Earth, a treasury for all to live upon

From stock markets to measuring GDP, conventional economics is in a mess. Do we need radical new ways to assess economic activity, asks **Mike Holderness**

HOW much political power can one number exert? Gross domestic product (GDP) is a strong candidate for the world's most potent numerical indicator. Politicians use it to rank states in order of production, and to guide policies to maintain their place in the pecking order. Its year-on-year changes dictate whether an economy is "in recession", which in turn influences what you pay for the loan to buy your home or run your business – and, indeed, the price of fish.

But look under the hood at the factors that feed into the calculation of GDP and you'll see some strange goings-on. For one thing, it's full of virtual production and trading. People who own their houses, for example, are deemed to pay themselves rent, which is included in GDP; it has to be this way, to keep the books tidy.

Then there are the important transactions that are not included. No attempt is made to value the services provided by the state, for example. Fees charged by private hospitals are included, but when it comes to state-run hospitals only the goods and services they buy in are deemed to contribute to GDP.

Also unaccounted for is activity in the "informal" economy. As well as dubious or downright illegal activities, this includes things people make and do for themselves, their families and their neighbours without cash necessarily changing hands.

Crucially, existing measures of GDP also fail to reflect the fact that some of the activity that contributes to GDP does harm rather than good. This distortion can encourage false choices – between promoting GDP and protecting the environment, for example. So jammed roads increase GDP through the increased sales of fuel that is wasted, but do nothing for people's quality of life. And for anyone concerned about air quality, statistics which ignore air pollution produce an inaccurate estimate of public well-being.

This clash between the economic measures of socio-economic phenomena and public perception of the same phenomena spurred President Nicolas Sarkozy of France into action. Early last year, he asked economists Joseph Stiglitz of Columbia University in New York, Amartya Sen of Harvard University and Jean-Paul Fitoussi of Sciences-Po (the Institute of Political Studies) in Paris, France, to set up the Commission on the Measurement of Economic Performance and Social Progress (CMEPSP).

The commission's report was published last month, and the onset of global recession – as determined by old-style GDP – means it is likely to be read more widely than it might otherwise have been. The report itself says that some members of the commission believe one reason the economic crisis took many by surprise is that "our measurement system failed us and/or... market participants and government officials were not focusing on the right set of statistical indicators". As a result, accounting systems "did not alert us that the seemingly bright growth performance of the world economy between 2004 and 2007 may have been achieved at the expense of future growth".

The report's 12 recommendations centre on changing the emphasis from measuring economic production to measuring human well-being, on the problems of defining well-being and – perhaps the thorniest of issues – how to measure environmental sustainability. The report notes that this last goal will require indicators of crises such as those linked to climate change or to the depletion of fishing stocks.

Measuring quality of life directly is not going to be easy. In passing, the report cites such gems as the finding that women in Columbus, Ohio, surveyed about their feelings, or "affect", while carrying out different activities, felt better walking than when they were having sex. Puzzlingly, the same researcher, Alan Krueger of Princeton University, has also discovered that "the correlation between life satisfaction and net affect is only 0.44": people's description of their separate experiences does not predict

PROFILE
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GDP's inability to account for environmental damage distorts economic choices

very well how they feel about their lives.

Yet "hedonology", as the study of pleasure is called, remains more interesting than the accountant's standard way of measuring well-being, which is to ask about our willingness to pay cash for an equivalent experience. Other efforts, such as the UN's Human Development Index are, say the commission's authors, too closely tied to GDP.

And what shall it benefit you to have cash or hedonic experiences now, if you know it will soon be all over? Proposing a sustainability index brings us up against the core of standard economics, from Adam Smith in the 18th century, right up to the present day: the zero value normally ascribed to natural resources.

Environmental groups promote the idea of the "carbon footprint" or general "resource footprint" as an index of sustainability. But it has been left to the World Bank, often seen as conservative, to develop a more radical measure it calls Adjusted Net Savings, which treats resources as capital.

The authors of the CMEPSP report stress that treating resources as assets or capital goods "does not mean at all that we consider that these assets should all be privately owned or submitted to market forces". Rather, many of them are "collective assets that cannot be managed efficiently by market mechanisms". Have we returned to the 17th-century English activist Gerard Winstanley's insistence that resources are "a common treasury for all to live comfortably upon"?

Any index of sustainability is bound to have little in common with the after-the-fact accounting that produces GDP, because it is, essentially, modelling the future. Here, we collide with the most miserable tool in the box of economics tricks: the measure of people's pessimism known as the discount factor.

If I offer you either £5 today or £10 one year hence, you are likely to take the £5. On this basis, your discount factor with respect to me is 50 per cent per year. Even using a modest 5 per cent discount factor for future environmental damage, a million units of damage done 100 years in the future has a net present value of few thousand units. The future simply disappears from capitalism's books.

"An alternative economic index will have immense power to drive policy"

Whatever index is used, reducing an entire economy's performance – and especially its sustainability – to a single integer is bound to lose a great deal of information. The CMEPSP report therefore envisages a "dashboard" of measures. As it argues, "a meter that weighed up in one single value the current speed of the vehicle and the remaining level of gasoline would not be of any help to the driver".

The report nevertheless acknowledges that if politicians do accept an alternative index, it will have immense power to drive policy. And prospects for acceptance turn out to be good. On 8 September, the European Commission issued a communication committing itself to "working to complement GDP and National Accounts (which presents production, income and expenditure in the economy) with environmental and social accounts". The European Commission has already adopted many of the report's proposals.

Despite such hopeful signs, GDP isn't going to go away any time soon. The ratio of GDP to national debt may be meaningless, but it looks seductively like real accounting. Currency traders won't feel well-informed if they express national debt as a multiple of happiness or green prudence. Producing useful tools for guiding policy – never mind ideal ones – is going to take a while. But at the very least, exploring the CMEPSP report's recommendations will promote an interesting social and scientific discussion of what "sustainable" and "happy" mean to each of us. ■