



Prosperity Index Methodology

HOW WE BUILD THE INDEX

The 2014 Legatum Prosperity Index™ offers a unique insight into how prosperity is forming and changing across the world.

Traditionally, a nation's prosperity has been based solely on macroeconomic indicators such as a country's income, represented either by GDP or by average income per person (GDP per capita). However, most people would agree that prosperity is more than just the accumulation of material wealth, it is also the joy of everyday life and the prospect of being able to build an even better life in the future. The Prosperity Index is distinctive in that it is the only global measurement of prosperity based on both income and wellbeing.

Attempting to understand how we move 'beyond' GDP is a particularly stimulating challenge, one that we strive to meet with academic and analytical rigour. This short methodological overview provides an understanding of how we constructed the 2014 Legatum Prosperity Index™ by combining established theoretical and empirical research on the determinants of wealth and wellbeing.

The Index values the need for a country to promote high levels of per capita income, but also advocates the need for countries to improve the subjective wellbeing of its citizens. Our econometric analysis has identified 89 variables, which are spread across eight sub-indices. Through this process we are able to identify and analyse the specific factors that contribute to the prosperity of a country.

We endeavour to create an Index that is methodologically sound. To that end, we also publish a full methodology document to provide the reader with all the information required to understand the Legatum Prosperity Index™ in a way that is transparent, useful, and informative.

- ### HOW DO WE MEASURE A COUNTRY'S OVERALL PROSPERITY?
- 1 Selecting the variables.** Starting with the current academic literature on economic growth and wellbeing, we identified a large number of variables (more than 200 in total) that have a proven impact upon wealth and wellbeing. The final variables were selected according to their global coverage and by using regression analysis to determine those that have a statistically significant relationship with wealth and wellbeing. The remaining 89 variables are divided into eight sub-indices depending on what aspect of prosperity the data influence.
 - 2 Standardisation.** The 89 variables use many different units of measurement. For example, the proportion of citizens that express confidence in financial institutions is measured in percentage terms, while capital per worker is measured in US Dollars. We transformed all variables to a common scale using a statistical technique called standardisation. A variable is standardised by subtracting the mean and dividing by the standard deviation.
 - 3 Variable weights.** When the methodology was set in 2010, we also determined the weight of each variable, using regression analysis. A variable's weight (or 'coefficient') represents its relative importance to the outcome (either income or wellbeing). In other words, statistically speaking, some things matter more to prosperity than others.
- ### HOW TO CALCULATE PI SCORES AND RANKINGS
- 4 Income and Wellbeing scores.** For each country, the latest data available in 2014 were gathered for the 89 variables. The raw values are standardised and multiplied by the weights. The weighted variable values are then summed to produce a country's wellbeing and income score in each sub-index. The income and wellbeing scores are then standardised so that they can be compared.
 - 5 Sub-index scores.** The standardised income and wellbeing scores are added together to create the countries' sub-index scores. Countries are ranked according to their scores in each of the eight sub-indices.
 - 6 Prosperity Index score.** Finally, the Prosperity Index score is determined by assigning equal weights to all eight sub-indices. The average of the eight sub-indices yields a country's overall Prosperity score. The overall Prosperity Index rankings are based on this score.