Has GDP outgrown its use?

By David Pilling

Governments and the media obsess about it while statisticians endlessly fiddle – but what is the real point of GDP and can it ever be accurately measured?

What do the price of hair-salon services in Beijing and sexual services in London have in common? The answer is that, depending on how you measure them – or indeed whether you measure them at all – the size of the Chinese and British economies will expand or contract like an accordion.

In April, statisticians working under the aegis of the World Bank determined that China’s gross domestic product was far bigger than they had previously realised. China was, in fact, just about to overtake the US as the world’s largest economy, many years earlier than expected. The reason? Statisticians had been overestimating the prices of everything from haircuts to noodles. As a result, they were underestimating the purchasing power of Chinese people and thus the size of the economy.

Last month, British statisticians worked some magic too. They declared that the UK economy – admittedly only a fraction of China’s size – was 5 per cent bigger than previously thought. It was as if they had suddenly discovered billions of pounds in annual revenue at the back of the nation’s couch. Here the explanation was simpler. Among other tweaks to their methodology, statisticians started counting the economic “contribution” of prostitution and illegal drugs.

... Gross domestic product has become a ubiquitous term. It is how we measure economic success. Countries are judged by how much they have of it. Governments can rise and fall according to how effectively their economies create it. Everything from debt levels to the contribution of manufacturing is measured against it. GDP is what makes the world go round. Yet what exactly does it mean? Outside a few experts, most people have only a shaky understanding. In fact, the more you delve into the whole concept of GDP – one of the most centrally important ideas in modern life – the more slippery it becomes. In the words of Diane Coyle, an economist who recently wrote an entire book on the subject, “GDP is a made-up entity.”

Coyle is a defender of GDP as a tool for understanding the economy so long as we grasp its limitations. When I spoke to her by phone, she was nevertheless amused at what she called “the regular fandango” and “public ritual” that accompanies the quarterly release of GDP data.
Even though those numbers are often within the margin of error and routinely revised, we invest them with as much meaning as a priest does his liturgies.

The title of Coyle’s book, GDP: A Brief But Affectionate History, makes clear her basic allegiance to the concept. Yet, she warns, “There is no such entity as GDP out there waiting to be measured by economists. It is an artificial construct ... an abstraction that adds everything from nails to toothbrushes, tractors, shoes, haircuts, management consultancy, street cleaning, yoga teaching, plates, bandages, books and all the millions of other services and products.” The people who measure GDP, then, are not involved in a scientific enterprise, such as discovering the mass of a mountain or the longitude of the earth. Instead, they are engaged in what amounts to an act of imagination.

GDP is a surprisingly new idea. The first national accounts that resemble modern ones were produced in the US in 1942. It is not particularly odd that governments didn’t bother much about sizing up their economies before then. Until the industrial revolution, agricultural societies barely grew at all. The size of an economy was thus almost entirely a function of national population. In 1820, China and India made up roughly half of global economic activity by sheer virtue of the number of people who lived there.

Simon Kuznets, the Belarusian-American economist often credited with inventing GDP in the 1930s, had severe reservations about the concept right from the start. Coyle told me, “He did a lot of the spade work. But conceptually he wanted something different.” Kuznets had been asked by US president Franklin Delano Roosevelt to come up with an accurate picture of a post-crash America that was trapped in seemingly interminable recession. Roosevelt wanted to boost the economy through spending on public works. To justify his actions, he needed more than just snippets of information: freight-car loadings or the length of soup-kitchen lines. Kuznets’ calculations indicated that the economy had halved in size from 1929 to 1932. It was a far more solid basis on which to act.

When it came to data, Kuznets was meticulous. But what, precisely, should be measured? He was inclined to include only activities he believed contributed to society’s wellbeing. Why count things like spending on armaments, he reasoned, when war clearly detracted from human welfare? He also wanted to subtract advertising (useless), financial and speculative activities (dangerous) and government spending (tautological, since it was just recycled taxes). Presumably he wouldn’t have been thrilled with the idea that the more heroin consumed and prostitutes visited, the healthier an economy.

