

The Easterlin Discount

A thick, horizontal yellow brushstroke with a textured, painterly appearance, spanning most of the width of the slide.

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Content

- z 1. How standard economic thinking influences policy making.
- z 2. Status effects (the Easterlin Paradox). Links with the sustainable development agenda.
- z 3. The Easterlin Discount.

From

- z Frijters, P, Krekel, C. (2019), A Handbook for UK Wellbeing Policy-Making. 338 pages.
- z It looks at how to actually do wellbeing policy. Theories, design, measurement, applications, link to existing methods, economic frameworks, effect lists, etc.

The Heathrow extension.

Table 1. Appraisal results for Heathrow Airport Northwest Runway scheme, Present Value (£billion, 2014 prices).

Appraisal results	Assessment of needs	
Carbon-traded (CT)/capped (CC)	CT	CC
Monetised (*indicates the demand reduction sensitivity results)		
Consumer surplus	54.8	33.6*
Producer surplus	-38.4	-25.8*
Government revenue	1.8	1.9*
Delays	1	3
Wider economic impacts	11.5	7.7*
Noise	-1	-1.5
Air quality	-0.8	-0.8
Carbon emissions	-0.9	-0.7
Biodiversity	0	0
Total benefits	69.1	46.2
Total dis-benefits	-41.1	-28.8
Net social benefit	28	17.4
Scheme capex and surface access cost	-16.1	-16
NPV (net social benefits and PVC)	11.8	1.4
Non-monetised*		
Surface access	Light green	
Quality of life	Neutral	
Community	Light red	
Place	Light red	
Local economy	Dark green	
Water and flood risk	Light red	

