

**ECONOMIC DEVELOPMENT FOR THE 21st CENTURY:
NEW MEASURES OF WELL-BEING
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It is a great pleasure for me to be asked to speak at this symposium on the topic of how universities can contribute to continental integration in the 21st century. In general, universities in South America have emulated the European model of preparing individuals to contribute to society by providing them with, as Rector Tobías says, the "summa" of knowledge. We are gathered this week, however, to provide guidelines on how the university as an institution can also become more "of this world," so to speak, and contribute on issues that affect the day-to-day quality of life for all members of society.

Since I am a central banker, I imagine some of the organizers and attendees of the symposium expected me to focus on economic and financial topics, such as inflation and monetary policy. It is certainly important to assess and evaluate macroeconomic stabilization policies, and I will have some remarks about the role of central banks at the conclusion of my remarks. However, I would like to spend most of my time discussing a more fundamental issue with which those concerned with economic policy must deal. This strategic question involves the very meaning and purpose of economic growth and development.

As I see it, the ultimate purpose of economic development efforts is to achieve a higher

level of material well-being and, in turn, human well-being in all its aspects. Traditionally, in the study of economics, human well-being has been assumed to be measured by income and wealth. The most commonly used measures that reflect individual and societal economic conditions are per capita income and gross domestic product. A growing body of thought, however, suggests that these and other common gauges of economic performance overlook important aspects of human existence. Because of this, I believe a broader approach is needed to inform economic policy. Measures that include such factors as education, health, and the power to make decisions that will lead to fuller lives must be given more prominence when we evaluate how well off we are. While we cannot hope to measure how people feel about their current economic state, we can move past concepts that focus solely on its material aspects, such as purchasing power.

I believe that human well-being is the unifying concept of this conference and can aid the universities in South America that are investigating ways to contribute more to economic development and the betterment of society. Likewise, viewing macroeconomic policy decisions in this context can result in better-informed analyses and better results in the long term.

A Brief History of the Study of Wealth and Well-Being

To begin, let us review, in very brief terms, the brief history of this concept in the discipline of economics. Traditional economic thinkers and models have dwelt mainly on explaining how economies grow. Macroeconomic growth, it is assumed, increases the income of a nation. In turn, increased national income is presumed to result in greater personal well-being. In the eighteenth century, Adam Smith in his book, *The Wealth of Nations*, forged a new human-based

concept of what makes some nations richer than others. He argued that productivity, rather than the amount of gold or silver bullion in the national treasury, is the source of the wealth of a nation. A nation grows wealthier, he wrote in 1776, when individuals produce items more efficiently; a country is not condemned to an accident of fate embodied in its mineral or other natural resources.

The description that Smith made of workers in a pin factory and their achievement of efficiency through specialization remains a vivid image to this day. However, economists have long recognized that growth does not rely solely on human endeavor and specialization to the point that workers feel like robots on an assembly line. Economist Robert Solow, building on this position, pioneered the development of a more rigorous classical model of growth that focuses on how capital makes labor more efficient. Growth rates differ among countries because of the differences in physical capital per person. People must have more equipment, such as automated machinery, at their disposal in order to produce more than that which they could through the efficiency of their own efforts.

More recently, people like Robert Lucas, in an equally rigorous way, have sought to broaden our concept of capital investment to include what many call human capital. Investment in human capital occurs mainly through training and education but also through better health care. In terms of education, for example, the more skilled workers are, the more they will be able to create and produce items of value. These, in turn, increase growth in output for the nation. An example of this model would be the growth of electronics, telecommunications, and other industries that would not exist without highly educated researchers (and human capital). Such industries have

created hundreds of thousands of new jobs and products that have increased the growth in the domestic product of many countries.

Although I have hardly done justice to the growth models that exist, it is safe to say that, on the whole, mainstream economists have tried to understand what makes economies grow by looking at different aspects of labor and capital. Operating in a very different tradition from Smith and his successors were socialist and utopian thinkers of the 19th century. Their approach revolved more around what was necessary for people to have a sense of well-being in the new economic systems that had taken shape in most of Western Europe. They promoted new social arrangements that addressed the central irony of the Industrial Revolution, namely, that this enormous mechanism for economic growth left millions still in poverty. People like Karl Marx, Charles Fourier, and many others urged more equitable distribution of the greatly increased material output engendered by the Industrial Revolution. They were also interested in making the effects of the Industrial Revolution on workers more humane. The theme that had already appeared, then, was that although workers might be increasing the overall wealth of their nations, they themselves were not benefitting from the increase in wealth. In other words, they did not feel better off. Indeed, they had a sense of ill-being, rather than well-being.

Other thinkers have gone in different directions, trying to understand the deeper social meaning of wealth and well-being. While the ideas of Marx and others were gaining popularity, Pope Leo XIII discussed the economic condition of workers in an industrialized economy in his papal encyclical of 1891, *Rerum Novarum*. Like the socialists, the pontiff wrote at a time when

the Industrial Revolution, despite the tremendous growth it spawned, had divided society into two classes--the ruling elite and the working people--and the condition of many workers was abysmal. His encyclical was aimed at defending the dignity and rights of each worker, and at dispelling the popularity of socialism by arguing for property rights. He agreed with Smith and others that growth came from productive labor and wrote that the "energy and effectiveness" of workers are "so important that it is incontestable that the wealth of nations originates from no other source than from the labor of workers."