Kuznets lost his battle. Modern national income accounts include both arms sales and investment banking services. They don’t distinguish between social “goods” – say, spending on education – and social “bads” (or necessities) – say, gambling, repairing the damage after hurricane Katrina or preventing crime. (Countries without much crime miss out on related economic activity such as security guards and repairing broken windows.) GDP is amoral. It is defined simply as the total monetary value of everything that has been produced in a given period.

The first thing to understand about GDP is that it is a measure of flow, not stock. A country with high GDP might have run down its infrastructure disastrously over years to maximise income. The US, with its ageing airports and less-than-pristine roads, is sometimes accused of precisely that.

Neither is any account taken of depleted resources. China has been growing at 10 per cent a year for 30 years. That makes no allowance for the (presumably) finite oil and gas reserves it has been consuming. (The assumption is that technology will always come to the rescue.) Nor does it account for what economists call “externalities”, the by-products of growth, including pollution. How much it may eventually cost to clean up polluted rivers and restore denuded forests is of no concern to GDP.

Coyle told me GDP provided “no sense of the trade-off between present and future”. Innovation could help us find alternatives to finite resources, such as metals, but GDP took no account of sustainability. That left us vulnerable to “tipping points”, such as the sudden collapse of fishing stocks.

Even the mechanical business of measuring everything produced is not as easy as it sounds. Let’s take a loaf of bread, the example provided by economist Ha-Joon Chang when I went to see him in his cubbyhole of an office in Cambridge. When valuing the loaf, if we also count the yeast and flour that go into it, then we have double-counted, he said. Output is measured by value-added: we calculate the value of the bread minus the value of the intermediate inputs, produced for example by the miller. Bread is a relatively simple product. But try working out the value-added of a car or an iPhone, which rely on fiendishly complex global supply chains. No wonder the UN System of National Accounts, a how-to GDP manual, runs to more than 700 pages.

GDP is better at measuring quantity than quality, said Chang, who has recently published a book, Economics: The User’s Guide, in which he casts a mischievous glance over our treasured economic assumptions. Take a table setting of a knife, fork and spoon. In output terms, a setting of three spoons is equally good. In quality-of-life terms, clearly not. Coyle calls GDP an “artefact of the age of mass production”.

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Indeed, one of the biggest failings of GDP is how atrocious it is at capturing services. That is a bit of a problem given that services now account for two-thirds of the output of many advanced economies. Statisticians are pretty good at measuring things you can drop on your foot, such as bricks and iron bars. But they struggle to measure intangibles such as landscape gardening, jet-engine service contracts or synthetic derivatives. How do you compare the output of a brain surgeon in Brazil, a mechanic in Germany and an investment banker in Nigeria?

‘A society can still become ‘better-off’ without a rise in GDP’

Let’s go back to the example of the Beijing haircut. Since you can’t know the price paid for every haircut, you need to take a sample. You may determine that on average a haircut in Beijing costs half the amount of one in New York. But how do you know you are comparing like with like? Do you judge the quality of the haircut, the skill of the hairdresser, the brightness of the decor? How about the quality of the mid-snip banter? Should we judge a nurse’s efficiency by how many patients he or she sees in a day, or the quality of care provided? In strictly mechanical terms, you could increase the efficiency of a philharmonic orchestra by getting it to play concertos at twice the speed.

‘It’s growth without end and without purpose’

You could argue that this is missing the point. A service is worth what the market will bear. No one will pay to listen to a sped-up orchestra. Yet there is a more fundamental issue at stake. Is more of a given service always better? That is the clear implication of how we measure GDP. Take banking. Before the 2008 financial meltdown, the size of the financial industry in the US had risen astronomically to reach nearly 8 per cent of GDP by 2009. (That was partly the result of changes in how banking was measured.) Yet a bigger banking sector, as we subsequently discovered, was not necessarily a good thing. Much of its size owed to an increasing capacity to generate “sophisticated” products, some of which turned out to be toxic. Given the lengthy recession that followed the crash, you could plausibly argue that an expanded financial industry destroyed GDP rather than created it. If banking had been subtracted from GDP, rather than added to it, as Kuznets had proposed, it is plausible to speculate that the financial crisis would never have happened.

