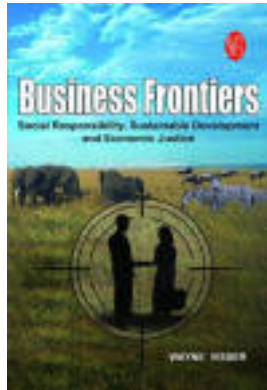


## **Business Frontiers:**

### **Social Responsibility, Sustainable Development and Economic Justice**

*By Wayne Visser (ICFAI Books, 2005)*



~ 6 BEYOND GROWTH ~

### **Measures of Progress**

#### ***The Concept of Indicators***

The world we live in is exceedingly complex. We use indicators to simplify things. Indicators work in the same way as a map. They are meant to be a guide, a representation of reality, which help us to understand the lie of the land. The scale of the map and what it is trying to measure will determine how accurately and completely it approximates reality.

It is the same with indicators. Some indicators are high level, global estimates; others are detailed, local measures. Some focus on economic activity; others on social welfare. They help us to understand 'where we're at' and how things have changed over time. Checked against our objectives, indicators tell us whether things are good or bad, better or worse.

So far, so good. Except that sometimes we get lazy. In the midst of our information overload, we are tempted to oversimplify. We settle for using in a 1:50 000 scale map, when we really need a 1: 5 000. Or we use a two-dimensional route map, when a three dimensional contour map is called for. This is the main problem with economic indicators today.

#### ***Limitations of GDP***

Gross Domestic Product (GDP) is the classic example. GDP is a simple and useful measure of economic activity: the sum of all the goods and services produced and sold in a country in a given year. Yet ever since its invention, politicians, multilateral agencies and economists have used GDP as a proxy measure for progress, welfare and quality of life.

This was never the intention. GDP's creator Simon Kuznets said in 1934: "The welfare of a nation can scarcely be inferred from a measurement of national income."

The main weakness of using GDP as a measure of progress is that it measures the *quantity*, but not the *quality*, of economic growth. Hence, if there is a war or an environmental catastrophe or a growth in the drugs trade, more goods and services are sold, but society is not better off as a result. To simplify, it makes no distinction between the 'goods' and 'bads' in the economy.

Another fundamental flaw with GDP is that it ignores vast areas of economic activity, simply because it is not included in the formal economy. This includes the 'invisible' work performed by households, parents, communities, charities, religious institutions, non-governmental organisations and the informal sector. The economic value of these 'free' activities is substantial.

The third limitation of GDP is that it hides inefficiencies and double counting. If a bakery in Cape Town bakes bread and trucks it up to Johannesburg to sell, and a Johannesburg bakery sends identical bread to Cape Town for sale, GDP counts the economic effort spent on both. But is this efficient? Are we better off than if each had sold the bread locally?

GDP also fails to pick up inequity or ethical considerations. It tells us nothing about the conditions under which the goods and services were produced, who are buying them or how the revenues are being distributed. We know that, despite economic growth over the past 50 years, the gap between rich and poor has widened.

We also know that many workers have suffered under oppressive regimes, poor working conditions and massive layoffs. We know that the production of many goods and services have resulted in negative impacts on the environment and community health. Yet, if GDP continues to go up, this is interpreted as 'all is well'.

Finally, GDP fails to capture local conditions. The economy may very well be growing nationally, but unemployment and poverty in an urban township might be acute. On the other hand, a rural village which has a negligible contribution to GDP and low official employment rates might be extremely self sufficient with a high quality of life.

The United Nations Development Programme puts this qualitative difference in a nutshell when it identifies the following five damaging forms of growth:

- Jobless growth which does not translate into jobs;
- Voiceless growth which is not matched by the spread of democracy;
- Rootless growth which snuffs out separate cultural identity;

- Futureless growth which despoils the environment; and
- Ruthless growth where most of the benefits are seized by the rich.

They call these types of growth which are “neither sustainable nor worth sustaining.”

