

## **"Economic policy making - beyond maximising GDP"**

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**"Beyond GDP; measuring progress, true wealth, and the well-being of nations"**

### **Decision making beyond GDP: needs and vision**

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## **1. Introduction**

Thank you for the invitation to speak at this very timely conference in the European Parliament.

This discussion at the international level has been going on for some time. But now, we can have the dream that with this Conference the Commission is completely committed to the idea that time has come for action. We need it for us if we want to be coherent with the Lisbon Strategy but I also have the conviction that the EU could take the lead in moving ahead at the global level.

I think it is important to underline that the purpose of Gross Domestic Product - GDP - is normally simply to measure economic output and economic growth. GDP is also used to project a country's potential economic growth. Moreover, GDP can be compared across countries with a minimum of methodological difficulties.

GDP was not created to be a measure for societal well being, but I recognise that it is often used as an indicator for that. I suppose that GDP has been used and is being used as an indicator for well being because it is up to now the best available measure. It has served well for a good number of years, but I think that all policy makers realise that GDP cannot be the only basis when deciding and devising an economic policy in today's society.

## **2. Limitations in using GDP as a measure**

Let me underline that economic growth is necessary to ensure poverty can be fought and social inclusion guaranteed. This all implies: a need for more jobs. We have to realise that even activities that are not strictly speaking really adding something to society in an economic sense, still provide people with a job and therefore with an income. You may think of activities like repairing a lock after a burglary, or cleaning a beach after an oil tanker was shipwrecked. Economic growth is also necessary to meet the challenges of the ageing society we are facing.

Economic policy should therefore focus on an indicator measuring economic growth. GDP as a measure still has future in giving an indication of the realised economic output and also in giving an indication of the potential economic growth. As with all economic data, it is not the precise level as such that is most important, but the trend and the relative position, in this case to other regions.

I can only observe, that GDP as a measurement has proven to be a reliable proxy for economic activity in that sense. However, using GDP as a measure has limitations. For instance: GDP does not take into consideration depletion of non-renewable resources. GDP also does not take into account the free-rider-problem. Seen from a modern policy maker's point of view this limitation must be overcome if we are to address the problems we are facing with climate change and other environmental issues.

Another limitation of GDP is that it does not give any indication of the income distribution. From a policy maker's point of view a huge deficiency that must be overcome in our fight for a more fair distribution of wealth in today's society.

Not does GDP measure a population's well-being or "quality of life". Understanding what defines "well-being" and "quality of life" is crucial, but subjective at the same time. It is not least crucial for policy makers from very rich parts of the world, where most material needs of the population have been or at least can be met.

Moreover, GDP measures are normally limited to countries. This is not always practical in a world where not only financial markets but all markets are becoming global.

One can conclude from this that modern policy makers cannot rely on GDP solely when designing policies. Policy must take into account what could be called social progress. Therefore GDP must be supplemented, not replaced, by other measures and perhaps more qualitative information.

### **3. Beyond GDP**

Our Western societies have developed so much that the ordinary citizen nowadays expects politicians not only to just deliver long term economic growth; growth should also be sustainable, including state of the art health services, social security, environmental protection et cetera. This is a just and big challenge in an ever more globalised world.

For some issues like environmental resources we could simply set a price. This would mean integrating some externalities into GDP. It sounds easy and it is necessary, but in reality it is extremely difficult - both politically and methodologically.

Think about the current discussion about emission trading. All of a sudden there is no more free-riding. It costs to pollute and of course industry reacts. This is in many ways a classical political fight between industry interest and "green" concerns.

Let me allay all doubts: I recognise that intellectual challenges and methodological issues need to be considered such as: What is the right price? How should the price be fixed? Will pricing of free goods benefit rich companies and rich societies? Even for what intuitively seems to be the simplest way of improving GDP as a measure there are many issues to consider.

The methodological issues do not get fewer when considering various indexes on "well-being" or "quality-of-life". Moreover, there are also many political issues to be considered. First of all what index is the best! And can any index be used in any country of the world?

Second, even if a country scores high on a "well-being" or "quality-of-life" index, can policy makers be sure that it is the result of a given policy-mix. And can policy makers in other countries simply

copy the policy mix and be sure that their population will become happier? Or can a high "well-being" or "quality-of-life" score be explained simpler e.g. that some people are just more positive than others? As you can understand this involves quite a lot of very subjective elements in what used to be a fairly objective and straightforward measure.

Many other issues such as globalisation of markets and the time-lag in policy effects could also be addressed.

#### **4. Conclusion**

I have made clear that moving beyond GDP is not as easy as it sounds. I have also made it clear that it might be difficult for a politician to get reliable answers from any type of index or GDP. Nonetheless, GDP, with all its inherent difficulties, might remain a useful measurement of economic output for some time but time has come for us to reflect on better measurement that would better take into account issues of public goods.

To me - whether relying on GDP or measures beyond - politics is about conviction. One can be inspired by all kinds of indexes and experiences but any politician will have to make up his or her own mind on how he or she considers society to develop and then fight for it to become a reality.

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