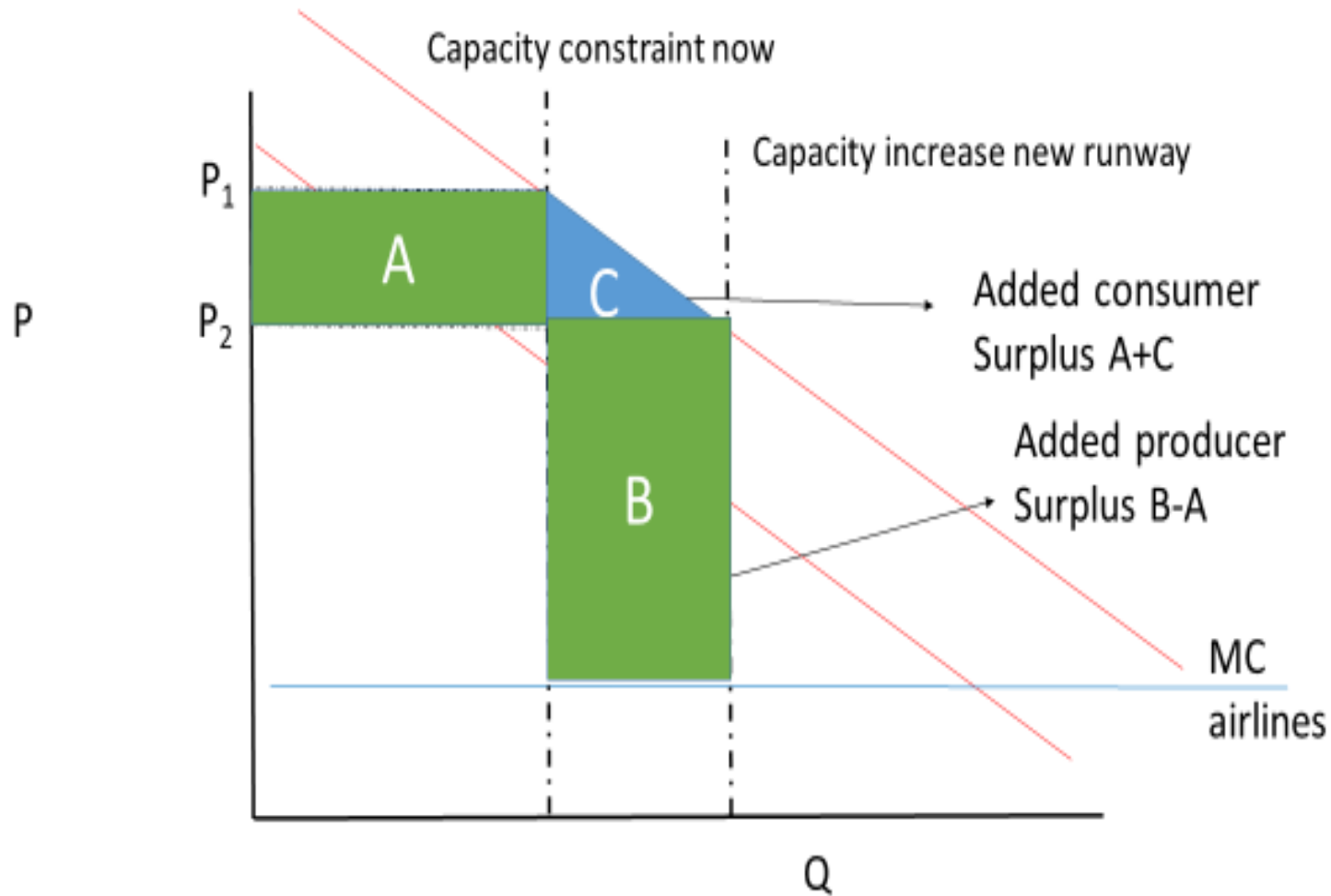
Source: Airports Commission analysis

* Colour coding is used to represent the Commission's view of the likely direction of the non-monetised impacts: dark red is strongly negative, light red is slightly negative, grey

On which basis the Airport Commission said

- z "Against the objective of maximising **economic benefits** and supporting the competitiveness of the UK economy the Heathrow Airport Northwest Runway option **performs most strongly**, generating **£69.1** billion of benefits, compared to £58.7 billion from the Extended Northern Runway scheme and £60.1 billion from the Gatwick Second Runway."

Producer/consumer surplus?



Note 1

- z This notion of consumer surplus is not truly observed. It is (WTP-price) deduced from estimated demand curves.
- z This is 19th century partial equilibrium thinking.
- z These numbers come from particular airport demand-supply models, with lots of calibrated and assumed parameters.

Note 2

- z The airport owners (a Swiss company) want the extension. They supposedly have to pay part of the Capex, which they would need to get back via a higher airport charge.
- z That charge would reduce consumer surplus and increase producer surplus. It is not reflected in the Table, possible for political reasons.
- z What you are seeing is advocacy.

Note 3.

- z The noise and air quality estimates come from supposed noise and air effects on physical health.
- z The report downplays the evidence on wellbeing (life satisfaction) by cherry picking counter-studies with different measures. That's what happens without an officially adopted measure of wellbeing.
- z The true effects are probably magnitudes higher.

Note 4a.

- z** Wider economic impacts are basically tourism effects. They come from partial equilibrium counting.
- z** Note that this violates normal general equilibrium thinking whereby tourism activity is on the margin just as productive as other activity that it crowds out (so more tourists do not increase GDP much, but mainly changes the mix of activities).

Note 4b

- z No difference is made between private surplus and government revenue: marginal utility from travel services and any form of expense is the same.
- z This reflects the assumption that the marginal utility coming from government activity is the same as that of private consumption.
- z It does not matter who gets the additional consumption: no distributional effects.
- z This is classic GDP thinking: $Y=G+C+I$
- z This is thus a statistical economic habit morphed into a rule of thumb about wellbeing.
- z This is where the inclusive growth agenda is downplayed and where sustainable development is downplayed (all consumption is presumed good).

Note 5

- z What is not measured does not count: the disruption of the communities in the way of the new runway does not count because effects are not measured.

