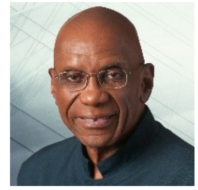

# Economic Letter July 2022


**The Human Development Index is the Best Measure of Economic Success**

Even though they know that GDP is a very imperfect measure, economists have settled on this value as the best available indicator of economic performance since the 1960s. However, since 1990 we have had a new indicator, the Human Development Index, which addresses some of the most troubling weaknesses of GDP as a measure of the success of economies.

The Human Development Index corrects for three major defects of the GDP measure: a dollar buys different amounts of any product in different countries; the residents of a country with better and more comprehensive health services live better lives those with the same income in a country with health services that are not up to standard; and the same is true for education.

The Human Development Index is made up of three indices, for income, health and education. To calculate the index for income we begin with the national income per person, and we correct for differences in the purchasing power of the same US dollar in every country included in the index. In a country where products are cheaper and the dollar goes further (Trinidad, for example), the average income is bumped up so that it reflects the fact that consumers in that country can buy more than a consumer in the Bahamas can afford with the average Trinidadian's income. The result of this exercise, for all countries, is the Gross National Income at purchasing power parity, the first element in the index. The index for health is based on life expectancy at birth and the index for education is based on years of schooling.

The Human Development Index gives an indicator of the quality of life in the world's nations that accords with observation and experience. The 189 countries in the 2020 Human Development Index are divided into four groups, from the highest-scoring to the lowest. In the top group the fourth ranking country in the world is the tiny nation of Iceland, with a population of around 300,000, a reflection of the fact that life expectancy at birth there is 83 years, students can expect to spend 19 years in the educational system, and average incomes are sufficient to purchase US$55,000 worth of goods and services.

There were at least ten very small countries in the highest category of Human Development, including Costa Rica and Panama in Central America, and the Bahamas and Barbados in the Caribbean. The other tiny countries in the highest category are mainly European and Middle Eastern, with Mauritius the sole African country in this group. Residents of countries in this group are generally all literate, they enjoy long and healthy lives, adequate shelter with modern amenities and reliable and widely distributed public utilities and services. The remainder of the Caribbean sits in the next highest category, with lifestyles that are of lesser quality, but still free of scourges such as famine and widespread poverty, with the tragic exception of Haiti.

The Human Development Index provides a better appreciation of economic success and failure than does any other measure. The economic and financial crises in Iceland, Ireland, Latvia and Cyprus in the last two decades have not materially affected the quality of life in those countries, because there was no deterioration of health and educational facilities, and the crises did not diminish the countries' international competitiveness or attractiveness to investors. These countries all remain in the highest category of Human Development.

The use of the Human Development Index also offers a truer perspective of economic adjustment programmes, and in particular those which attract the financial support of the International Monetary Fund. The Fund was established to provide temporary accommodation to countries while they address the circumstances and policies which have left the economy short of foreign currency. The finance provided by the Fund is not suited for investment in hotels, factories, infrastructure, health facilities, education, or any aspect of the competitiveness or growth of the economy.

It should therefore come as no surprise that there is usually a disconnect between the International Monetary Fund's judgment of the success of its programmes of financial support, and the perception of the affected populations. The Fund is concerned that borrowers should not sacrifice the quality of life to ensure there will be adequate foreign exchange to service its debt in the future, and it will not knowingly conclude agreements with governments on such terms. However, the responsibility for implementing the adjustment strategy lies with the country. We should therefore only expect an improvement in the Human Development Index in the wake of a Fund programme if government has fully implemented an announced adjustment strategy. Even in cases where investment, reforms and systems upgrades have been made, the end of a three-year Standby Agreement will usually arrive before any improvements in health, education or international competitiveness have become apparent.

The use of the Human Development Index can also temper expectations about the impact of the exploitation of a new natural resource, as in the case of oil in Guyana, or the energy price windfall in Trinidad-Tobago. The country will have available a sudden abundance of foreign currency, and national income may rise sharply as a result. However, it will take much longer to upgrade health and education, public utilities and public services, and ensure that the benefits of the foreign currency windfall are distributed across the country and among various income groups.