Summary of Evidence Session "Beyond GDP: Other Income Measures of Growth"

Anthony Atkinson, Paul Schreyer, and Jean Paul-Fitoussi[1], 2nd of May, 2012

The Growth Commission aims to develop a strategy for the UK to support medium to long term growth. The Commission uses the term "growth" as shorthand for prosperity, which, in turn, it sees as a combination of material living standards/well-being, equity, and sustainability. Improvements in material living standards are commonly equated to increases in real Gross Domestic Product (GDP) per capita. In theory, however, real GDP per capita is known to have significant limitations as an indicator of material well-being. This evidence session discussed the background to these limitations and explored other (income-based) measures of material living standards. This session took place on the 2nd of May 2012, and took evidence from Jean-Paul Fitoussi, Sir Tony Atkinson and Paul Schreyer.

Jean-Paul Fitoussi motivated the session with a simple argument – that what we measure determines what policies we design; and that the suitability of what we measure has been recurrently called into question, most recently, and most starkly by the Great Recession. Professor Fitoussi argued that the crisis has revealed that we have not been doing as well it had been suggested by pre-crisis metrics (i.e. the national accounts). Output measures had been exaggerated by bubbles in asset price in ways that were clearly not sustainable. Also, he argued that the fact that in some countries GDP has returned to pre-crisis level does not capture the diminution in the sense of well-being experienced by their citizens.

He referred to the Japanese nuclear disaster to illustrate the measurement problem. This has created a great deal of anxiety and may have led to harmful health effects on a large number of people. And yet, the expenditures required to respond to the disaster may indeed increase GDP, although no one would claim that the Japanese population is in anyway better off as a result. The mechanical nature of the national accounts does not tell us much about the way in which living standards have evolved. This point formed a point of consensus amongst all three evidence givers. Additional related points of agreement were (i) that there are other (income) measures, for which data is already available, which are better suited to the purpose of evaluating material living standards; and (ii) that the distribution of income should be an integral part of those other measures, as opposed to be being taken as an supplement to those measures.

[1] **Disclaimer:** This summary document represents the views of the evidence givers and not necessarily those of the commissioners.

Paul Schreyer stressed that GDP is a useful measure of economic activity (or economic output), particularly appropriate for the purpose of monitoring the supply side of the economy. GDP was not designed with the purpose of measuring material living standards in mind. Other measures, which can be derived from the national accounts, are better suited for that purpose. In this sense, the discussion should be about "GDP and beyond" and not about "Beyond GDP", i.e. GDP should be *supplemented*, not *supplanted* by other measures of material well-being.

Echoing these remarks, Tony Atkinson argued that, over time, GDP metrics have drifted away from the household as a unit of analysis towards the supply (i.e. production) side of the economy. One of the consequences of this trend was the opening up of a gulf between movements in real GDP and the living standards that households experience.

In theory, it has long been known that GDP is a relatively poor metric of material living standards. In practice, and up until recently, GDP has correlated well with more meaningful indicators, so that not much was in using it as a proxy, while much was gained as GDP data was timelier and relatively easier to understand. The experience of the last few decades, however, suggests these pragmatic advantages have been eroded and that the quality of GDP as a proxy of material living standards has deteriorated substantially.

Tony Atkinson showed empirical evidence suggesting that the relationship between real GDP and what people perceive to be their own living standard has become more complex and opaque overtime, both for the UK as well as for the euro area as a whole.

In the euro area, between 1999 and 2011, growth in real GDP and in gross disposable real income of households was very different (Figure 1). From 2003, household income grew less than GDP, but it was protected when GDP fell in 2008. Although the latter fell by approximately 5 percentage points after 2008, the combined effect of automatic stabilisers and active intervention served to moderate the impact of the recession on household disposable incomes.

The OECD is working with the Eurostat to develop measures of household disposable income within the national accounts (as opposed to relying on survey data). The OECD/Eurostat measures include adjustments for publicly funded services (most notably health care and education) and allow for how income is distributed. Paul Schreyer presented experimental data for France (Figure 2), one of the first countries to undertake a study that combines distributional information from household surveys with sector-wide information from the national accounts. The aim is to add consistent distributional information to the national accounts data on household income (Fesseau and Le Laidier 2010).