Pope Leo did not believe, however, that wealth was the sum total of the existence of human beings. He believed there was much more to life than the work that was aimed at increasing the wealth of a nation. He wrote:

"...(I)n the case of the worker, there are many things which the power of the state should protect; and, first of all, the goods of his soul. For however good and desirable mortal life be, yet it is not the ultimate goal for which we are born, but a road only and a means for perfecting, through knowledge of truth and love of good, the life of the soul."

His encyclical laid the groundwork for one of the themes that the Catholic Church has pursued through the centuries: social justice. In the late 1960s, Pope Paul VI wrote an encyclical on the development of peoples, *Populorum Progressio*, which touched on his worry about increasing wealth at the expense of workers. In it, he clearly continued the search for economic

justice: "Increased possession is not the ultimate goal of nations nor of individuals. All growth is ambivalent." Later, he writes, "To speak of development is, in effect, to show as much concern for social progress as for economic growth....The mistakes of their predecessors should warn those on the road to development of the dangers to be avoided."

Obviously, in their capacity as leaders of the Roman Catholic Church, Popes Leo and Paul went well beyond the world of economics in terms of what they believed contributes to the well-being of humankind. However, this theme is still germane, especially at this gathering of universities with a Catholic tradition. It is relevant more broadly as well. Social concerns about growth, economic development, and wealth are with us today. Economists have certainly not been immune to these concerns, even though the statistics they use often seem cold and inhuman. Now that I have outlined briefly the history of the study of the causes and effects of economic growth, I will turn next to describing what new measures of economic conditions are being used and how new economic models of growth developed by contemporary economists speak to the issue of human well-being.

New Measures and Models

As we know, broad output measures, particularly gross national product (GNP) or gross domestic product (GDP), have long been the standard gauges of how well a country is doing economically. But they have their shortcomings. For example, following natural disasters, such as a hurricane or an earthquake, GDP usually goes up because of the re-building needed. However, this kind of growth in GDP ignores the devastation that has been wrought on the lives of those

people affected by the hurricane or earthquake.

More generally, economic statistics such as GDP seem to do a poor job of measuring how well off people feel. That is because these statistics are designed to measure output or production and how they are put to use. Such statistics are not able to measure economic well-being per se. For example, in the United States over the past 20 years, output has increased thanks to the fact that more people, particularly women, have been entering the labor force. Two-wage-earner families have higher incomes and have been creating increased demand for services out of the home. However, the GDP measurement merely reports the fact of the increase in gross domestic output. It does not reflect whether the second wage-earner actually wanted to go to work or had to go to work to support the family. Nor does it measure whether the second wage-earner likes or dislikes the new situation. People may have larger homes but much less time to enjoy them. They may eat out more often, but more out of necessity than pleasure. Economists simply cannot tell whether society is better off or worse off in this case. In all likelihood, some people are better off while others are worse off. But output data will never make clear whether the sense of economic well-being in society has gone up or down.

Similarly, in the United States, we often see a disparity between how the economy is doing and how people feel about their own situation. Last August, for example, the U.S. government announced revised GDP figures for 1990 to 1992. The new numbers showed that the economy grew more in 1990 and 1992 than previously reported, and the recession was not as deep in 1991. On the same day the government unveiled these figures, consumer confidence (as measured by a

business group in New York City) stood at a low and depressed level.

Examples such as these have prodded economists to look for new ways of measuring material well-being. Within the past few years, three international organizations--the United Nations, the International Monetary Fund, and the World Bank--have each begun to use alternative measures to assess progress. In one of its indexes--the Human Development Index--the United Nations measures wealth as the quality of life by focusing on life expectancy, educational standards, and individual purchasing power. According to this report, a developing Central American country like Costa Rica ranks much higher in its human development score than in its total output per capita. Specifically, Costa Rica ranks 76th by total output per capita, but 42nd by human development. The discrepancy is due to the fact that the average Costa Rican lives longer, receives a better education, and drinks cleaner water than many residents of other nations.

In recent years, the World Bank has also moved away from relying so heavily on growth in GDP per capita as a way to measure whether people are becoming better off. Since its charter is to help developing nations come up to the level of industrialized nations, the World Bank had relied in the past on growth in aggregate output as its standard. It has now moved toward looking more at whether people are fed, clothed, housed, educated, and cared for medically.

The IMF, meanwhile, has changed the way that it compares living standards among nations. In the past, it compared national incomes based on the exchange value of currencies. It now compares national incomes according to purchasing power. This change in measures brings the

focus more on comparisons of actual living standards from country to country. In doing so, it reminds us, for example, that our positive view of the high GDP per capita in a country like Japan has to be tempered by the modest housing most people there have.

