PROJECT SYNDICATE Print

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Green Domestic Product?

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SANTIAGO – One of the recurrent themes at the United Nations' spectacularly unsuccessful Rio+20 summit in June was the need to change how we measure wealth. Many argue that we must abandon our "obsession" with Gross Domestic Product and develop a new "green" accounting standard to replace it. In fact, doing so could be a serious mistake.

GDP is really just an account of the market value of all goods and services. This sounds like a good indicator of wealth, but, as is frequently pointed out, it includes things that do not make us richer and leaves out things that do.

For example, if people are not compensated for the harm done by pollution, its adverse effects will not be included in GDP. If we pay to clean up pollution, this increases GDP, but no wealth has been created. Likewise, there is economic value produced when wastewater is naturally cleaned by wetlands, but no transaction has occurred, so it is not counted in GDP.

It is worthwhile to consider these limitations of GDP as a measure of wealth. And it could make sense to produce a better GDP, which adds uncounted benefits, subtracts the costs of externalities, and excludes activities that generate no wealth. Unfortunately, many of the proposed "green" substitutions, however well intentioned, may not address these limitations adequately and could, in fact, produce worse outcomes.

One prominent example reported in the run-up to Rio+20 and used to support "greening" GDP centered on the Nakivubo Swamp in Uganda's capital, Kampala, where wastewater flows from the city toward Lake Victoria. Without the swamp's purification services, a study showed, Kampala would need a sewage plant costing at least $2 million a year.

According to economist Pavan Sukhdev, the former head of the United Nations' Green Economy Initiative, the point was simple: "It's going to cost $2 million per year to do what the swamp was doing for free, and they don't have that money." Thus, swayed both by the uncounted benefits from wastewater treatment – estimated at up to $1.75 million a year – and the potential outlay to build a sewage plant, Kampala decided to protect the area. "Economic logic prevailed," says Sukhdev.

The Nakivubo Swamp is an excellent example of the need for careful valuation of the environment. Such information is crucial for making good decisions. For example, if the wetland were to be destroyed to make way for a new district, we know that its benefits would have to be at least $1.75 million higher than the costs.

But there is also a significant risk of political misuse of such information. Kampala's decision-makers decided to protect the area. In other words, they rejected ever considering alternative possibilities for the area.

Green campaigners often seek such outcomes, but they are entirely unjustified. The swamp is close to the city center and its industrial center, and there is a land shortage in Kampala. In all likelihood, the net benefits of job creation and economic growth that could result from creating a new district (in place of the swamp) would be dramatically higher than the $1.75 million. There is a reason why few large, rich cities, if any, have undeveloped wetlands in their midst.

If green measures are used to shortcut the political process, we can actually end up worse off, because countries will be deprived of jobs, wealth, and welfare, while relatively small environmental benefits will be achieved. The Nakivubo Swamp is not a case of economic logic prevailing, but exactly the opposite – a failure to consider all options and choose the best.

Imagine if our ancestors had made a similar valuation in the past, deciding to protect swampland at all cost. Much of lower Manhattan would still be a swamp, rather than being turned into the powerhouse of New York City, at a huge cost to society.

In general, green accounting may end up being more biased than conventional GDP measures. Green GDP does include uncounted losses, so it avoids the problem of overestimating our wealth, but it fails to account for the potentially much larger benefits of innovation.

For example, the World Bank claims that in order to be green, we need to take into account that consuming fossil fuels will deprive future generations of those resources. In reality, burning fossil fuels over the past 150 years has enabled us to be free to create and innovate an amazingly richer world of antibiotics, telecommunications, and computers. These will further enrich the future, but are not counted.

Moreover, as we have burned fossil fuels, we have simultaneously found new resources and discovered new methods, such as horizontal fracturing, which has dramatically increased the availability of natural gas while driving down its cost. All of this leaves future societies amazingly richer – but would be missed in green GDP measures.

In practice, green accounting might easily have led our forefathers not to cut down forests, because this would entail losing a valuable resource. But converting forests to agriculture led to cities and civilization. Innovation and substitution followed, which ultimately produced many more calories and much more wealth.

Most policymakers still focus on GDP, because, while not perfect, it is strongly correlated with highly prized real-world outcomes. A country with higher GDP generally has lower child mortality rates, higher life expectancy, better education, more democracy, less corruption, greater life satisfaction, and often a cleaner environment.

So, while green accounting certainly can play a role, we must not allow it to become a roadblock to development.

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