Stouffer's work. At about the same time that Merton wrote his book, James Duesenberry explored the relationship between income aspirations and social status. His specific interest was in ascertaining how this relationship influences savings behavior, but the empirical work on which he based his analysis was remarkably similar to Merton's work. He relied on sociological research based in public opinion polls in the United States in the 1940s, and found that those at the highest levels of income said that they needed a higher percentage increase in income to live comfortably than did those in all income groups other than the poorest one. Duesenberry used this and data from other studies to test his theory that people who associated with others who had more income tended to be less satisfied with their income than were people who associated with others who were at the same income level (Duesenberry 1949: 47-50). Kapteyn's more recent work (1999) on savings in the Netherlands supports these results.

world, say they cannot afford everything they really need (Veblen 1967; Schor (1998). The importance of relative income differences to perceived wellbeing, meanwhile, depends in part on social norms, which vary among societies.[28]

The concept of changing reference norms and aspirations is also relevant to the economic development process in poor countries. An anecdotal example comes from Peru in the 1960s. Richard Webb of the Instituto Cuanto interviewed a random sample of urban workers. Respondents of many different income levels were asked how much more income than they currently earned would they need to 'live well'. The vast majority of respondents—across all income levels—responded that they would need twice as much as they currently earned.[29]

Increasing income levels and economic growth is a necessary if not sufficient condition for development. And the process can be quite uneven. Thus aspirations and reference norms may adapt upwards well before significant sectors of society see the benefits. The integration of global markets, meanwhile, has been accompanied by a marked increase in the availability of global information, including information regarding living standards within poor countries and beyond their borders. Many developing countries, particularly in Latin America, have large gaps between the very wealthy and the rest of society, gaps which pre-date the current wave of global integration. Such inequalities are often exacerbated by integration into global markets, particularly when skilled labour benefits disproportionately from the process and increases wage gaps across sectors, as has been the case in Latin America.[30] Narrowing such gaps, which usually requires expanding the pool of skilled labour, is likely to take an order of magnitude longer than it does to increase awareness about them.

While the concepts of rising aspirations and relative deprivation are not at all new to the study of development economics, they are not well incorporated into our existing measures of progress. Yet in the end, they may have significant effects on individuals' assessments of their welfare and even on their definitions of poverty.

5 The economics of happiness in developing countries: an initial exploration

There are very few studies of happiness in the developing economies, and to the extent they exist, they tend to cover individual countries. As far as we know, our study of reported wellbeing in Latin America and Russia is the first such study in a large

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28 For different societies' tolerance for inequality, see Esping-Andersen (1990) For an excellent overview of trends in mobility and opportunity in the United States, see McMurrer and Sawhill (1998). For a brief account of divergences between public beliefs and recent trends, see Graham and Young (2003).

29 Richard Webb survey cited in *Oiga* magazine, Lima, circa 1965.

30 For trends in inequality related to the opening of capital markets and the liberalization of trade in Latin America, see Behrman, Birdsall, and Székely (2001).

sample of developing countries, allowing us to draw more general, if tentative, conclusions.[31]

Most of the countries in our sample were also in the process of increasing their integration into the world economy. This was certainly the case in Peru and Russia, the two countries where we conducted the most detailed analysis. We cannot, of course, definitively establish the effects of integrating or 'globalizing' on individuals' welfare in these countries, in no small part because of the difficulty of precisely defining globalization, and in part because of the absence of a counterfactual scenario (in other words, without evidence on what would have happened had the countries not opened up). At the same time, we were able to incorporate some relevant aspects of the integration process, such as widening gaps between the returns to skilled and unskilled labour (in the case of Latin America), and increased access to global information and communications (internet, etc.), into our analysis.

Our work began as an attempt to better understand the determinants of income mobility (a proxy for the distribution of opportunities) and movements in and out of poverty in countries that are opening their economies.[32] We expanded our approach to examine the role of perceptions of past and future mobility, linking data on subjective wellbeing to detailed over-time data on income mobility for the same respondents. We introduced this approach to data collection in Peru, and were subsequently able to apply it to data from Russia. Unfortunately, we did not have similar mobility data for the larger Latin America-wide sample, which is a large cross-section survey of respondents in 17 countries.[33] In Peru, we re-interviewed a sub-sample (500) of respondents in a large, nationally representative panel for 1991-2000, and asked a number of questions about their perceptions of their past progress and for their future prospects. We repeated this perceptions survey three years in a row. For the region-wide sample, we relied on cross-section data on income and other sociodemographic variables, as well as perceptions.

Our survey data allowed us to explore, albeit *indirectly*, the links between policy reforms related to global integration, and poverty, mobility, and wellbeing. As

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31 See Graham and Pettinato (2002a, 2002b) and Graham and Pettinato (2001). There have been some smaller studies in particular countries, such as Namafie and Sanfey (1998) in Kyrgystan, Rojas in Mexico (2003), and Ravallion and Lokshin in Russia (1999). As far as we know, there are no other region-wide studies in the developing countries. Hayo (2003) has recently completed a study in the transition economies in Eastern Europe.

32 For detail on the data and the underlying methodology, see Graham and Pettinato (2002a) and Graham (2003b) For an excellent summary of the few mobility studies that do exist in the LDCs, see Baulch and Hoddinot (2000).

33 The Latinobarometro survey consists of approximately 1000 interviews in 17 countries in Latin America, providing 17,000 observations for statistical analysis. The samples are conducted annually by a prestigious research firm in each country, and are nationally representative except for Brazil and Paraguay. The survey is produced by the NGO Latinobarometro, a non-profit organization based in Santiago de Chile and directed by Marta Lagos (www.latinobarometro.org). The first survey was carried out in 1995 and covered eight countries. Funding began with an grant from the European Community and is now from multiple sources. Access to the data is by purchase, with a 4 year lag in public release. Graham has worked with the survey team for years and assisted with fund raising, and therefore has access to the data.

mentioned above, it is notoriously difficult to disentangle the effects of globalization-related trends and policies on poverty from those of other structural or pre-existing trends. At the same time, there is little doubt that the economic transitions in these countries had effects on poverty and inequality, and created new winners and new losers. Accepting the limitations, our results strongly support the important role (highlighted in the literature above) that relative income differences, reference norms, and other non-income factors play in determining wellbeing in the advanced economies. Indeed, more generally we found that the determinants of happiness in general are very similar in the developing economies to those in the advanced economies.

6 Measurement error and other concerns

Prior to reviewing our results, it is necessary to mention possible sources of measurement error in both our panel and perceptions data. Panel data on income mobility are rare, as it requires following individuals over a prolonged period of time. And the most obvious drawback of panel data is its scarcity. There is a paucity of such data, in large part due to the expense of generating it. There are only a small number of nationally representative panels for developing countries. Even then, the data are rarely without flaws. Respondents move, leading to attrition and possible bias. Attrition tends to be greatest at the tails of the distribution, as the wealthiest respondents tend to move to better neighbourhoods, and the poorest ones move in with others or return to their places of origin.[34] In addition, as respondents in the panel age, they also may become less representative of the population as a whole.