The medical industry is another example. The US spends about 18 per cent of GDP on healthcare. Much of that is eaten up by insurance, inflated drug costs and unnecessary procedures. Outcomes, in terms of life expectancy and years of healthy life, are not obviously better than in countries that spend half the amount. It’s worth asking, therefore, whether the US might be better off if healthcare spending contributed less to GDP, not more.

If some services are overemphasised, some are not counted at all. GDP mostly takes into account things that are bought and sold. Swaths of non-marketed activity are entirely invisible. The most obvious is housework. There is no monetary value at all assigned to cooking, cleaning, child-rearing and caring for older or disabled people at home. That is partly because such work, often done by women, is undervalued. It is also difficult to estimate. Yet not counting housework is in some ways absurd. In Japan, the government is campaigning to get more women to work in order to raise GDP. In many ways this is a good idea. Yet it’s still worth conducting a thought-experiment. Imagine that many of the nominally unemployed women are looking after children or elderly relatives. Now decree that each of those women should work in the house next door, where, for an hourly rate, they can look after their neighbour’s child or parent. Overnight, the GDP of Japan would be larger. But in terms of actual work performed, absolutely nothing would have changed. The only difference would be that grandpa would now wonder about the stranger looking after him – and the government would have found itself a new source of taxable income.

‘It’s growth without part of that elite, GDP growth has been, at best, irrelevant.

Growing inequality, a subject of sudden and urgent interest in advanced economies, is another reason why headline growth may miss the true picture. The performance of the US economy has been mostly exceptional for decades. Yet according to Robert Reich, former secretary of labour and now a professor at the University of California, Berkeley, median wages, adjusted for inflation, haven’t budged since the 1970s. Almost all the benefits of growth have gone to the top 1 per cent. If we’re not part of that elite, GDP growth has been, at best, irrelevant.

On the other hand, says Coyle, GDP is particularly bad at capturing one of the most important features of modern economies: innovation. So-called “hedonic accounting” seeks to adjust for the fact that equipment like computers is improving all the time. If you buy a computer today that has four times the computing power of the one you bought a year ago but costs the same, then in reality its price has fallen. Put another way, you are better off.

As author Jeremy Rifkin points out in his recent book The Zero Marginal Cost Society, the price of many products – online music, internet-enabled car-sharing, Wikipedia, solar energy, Skype – is tending to zero. How do we value economic activity if it doesn’t command a price? Not that long ago, millionaires died for want of antibiotics that today cost pennies. “Even if the market value of what you produce doesn’t actually go up,” Chang tells me in his Cambridge office, “if people are living better, eating better and having more leisure time, then you should say that this society has become better off.”

That raises the almost philosophical question of whether we need growth at all. The slow realisation that GDP is failing adequately to capture our economic and social realities has spawned a mini-industry in efforts to measure progress in different ways. Former French president, Nicolas Sarkozy, commissioned leading economists, including Joseph Stiglitz and Amartya Sen, to look into better

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At the heart of the GDP debate is an anxiety that our societies have been somehow hijacked by pursuit of a single data point. Their report, *Mismeasuring Our Lives: Why GDP Doesn’t Add Up*, concluded that our standard metric of economic wellbeing was not up to the job. Worse, they thought too much focus on GDP could send policy makers in the wrong direction — for example, expanding their banking industries and ignoring more basic things such as access to education or health. “If we have the wrong metrics, we will strive for the wrong things,” they concluded.