### ***Alternatives to GDP***

Critics of GDP have not been without suggestions for improvement. These fall into two categories: 1) adjustments to GDP, to be a better indicator of overall welfare or quality of life, and (2) separate indicators to supplement GDP. Both approaches are valid and they are not mutually exclusive.

#### *Human Development Index*

The most widely recognised adjusted- GDP measure is the Human Development Index, produced by the United Nations since 1990. In 1995, they also introduced variations in the form of the Gender-related Development Index (GRI) and the Gender Empowerment Measure (GEM), and in 1997, the Human Poverty Index (HPI).

The basic dimensions of the HDI and its related indicators are life expectancy, knowledge (adult literacy rate and combined enrolment ratio for primary, secondary and tertiary education) and standard of living (adjusted per capita income in purchasing power parity (PPP) US\$). The HPI also includes measures on underweight children, access to safe drinking water, health services and sanitation, income inequality and long term unemployment (more than 12 months).

One of the conclusions of the 2000 *Human Development Report*, which contains HDI rankings for 1998, is that “the link between human development and economic prosperity is neither automatic nor obvious”. For example, while South Africa ranks 49<sup>th</sup> in GDP per capita (PPP US\$) out of 173 countries, it is ranked only at 103 in terms of its HDI score.

Furthermore, South Africa has virtually the same HDI (0.697) as El Salvador (0.696), but more than double the GDP per capita (PPP US\$). Conversely, Vietnam and Guinea have similar incomes, but vastly different HDI values (0.671 and 0.394 respectively). Sweden, on the other hand, ranks only 21 on GDP per capita, but 6 on the HDI.

One of the great strengths of the HDI is its high profile and widespread acceptability as an alternative measure of success. It allows important insights into the extent to which economic wealth has translated into human development in each country, or how much human development has been achieved despite economic limitations. Perhaps the HDI’s greatest weakness is that it fails to factor in deterioration in environmental quality.

### *Index for Sustainable Economic Welfare*

Arguably, the most sophisticated adjusted-GDP measure is the Index for Sustainable Economic Welfare (ISEW), developed by former World Bank economist Herman Daly and co-author John Cobb. The first ISEW, calculated for the United States, was published in their 1989 book *For The Common Good* and plotted against GDP over the period 1950 to 1986.

The ISEW uses personal consumption as its starting point, but then adjusts for various positive and negative welfare measures. These variable factors include: distributional inequality; services related to household labour, consumer durables, streets and highways; public expenditure on health and education; expenditures on consumer durables; defensive private expenditures on health and education; expenditures on national advertising; costs of commuting; costs of urbanisation; costs of automobile accidents; costs of pollution of water, air and noise; loss of wetlands and farmland; depletion of non-renewable resources; long term environmental damage; net capital growth; and change in net international position.

The ISEW has been calculated for nine countries to date, including Australia, Austria, Chile, Germany, Italy, Netherlands, Sweden, UK and USA. An ISEW has not yet been calculated for South Africa, but it is likely that it would display the same pattern as the other countries when plotted against GDP. Namely, that despite ongoing economic growth since the 1950s, the ISEW has slowed, levelled or declined.

Put simply, although we have become collectively richer in money terms, we are less well off in welfare or development terms. At some threshold point in the past 50 years, our industrial growth lifestyle has begun to erode the very quality of life it was supposed to enhance. Economic expansion no longer automatically translates into improved well-being.

### *Genuine Progress Indicator*

Another adjusted-GDP indicator, which takes a similar approach to the ISEW, is the Genuine Progress Indicator (GPI), developed by Redefining Progress, a US public policy research organisation. The GPI includes more than twenty aspects of economic life which the GDP ignores. Hence, GDP is adjusted for the following factors: the value of household and community work; defensive expenditures on crime, car accidents and pollution cleansing equipment; the distribution of income; resource depletion and degradation on the habitat; and loss of leisure.

