

Written evidence submitted by the Matthew Lesh, Head of Public Policy, Institute of Economic Affairs

Introduction

The Institute of Economic Affairs ("IEA") welcomes the opportunity to submit to the Environmental Audit Committee's inquiry on Aligning the U.K.'s economic goals with environmental sustainability.

The IEA is the U.K.'s original free-market think-tank, founded in 1955. Our mission is to improve understanding of the fundamental institutions of a free society by analysing and expounding the role of markets in solving economic and social problems. This submission is authored by Matthew Lesh (Head of Public Policy). The views expressed are those of the author and not those of the Institute (which has no corporate view), its managing trustees, Academic Advisory Council, or other senior staff.

The Committee is investigating whether the U.K.'s economic goals – as measured by GDP growth – is consistent with environmental sustainability. The inquiry is built on Professor Sir Partha Dasgupta's claim that 'GDP does not account for the depreciation of assets, including the natural environment [and] therefore encourages us to pursue unsustainable economic growth and development' (Dasgupta, 2021). Dasgupta's solution uses an alternative measure: 'inclusive wealth'. This could include produced capital (tools, machines, buildings & infrastructure), human capital (knowledge, aptitude, education, health & skills) and natural capital (plants, animals, air, water, soils & minerals).

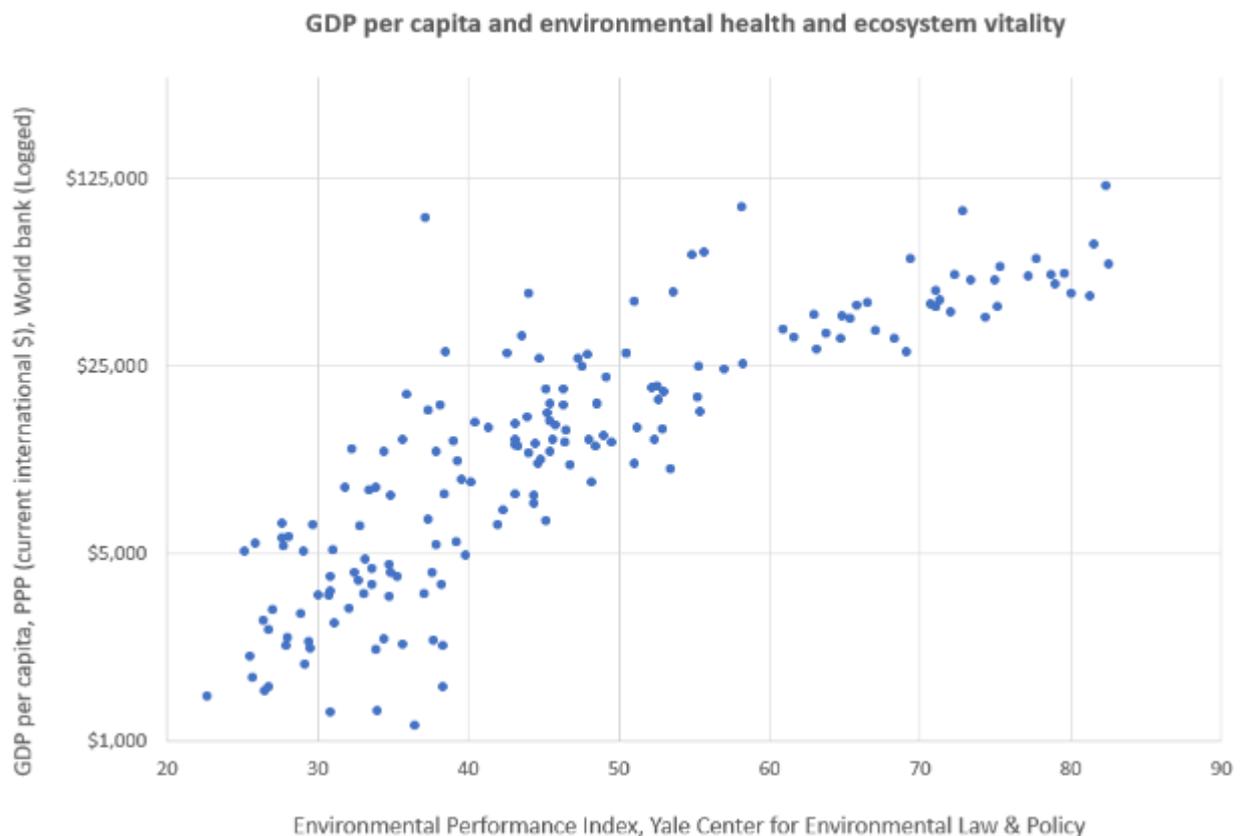
This submission challenges moving away from GDP and towards 'inclusive wealth'. Firstly, GDP, while imperfect, is a suitable proxy for prosperity and need not come at the expense of the environment. Secondly, aggregated measures like 'inclusive wealth' are less valuable than specific measures for policymakers and the public. Thirdly, the straightforward way to account for environmental depreciation is to price negative externalities rather than changing measures.