Another problem with longitudinal data is accounting for error in reporting income, a problem that is gravely aggravated by policy shocks such as devaluations and/or high levels of inflation. People who are self-employed or employed in the informal sector have a difficult time estimating any sort of monthly or annual salary, in part because their income fluctuates a great deal. Thus expenditure data are more accurate than income data for samples with large numbers of self-employed and/or formal sector workers and agricultural workers. It is also more difficult to under or mis-report expenditures. Yet expenditure data miss part of the story, particularly at the upper end of the distribution, and do not capture volatility in income flows, as people tend to smooth their consumption where possible by dis-saving.

Adding perceptions data to longitudinal data has benefits, but creates its own set of methodological problems. As discussed above, happiness questions are open-ended. While they are not very useful in measuring the wellbeing of particular individuals, there is surprising consistency in the patterns of responses both within and across countries. Psychologists find that a number of wellbeing indicators validate how most individuals respond to happiness or life satisfaction surveys.

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[34] In our studies, we had a 38 per cent attrition rate over a 5 year period in Russia, and a 25 per cent attrition rate for the 3 year period covered by our perceptions survey in Peru (for the 1991-2000 living standards measurement survey, we had less attrition).

The questions are usually based on a four point scale; 'how happy or satisfied are you with your life', with two answers above and two below neutral. The correlation coefficient between happiness and life satisfaction questions is approximately 0.50, and the microeconometric equations have almost identical forms.[35] The data are most useful in the aggregate, as how an individual answers a question on happiness, for example, can be biased by day-to-day events. Thus the same person could answer such questions quite differently from day to day or year to year. The simple correlation from a regression of happiness in year two on happiness in year one was 0.2734 for our Russia sample, suggesting a significant amount of fluctuation in happiness levels. (Given the highly volatile economic context in Russia during the period, this correlation is probably lower than the average for other countries.)

Accuracy in reporting is another major issue. Responses can be biased by the phrasing or the placement of questions in the survey. Another problem is bias introduced by different or changing reference norms. If you ask people how much income would they need to make ends meet, and/or to be happy, they usually base their answers on their existing income and increase it by some proportion, regardless of the absolute level. Alternatively, people base their answers on others in their community or others 'like themselves'. When we asked people in our Peru survey to compare themselves with others in their community and then with others in their country, we found much more consistency in how respondents compared themselves to those in their community than to those in their country, which is a much vaguer reference point.

Accepting that there is a large margin for error in both kinds of data, our results provide information that static income data alone would not. Caution is necessary in interpreting the results, and we are hopeful that they are not merely artifacts of measurement error.

7 Poverty and mobility trends in two 'globalizing' economies: Peru and Russia

Both Peru and Russia underwent dramatic economic transitions, based on the implementation of market-oriented reforms and integration into the world economy, during the 1990s. The following review of trends in poverty and inequality in each country, while cursory, provides the contextual background for the discussion of the results of the wellbeing surveys.

In Peru, the combination of inflation and macroeconomic collapse in the late 1980s and then the stabilization policies necessary to halt hyper-inflation and unsustainable fiscal deficits in 1990 resulted in an unprecedented increase in poverty. The poverty headcount went from 12.7 per cent of the population in 1985 to 54.7 per cent at the time of stabilization.[36] As is usually the case, the poor were the least equipped to

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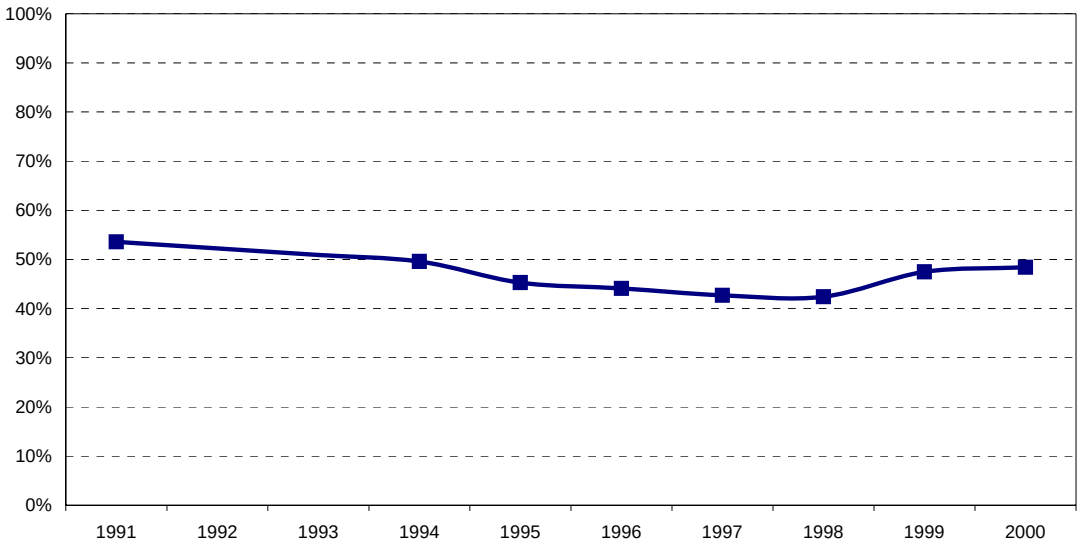
35 Blanchflower and Oswald (2004) get a correlation coefficient of .56 for British data for 1975-1992 where both questions are available; Graham and Pettinato (2002a) get a correlation coefficient of 0.50 for Latin American data for 2000-01, in which alternative phrasing was used in different years.

36 This is based on the World Bank's living standard measurement survey and on a minimum wage/minimum basket of goods definition of poverty. For detail on these trends and definitions, see the chapter on Peru in Graham (1994).