Figure 1: Gross Disposable Income VS GDP in the Euro Area

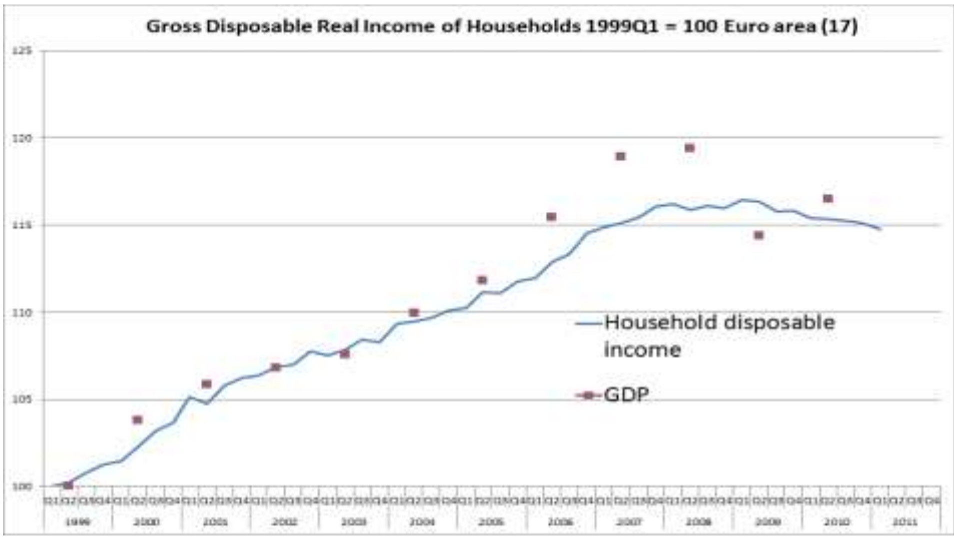


Figure 2: France Adjusted Disposable Income (OECD

per CU, in euro

	Q1	Q2	Q3	Q4	Q5	Q5/Q1	All households
Primary income	7 500	17 200	24 400	32 800	60 600	8,1	28 600
Contributions and taxes	-2 800	-6 600	-9 800	-13 500	-24 800		-11 500
Benefits and other transfers	5 400	5 800	6 400	7 500	14 200		7 800
Disposable income	10 100	16 400	21 000	26 800	50 000	5,0	24 900
Social transfers in kind	**7 400**	**5 900**	**5 400**	**5 000**	**5 100**	**0,7**	**5 800**
Adjusted disposable income (after social transfers in kind)	**17 500**	**22 300**	**26 400**	**31 800**	**55 100**	**3,2**	**30 700**
Consumption expenditure	9 900	15 400	19 800	24 400	33 100	3,3	20 600
Actual consumption	**17 300**	**21 400**	**25 100**	**29 400**	**38 200**	**2,2**	**26 400**
Social transfers in kind in % of disposable income	*73*	*36*	*26*	*19*	*10*		*23*
Social transfers in kind in % of actual consumption	*43*	*28*	*22*	*17*	*13*		*22*

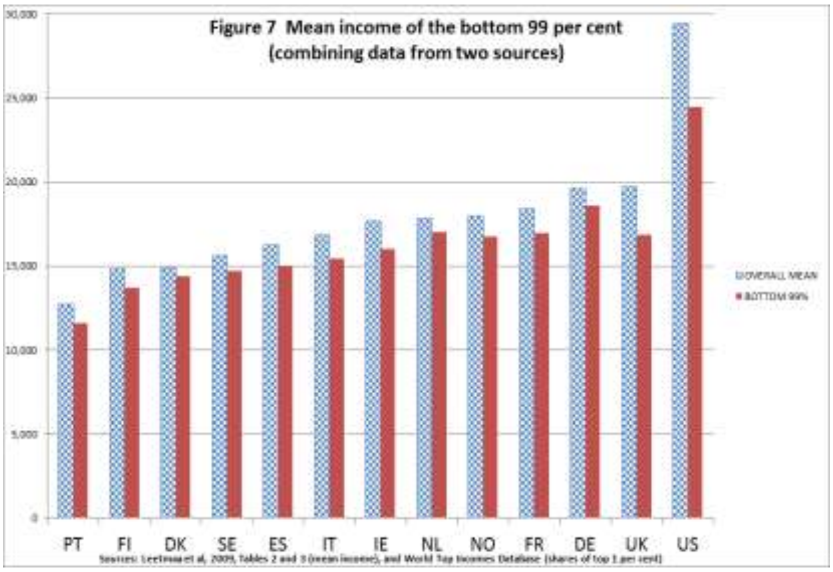
Source: Fesseau and Le Laidier (2010).

