

The Development of Public Policy: The Role of the Index of Economic Well-being

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In 1998, the Centre for the Study of Living Standards (CSLS), a non-profit, independent research organization based in Ottawa, Canada, released the first version of the composite Index of Economic Well-being (IEWB). Since then the IEWB has been published in leading international journals (Osberg and Sharpe, 2002a, b, and c) and has received attention from international organizations (OCDE, 2001) and national governments, including that of the United Kingdom (Donovan and Halpern, 2002) and France (Travail et Emploi, 2003). This paper highlights what we think is the contribution of the IEWB to the debate on the measurement of well-being and to the development of public policy

A frequent refrain in the “social indicators” literature is the (true) statement that there is more to “well-being” than economics, but it is also recognized that a key component of overall well-being is economic well-being or “access to economic resources”. Although there are good grounds for thinking that national income accounting measures may not necessarily be a good guide to popular perceptions of trends in economic well-being, GDP per capita is probably the single most often mentioned criterion of economic progress. The development of the IEWB has been motivated by the question of whether it is possible to find a better measure of “access to economic resources.”

An important point of difference with other indices is that the IEWB does not assume that “society’s economic well-being” is a single, *objective* number. Rather, the IEWB attempts to provide each individual in society with a means of making a subjective evaluation of objective data in coming to a personal conclusion about society’s well-being. Well-being has multiple dimensions and individuals differ (and have the moral right to differ) in their subjective valuation of the relative importance of each dimension of well-being. But because all adults are occasionally called upon, in a democracy, to exercise choices (e.g. in voting) on issues that affect the collectivity (and some individuals, such as civil servants, make such decisions on a daily basis), citizens have reason to ask questions of the form: “Would public policy X make ‘society’ better off?” Presumably, self-interest plays some role in all our choices, but unless self-interest is the sole criterion, individuals need some way of adding up society’s economic well-being if they are to answer such questions.

The hypothesis underlying the IEWB is that indices of society’s economic well-being can best help individuals to come to reasonable answers about social choices if information is presented in a way that highlights the objective trends in major dimensions of well-being and thereby helps individuals to come to summative judgments – but also respects differences in values. Although it may not be possible to define a universally agreed *objective* index of society’s economic well-being, individuals still have the problem (indeed, the moral responsibility) of coming to a *subjective* evaluation of social states, and they need organized, objective data if they are to do it in a reasonable way.

There is both a logic and a practical rationale to the identification of four components. The logic of the architecture is that it recognizes both trends in average outcomes and in the diversity of outcomes, both now and in the future, as Table 1 illustrates.

<i>Table 1 - Dimensions of Economic Well-being or Command over Resources</i>		
Concept	Present	Future
“Typical Citizen” or “Representative Agent”	Average Flow of Current Income / Consumption	Aggregate Accumulation of Productive Stocks
Heterogeneity of Experiences of all Citizens	Distribution of Income - Inequality and Poverty	Insecurity of Future Incomes

When GDP per capita (or an alternative per capita income flow variable, such as personal income) is used as a summative index of well-being, the analyst implicitly is stopping in the first quadrant – assuming that the experience of a representative agent can summarize the well-being of society and that the measured income flow optimally weights consumption and savings, so that one need not explicitly distinguish between present consumption flows and the accumulation of asset stocks which will enable future consumption flows.

However, if society is composed of diverse individuals living in an uncertain world who typically “live in the present, anticipating the future”, each individual’s estimate of societal economic well-being will depend on the proportion of national income saved for the future. GDP is a measure of the aggregate market income of a society that does not reveal the savings rate, and there is little reason to believe that the national savings rate is automatically optimal – or that citizens would all agree on what an optimal savings rate is. Hence, a better estimate of the well-being of society should allow analysts to distinguish between current consumption and the accumulation of productive assets, and thereby enable citizens to assess social outcomes according to their differing values.

As well, individuals are justifiably concerned about the degree to which they and others will share in prosperity – there is a long tradition in economics that “social welfare” depends on

both average incomes and the degree of inequality and poverty in the distribution of incomes. If the future is uncertain, and complete insurance is unobtainable, risk averse individuals will also care about the degree to which their personal economic future is secure.

These four components therefore have a logical rationale and a manageable number of headings. If the objective of index construction is to assist public policy discussion, one must recognize that when too many categories have to be considered simultaneously, discussion can easily be overwhelmed by complexity. The IEWB therefore does not adopt the strategy of simply presenting a large battery of indicators. However, reasonable people may disagree in the relative weight they would assign to each dimension – e.g. some will argue that inequality in income distribution is highly important while others will argue the opposite. Hence, we argue that it is preferable to be explicit and open about the relative weights assigned to components of well-being, rather than leaving them implicit and hidden.

An additional reason to distinguish the underlying components of economic well-being is that for policy purposes it is not particularly useful to know only that well-being has gone “up” or “down”, without also knowing which aspect of well-being has improved or deteriorated. In the presentation of the IEWB *explicit* weights are specified for the components of well-being, and the sensitivity of aggregate trends to changes in those weights are tested, in order to enable others to assess whether, by their personal values of what is important in economic well-being, they would agree with an overall assessment of trends in the economy. In practice, policy initiatives often have multiple impacts – e.g. trade liberalization may enable a higher level of average consumption at the cost of greater levels of economic insecurity – so an assessment of the desirability of such policies depends partly on the relative weight to be assigned to each dimension of well being.

Our basic perspective is that a society's economic well-being depends on total consumption and accumulation, and on the individual inequality and insecurity that surround the distribution of macroeconomic aggregates. In our empirical work, we estimate:

- [1] effective per capita consumption flows – which includes consumption of marketed goods and services and government services, and adjusts effective per capita consumption flows for household production, changing household economies of scale due to changing family size, trends in leisure time and increased life expectancy;
- [2] net societal accumulation of stocks of productive resources – which includes net accumulation of tangible capital and housing stocks, net changes in the value of natural resources stocks and environmental costs, net change in the level of foreign indebtedness, accumulation of human capital and intellectual capital in R&D investment;
- [3] income distribution – the intensity of poverty (incidence and depth) and the inequality of income; and
- [4] economic security from job loss and unemployment, illness, single parent poverty and poverty in old age.

Each dimension of economic well-being is itself an aggregation of many underlying trends, on which the existing data is of variable quality – and often differs across countries. Figure 1 provides a typology of the variables in the index. The IEWB has been estimated for Canada, the United States and selected OECD countries. Unfortunately, no time series is available at this time for France. Details on the construction of the IEWB, as well as the estimates themselves, are freely available at www.csls.ca.

The development of public policy involves social choice and rational social choice requires the organization of information in a meaningful manner. We believe that the IEWB informs the political process by focusing attention on the four crucial dimensions of economic well-being (consumption flows, accumulation of wealth, income distribution and economic security) and thereby enabling citizens to make informed judgments about the tradeoffs between trends in these dimensions.

References

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Figure 1: The Index of Economic Well-being