A healthy environment is not in conflict with GDP growth

GDP refers to the final market value of all goods and services produced within a country during a period, a measure of the total output. It is far from a perfect proxy of wellbeing. There are measurement issues, such as figuring out what a nation produces in a global supply chain, factoring in quality improvements or estimating the actual value of public sector contributions. GDP does not include valuable activity that is not sold on the market, from child raising to charity volunteering. GDP was designed with maximising short-term employment – accordingly focuses on current consumption rather than capital investment that boosts growth rates over time. Politically, an excessive focus on GDP encourages problematic and excessive state interventions. Sir John Cowperthwaite, a governor of Hong Kong, famously refused to compile statistics on the gross output of Hong Kong on the basis that it would just lead to the temptation to unnecessarily 'manage' the economy (Monnery, 2017).

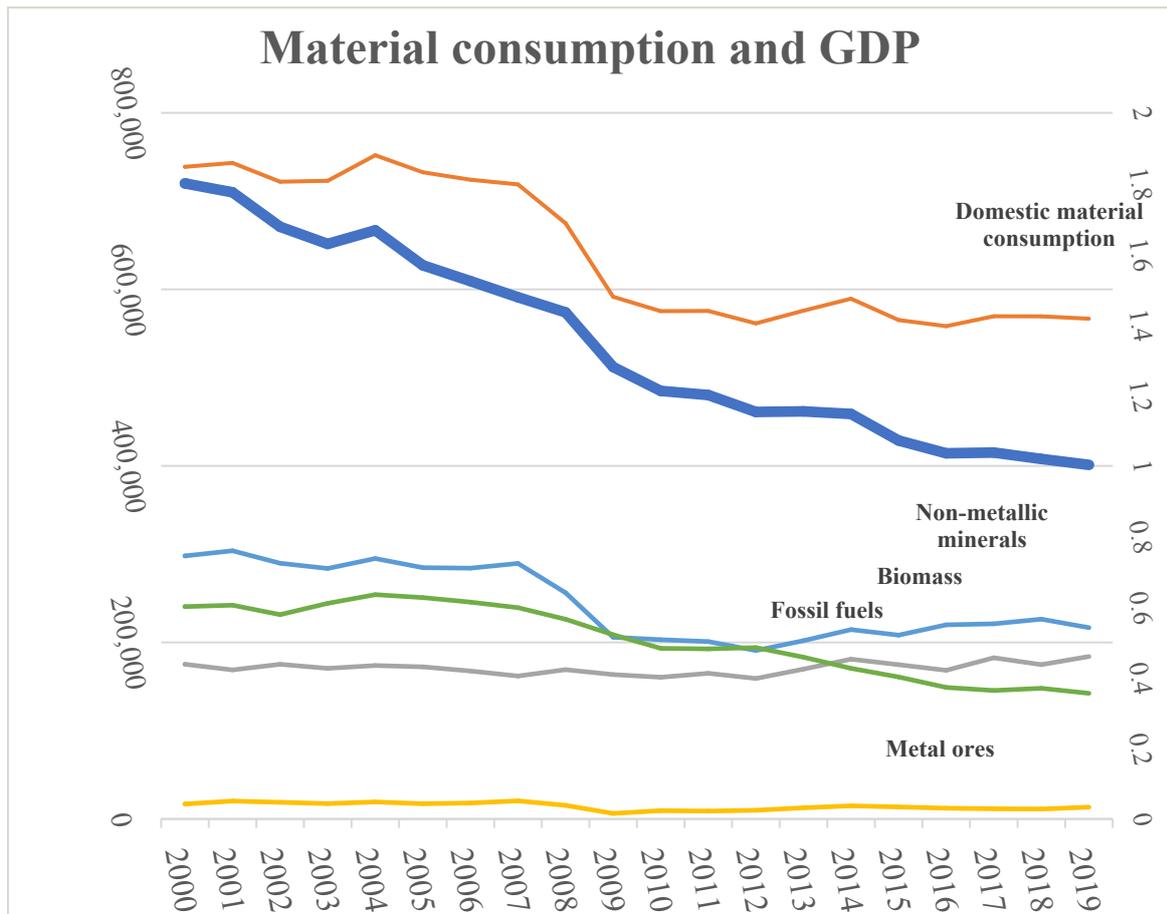
Nevertheless, GDP does have some value. Economic output and employment play an outsized role in human satisfaction. GDP is positively correlated with plentiful other measures of human progress like longer life expectancy and declining malnutrition (Rosling, 2018). The dramatic increase in GDP per capita over the last few centuries has marked a seismic change in our ability to live satisfying lives, communicate with each other, having access to plentiful food and entertainment. **The ability to produce more means individuals can consume a more expansive array and higher quantity of products, spend more time in good health and live longer and more fulfilled lives.**