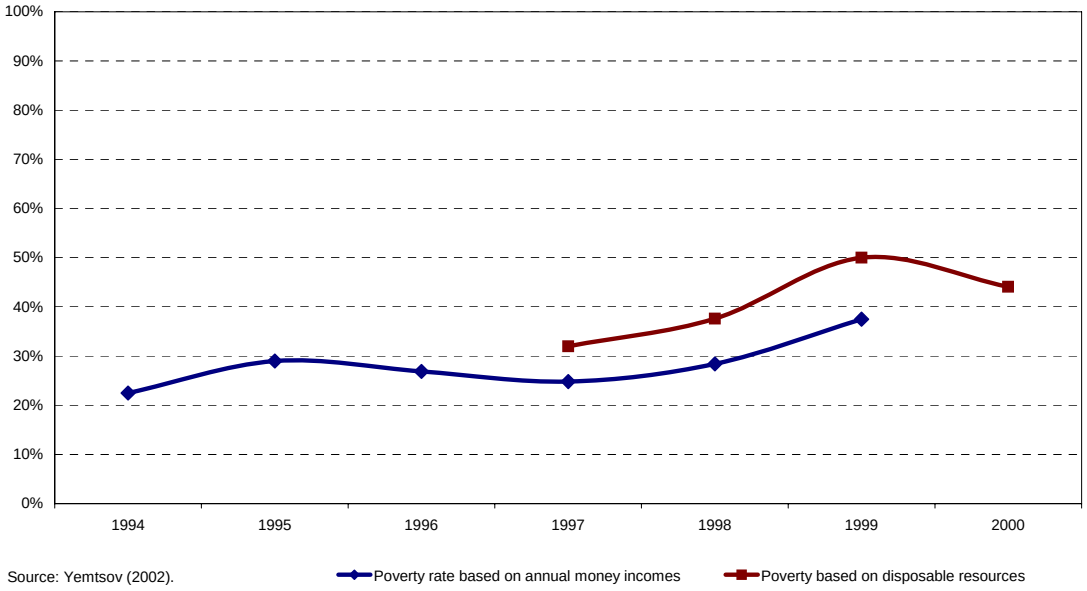
protect themselves from hyperinflation and from the disruptions caused by stabilization. Yet the counterfactual scenario, e.g., the absence of stabilization policies, may well have led to even greater poverty increases. The poverty rate fell to a low of 41 per cent by the mid-1990s as a result of high levels of growth. It then increased again to almost 50 per cent by the year 2000, in part a result of a worldwide economic slowdown and in part due to economic adjustments necessitated by the Fujimori government's excessive pre-electoral spending (see Figure 1).

Figure 1
Poverty rate in Peru, 1991-2000



Source: ENNIV, ENAHO

Figure 2
Poverty rate in Russia, 1994-2000



Source: Yemtsov (2002).

In Russia, poverty was on the rise and health indicators were declining (if not well documented) well before transition as the centrally-led economy faltered. The most dramatic changes, though, occurred during the post-1990 turn to the market. The poverty headcount rose from roughly 22 per cent in 1994 to a height of 50 per cent during the aftermath of the 1998 devaluation, and then fell to closer to 40 per cent in the subsequent years (see Figure 2).

In both cases, the standard measurement error problems in correctly assessing poverty rates were compounded by the shocks to purchasing power that resulted from sharp devaluations—in 1991 in Peru and in 1998 in Russia, shocks which had differential effects across cohorts and sectors. Thus these figures are not indisputable; there are higher and lower estimates for the same years for the same countries. Regardless, even lower end estimates for these rates are high by most countries' standards.

The poverty picture in both countries is compelling on its own. In addition, over-time data on income mobility depict a tremendous amount of movement up and down the income ladder and in and out of poverty. In a comparison of relative mobility rates, we found that a higher percentage of respondents went from 'rags to riches'—or from the bottom to the top quintile in a ten year period in Peru (5 per cent) than in a similar period in the United States (1 per cent), for example.[37] Yet a surprising 11 per cent of

Table 1
Relative economic mobility matrices

	United States, 1979-89					
	1989 Q					
1979 Q	Bottom quintile	II	III	IV	Top quintile	Total
Bottom quintile	**61**	24	9	5	1	100
II	23	**33**	28	14	3	100
III	8	25	**30**	26	11	100
IV	5	13	23	**33**	26	100
Top quintile	3	5	11	23	**59**	100
Total	100	100	100	100	100	100

	Peru, 1991-2000					
	2000 Q					
1991 Q	Bottom quintile	II	III	IV	Top quintile	Total
Bottom quintile	**45**	25	19	6	5	100
II	25	**25**	23	14	13	100
III	16	23	**22**	20	19	100
IV	11	18	18	**32**	21	100
Top quintile	3	9	18	28	**42**	100
Total	100	100	100	100	100	100

Source: Mishel, Bernstein and Schmitt (1999) for the US; and Graham and Pettinato (2002a) for Peru.

[37] In both these cases, some of the mobility that we find could be driven by newly educated individuals entering the labour force. Yet as neither study controls for this, the rates are comparable—if perhaps slightly higher than they would be if we were able to implement such controls.

respondents in the middle of the distribution (quintile 4 in Peru) fell back all the way to the bottom quintile during the same period, which is analogous to falling from the middle class into extreme poverty (see Table 1).

Mobility in Russia during a shorter, five year period (1995-2000) is equally notable, with 12 per cent of those in the bottom quintile moving all the way to the top quintile, and 14 per cent of those in the fourth quintile moving down to the first, or well below the poverty line (see Table 2). An important caveat in comparing the two, however, which is noted above, is that the Peruvian data is in expenditure, which fluctuates much less, while the Russian data, which is in income, fluctuates much more and is rift with problems of under-reporting.

Even accounting for a significant degree of measurement error, these data suggest a remarkable amount of movement in and out of poverty. While some of these changes might have happened in the absence of policy changes related to these countries' integration into the world economy, it is hard to imagine that the overall poverty picture is independent of their effects.

Looking at income sectors more broadly, it is evident that the rewards from the reform process were shared differentially.[38] In Peru, the losers were not always the poorest. In many instances the poor gained from improved (and often targeted) public health and education services, and from the increased access to other services, such as telephones, which resulted from privatization. Many in the middle sectors, meanwhile, typically had completed secondary education but did not attend university and depended heavily on the public sector and public enterprises for employment. With the opening of trade and capital markets, the skilled, e.g., those with university and technical education, who also tended to be at higher levels of the income distribution, made the greatest gains, while public sector jobs became fewer in number and less desirable. Thus those in the middle tended to fare less well, at least in

Table 2
Relative economic mobility matrices
Russia, 1995-2000

1995 Q	**2000 Q** Bottom quintile	II	III	IV	Top quintile	Total
Bottom quintile	**33**	27	16	13	12	100
II	25	**28**	20	16	10	100
III	19	19	**25**	21	15	100
IV	14	15	23	**25**	23	100
Top quintile	9	11	16	25	**40**	100
Total	100	100	100	100	100	0

Source: RLMS Round 6 and Round 9, author's'calculations using equivalized household income in 1993 adjusted rubles.

38 I discuss winners and losers in Peru in detail and summarize much of the existing studies in Graham (1998). For a broader discussion of these issues worldwide, see Birdsall, Graham, and Pettinato (2001).

relative terms, while the skilled and wealthy fared the best in both relative and absolute terms.[39]

In Russia, the collapse of the centrally planned economy and virtually unregulated privatization, among other trends, created entirely new cohorts of big winners and big losers, including new poverty among highly educated individuals who previously worked in large defence and other public enterprises, and a small but highly visible cohort of new 'millionaires'.[40] These broad trends, as well as less easily documented differentials between winners and losers at the local and micro level, are reflected in the results of our perceptions surveys (discussed below).

