Towards a better measure of well-being

by Joseph Stiglitz, September 13 2009, Financial Times

A political leader attempting to promote the well-being of his citizens is pulled in different directions: he will be graded on economic performance but there are many other dimensions to the quality of life, including the state of the environment. While there is no single indicator that can capture something as complex as our society, the metrics commonly used, such as gross domestic product, suggest a trade-off: one can improve the environment only by sacrificing growth. But if we had a comprehensive measure of well-being, perhaps we would see this as a false choice. Such a metric might indicate an increase in well-being as the environment improved, even if conventionally measured output went down.

This was one of several motivations for Nicolas Sarkozy, president of France, when he established the International Commission on the Measurement of Economic Performance and Social Progress, which I chaired and for which Amartya Sen served as adviser and Professor Jean-Paul Fitoussi of the Institut d'Etudes Politiques served as co-ordinator, and whose final report is issued on Monday.

National income statistics such as GDP and gross national product were originally intended as a measure of market economic activity, including the public sector. But they have increasingly been thought of as measures of societal well-being, which they are not. Of course, good statisticians have warned against this error. Much economic activity occurs within the home – and this can contribute to individual well-being as much as, or more than, market production.

There are concerns, too, that a focus on the material aspects of GDP may be especially inappropriate as the world faces the crisis of global warming. Should we “punish” a country – in terms of our measure of performance – if it decides to take some of the fruits of the increase in productivity from the advancement of knowledge in the form of leisure, rather than just consuming more and more goods?

What we measure affects what we do. If we have the wrong metrics, we will strive for the wrong things. In the quest to increase GDP, we may end up with a society in which most citizens have become worse off. We care, moreover, not just for how well off we are today but how well off we will be in the future. If we are borrowing unsustainably from this future, we should want to know.

Flawed statistics may also lead us to make incorrect inferences. In the years preceding the crisis, many in Europe, focusing on America's higher rates of GDP growth, were drawn to the US model. Had they focused on metrics such as median income – providing a better picture of what is happening to most Americans – or made corrections for the increased indebtedness of households and the country as a whole, their enthusiasm might have been more muted.
No good accountant would ignore the depreciation of a company’s capital, but the standard GDP measure not only does that but also takes no account of resource depletion and environmental degradation. Our increased awareness of the scarcity value of environmental resources makes this lacuna especially troubling.

Advances in research across a number of disciplines enable us now to develop broader, more encompassing measures of well-being. Such measures recognise that unemployment has an effect that goes well beyond the loss of income to which it gives rise. Health, education, security and social connectedness all are important to quality of life – but are not adequately reflected in GDP.

Though the commission was established before the recession hit, the crisis has made its work even more relevant. A good set of metrics captures the notion of economic as well as environmental sustainability. And there have been long-standing concerns about the use of market prices, especially for evaluating long-run sustainability. These proved warranted: the seemingly strong performance of some countries (as indicated by GDP) was not sustainable and was based on “bubble” prices that exaggerated profits and output.

The work of our commission has, not surprisingly, struck a global chord. Even before we convened, Bhutan was creating a measure of GNH, or gross national happiness, and Thailand was working on its own index.

GDP will, of course, continue to be used as a measure of market activity – though hopefully the reforms that we propose will make it a better measure of that. But there will be increased focus on sustainability – on what is happening, for example, to broad measures of society’s wealth, including its natural assets. When it comes to measuring societal welfare, we will have to look to other metrics. Some already exist; others will have to be constructed. Our report provides guidance on what is required.

Too often, we confuse ends with means. One of the criticisms of our economies in the years prior to the crisis is that they did exactly that – a financial sector is a means to a more productive economy, not an end in itself. Even worse is to confuse an improvement in a measurement of well-being with an improvement in well-being itself. Our economy is supposed to increase our well-being. It, too, is not an end in itself. Hopefully, the work of our commission will have increased the impetus to align the metrics of well-being with what really contributes to quality of life – and, in so doing, help us direct our efforts at those things that really matter.