All of these searches for better measures underline the commonly felt need for something more meaningful than existing statistics to show whether people are actually economically better off. A Harvard economist, Amartya Sen, has developed a philosophy of economic development that uses mortality data to analyze the economic performance of nations. Sen concludes that the way nations handle famine, health care, sexual and racial inequality, and poverty are a truer reflection of economic well-being than income and the stock of financial wealth. The purpose of Sen's work is to use statistics that he believes more directly relate to well-being.

Well-Being as a Unifying Concept

In my view, there is a definite need for new concepts and measures of well-being to be incorporated into the framework of academics and policymaking. Focusing on aggregate output measures has led to attempts to spur growth by encouraging growth of its separate components, either consumption, investment, net exports, or government. Often, national governments have tried to increase growth through deficit spending and trade barriers, policies that are detrimental to growth and well-being in the long term.

In the 1930s, Raoul Prebisch pushed this line of thought forward for South America. He argued that South America had become too dependent on exporting its natural resource

commodities. As a result, he argued, there was little value-added economic activity--nor was much developing in South America. This argument led to a policy of import substitution, whereby imports were discouraged in an effort to catalyze the development of local industries. The mechanism often entailed restrictions on foreign investors as well as trade barriers that protected domestic processing and manufacturing. Now that Latin American countries are coming away from this mode of thinking, it is a particularly good time to conceive of new ways of accomplishing economic development.

Now, it would not be appropriate for me to conclude my comments today without mentioning something about how central banks can contribute to economic well-being. It is important to remember that central banks must focus their efforts on monetary policy. Therefore, they cannot take a direct role in economic development. For example, they cannot pick winners, as we say in the United States. Thus, I applaud efforts I see in former communist countries whereby central banks are no longer in the business of lending to businesses, old or new. However, central banks can have an indirect effect on economic well-being by focusing on the long term versus the short term. By providing price stability over the long term, they can encourage trust in the future and create an atmosphere in which people are willing invest in their own human capital through education as well as in new businesses. Price stability in fact is one key to economic development, no matter what kind of measure of well-being is used. In addition, central banks can also use monetary policy to increase a sense of well-being by mitigating the painful effects of difficult transitions, such as when an economy is in a deep recession.

If policy debates centered more on ultimate concepts of economic well-being and somewhat less on measures like GDP, both monetary and fiscal policymakers would find it easier to deal with periods of malaise like the present one in the United States. Growth in my country has been rather slow for some time, but at the same time some fundamental changes are occurring that augur well for the future. Debt levels are being reduced, for instance. Businesses are becoming much more efficient. Perhaps most importantly, significant steps have been taken to decrease the federal budget deficit. If American society becomes obsessed with a certain rate of output growth, then pressures could mount on policy making bodies to spur growth even though such efforts could undermine the structural adjustments that are so important for the long run. A greater focus on well-being might help us keep our sights on the long-term gains on the horizon.

Broader concepts of well-being could help shape the policy debate in other circumstances. Suppose that a central bank is facing the situation of high inflation. Arguing purely from an economic perspective, the benefits of a noninflationary economy are considerable. However, if policy makers in a society are guided by a strategic focus on well-being, they might find reason to choose a slower path to achieve this goal. That is because disinflation is not without transition costs. Many individuals and businesses would have to undergo considerable adjustments; those who are debtholders could find their financial position affected in a strongly adverse way. It might be more humane to reduce inflation over a longer period of time--for example, five years rather than three.

Aside from stabilization policies, a focus on well-being is needed in other areas of the policy

arena. For example, in the current health care debate in the United States, much of the discussion dwells on the rising costs of health and the increasing relative share of health expenditures in GDP. I certainly share concerns about inflation in any sector of the economy. Still, in a wealthy country like the United States it is to be expected that a larger share of expenditures would go toward health rather than toward food and other items needed for basic survival. Thus, perhaps the reform debate needs to have a wider focus, one that accepts this fact and instead puts less emphasis on cost reduction and more emphasis on the proper roles of government, businesses, and the individual in bearing the costs of health care.

Universities can and, in my opinion, should play a major role in stimulating this debate about the goals of economic policy and the measures of progress toward these goals. One of the most obvious steps they can take is to discourage economists from falling back on the convenient habit of taking more measurements based on the same available data. Universities can be the agent for social change by encouraging economists and other thinkers to devise new ways of measuring well-being as part of the study of economics and economic research. Universities can also bring other disciplines into the debate. On a wider intellectual level, universities are interdisciplinary and thus well positioned to lead the way to broader concepts. They can also help educate the public and raise the level of debate about policy issues.

Conclusion

In conclusion, universities, it seems to me, are uniquely situated to lead the way in developing policies that help people truly become better off. I urge the leaders of universities in

South America to meet the challenges I have outlined: to foster a higher level of debate of the goals of economic policy, to bring together various disciplines to develop more meaningful concepts, and to encourage scholarship that focuses on developing new methods of measuring economic well-being. Perhaps both the intellectual tradition of economics and the traditional social concerns of the Roman Catholic Church can be blended to find methods of economic development that promote social justice as well as economic well-being. I believe this would be a worthy goal for universities everywhere in the 21st century.