The extent of new losses and gains is in part reflected in inequality trends, as measured by the Gini coefficient, in both countries. In Peru, where inequality was already quite high, the Gini increased slightly, from 0.46 in 1991 to 0.49 in 2000. In Russia, where inequality was unusually low prior to the transition (well below OECD standards), the Gini went up from 0.42 in 1994 to 0.44 in 2000.[41]

The results of our surveys of subjective wellbeing during those transition periods are useful in helping understand the effects of all of these trends on the welfare of different cohorts in both countries. In addition, in a very indirect manner, they may help us better understand who the winners and losers were, or at least suggest a slightly different definition of winners and losers than does income data alone.

8 Perceptions of wellbeing in 'globalizing' economies

Our most significant and surprising finding in Peru was that almost half of the respondents with the most upward mobility reported that their economic situation was negative or very negative compared to ten years prior (see Figure 3). We conducted a similar analysis based on comparable data for Russia, and found an even higher percentage of frustrated respondents—or 'frustrated achievers' as we now call them (Figure 4).[42]

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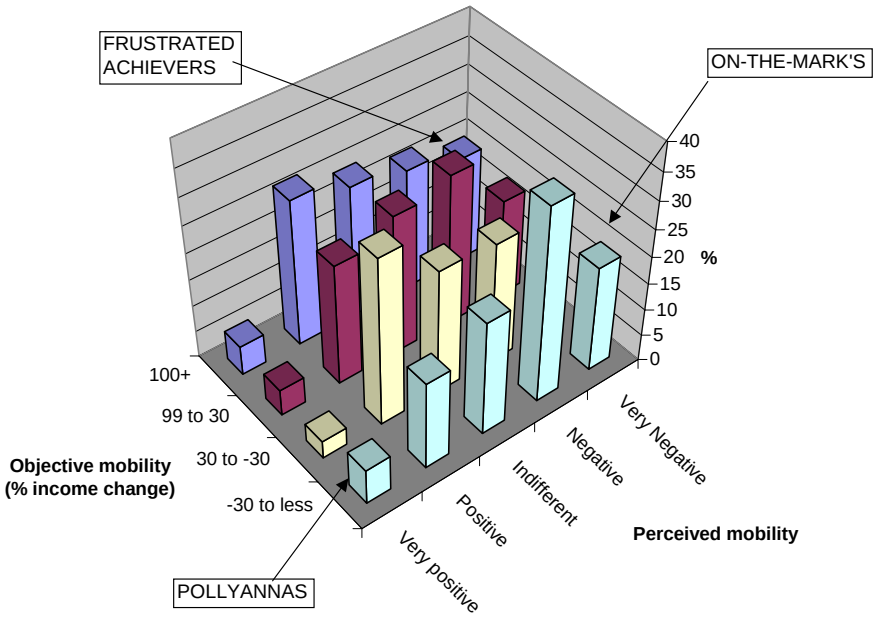
39 Behrman, Birdsall, and Székely (2001), for example, find that the marginal returns to completing higher education in the 1990s increased markedly relative to completing secondary and primary, while the marginal returns to completing secondary education relative to primary education narrowed. In recent work pooling seven years of Latinobarometro data (1997-2004), with a sample of over 100,000 respondents, Andy Felton and I find that those with a completed high school education are disproportionately represented among the unemployed, as opposed to those with less than seven years education or those with university or technical education.

40 The economic transitions in both countries have been documented extensively elsewhere. For excellent accounts, see Gaddy and Ickes (2002), and Wise (2003).

41 For Peru, see De Ferranti *et al.* (2003); for Russia, see Yemtsov (2002).

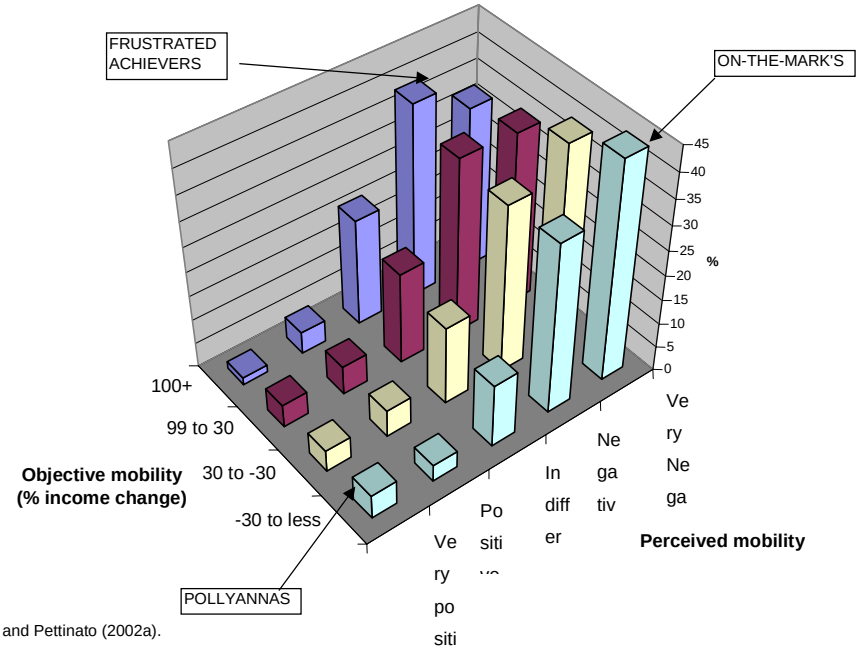
42 The Peruvian data are in expenditures and the Russian data are in income. The uncertain economic context in Russia and the income data makes potential error an even larger problem. In one attempt to correct for error, we eliminated the roughly 60 zero income respondents from our Russia panel, as many of them also reported that they were employed.

Figure 3
Long term perceived mobility vs. 1991-00 income mobility: Peru 2000



Source: Graham and Pettinato (2002a).

Figure 4
Perceived past mobility vs 1995-99 income mobility: Russia, 1999



Source: Graham and Pettinato (2002a).

A closer look at these frustrated achievers (FAs) shows that they are at or near average income (and therefore not the poorest in the sample), and that they are more urban and slightly older on average than non-frustrated respondents with upward mobility. There are no significant gender or educational differences.[43]

Our frustrated achievers scored lower on a whole host of perceptions questions, such as their perceived prospects of upward mobility, and their positions on a notional economic ladder. In keeping with the direction of these findings, the FAs also had a higher fear of being unemployed in the future. In addition, the Russian FAs were more likely to want to restrict the incomes of the rich, and were less satisfied with the market process and with democracy (we did not have the same questions in the original survey for Peru).[44]

In Peru the likelihood of having upward mobility and being frustrated (a frustrated achiever) is negatively related to initial income levels.[45] In other words, the frustrated achievers started from lower income levels, on average, even though they were not the very poorest in the sample at the time that they answered our survey. This is not surprising, as thus even large percentage increases in their incomes will seem insufficient to reach the levels of wealthier groups. The FAs were also more likely to be urban, and therefore more informed about the lifestyles of others, including those of the very wealthy.