Perhaps most strikingly, with relevance to Environmental Audit Committee, is the link between GDP and better environmental health and ecosystem vitality. Countries with higher GDPs tend to be better environmental stewards.

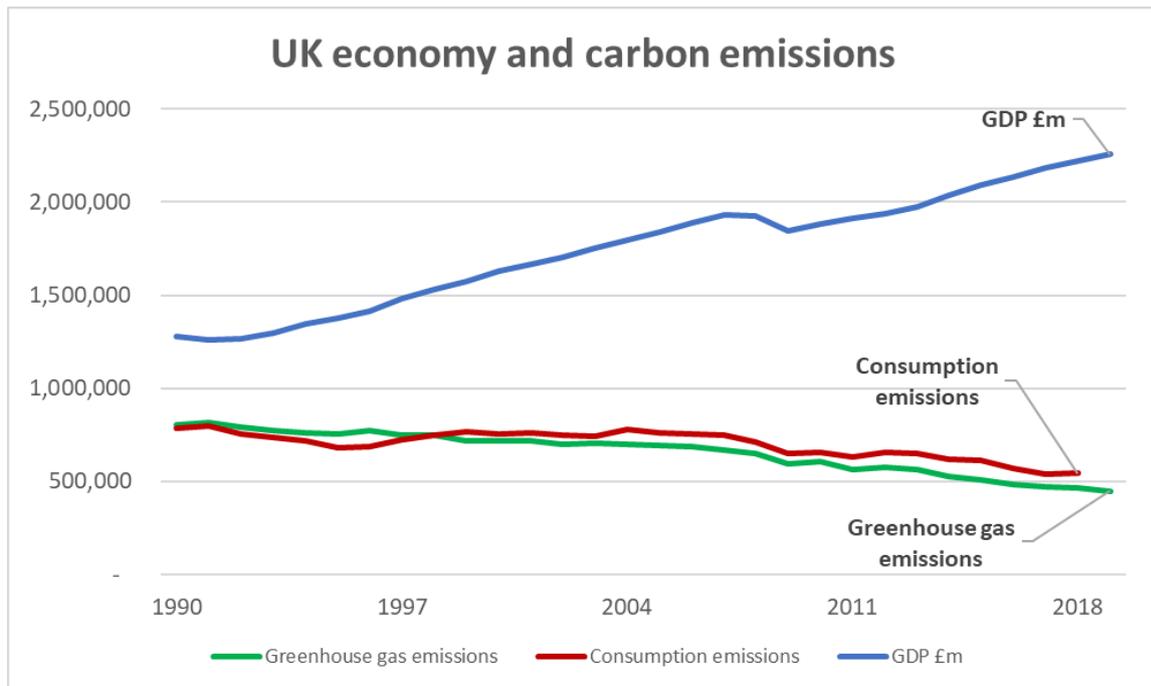


Countries with a higher per capita GDP perform better on the Yale Center for Environmental Law and Policy's Environmental Performance Index, which considers 32 measures including air quality, drinking water, biodiversity and habitat, fisheries, and climate change. This is sometimes referred to as the 'Environmental Kuznets Curve': the tendency for environmental measures to worsen in the initial stages of development but, over time, improve as people become more interested in and capable of protecting the environment (Alam et al., 2016; Shafik, 1994). There is a clear need to reduce carbon emissions to address climate change. But this cannot be achieved, either politically or environmentally, by diminishing the importance of economic growth and broader prosperity.

There is no need to reject economic growth, as conventionally measured, to protect the environment better — quite the contrary. Economic growth is typically achieved by boosting productivity which means, by definition, using the same or fewer inputs to achieve more outputs. Or put differently, getting 'more from less' (McAfee, 2019). The U.K. economy has grown for decades while using fewer resources and fewer carbon emissions. We are now producing more food with less fertiliser, water, pesticides, and land. We are making cans with less aluminium and cars with less steel. This isn't because of central direction or changing economic targets, but because of prices and the incentives built into the market system that strives towards efficiency and innovation. The economy has also dematerialised, or put differently, become more technically advanced and knowledge-based so physical things are no longer the only source of our growth. This came along with the computer, the internet and other digital technologies.



We have made substantial progress in the face of environmental challenges: resources have not run out, the hole in the ozone layer is shrinking, there are fewer oil spills, and per capita greenhouse emissions are falling. Environmental progress is most striking in more affluent, developed countries, which have reduced air pollution, cleaned previously putrid rivers like the Thames, and opened green spaces for public enjoyment. If anything, humanity needs more economic growth to achieve the resources and innovation to address issues like climate change.



