Economic Growth and Well-Being: The Limits To Pessimism

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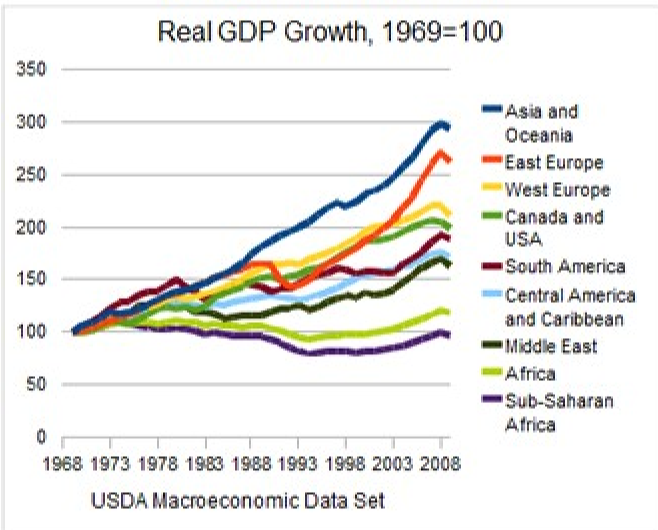
Gross Domestic Product is simple in concept: it tallies the total output of goods and services produced within a country's borders over time, providing a single number to describe the size of the economy. Bigger economies tend to harbour higher consuming citizens, and few people or nations turn down the opportunity to consume more when given the chance. Broadly, that is why GDP is often used to assess government policies, measure progress in developing countries, and, more controversially, track overall well-being. If more is better, that makes a good sense. But what if more is worse?

There are good reasons to wonder. GDP does not, in fact, include the value of *all* output. Market activity regularly produces output that goes un-priced, as is the case for negative externalities like air pollution and positive externalities like education. Depletion of natural resources can also be considered a kind of "output" that may be un-priced or under-priced depending on the terms of their use. In general, there are plenty of human activities that contribute positively or negatively to others' welfare and are not included in GDP statistics. Volunteer efforts and unpaid domestic labour are two oft-mentioned examples of this kind.

Among economic activities that do have prices attached, some seem to give the wrong signal when included in GDP. After all, what sort of indicator of well-being rises when bad things happen—even things like oil spills, car crashes, and cancer diagnoses? At first inspection, it looks like GDP has the potential to be both a faulty indicator and a cheerleader for unfortunate events. Perhaps, argue some, economists need to learn to subtract from GDP.

So, can GDP be a useful measure of overall well-being, or is it more likely to be a distraction that would fail to alert us if the costs of economic growth came to dominate the benefits?



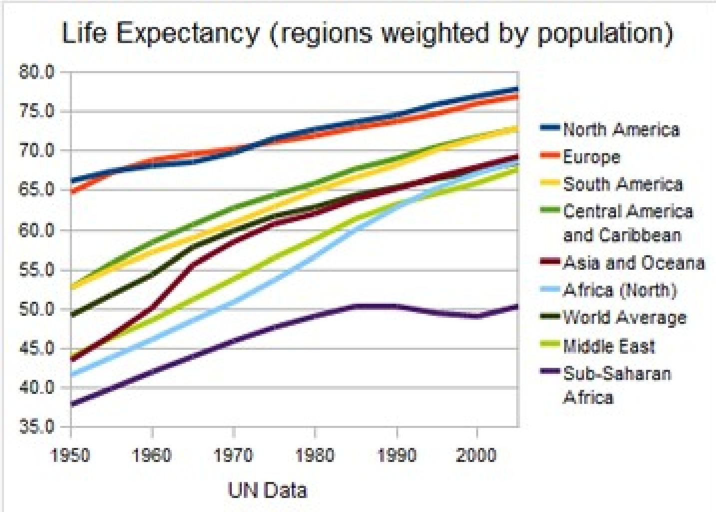
Consider first the merits of trying to distinguish between GDP-increasing expenditures that improve well-being and those that detract from it. There may be less to that idea than at first seems likely, since unfortunate events like oil spills, car crashes, and cancer diagnoses do nothing to raise GDP by themselves. Rather, it is the cleanup of oil spills, the rescue services of ambulances after car crashes, and the treatment of cancer patients that raise GDP. There is a common pattern in these scenarios: a problem arises, time and effort and equipment are put toward solving it, and GDP rises as those factors are compensated.

Viewed that way, GDP growth as a result of an oil spill does not look very different from growth as a result of other, supposedly more virtuous causes. In fact, almost all expenditures that count toward GDP are the result of people spending money to solve problems. If you are hungry, you buy food; stranded without a car, hire a cab; sick, buy medicine. That the original state of affairs causing you to spend money is undesirable does not necessarily indicate that a resulting increase in GDP is bad.

What about the possibility that a country might grow to a point where the costs of more economic growth overcome the benefits? It would be silly if, for example, an extra $1 million in economic growth created so much pollution that people were compelled to spend an extra $2 million on asthma medications. GDP would presumably grow in such a scenario (at least in the short-run), masking the underlying reality.

Some observers, noting that personal wealth, beyond a certain level, seems to have a small effect on self-reported happiness, argue that economic over-growth is already a reality. However, much else in the burgeoning research on happiness surveys suggests that GDP may yet have legs as a happiness tracker. Numerous studies have found a positive correlation between subjective indicators of well-being and income *within* countries, and two recent analyses using data from the 2006 Gallup World Poll (involving 134,000 respondents from 130 countries) found a strong positive correlation between income and life satisfaction *within and between* countries[1]. These studies did not find that the relationship was affected by a "satiation point".

Because self-reported measures of well-being are often regarded skeptically, it is worth looking at some objective measures of well-being and their historical relationship with GDP growth. Life expectancy is one such objective measure, and it is particularly useful because it encompasses other important measures, such as access to basic health care, safe water, nutritious food, and sanitation. The historical trend has been, almost without exception, positive. In 1900, global average life expectancy was around 31 years. Today, the world average is 68 years and children born in 153 of the world's 195 countries can expect to live to at least 60 years. Even the most lagging region in the world, Sub-Saharan Africa, has seen improvements. At 50, life expectancy in Sub-Saharan Africa is 60% higher than the global average 100 years ago. There is plenty of room for improvement, to be sure, but these numbers provide important context when considering whether economic growth has so far been harmful or helpful to overall well-being.



Life expectancy, as it turns out, is highly correlated with GDP per capita. Although correlation does not imply causation, the relationship between the two figures carries vital information. Because steady growth in life expectancies has coincided with strong economic growth throughout the world, we can place a lower bound on the possibilities for pessimism. In other words, even if we give GDP rises no credit for increasing life expectancies—an overly cautious assumption—we can at least be sure that economic growth has not done much harm to them. It is doubtful that life expectancy increases would have occurred at all if economic growth had been working in the opposite direction all this time.

Particularly because of all the things that GDP does not count, it is theoretical possibility for a country to pass from economic to uneconomic growth. But those who discount the value of GDP as a rough proxy for overall well-being are probably jumping the gun, and we ought to celebrate the so-far positive trend between the two figures.

[1] See *Economic Growth and Subjective Well-Being: Reassessing the Easterlin Paradox and Income* (Stevenson and Wolfers, 2008), and *Health and Well-Being around the World: Evidence from the Gallup World Poll* (Deaton, 2008).