What explains these frustrations? Relative income differences could certainly be a plausible explanation. Both Peru and Russia have high degrees of inequality. The FAs were more likely to score lower on the notional economic ladder in both surveys. In Peru, the FAs were more likely to compare their situations negatively to others in their community and their country, with slightly more negative responses when the country rather than the community was the point of reference (this latter question was not in the Russia survey). This suggests that respondents are aware of both local inequality and country-level inequalities.

A lack of adequate social insurance and insecurity could be another explanation. As noted above, the frustrated achievers had a higher fear of unemployment than non-frustrated achievers. Thus even though the FAs are doing well by objective income measures, they perceive that there is no guarantee of stability or maintaining their levels of earning. This is not surprising, given that both surveys were conducted in

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43 For a complete picture of the statistically significant differences between frustrated and non-frustrated upwardly mobile respondents, see Graham and Pettinato (2002a: Chapter 4).

44 In an initial and at this point cursory analysis of the 2003 Peru survey data, Graham and MacLeod (2004) find that the frustrated achievers are less likely to favour democracy, but there is no link with market policies. Yet the results are also not fully comparable as a much lower number of respondents had upward mobility during this latter period and thus there was a far lower percentage of frustrated achievers.

45 In a logit regression, with upward mobility as the dependent variable, and other demographic controls included, initial expenditure levels and log expenditure levels (in separate equations) were both negatively and significantly correlated with upward mobility. Results available from the author on request.

very volatile economic contexts, and the objective mobility data reveal a remarkable degree of vulnerability, as discussed above.

We explored whether the frustrated achievers suffered more from this volatility, which in turn might drive some of their frustrations. Yet in Peru, the FAs have less volatility in their income trajectory, as measured by the coefficient of variation, a puzzling result if uncertainty or volatility is an explanation for the frustrations. In Russia the coefficient of variation is higher, which seems a more intuitive finding. It is possible that while our frustrated achievers may be concerned about inequality and unemployment, they may also view income variance as a reflection of new opportunities, at least in Peru (Clark 2003).

Studies comparing Europe and the United States find that tolerance for inequality varies across societies.[46] The studies show that in some societies, like the United States, inequality seems to have little, if any effect on wellbeing, in contrast to its larger, negative effects in European countries. At the same time, cross-country happiness studies consistently rank countries with strong safety nets and social welfare systems, such as the Nordic countries, at the top of the worldwide rankings.[47] Yet the same pattern does not hold in the developing economies. This may be because universal welfare systems are rarely the norm in the latter set of countries. Thus there may be a slightly higher tolerance for volatility and insecurity, particularly in those with large informal sectors. This could explain our findings on variance in Peru.

The fact that most of the FAs were at mean levels of education is relevant to the discussion of volatility versus opportunity. As noted above, with the opening of trade and capital markets in the 1990s in Latin America, those with higher levels of education are gaining high marginal returns compared to the rest of society, while those with secondary education are seeing decreasing marginal returns compared to those with primary education.[48]

Our mobility matrices suggest that some of those in the middle are experiencing drops into extreme poverty, and may be becoming a new sector of 'vulnerable' near poor. In some instances the poor actually gained during these transitions, at least relative to those in the middle. Broader cross-country studies of the effects of trade opening on poverty, meanwhile, yield very mixed results. These depend a great deal on the nature of the trade opening and on the structure and skill mix in the tradable and non-tradable sectors prior to the opening.[49] At best, the picture is complex. Identifying the winners and losers in the globalization process is difficult at best, as there can be winners and losers among both the poor and the middle sectors.

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46 See, for example, for example, Benabou and Ok (1998); and Piketty (1995); and Alesina, Di Tella, and MacCulloch (2001). Sceptics of this study question the results. One potential problem with this paper is the extent to which within state inequality is a useful or realistic reference point for US respondents.

47 See the happiness surveys cited in ILO (2004).

48 See Behrman, Birdsall, and Székely (2001).

49 See, among others, Goldberg and Pavcnik (2004).

Lastly, it is quite plausible that some of the frustrations that we find are driven by individual character traits rather than by economic and other variables. There is probably some per cent of every sample that will always be negative or unhappy, regardless of objective conditions. That led us to ask if our population samples were significantly different from other population samples. Unfortunately, we do not, at this point, have similar income mobility and perceptions data for a broader sample of countries, which would allow us to compare the percentage of frustrated achievers across countries.

Yet we were also able to explore the broader question of whether the determinants of happiness differ in the developing economies from those in the advanced industrial economies. We compared the determinants of happiness in Latin America and in Russia with those of the United States. For the US, we used the pooled data for 1973-98 from the GSS. For Russia, we used the most recent available survey (2000) from the Russian Longitudinal Monitoring Survey (RLMS). For Latin America, we relied on the 2001 Latinobarometro survey because it is the one year for which we have variables for both self-reported health status and for being a minority, which makes it comparable to the US and Russia surveys (see Tables 3, 4, 5).

We find a remarkable degree of similarity: there were similar age, income, education, marriage, employment, and health effects.[50] In all contexts, unemployed people are less happy than others. Self-employed people, meanwhile, are happier in the US and in Russia on average, while in Latin America, they were less happy. While in the US

Table 3
Happiness in Latin America, 2001

Dependent variable: Happiness

Independent variables	Coef.	z
Age	-0.025	-4.21
Age squared	0.000	4.72
Male	-0.002	-0.07
Married	0.056	1.63
Log wealth index	0.395	10.56
Years of education	-0.003	-0.64
Minority	-0.083	-2.49
Student	0.066	1.01
Retired	-0.005	-0.06
Homemaker	-0.053	-1.04
Unemployed	-0.485	-7.54
Self-employed	-0.098	-2.33
Health (self-reported)	0.468	24.58
Pseudo R^2	*0.062*	
Number of obs.	*15209*	

Note: * Ordered logit estimation; country dummies included but not shown.
Source: Latinobarometro (2001); author's calculations.

50 The coefficient on marriage for Latin America is positive but short of significant for the 2001 sample. For other years for which we have data, the coefficient on marriage is positive and significant.

self-employment is a choice, in Latin America the self-employed are often in the informal sector by default. Another difference is that women were happier than men in the US, while in Russia men were happier than women (due to disparities in status?) and in Latin America there was no gender difference. Blacks are less happy than other races in the US, and similarly, those that identify as minorities in Latin America are less happy. In contrast, minorities living in Russia are happier than ethnic Russians.

Table 4
Happiness in Russia, 2000

Dependent variable: Happiness

Independent variables	Coef.	z
Age	-0.067	-7.42
Age squared	0.001	7.15
Male	0.152	2.80
Married	0.088	1.40
Log equivalent income	0.389	11.48
Education Level	0.015	0.96
Minority	0.172	2.46
Student	0.199	1.59
Retired	-0.378	-3.97
Housewife	0.049	0.33
Unemployed	-0.657	-6.51
Self-employed	0.537	2.23
Health index	0.446	3.82
Pseudo R^2	0.033	
Number of obs.	5134	

Note: * Ordered logit estimation.
Source: Graham, Eggers, Sukhtankar (2004).