GDP is not an end in itself but rather an enabler of greater human prosperity. Policymakers do not exclusively focus on GDP. The decision to levy high and growing taxes – to fund a welfare state, defence and more – has a detrimental impact on economic growth yet is decided to be important. Since March 2020, governments across the world have opted to protect human life by putting in place restrictions to limit the spread of Covid-19 at an enormous cost to economic growth. Nevertheless, among many conflicting goals and priorities, policymakers continue to strive for GDP growth to enable a higher quality of life. **GDP is the worst way to measure human prosperity – except for all the others that have been tried.**

There is limited value in aggregated measures

The notion that GDP should be replaced by an aggregate measure that considers broader factors is not a new demand. There has been significant previous discussion about concepts like the 'gross national happiness' or the 'human development index'. Yet these alternative measures have not proven popular or useful by policymakers. A key reason is that an aggregate inevitably contains less useful information than individual measures (Booth, 2012).

A statistician could create a measure that combines **Healthcare outcomes, Educational attainment, Crime levels, and Economic output (HECE)**. But if the aggregate measure is to be improved, it must immediately be disaggregated to identify and improve the component parts. So, in other words, the only way to enhance HECE outcomes will be to focus on H, E, C or E. A specific focus on improving hospital patient outcomes would mean focusing on the health metrics compared to a criminal justice reform plan that focuses on crime metrics. So combined measure will be less beneficial for policymaking than each measure.

The same issue applies to 'inclusive wealth'. If a policymaker were seeking to improve 'inclusive wealth', they would immediately need to disaggregate the component parts to focus on, such as air quality, school outcomes, or machinery investment. There would be little subsequent value in recombining the different measures. Or put differently, an increase in local air quality would have a direct, positive impact on people's quality of life, while a slight increase in 'inclusive wealth' would

be quite distant and irrelevant. The more local and narrow a measure, the more relevant it is to facts on the ground or meaningful change.

