THE OECD INCLUSIVE GROWTH FRAMEWORK: FIRST RESULTS AND PLANS FOR THE FUTURE

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BACKGROUND
Measuring well-being: why?

- GDP is not a metric of people’s well-being and *is often at variance with people’s personal experiences*;
- GDP should be recognized as a *means to an end*, not the ultimate objective of policy;
- There is a need for *better measures of well-being* that:
  - reflect distributions
  - reflect quality of life
- Not only an issue of fairness and social justice, but key to *enhance long-term growth prospects and restore trust*;
- Ultimately, we need *improved measures* to make *better policies*. 
OECD Well-being Framework

Averages and distributions

INDIVIDUAL WELL-BEING
[Populations averages and differences across groups]

Quality of Life
- Health status
- Work-life balance
- Education and skills
- Social connections
- Civic engagement and governance
- Environmental quality
- Personal security
- Subjective well-being

Material Conditions
- Income and wealth
- Jobs and earnings
- Housing

Today

SUSTAINABILITY OF WELL-BEING OVER TIME
Requires preserving different types of capital:
- Natural capital
- Economic capital
- Human capital
- Social capital

Tomorrow

Source: OECD, 2013
MEASURING INCLUSIVE GROWTH
Inclusive Growth: Developing a measure of Multidimensional Living Standards (1)

• Applying well-being framework to develop an overall measure, needed to quantify and analyse policy trade-offs

• No aggregate measure of 11 dimensions but of some key dimensions

• Simplest case: combining income levels and income inequalities: the income-based measure of living standards
  
  – Measure of average household income corrected for deviation of target group from the average

  – Target group: median, bottom 10%,...a normative choice

Living standards = income of target group

\[ W = W \left( y_1, y_2, \ldots, y_N \right) \]

General

\[ W = \left( \frac{1}{N} \sum y_i^{1-\tau} \right)^{\frac{1}{1-\tau}} \]

CES specification

\( y_i \): income of household group \( i \)
\( \tau \): 'aversion to inequality':
\( \tau = 0 \rightarrow W = \bar{y} \)
\( \tau = 1,5 \rightarrow W \approx \text{median}\ (y) \)
\( \tau = 10 \rightarrow W \approx \text{bottom decile}(y) \)
Social welfare function (2)

Presentation as

\[ W = \bar{y} [1 - I(y_1, y_2, \ldots y_N, \tau)] \]

Average Adjustment for distribution

\( \bar{y} \): average HH income

\[ I(y_1^*, y_2^*, \ldots y_N^*, \tau) \equiv 1 - W / \bar{y} : \]

Kolm – Atkinson inequality measure:

relative distance of target group from average
Simplest case: Income-based measure of living standards

Target group: median household
Average annual percentage change, 1995-2012
Inclusive Growth: Developing a measure of **Multidimensional Living Standards (2)**

- But our work on well-being tells us to go **beyond income**
- 2 most important factors for people’s life assessment in addition to income:
  - **Jobs** (low risk of unemployment)
  - **Health**

- Measure of **Multi-dimensional Living Standards** adjusts income-based measure for risk of unemployment and differences in life expectancy vis-à-vis best performer
Equivalent income (y*) =

Household real disposable income
less monetised loss due to unemployment
less monetised loss due to lower life expectancy than best performer in the sample

Multi-dimensional living standards:

\[ W^* = W \left( y_1^*, y_2^*, \ldots, y_N^* \right) = (\bar{y} + \bar{\mu})(1 - I) \]

Growth is inclusive if \( W^* \) rises
Choice of variables

- **Income**: Household real disposable income
- **Jobs**: unemployment
  - strong determinant of subjective WB
  - refinement: unemployment by duration or outflow rate
  - alternative: employment rate: captures differences in labour market participation
Choice of variables (2)

- **Health**: Life expectancy
  - Morbidity preferable?
  - But: data availability and aggregation
  - Also, significant variance between countries and socio-economic groups
  - Likely to be more accentuated in developing countries and emerging economies
Valuing health and jobs with shadow prices that reflect average preferences

<table>
<thead>
<tr>
<th>Panel regression:</th>
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<tr>
<td>$LS_{j,t} = a_j + b_t + \alpha \log y_{j,t} + \beta^T T_{j,t} + \beta^U U_{j,t} + \varepsilon_{j,t}$</td>
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- **LS**: Life satisfaction
- **y**: HH real disposable income
- **T**: Life expectancy
- **U**: Unemployment rate

- Compensating differentials for T and U as constant share of HH income
  - 1 year of life expectancy ≈ 5% of income
  - 1 %pt of unemployment ≈ -2% of income
SOME RESULTS
Decomposition of average growth in MLS between 1995 and 2012

USA – AUS: similar GDP/cap and real HH income growth
But unemployment declines in AUS, life expectancy rises and inequality effects are small
⇒ Growth in living standards AUS>USA
Subperiods: EU and US before the crisis (1995-2007)...

Decomposing growth in multidimensional living standards for median households (X)

- **Stronger income growth in the US**
- **But longevity increases less rapidly than in the EU**
- **Income of middle class in the US grows less than average income**
... and during the crisis, 2007-12

Similar effects in EU and US due to the crisis, drop in multidimensional living standards (X):

- *Increase in unemployment*
- *Very weak income growth*
- *Increase in inequalities, also in the EU*

But note: continued differences in the evolution of longevity
In normal times, income and longevity growth are the main contributors to growth in MLS (+1 year of longevity = +5% in income).
Accounting for growth of living standards during the crisis, 2007-2012

Strong impact of rise in unemployment on MLS growth during crisis (+1ppt unemployment = -2% income)

=> GDP does not reflect the ‘true human cost’ of the crisis!
USA higher income levels than AUS
But overcompensated by differences in LE and inequality
Inclusive Growth: What’s next?

- **Measurement agenda:**
  - Timeliness and completedness of data
  - Testing robustness of MLS measure
  - Alternative measures for the jobs dimension: long-term unemployment

- **Break-down by gender and level of education**

- **Introduce inequalities in health**
Unequal opportunities from good health can be large and will likely increase the impact of inequality.

Gap in life expectancy among men at age 30 by education

Years of life expected for men with tertiary education less those for men with below upper secondary, 2010.

Source: Eurostat database complemented with national data for Austria, Netherlands and Switzerland.
Assessing the impact of various growth-enhancing policies on the level and distribution of income, jobs and health (and other well-being dimensions)

For example:
- Who benefits most from structural reforms?
- Easing job protection legislation (e.g. reducing duration of unemployment benefits or stepping up job search and activation programs) has positive effects on employment but also important (negative and positive, resp.) distributional effects – what is net effect?
- Environmental regulation may have negative effects on productivity and income growth but positive effects on health
Thank you!

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Additional slide: median households not necessarily benefiting from GDP growth...

Source: OECD Income Distribution and Annual National Accounts Databases.