Table 5
Happiness in the US, 1972-98

Dependent variable: Happiness

Independent variables	Coef.	z
Age	-0.025	-5.20
Age squared	0.038	7.53
Male	-0.199	-6.80
Married	0.775	25.32
Log income	0.163	9.48
Education	0.007	1.49
Black	-0.400	-10.02
Other race	0.049	0.59
Student	0.291	3.63
Retired	0.219	3.93
Housekeeper	0.065	1.66
Unemployed	-0.684	-8.72
Self-employed	0.098	2.29
Health	0.623	35.91
Pseudo R^2	0.075	
Number of obs.	24128	

Note: * Ordered logit estimation; year dummies included but not shown.
Source: GSS data, author's calculations.

Even these subtle differences in the determinants of reported wellbeing suggest that its analysis highlights policy issues, such as opportunities for stable employment and gender rights, which are (or should be) on the policy agendas of many developing countries. The findings for the advanced industrial economies strongly suggest that these factors matter to wellbeing. And while these issues often enter the public debate as a result of pressure from special interests such as unions or NGOs, it is novel to find strong backing for them in individual assessments of welfare.

Taking our analysis a step further, we found that, in both Latin America and Russia, happier people were more likely to support market policies, to be satisfied with how democracy was working, and to prefer democracy to any other system of government. A cross-canton study in Switzerland by Bruno Frey and Alois Stutzer, meanwhile, finds that people who participate in direct democracy are happier than those who do not, all else being equal (Frey and Stutzer 2002). While we do not have similar information on respondents' voting patterns, our results do suggest a virtuous circle of sorts, between happiness and support for democracy (even though we cannot establish the direction of causality).

Happier people, on average, had higher prospects for their own and their children's future mobility; were more likely to believe that the distribution of income in their country was fair; placed themselves higher on a notional economic ladder; and had lower fear of unemployment.[51] In contrast, the negative perceptions of our frustrated achievers in Peru and Russia are correlated with lower life satisfaction (happiness) scores; lower scores on a notional societal economic ladder (compared to non-frustrated respondents of comparable income levels); lower perceived prospects of upward mobility; higher fear of unemployment; and less satisfaction with market policies and a lower probability of preferring democracy as a system of government.

We are not aware of surveys in the OECD economies which take our approach and compare objective trends in income mobility with reported trends. However, there are some studies in the US and Europe which link people's perceptions about mobility—such as perceived prospects of upward mobility—with voting behaviour and views about redistribution.[52] Most of these studies suggest that societies with widely held faith in prospects for upward mobility are more tolerant of income inequality than those where social mobility is more limited.

Our preliminary analysis suggests that there may be a similar relationship between views about upward mobility and tolerance for inequality. We examined responses to several questions related to redistribution in the 2001 and 2002 Latinobarometro. A question in the 2001 survey asks respondents to place themselves on a nine-point scale, where one is preferring more freedom and more money and nine is preferring more rules and more equality. Respondents who had higher prospects of upward mobility scored lower on the scale and were less likely to prefer equality and

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51 The ELQ question asked respondents to place themselves on a 9 step ladder representing their society, where the poor are on step 1 and the rich are on step 9. Support for market policies was measured by an index based on several scaled questions about the private sector, foreign investment, free trade, and privatization. For detail, see Graham and Pettinato (2002a).

52 See Benabou and Ok (1998) and Piketty (1995).

regulation.[53] This finding is similar to those for the US. Yet in contrast to the US, the Latin American respondents who supported more equality were also happier, on average.

Rather surprisingly, wealthier people were more likely to support more rules and more equality, (which may also explain the correlation with higher happiness levels). We found consistent results on wealth in a question in the 2002 survey, which asks respondents if taxes should be lower even if social welfare spending suffers. A surprising 23 per cent of respondents opt for the 'strongly agree' response, and 44 per cent agree. As in the case of supporting more equality in 2001, those with higher levels of wealth and education (and respondents over age 33) were less likely to agree with low taxation at all costs.[54]

At least some of these results reflect Latin Americans' mistrust of the state's ability to redistribute fairly and to provide services to the poor rather than widely held beliefs about prospects for upward mobility (only 13 per cent of Latin American respondents believe that the income distribution is fair or somewhat fair).[55] To the extent that there is modest support for redistribution, it seems to be among wealthier rather than poorer groups. The poor typically receive fewer benefits from state spending than do wealthier groups in the region.

Concerns about inequality may also respond to changing reference norms related to globalization. Increased access to global information—via the media and the internet—has accompanied increasing economic integration in the past decade in the region. While our information on these trends is limited, we do have data on respondents' ownership of televisions and radios as well as access to the internet. Controlling for the usual sociodemographic variables, we find that those respondents with greater access to the media and the internet are more likely to think that the distribution of income in their country is unfair, are more concerned about corruption, and are more likely to express willingness to participate in a political protest.[56] While these findings are at best suggestive, it is certainly plausible that awareness of inequality is heightened and/or that reference norms adapt upwards as more information about the living standards of others, both within and beyond one's national borders, is readily available.

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53 In a regression with the variable EQUALSUP as the dependent variable, the coefficient on our prospects of upward mobility variable—POUM—was negative and significant. The coefficient on the wealth index was positive and significant. It even remained positive when we squared it to see if there were differences in the attitudes of the very wealthy. Results available from the author.

54 We also split the sample (according to two different methods) into those respondents that were likely to pay taxes and those that were not, but did not get results that were significantly different. See Graham and Sukhtankar (2003).

55 In an earlier study we found that support for redistribution was lower in poorer, more unequal countries in the region than in the wealthier ones, while within countries wealthy people were more likely to favor productivity over redistribution. This finding is based on a question in the 1998 Latinobarometro asking respondents if what their country needs most to get ahead is more redistribution or more productivity. For detail, see Graham and Pettinato (2002a: Chapter 3).

56 See Graham and Sukhtankar (2004 and 2003).

Rather surprisingly, we found that a remarkably similar percentage of respondents in the United States and Latin America thought that their children would live better than they (57 and 58 per cent, respectively). In contrast, far fewer Latin American respondents than US respondents felt that they lived better than their parents did.[57] Views about the causes of poverty were also remarkably similar (even though the questions are not fully comparable). In the US, 36 per cent of respondents say that lack of effort on the part of the poor themselves is a 'very important' cause of poverty, while 43 per cent say that it is 'somewhat' important and 21 per cent say not important. In Latin America, 36 per cent of respondents say that poverty is a result of lack of effort on the part of the poor themselves, while 63 per cent of respondents say that it is the result of bad circumstances.