The other central issue with aggregating is the lack of consensus about what outcomes should be maximised, or values should be balanced and traded off in policymaking decisions. Should we prioritise equality, justice, or freedom? Friendship, marriages, or academic rigour? Creativeness, openness, or innovation? Air pollution, animal welfare or resource depletion? How does one weigh each one of these concerns? These are all important and worthy causes, and policy may (or may not) have a role. But to do so, policymakers must focus on the specific issue. It is unclear how combining them does very much. Realistically there may be no optimal way to assess human prosperity. There are limitless alternative priorities and measurement tools, with no consensus about what it means to give the 'good life' or what value should be maximised. Individuals in a free society are, ideally, given as much liberty as possible to decide what is in their interest.

More specifically, it is conceptually muddled to suggest that a concept like 'inclusive wealth' can replace GDP. The measure of a stock (the total) cannot substitute for a measurement of a flow (the increase over a period). For example, the ONS concluded that the 'natural capital' of the U.K., the economic contribution by farmland, woodland, mountains, minerals, hydrocarbons and the marine environment, to be £761 billion over 100 years (Office for National Statistics, 2018). *The Times* compared this figure to the size of the overall economy in the same year (£1.9 trillion) (Gosden, 2018). But this wrongly compares the stock of natural wealth to the flow of annual growth in the economy. A more accurate comparative point for natural capital would be household wealth, estimated to be around £10 trillion. This comparison led Tim Worstall of the Adam Smith Institute to conclude that measuring natural capital is a good idea, however, its importance should not be overestimated:

'Certainly, we'd miss it if it were gone, decidedly miss it. But the interesting outcome of this measurement of natural capital is quite how much of our living standards doesn't stem from it at all but instead simply from the collective efforts of us humans in adding to, rather than extracting from, the value of that natural world.' (Worstall, 2018)

The best way to address environmental issues is to use the price mechanism

The notion of 'inclusive wealth' is meant to focus policymakers on addressing the issue of natural capital depletion. The protection of the natural environment or an issue like climate change, in which there are negative externalities from market activity, may very well be genuine issues of concern to policymakers. Indeed, while GDP is correlated with positive environmental outcomes, it does not contain any information about resource depletion. But a new aggregate measurement does not address the underlying issues.

In the case of climate change, the straightforward solution is the introduction of a carbon tax that would require market actors to internalise the external impact of their activities. A carbon tax would ensure cost-effective carbon reduction, encourage innovation, and limit rent seeking. There would be challenges, including calculating out the social cost of carbon, addressing the impact on industry, and compensating taxpayers to minimise the regressive implications. Nevertheless, a carbon tax would address concerns that economic growth measures fail to consider environmental depletion, as market actors would already pay the costs.

On the other hand, the extent to which policymakers should be concerned about resource depletion is questionable. From Thomas Malthus to Paul Ehrlich's *The Population Bomb* and the Club of Rome, there is nothing new about the notion that humanity is on the verge of running out of resources to sustain our population (Ehrlich, 1997; Meadows et al., 1972). Yet society has grown much larger, become better fed, and resources have become more abundant. In 1980, economists Julian Simon and Paul Ehrlich bet about the price of five metals in a decade. Ehrlich thought they would be higher; Simon thought discovery and more efficient usage would lower prices. Simon was right. Prices declined by more than half over just a decade.

We do not run out of resources because markets respond dynamically to scarcity. If a resource is running short, the prices increase. Price rises send signals to users of the resource to embrace scientific invention to be more innovative, be conservative in their usage, and substitute alternative resources (i.e. transitioning from whale oil to kerosene). A higher price also incentivises existing producers and entrepreneurs to find more of the resource or develop an alternative (i.e. the invention of plastic to replace ivory). In the longer run, this market dynamic leads back to lower prices. Humanity is not on the verge of running out of industrial society's mineral or metal building blocks (Worstell, 2015). In other cases, like coal or natural gas, the likely outcome of various policies to tackle climate change will be resources left in the ground. In sum, humanity can overcome the challenge of limited resources with a functioning market system.

February 2022

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