Reflections

- z 1. This is steeped in GDP logic and economic thinking of the 1980s.
- z 2. These assumptions are normal in many Western bureaucracies.
- z 3. This is the bureaucratic battleground where sustainable development and inclusive growth lose.
- z 4. The reality of Cost-Benefit methodology is one that has picked up habits from different times and disciplines. Its evolutionary.
- z 5. To have policy effect one must engage with this.

Consumption externalities?

z Adam Smith claimed that

y “the great secret of education is to direct vanity to proper objects”

z This is a claim about i) the existence of vanity and ii) the ability of authority to direct it.

z Here, we will only look at the implication of i) but encourage everyone to think about ii).

z We will think of ‘vanity’ and ‘status seeking’ as negative consumption externalities.

Animal evidence on the importance of status and its distribution (fairness)

z This video

(<https://www.youtube.com/watch?v=-KSryJXDpZo>) shows how the pleasure from something depends on what someone else gets.

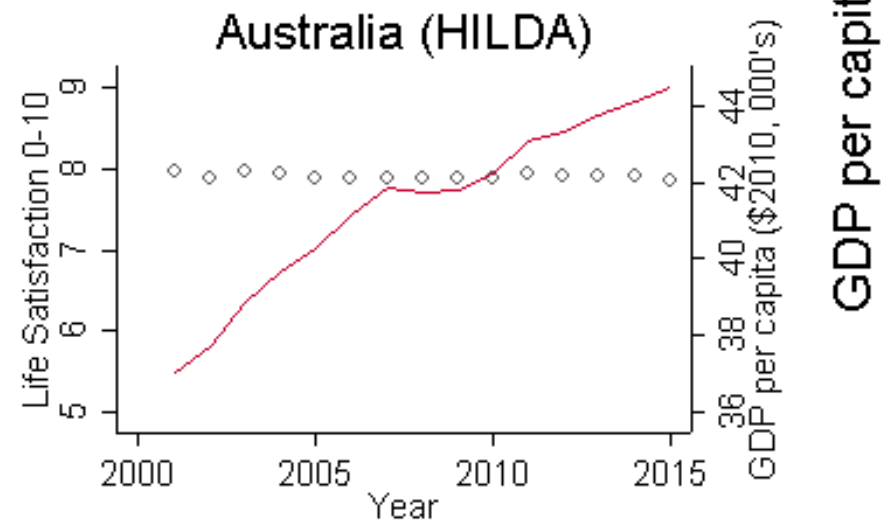
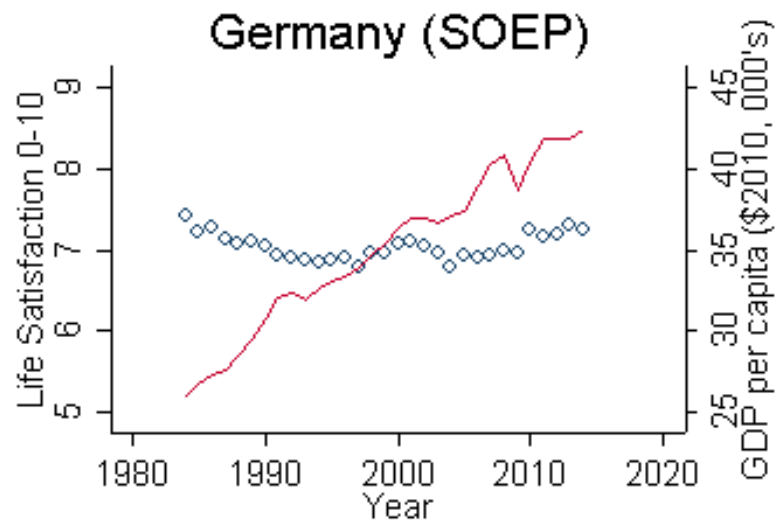
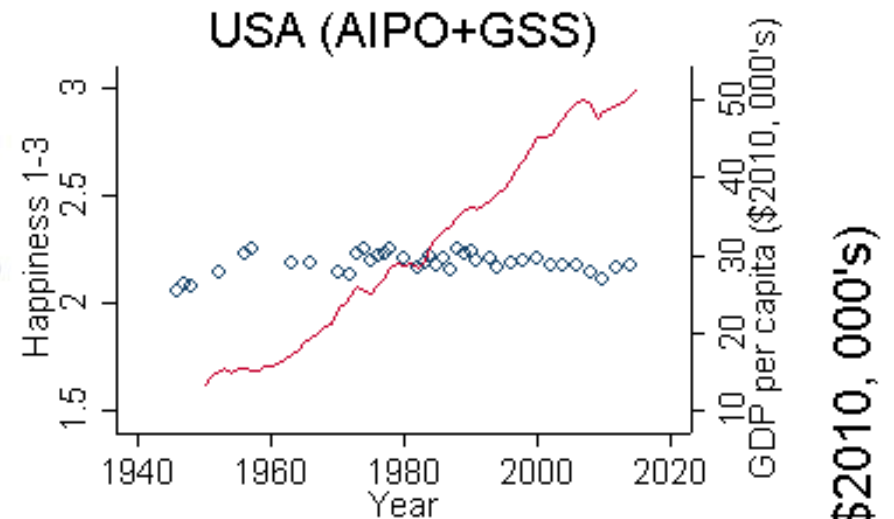
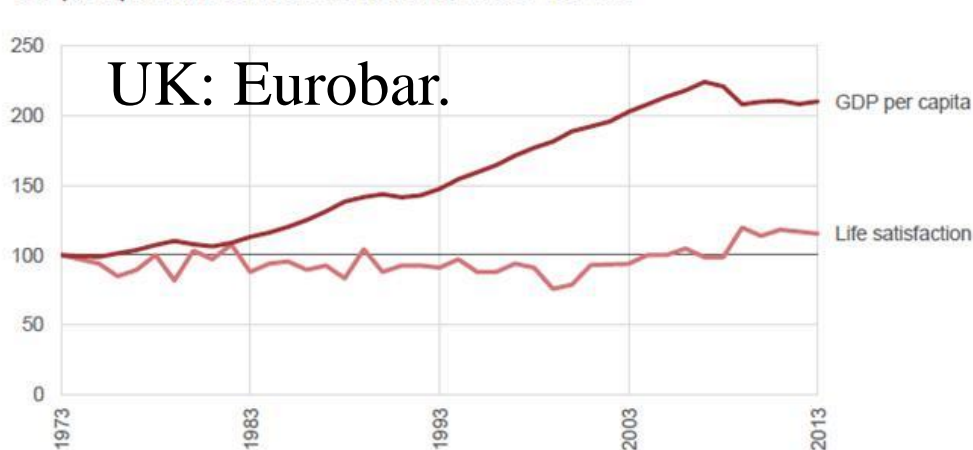
z Wolves and dogs display sensitivity to status too (<https://www.popsci.com/dogs-wolves-inequity>). Wolves more than dogs.