Our results suggest that Latin Americans still have a remarkable amount of faith in individual effort and prospects for getting ahead.[58] Some of this faith is, no doubt, based on realistic assessments by respondents and the awareness that their children are likely to have, at the least, access to more and better quality education than they did. Some reflects hope and expectations as much as anything else. For our smaller Peru sample, we found that some of the same respondents that assessed their own situation more negatively than was warranted by objective income measures still assessed their children's prospects in a positive light.

Those with higher prospects for upward mobility were also more likely to favour market policies, to support democracy over any other system of government, and to place themselves higher on the notional economic ladder.[59] In contrast, our frustrated achiever respondents in Peru and Russia, who on average had higher fear of unemployment and lower POUM scores, tended to be less supportive of market policies and of democracy.[60] Our findings yield notable public frustration, which is linked to concerns about income differentials, unemployment, and vulnerability to poverty rather than with absolute poverty. They also suggest that respondents' concerns about relative income differences may be heightened with increasingly available information about the wealth and lifestyles of others—both in their country and beyond, as increased media and internet access have made global information much more readily available to the average citizen. Frustration also seems to be linked to reduced support for markets and democracy. Our findings do not, however, suggest that there is widespread public support for redistribution. If anything, they suggest that the public's faith in the state's capacity to redistribute fairly is quite minimal, and that it is weakest among the poor.

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57 The US data are from the GSS while the Latin American data are from the 2001 Latinobarometro. For a detailed discussion, see Graham (2002).

58 Authors' calculations based on GSS data and on the 2000 Latinobarometro survey.

59 See Graham and Pettinato (2002a).

60 See Graham and Pettinato (2002a).

9 Causality conundrums

While the frustrations and unhappiness that we find are indeed linked to policy relevant questions, the direction of causality is not fully clear. We do not know whether policies and/or environments drive the frustrations, or underlying character traits (such as lower innate levels of happiness) drive more negative assessments of policies and environments. In other words, it may well be that happier people assess whatever policy environment they live in more favourably, and that more frustrated or unhappy people are more likely to be pessimistic about the future and concerned about relative income differences or insecurity.

Table 6
The effects of happiness on income in Russia, 1995-2000

Dependent variable: Log equivalence income, 2000 (OLS)

	a		**b**		**c**	
Independent variables	coef	t	coef	t	coef	t
Age	-0.013	-3.00	-0.013	-2.97	-0.015	-3.25
Age squared	0.000	3.18	0.000	3.15	0.000	3.52
Male	0.010	0.42	0.010	0.42	0.000	-0.02
Married	0.205	7.84	0.205	7.84	0.205	7.84
Education level	0.030	4.51	0.030	4.51	0.030	4.44
Minority	0.121	3.98	0.123	4.03	0.122	4.00
Student	-0.034	-0.34	-0.030	-0.31	-0.037	-0.38
Retired	-0.191	-4.85	-0.190	-4.83	-0.166	-4.18
Housewife	-0.249	-3.90	-0.249	-3.90	-0.239	-3.73
Unemployed	-0.345	-8.16	-0.344	-8.12	-0.343	-8.07
Self-employed	0.142	1.46	0.141	1.46	0.128	1.33
Health index	0.060	1.11	0.059	1.09	0.056	1.04
Log equiv income 95	0.242	18.11	0.243	18.12	0.224	15.69
Log equiv income 95, poor**	*	*	*	*	0.009	2.60
Log equiv income 95, rich**	*	*	*	*	0.018	4.36
Unexplained happiness, 95***	**0.030**	**2.64**	**0.063**	**2.32**	**0.027**	**2.38**
Unexp. happiness, 95***, 2nd quint	*	*	**-0.044**	**-1.14**	*	*
Unexp. happiness, 95***, 3nd quint	*	*	**-0.036**	**-0.95**	*	*
Unexp. happiness, 95***, 4th quint	*	*	**-0.063**	**-1.71**	*	*
Unexp. happiness, 95***, 5th quint	*	*	**-0.023**	**-0.65**	*	*
constant	5.833	36.35	5.823	36.19	5.936	34.62
No. of observations	4457		4457		4457	
adjusted R-squared	0.134		0.133		0.152	

Note: * omitted; ** 'poor' is defined as bottom 40% of the income distribution in 1995; 'rich' is the top 20%; *** the residual of basic happiness 1995 regression

Regression a: no income quintile distinctions

Regression b: testing for a difference in the effect of unexplained happiness on 2000 income, by 1995 income quintile

Regression c: testing for a difference in the effect of 1995 income on 2000 income, by 1995 income quintile

Independent variables are from 2000 unless otherwise noted.

Source: Graham, Eggers, and Sukhtankar (2004).

At least some of the explanation for patterns in reported wellbeing lies in character traits. One of our studies finds that only 3 per cent of the variation in happiness is explained by socioeconomic and demographic variables; the rest is either behavioural or error driven.[61] Yet there is also an explanatory role for factors that policy can influence, such as income inequality, macroeconomic volatility, and large gaps in rewards to different education and skill cohorts.

In a very recent study, we tried to get a better understanding of the interaction between contextually driven attitudes and behaviourally driven ones, as well as the channels of causality. We conducted an additional analysis—based on Russian data for which we had observations on both happiness and income at two points in time, as well as on a number of perceptions variables. We found that these behavioural traits have a role in explaining differences among individuals' performances and outcomes.

As reported in Table 6, we found that happier people earn more income in later periods, on average, than less happy people.[62] Our method of analysis entailed calculating the residual or unexplained happiness for each respondent in the first period—e.g., the happiness that was not explained by the usual socioeconomic and demographic variables. We posit that this must be close to the behavioural component of reported happiness. We included that residual as an independent variable with second period income as the dependent variable. Controlling for first period income, we found that our residual had positive and significant effects on second period income. We also found that happier people were healthier in future periods.

Accepting that there is a large margin for error and/or correlated error in this analysis, our results suggest that happier people seem to earn more income, perform better in the labour market, and are healthier. Psychologists attribute traits such as positive outlook and high self-esteem (so-called positive cognitive bias) to happier people. It is not surprising that these traits also contribute to productivity and health. And while not statistically significant, our findings suggest that the correlation between happiness and future income was stronger for those at lower levels of income, while the role of first period income was more important for future income for those at higher levels of income (Table 6). A positive outlook and high self-esteem may be valuable labour market assets for those with less assets or income, particularly for those who provide services. In other words, happiness may matter more to the future income of the poor than to that of the rich!

Indeed, it is plausible that some of what we find is explained by people's abilities to forecast or predict their future income, and thus first period attitudes merely reflect people's knowledge of the future.[63] The highly unstable nature of the Russian context, however, renders this unlikely as the *entire* explanation. Our results suggest that having a positive attitude in general, as well as a positive attitude about future

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61 See Graham, Eggers, and Sukhtankar (2004).