The pattern revealed by the GPI is also similar to the ISEW. While GDP has more than doubled in America since the 1950s, the GPI shows an upward curve from the early fifties until about 1970, but a gradual decline of roughly 45 percent since then. The authors

conclude that modern economic growth is actually uneconomic – the costs have begun to outweigh the benefits.

Put another way, they say that “much of what we now call growth or GDP is really just one of three things in disguise: fixing blunders and social decay from the past, borrowing resources from the future, or shifting functions from the traditional realm of household and community to the realm of the monetized economy.”

#### *Pilot Environmental Sustainability Index*

The Pilot Environmental Sustainability Index (PESI) is an example of an indicator that seeks to supplement, rather than adjust pure economic measures like GDP. The PESI was developed by the World Economic Forum, in collaboration with the Yale and Columbia Universities, and launched at their annual meeting in Davos, Switzerland in 2000.

The PESI has been calculated for 56 economies, with South Africa ranking 43<sup>rd</sup>. It is an extremely comprehensive index, comprising 64 variables grouped into 21 factors under the following five components: environmental systems, environmental stresses and risks, human vulnerability to environmental impacts, social and institutional capacity and global stewardship.

One of the primary conclusions from the PESI analysis is that “there is no clear relationship between a country’s observed economic growth rate and its environmental sustainability.”

Interestingly, a correlation does exist between an economy’s PESI and its Economic Competitiveness Index. This suggests that economic performance and environmental sustainability are not necessarily trade offs. At the same time, the relationship is not automatic or direct. For example, while Sweden’s Economic Competitiveness Index is almost half that of the United States (0.9 versus 1.6), its PESI score is significantly higher (76 versus 68).

#### ***Community-Based Indicators***

Another facet of new economics thinking is to encourage local economic activity and community driven self-reliance. Development of community based economic indicators of welfare and quality of life is a critical success factor in this process. National measures are useful for informing national policies. But quality of life is always a local experience. GDP, ISEW and GPI may all be improving, but this is not helpful to a local community experiencing job layoffs, increased crime and living next to a polluting factory.

An example of community indicators is the Quality of Life Index developed by Pierce County, Washington, USA. This benchmark project tracks 80 indicators, which are grouped into following nine separate areas of concern, referred to as ‘goal categories’: affordable housing; clean environment; cost effective infrastructure; cultural and

recreational opportunities; educational excellence; effective regional transportation; health and safety of persons and property; healthy economy; and proper distribution of land.

Tracking the Quality of Life Index between 1989 and 1996 showed an overall improvement of 6 percent. The true value of the measure, however, is in its detail. Pierce County knows that 46 indicators have improved, 26 have declined and 8 have showed no real change. This kind of localised information empowers the community to tackle those specific areas where quality of life is suffering, enhance those that are stagnant and maintain those that are improving.

Each community needs to develop its own priorities and measures to determine whether their lives are better or worse off as a result of global, national and local forces. For those communities just beginning to take charge of their destiny, there are others to learn from, as well as books such as Maureen Hart's *Guide to Sustainable Community Indicators*, which should prove valuable sources of inspiration.

### **Conclusion**

Over the past 100 years, we have become increasingly aware of the interconnectedness of our global world. A highly complex web of relationships and dynamic forces shape our lives, and yet we still use outdated, simplistic and incomplete measures of progress, such as GDP. As futurist Hazel Henderson says, this is "literally like trying to fly a 747 with only one gauge on the instrument panel." Citing another analogy, she says, "Imagine if your doctor, when giving you a check up, did no more than check your blood pressure."

In our fast-paced, information-overloaded society, indicators will become more and more important feedback signals in helping us to make effective decisions. Hence, we can no longer afford to be generating measures that mislead or disguise the real state of our progress. We need to put economics into its proper perspective, as one measure of one dimension of human activity, with potentially positive and negative impacts on society and the environment.

By creating more balanced, holistic indicators, economics can once again be made to serve humans and the planet and not the other way around.

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### **Source:**

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