Other well-known studies

- z Kuhn, P., Kooreman, P., Soetevent, A., & Kapteyn, A. (2011). The effects of lottery prizes on winners and their neighbors: Evidence from the Dutch postcode lottery. *American Economic Review*, 101(5), 2226-47.
- z Perez-Truglia, R. (2018). The effects of income transparency on well-being: evidence from a natural experiment.

GDP per head and Average Life Satisfaction

GDP per capita and life satisfaction, 1973-2013, indexed 1973=100



Year

Hat-tip for $\frac{3}{4}$ of the slide: Andrew Clark

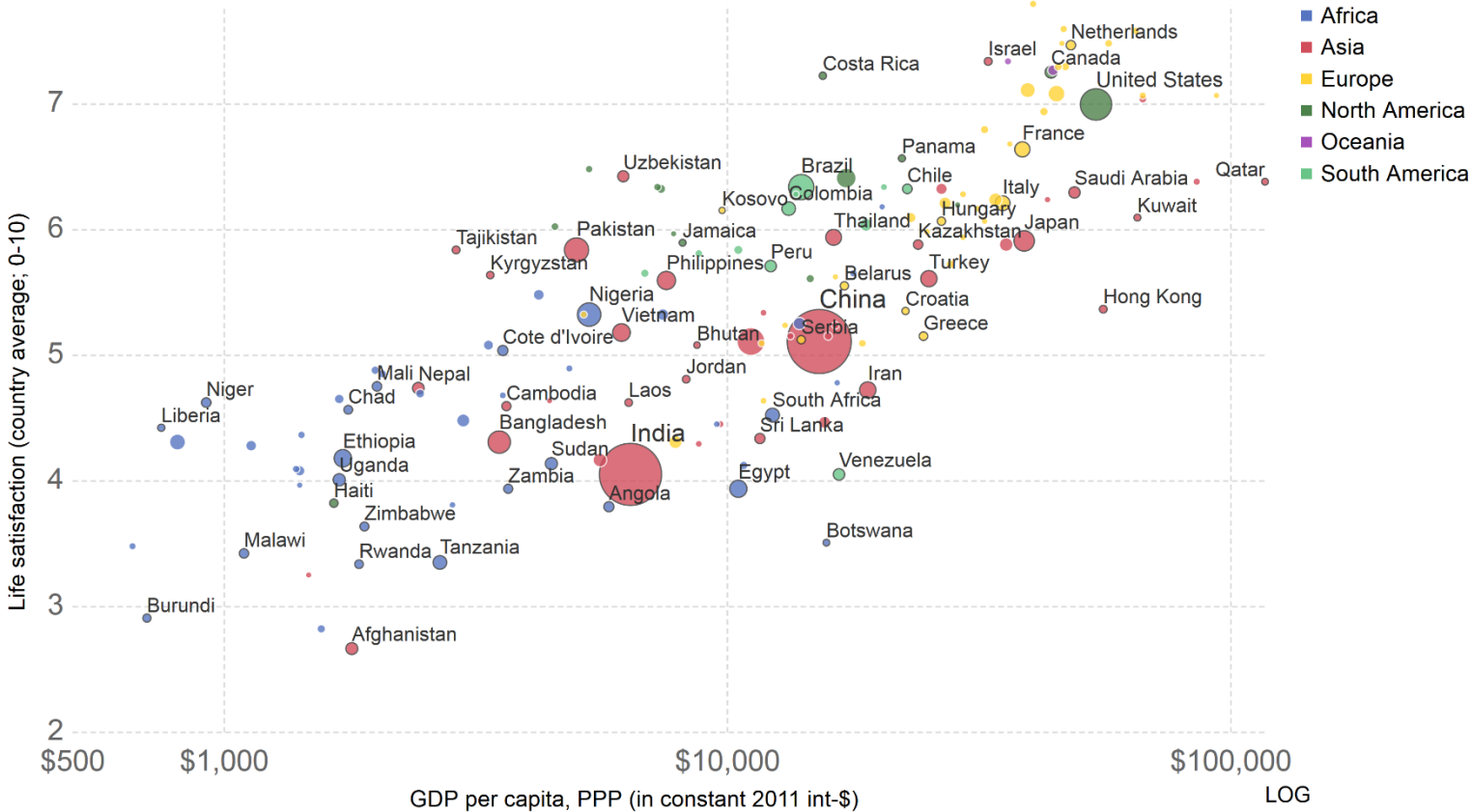
A partial Easterlin Paradox?

- z Rich countries no longer see increases in Wellbeing as their GDPs rise further (Ceteris paribus), because basic comforts are already met and further higher consumption do not increase average status.
- z The uncoupling of GDP and Wellbeing is well-established for the US (no WB increase since 1950s), and also holds for the UK and rich-Europe.

But between countries?

