From Measuring Production to measuring well-being

Joseph E. Stiglitz
Melbourne
July 29, 2010
What you measure affects what you do

• Which is why accounting/accounting systems are so important

• Bad accounting played a big role in the current economic crisis
  – Partially related to failures of market prices
  – But also partially related to accounting rules
    • Banks were allowed to move things off balance sheet
    • We weren’t measuring what we should be measuring
• GDP was created to measure market—outgrowth of Keynesian economics
• But overtime evolved into a measure of well being
• Never intended to be a measure of well-being
• And is increasingly facing problems even as a measure of market production
• Large number of econometric studies analyzing determinants of economic performance
  – But if the measurement of performance is flawed, then inferences drawn from such measures is at risk of being flawed
  – US appeared to be doing well before the crisis
    • 40% of profits in corporate sector—phony
    • 30-40% of investment was in real estate sector—bubble prices
  – Markedly different views of “good” performance provided by UNDP HDI indicator at GDP per capita
• Accounting can be viewed as part of the economics of information
  – Part of our information system that enables us to make appropriate decisions
• Example: every firm takes into account depreciation of capital
• But national income accounting doesn’t take into account depletion of natural resources/degradation of environment
Why the International Commission?

Two concerns:

1. Numbers didn’t seem to reflect individual perceptions of what was going on
   - Leading to mistrust of government
   - Example: in US, GDP per capita has been going up year after year (until 2009), but most families were actually worse off, year after year

2. Government given conflicting objectives
   - Should it maximize GDP
   - Or should it pay attention to environment
   - Some of these conflicts are “fake”—would disappear with appropriately defined measures
Three Working Groups

• Traditional problems with income measurement
  – Many of these problems have been long recognized
    • Government
    • Quality adjustments
  – But their significance has grown

• Assessing well-being
  – New tools allow better assessment
  – Often marked discrepancies with GDP

• Sustainability

• Cross cutting issue: income distribution
Single Indicator or Dashboard

• Clear that one could not construct a single indicator that would summarize all the relevant information
• Especially since some prices might not be reliable
• Challenge—find a small set of indicators that provide a good picture of how well the economy is doing
Traditional measurement problems

• In public sector, measurement of output by input
  – Implicit assumption about productivity
  – Increasing size of public sector meant that this is an increasingly important problem
  – Some European countries have already begun to tackle the problem
    • Difficult—not just years of schooling; need measure of quality
Health care sector

• Large parts publicly provided; other parts prices distorted
• Again, tend to measure output by input
• Have some output indicators (life expectancy, etc)
• US spends more than others, outcome poorer
  – Would like to measure “value added”—perhaps Americans are inherently not as healthy as those in other advanced industrial countries
  – More likely explanation: economic and social system leads to patterns of living/consumption that is less healthy
    • Increasing problem of obesity
    • Fast foods, stress
    • Then medical system is “undoing” damage caused by other parts of the economic system
• Explains a large part of difference in income per capita in US and some European countries
Household Production and Leisure

- Some of increase in measured GDP is shift from (unmeasured) household production to measured market production—not real increase in well-being
  - Reduced time in home may even be reducing investments in children
- Individuals care about leisure
  - But GDP only looks at income
  - Marked changes in leisure/differences in leisure across countries
    - Particularly pronounced over last 30-40 years
  - Again, much of the difference in GDP per capita is related to differences in hours worked
    - France even has higher output per hour
Measurement of Well-being

• We often do not measure what we care about
• Studies show that people care about
  – Connections (Putnam)
  – Work (quality of work and workplace)
    • Negative effects of unemployment cannot be offset just by giving people income
  – Health
  – Education
Sustainability

• What matters is not just consumption today but “lifetime” consumption
• For a society—we care about future generations
• Best way of assessing whether consumption is sustainable is an assessment of what is happening to (total) wealth
  – If wealth is decreasing, then current consumption levels are not sustainable
• Difficulty is getting a full assessment of wealth (especially natural capital) and accurate prices with which to value various assets
  – We need to value the degradation of the environment, the depletion of natural resources
    • What price should we associate with the using up of the carbon space in the atmosphere?
    • We know that the zero price we currently use is wrong
  – Which is why we need to include a few physical indicators in our “dashboard”
National and Global Dialogue

- Part of the objective of rethinking our measurement systems is to generate a national and global dialogue
  - On what we care about
  - Whether what we are striving for is achieving what we care about
  - And whether this is reflected in our metrics