62 See Graham, Eggers, and Sukhtankar (2004).

63 I would like to thank a number of participants at the Brookings Warwick Conference on: 'Why Inequality Matters: Lessons for Policy from the Economics of Happiness', June 2003, for discussing this insight, and in particular Gary Burtless for raising the point.

opportunities, is linked to better earnings—and health—outcomes. There is also broader psychological evidence that character traits, such as high self-esteem and optimism, have effects on individuals' labour market performance and on their health outcomes (Diener and Seligman 2004; Cummins and Nistico 2002).[64] It may be that behavioural or attitudinal variables may be more important in extremely uncertain contexts such as in Russia, where it is more difficult to predict the future. Research based on comparable data for other countries is necessary to test such a proposition.

These results do not allow us to establish a direction of causality, and at most they are suggestive. It is possible that causality runs in both directions: from policy relevant variables or factors such as economic performance to happiness, as well as in the other direction.

At a minimum, it is clear that using longitudinal data on both mobility and on subjective wellbeing gives a very different picture of how people are faring in developing countries than looking at standard income or distribution data in isolation. While it is fairly standard to equate wellbeing or utility with income, our research and that of many others suggests that there are very important non-income determinants of wellbeing. These elements of wellbeing also seem to have a correlation with labour market performance and future earnings outcomes. An unanswered question, however, is how can we most usefully—and prudently—incorporate these novel approaches and new kinds of data as we try and better understand the complex relationships between globalization, poverty, and inequality.

10 Conclusions

Our research, which relies on the conceptual frame of the economics of happiness, and uses panel data and surveys of reported wellbeing as analytical tools, yields a different, albeit complementary, picture of the dynamics of poverty and inequality in developing economies in the process of integrating in the global economy than does analysis based on standard, money metric measures. We focused on income mobility and on reported wellbeing as a way to gauge movements in and out of poverty and distributive trends across time and across cohorts within countries. That helped us assess the importance of relative as well as absolute differences. We collected data on two very different countries in the process of integrating into the global economy—Peru and Russia. Perhaps the most notable finding from this research is the consistent gaps between measures of welfare as gauged in standard terms such as earned income or consumption expenditures, and those reported in surveys of wellbeing.

One problem is that it is difficult to cleanly separate cause from effect when assessing the importance of these gaps. The differences between measured and reported welfare may be driven by the effects of non-income variables which our standard measures do not capture—such as job insecurity, relative income differences, and health and marital status. Yet it is also quite plausible that less happy people are more likely to attribute importance to these insecurities and differences, as well as less likely to be

64 Diener and Seligman (2004); Cummins and Nistico (2002).

healthy and to get married. Research attempting to disaggregate behavioural from contextual determinants of welfare is only in the nascent phases.

Despite this unanswered question, the determinants of reported wellbeing seem to be consistent across countries and time, and suggest that there are limits to the extent that income growth alone can increase happiness. Yet most development objectives cannot be achieved without growth. Globalization is a major engine of growth, at least in the aggregate. Determining at what point in the development process it is worth making tradeoffs to achieve other objectives remains a challenge, and the answer is likely to vary across countries and cultures.

In addition to growth, globalization either introduces or exacerbates other trends that affect people's wellbeing as much if not more than income. An important such trend is the increasing flow of information about the living standards of others, both within and beyond country borders, which can result in changing reference norms and increased frustration with relative income differences, even among respondents whose own income is increasing. Globalization can also introduce increased volatility and insecurity for many cohorts, particularly those that are not well positioned to take advantage of the opportunities created by the opening of trade and capital flows. This insecurity, and the very real threat of falling into poverty for the near poor and middle sectors, contributes to negative perceptions of the globalization process, particularly in countries where social insurance systems are weak or where existing systems are eroding.

Our results also suggest that reported wellbeing and individual perceptions may have effects on economic outcomes. Many of these perceptions, such as people's perceived prospects of upward mobility (which are highly correlated with subjective wellbeing), have documented effects on economic and political behaviour. The contextual determinants that seem to affect these perceptions, such as large relative income differences, insecurity related to rapid and/or extensive economic change, poor job quality, and poor health, are all variables which can be influenced by policy. Improvements in virtually all of these policy areas are likely to have positive effects on aggregate economic outcomes as measured in standard income measures, as well as on reported wellbeing. Better functioning labour markets and more effective safety nets, for example, could both increase growth and reduce the long-term costs associated with short-term poverty spells.[65] Those in the middle group are often very vulnerable to falling into poverty, particularly in countries that integrate into international financial markets before their financial and regulatory institutions are adequately developed.[66]

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65 Rodrik (1996), for example, shows that the developed countries that devote higher percentages of their GNP to trade spend more per capita on safety nets and social insurance mechanisms than those that trade less. Diwan (2001), meanwhile, shows that the poor often face long-term, non-recuperable costs from short-term poverty spells. Children missing years of school during crisis years is a case in point.

66 For the effects of short-term financial crises on poverty trends in emerging market countries, see Cline (2002). For the effects of financial market integration on countries with different levels of institutional development, see Prasad *et al.* (2003). For the proximity of the near poor to the poor in terms of indicators such as infant mortality, see Birdsall (2004).

Our results also highlight a need to better understand and incorporate the interaction between norms about fairness and equity with economic progress and change—including integration into global markets and information systems. Norms about what is fair are endogenous to policy choices in the long run. The importance accorded to unions, for example, has long-run effects on their bargaining power and thus wages in the sectors that they represent.[67]

Tolerance for inequality seems to be much higher in contexts where there are perceived (even if not real) prospects for upward mobility.[68] Downward mobility, or the threat thereof, is more likely to cause frustration and social unrest than is persistent poverty, as in the case of our frustrated achievers in Peru and Russia, or more generally as in Argentina in the 1990s. Relying on income measures of wellbeing alone can mask a tremendous amount of latent social unrest. The frustrations that our research finds are closely linked to and may even determine respondents' views about market policies and democracy, and thus ultimately to political support for continued integration in the global economy.

The more fundamental point is that relying on broader measures of welfare gives us a more complete picture of the impact of globalization on the welfare of countless individuals, and helps explain the gap between empirical and technical assessments of the benefits of the globalization process and those of the average citizen (or at least the vocal proponents who claim to speak in the interests of the average citizen) in both developed and developing countries.

In the end, the results from surveys of reported wellbeing drum home an old saw that seems to need constant reinforcing: growth is a necessary but not sufficient condition for poverty reduction. Other key factors—such as public investments in health; institutions that can ensure adherence to basic norms of equity and fairness; and collective investments in social insurance to protect workers from the volatility that often accompanies integration into global markets—are essential. Without them, globalization will only create opportunities for those that are best positioned to take advantage of them, leaving behind large sectors of poor and vulnerable individuals.

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67 Atkinson (1999) makes the point that the loss of union power played a role in the reduced relative wages of blue collar workers, and now a bigger gap has become more acceptable.

68 For a short critique of the gaps between perceived equality of opportunity in the United States and the empirical evidence, see Graham and Young (2003).

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