GDP per capita vs Self-reported Life Satisfaction, 2017

Vertical axis shows national average self-reported life satisfaction in the Cantril Ladder (a scale ranging from 0-10 where 10 is the highest possible life satisfaction). Horizontal axis shows GDP per capita based on purchasing power parity (i.e. GDP per head after adjusting for inflation and cross-country price differences).

Our World
in Data

Source: World Bank, World Happiness Report (2018)

OurWorldInData.org/happiness-and-life-satisfaction/ • CC BY-SA

GDP and Life-sat

(Rough implication)

- z Status concerns are evolutionary hard-wired.
- z They are a negative consumption externality.
- z But greater consumption at the bottom (via eg. the welfare state) does buy aggregate wellbeing.

How to translate to C-B ?

- z What rules of thumb would you advocate be added to the current C-B habits as practised in many countries?
- z Note that any indefinite answer basically supports the status quo. The clock is always ticking whilst we contemplate perfection.

A suggestion

- z An **Easterlin Discount**: a percentage reduction in the value counted for all forms of private market-mediated consumption above the welfare state minimum.
- z So all private goods and services above the minimum.
- z But not government expenditure.
- z Not noise and other 'basic comforts' subject to health and safety regulations.

How would that work out?

Table 1. Appraisal results for Heathrow Airport Northwest Runway scheme, Present Value (£billion, 2014 prices). 50% Easterlin Discount and re-arranged.

Appraisal results	With or without Easterlin Discount	
	Without ED	With ED
Carbon-traded (CT)		
Monetised		
Consumer surplus	54.8	27.4
Producer surplus	-38.4	-19.2
Scheme capex and private paid surface access cost	-13.6	-6.8
Primary surplus change	2.8	1.4
Delays	1	1
Wider economic impacts post-tax	6.9	3.45
Noise	-1	-1
Air quality	-0.8	-0.8
Carbon emissions	-0.9	-0.9
Biodiversity	0	0
Government paid surface access costs	-2.5	-2.5
Taxes (40%) from wider economic impact	4.6	4.6
Government revenue	1.8	1.8
NPV (net social benefits and PVC)	11.9	7.05
Non-monetised		
Surface access	Light green	
Quality of life	Neutral	
Community	Light red	
Place	Light red	
Local economy	Dark green	
Water and flood risk	Light red	

Note

- z You need to make tricky decisions:
 - y Capex private? Capex public?
 - y Noise, air quality, value added in the wider economy, delays?
 - y % government take from economic activity?
 - y Blanket discount versus area-specific one?
 - y Discount on the level of the market price or the WTP?
- z Each of the implicit decisions made are highly debatable. That's the business one is in when one engages with the policy process.

And if we'd
presume no
net gain
from the
extra
tourists (only
substitution)
?