Apart from the focus on household income, the second main point of consensus was the need for the measurement of material well-being to allow for distributional considerations as an integral part, and not just as an addendum to its measures of living standards. Incorporating distributional concerns would change the way that we assess economic performance. Tony Atkinson showed that, in the UK, growth in inequality-adjusted incomes was lower than the growth in mean incomes by nearly half a per cent per year during 1961-2010. This reflects the fact that inequality rose in the past quarter of century. Similarly, among OECD countries, the income growth experienced by 80% of the population has been below the rate of growth of the overall economy (i.e. the average) and the gap increases for lower income deciles.

The view of the panel was that if we want to evaluate the impact of economic growth on society as a whole, we ought to be looking at what is happening to *most* citizens (a view also put forward in Fitoussi and Stiglitz, 2011). One way of doing this is to use *median* instead of *mean* income (the Stiglitz-Sen-Fitoussi[2] report argues this provides a better measure of what is happening to the "typical" individual or household than mean income). Another way is to focus on the mean for the bottom 99 per cent of the population, i.e. excluding the top 1% of the income distribution.

Figure 3 follows the later approach, using 2007 data for several OECD countries. The chess-board filled columns show mean income (national accounts household disposable income per head, excluding the value of public service). The solid columns show the effect of removing the top 1 per cent of the income distribution – a non-negligible reduction of mean income for all the countries considered, which is particularly significant in Anglo-Saxon countries (Atkinson, 2011).

Figure 3: Mean Income of the bottom 99 per cent



The third and final point of agreement was the need for any society to form an assessment about whether its current consumption or well-being is sustainable in the future.

Professor Fitoussi, in particular, voiced the concern that problems could originate not only from the lack of measures of sustainability, but also from the use of partial/imperfect measures of sustainability which may encourage the adoption of inappropriate policies. He cited Europe as a case in point. The financial sustainability of the Eurozone countries is under close scrutiny, and considerable attention is being drawn to the sustainability of public debt of each country in particular. This partial view of sustainability is informing the imposition of austerity programmes on peripheral countries - pro-cyclical policies with potentially harmful effects for broader measures of economic sustainability.

[2] Fitoussi, J-P, A. Sen and J.E. Stiglitz, 2009, "Mismeasuring Our Lives: Why GDP Doesn't Add UP", New York: The New Press.

The presentations were followed by a Q&A session with the Commissioners. Several questions focused on the policy implications of the proposed metrics. Paul Schreyer addressed these questions using an example of economies that are experiencing a resource boom. In such cases, GDP is not a good measure of the sustainability of their economic growth unless adjusted for resource depletion. There was also discussion of how these metrics could help to evaluate whether social programs have achieved their goal of reducing inequality. Professor John Van Reenen and Professor Francesco Caselli questioned which specific measure we should focus on, and whether the data are available. There was consensus that greater emphasis should be placed on household income measures adjusted for inequality. In the UK, the data required to compute such measures is readily available. It should attract greater interest from academics, policy makers and the media. But above all a challenge was to change the terms of the debate. Recent experience suggested that the focus on the media and policy-makers remained on quarterly GDP estimates that are presented as if they were meaningful measures of material well-being. A challenge for the commission would be change the terms of the debate and to suggest how measurement could be put on a sounder footing.

References:

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