PRESS RELEASE
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BUSINESS CYCLE BLUES: 
New evidence of the psychological effects of economic recession and recovery

People do not psychologically benefit from economic expansions nearly as much as they suffer from recessions. That is the central finding of new research published today by the Centre for Economic Performance (CEP). Jan-Emmanuel De Neve and his colleagues find evidence that the life satisfaction of individuals is between two and eight times more sensitive to periods when the economy is shrinking than at times of growth.

Their results suggest that policy-makers seeking to maximise wellbeing should focus more on preventing busts than promoting booms. They also help to explain why increases in GDP do not always pay off in increases in happiness: the modest happiness gains accrued over years of growth can be wiped out by just a single year of contraction.

How do macroeconomic changes affect people’s wellbeing? The psychological impact of economic expansion and recession is particularly salient given the massive swings of recent decades – see-sawing from boom to bust and back again. The new CEP study reveals an important asymmetry in the way that individuals experience positive and negative fluctuations of the business cycle.

To explore how individuals react to positive and negative growth, the researchers analyse wellbeing measures from three large datasets: the Gallup World Poll of 151 countries; a representative sample of 2.5 million Americans; and Eurobarometer, a twice-yearly opinion survey conducted by the European Commission.

In general, they find that growth is significantly associated with wellbeing. But when split across positive and negative growth, this result is mostly driven by the negative growth years. Recession years are significantly associated with losses in wellbeing, but there is not an immediate relationship between positive growth years and wellbeing.

Greece’s experience is illustrative. The country’s real GDP grew by more than 50% between 1981 and 2008, while life satisfaction edged up by 5-10% overall (with most of the gains made over the decade of stable growth to 2008). But the recession that began that year led to a decrease in average wellbeing that erased all prior gains. Average wellbeing in Greece now stands at a level below historical records, despite real GDP remaining at a level well above historical figures. The psychological costs of the recession cut even deeper than the negative growth numbers would indicate.

So why do people experience macroeconomic losses more negatively than they experience equivalent gains positively? A deep-rooted mechanism could be that individuals simply react more strongly to negative developments. People’s disproportionate sensitivity to negative stimuli may have an explanation rooted in evolutionary biology, since in terms of survival the avoidance of threats is more important than a missed opportunity.

Periods of economic contraction not only involve a loss of national income but also an increase in uncertainty, which is arguably intensified by the disproportionate coverage of negative news
about macroeconomic trends compared with positive trends. Volatile business cycles and the resulting uncertainty are also attention-seeking stimuli.

Jan-Emmanuel De Neve comments:

‘Our findings suggest that policy that is designed to engineer booms but which risks even relatively short busts is unlikely to improve wellbeing in the long run.

‘Growth policy can not solely be evaluated on the basis of how much the economy has grown but needs to also be understood in terms of how the economy has grown. The psychological impact of the growth trajectory—whether volatile or smooth—is understudied even though it is felt strongly by ordinary citizens and results in markedly different reports of life satisfaction.’

‘Steady positive growth that minimises the risk of contraction seems the most likely route to improving general wellbeing.’

ENDS

Notes for Editors:
Dr Jan-Emmanuel De Neve of the Centre for Economic Performance explains his latest research on the effect of the recent recession on people's wellbeing in the film ‘The Untold Story of the Recession: The Psychological Cost’ (view here: https://www.youtube.com/watch?v=cOsWih883v8) produced by Econ Films*.


For further information contact:
Jan-Emmanuel De Neve, email: j.deneve@ucl.ac.uk or J.De-Neve@lse.ac.uk; or Helen Durrant, email: h.durrant@lse.ac.uk

* Econ Films are a production company specialising in films about economics for any audience.