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Primary surplus change	2.8	1.4
Delays	1	1
Wider economic impacts post-tax	0	0
Noise	-1	-1
Air quality	-0.8	-0.8
Carbon emissions	-0.9	-0.9
Biodiversity	0	0
Government paid surface access costs	-2.5	-2.5
Taxes (40%) from wider economic impact	0	0
Government revenue	1.8	1.8
NPV (net social benefits and PVC)	0.4	-1
Non-monetised		
Surface access	Light green	
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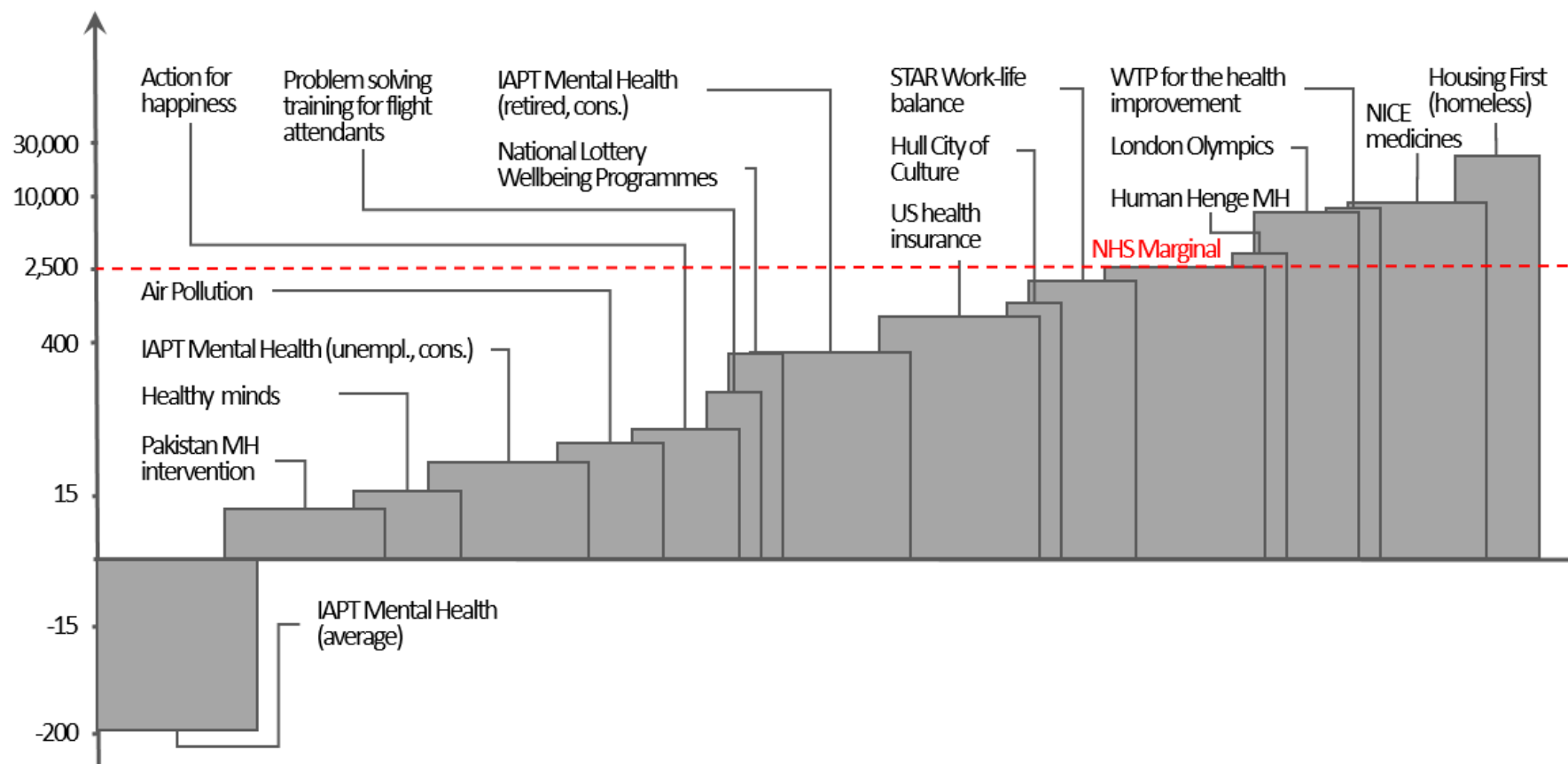
Lessons

- z The reality of policy making is a very murky business that is easy to criticise, but hard to change.
- z The current reality of policy-funding CB argumentation is loaded against sustainable development, inclusive growth, and consumption externalities.
- z The Easterlin Discount unites several agendas but comes with new questions.

The ideal?

- z If we were not constrained in sticking to CB, what kind of policy-funding argumentation would I advocate?

Well-being cost-effectiveness?



A WELLBY is one unit of life satisfaction for one person for one year.

Costs are net public costs in pounds. All other effects are calculated via wellbeing.

See further?

- z Frijters, P, Krekel, C. (2019), A Handbook for UK Wellbeing Policy-Making. Working Paper LSE.
- z Available on request.