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Prosperity Isn't Just a Matter of Wealth

Man does not live by GDP alone. An introduction to the Legatum Institute's latest Prosperity Index.

BY PETER PASSELL | NOVEMBER 2, 2012



It doesn't take a degree from Oxford to understand that a nation's average income -- even after adjustments for purchasing power, to make international comparisons more relevant -- is an inadequate measure of comparative well-being. That reality has inspired numerous attempts to create a better measure. The latest, most comprehensive, and arguably most insightful, is the **Legatum Institute's Prosperity Index for 2012**, released just this week. I can't claim utter objectivity here: I've been a consultant to the Legatum Institute. I suspect, though, that you won't need much convincing to be captured by this ambitious effort.

Back to that pesky measurement problem. For decades, the United Nations has been brewing a straightforward improvement on income rankings on a regular basis, work largely inspired by the passions of Nobel Prize-winning economist Amartya Sen. The UN's **Human Development Index** blends per capita income, years of schooling, and life expectancy. And in the past few years, it's added an "**inequality adjusted**" version that discounts each component according to how equally it is distributed in the population before combining them in index form.

Obviously, though, other elements matter to well-being -- among them human rights, economic freedom, socioeconomic mobility, personal security, social insurance, and social cohesion. Other indexes try to capture one or more of these attributes. Thus the Heritage/WSJ **Index of Economic Freedom** ranks countries according to ten criteria ranging from property rights to entrepreneurship. The World Economic Forum **measures** national competitiveness, writ large. The **Life Satisfaction Index** simply cuts to the chase, ranking countries according to surveys of self-reported happiness.

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The Legatum Institute's approach is truly catholic (with a small c). First, countries are rated according to eight sub-indexes (economy, entrepreneurship/opportunity, governance, education, health, safety/security, personal freedom, and social capital), which are derived from 89 variables. Some are objective (e.g. the unemployment rate) and some subjective (the percentage who answered "yes" to the question: "Did you worry yesterday?") The raw data, by the way, can be accessed on the website.

Scores on each of the eight sub-indexes are given equal weight in producing the aggregate rankings. Note that this weighting is inevitably arbitrary -- your opinion about whether economic opportunity is more or less important a component of

prosperity than personal freedom, for example, is as good as mine. And one of the neat things about the Prosperity Index website is that it gives readers the tools to reweight the sub-indexes to see how sensitive the rankings are to their choices.

OK, so much for the methodology, but what are the results? Not surprisingly, northern European countries (not to mention New Zealand, Australia, and Canada) did very well. Meanwhile, much of sub-Saharan Africa, along with a handful of failed states (e.g. Afghanistan, Haiti, Pakistan), did very badly. For the record, Norway ranks number one, as it has since the PI was introduced in 2009, while the Central African Republic is dead last (in the 142nd position). There are some surprises in the rankings, though (hints: Turkey, Kenya, the United States). But why spoil the fun when you can check it out yourself with just a **click?**

What's most interesting to me (and more relevant to **Democracy Lab**) are some of the conclusions highlighted in the report:

Average sub-index scores have risen since 2009 in every category but one: Safety and security. Much of

that decline follows from Latin America's disappointing performance, as the region struggles with drug violence and exceptionally high levels of economic crime. But sub-Saharan Africa is not far behind.

Countries with high marks for social capital are almost all lightly (and effectively) regulated, while those with low marks suffer from big bureaucracies. But which is the cause, and which the effect? The Legatum analysts make a convincing case for social capital driving regulation, not the other way around. One implication: Deregulation won't get you where you want to go unless the social capital is there to pave the way.

Tolerance of immigrants and ethnic minorities goes hand in glove with prosperity. What's trickier to tease out is the direction of causality. Either way, though, it bodes ill for much of Western Europe, which is fraying on both ends of the equation.

The second-tier east Asian economies including Indonesia, Malaysia, Thailand, and Vietnam (a.k.a. the Tiger Cubs) are on the rise -- a reality reflected in the fact that all of them are now receiving more foreign direct investment (as a percentage of GDP) than very prosperous South Korea. But they have a long way to go to building the levels of human capital necessary (though not sufficient) to achieve high-income status. (The photo above shows a ceremony welcoming the Chinese God of Fortune in Hong Kong, one of the countries that has already made that grade, and which scores correspondingly high in the Index.)

While very different in many ways, Costa Rica and Botswana share the distinction of being islands of prosperity in problematic regions. In a word, the key to their success is "institutions," as reflected in very high scores in the governance and personal freedom sub-indexes.

In the case of large countries, the rankings can mask enormous variations in the component parts of prosperity. Take India, which ranks a miserable 138th on "social capital," a measure of social cohesion. Yet ranked on its own, the state of Gujarat would be 15th in the world -- tied with Germany!

The sun is peeking through the clouds in the newest of New Europe -- specifically, Slovakia and Moldova. While neither of these battered shards of the Soviet empire was given much chance of success when they were liberated, they are showing major gains in education and security/safety.

In any case, there's a lot of food for thought here. **Check out the report** and share your views.

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AaronJA

A curious result for New Zealand:

1st Education

2nd Governance

4th Social capital

13th Entrepreneurship

27th Economy.

I wonder why the second best-governed country in the world, with the best education, as well as high levels of entrepreneurship and personal freedom, has such an awful economy.

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