The best-known expression of GDP scepticism is sadly one of the most idiotic. The Bhutanese Gross National Happiness index, which purports to capture human progress in more holistic terms, doesn’t bear much scrutiny. A much better metric, the human development index, which takes into account life expectancy, literacy and education as well as standard of living, puts Bhutan 140th in the world, two up from the Republic of Congo. (Norway is top and Niger, at 187, bottom.) Bhutan’s “Gross National Happiness” looks like an attempt to cover up its poor performance.

A more serious probing of what might be called the “growth myth” — the idea that the pursuit of GDP is the be-all and end-all — was undertaken by Robert Skidelsky, a renowned economic historian. Together with his son, moral philosopher Edward Skidelsky, he wrote a book, *How Much is Enough? Money and the Good Life*. The question addressed is what drives people in affluent societies to seek ever more wealth when they know, intuitively, that this fails to bring them extra happiness.

The Skidelskys accept that poor countries need growth to catch up with western living standards but they wonder why affluent societies are so growth-obsessed. Their starting point is a 1930 essay written by John Maynard Keynes, *Economic Possibilities for Our Grandchildren*, in which he assumed that, as consumption reached certain levels, the incentive to work harder would tail off. (Another failing of GDP is that it takes no account of how many hours people work.) In the age of abundance, Keynes thought, people would naturally forego the chance to consume ever more in favour of leisure. He imagined that, by now, none of us would be working more than 15 hours a week.

Some months ago, I caught up with Skidelsky, the elder, in Hong Kong. I asked him what had gone wrong with Keynes’ theory. We were sitting on the terrace of a five-star hotel. As we talked, helicopters took off for Macau bearing gamblers to the baccarat tables, where they would try to win yet more money. Why were humans so insatiable? One reason was that wants were relative, he said. Money conferred status. So having “enough” meant having more than other people. If everyone were well off, we would all fly to our exclusive Caribbean retreat only to find the beach full of similarly well-heeled people and no one with much inclination to bring us Martinis and canapés.

Another reason was inequality. A fifth of British people lived below the poverty line, he said. Rather than redistribute wealth better, as Skidelsky advocated via a basic income, the thinking was to enlarge the pie further. That obliged us to stay on a constant growth trajectory, which put us on a never-ending treadmill. “It’s growth without end and without purpose,” he said.

The Skidelskys’ book has been criticised for assuming to know what is good for people and where the limits of their desires should be. Coyle, for one, profoundly disagrees with the thesis. The pair’s notion of the good life, she told me, came from a particular stratum of British society: “a fine glass of claret, a good book and Radio 3 on in the background”. The problem was that they didn’t allow for changing wants. Nor did they give much credence to innovation, much of which they brushed off as an illusion created by devious advertisers. Coyle thought innovation was real. “Would you give up the internet or new flavours of breakfast cereal?” she asked. “I don’t want a professor of economic history telling me what I can choose and what I can’t.”
At the heart of the GDP debate is an anxiety that our societies have been somehow hijacked by pursuit of a single data point. No one seriously imagines that simply making an abstract number bigger and bigger can be a worthy goal in its own right. Yet GDP has become such a powerful proxy for what we do hold dear that we find it hard to see past it. Few economists are blind to its many limitations. Most, nevertheless, give the impression of wishing to maximise it at all costs.

Coyle argues that we should invent new ways to reflect economic reality. She advocates what she calls the “dashboard approach”. The Better Life Index, developed by the Organisation for Economic Co-operation and Development, for example, allows users to compare the performance of countries according to 11 criteria ranging from income and housing to health and work-life balance. By plugging in the criteria you value most you can see how a particular economy performs. If, say, employment is your priority, then Switzerland and Norway are best. If, on the other hand, you’re more interested in a combination of high income and education, then the US is the place to be.

In theory, this approach would allow voters to decide what is important and politicians to craft policies to achieve desired results. In practice, the combination of multiple criteria measured according to multiple yardsticks renders the exercise subjective and fuzzy. GDP may be anachronistic and misleading. It may fail entirely to capture the complex trade-offs between present and future, work and leisure, “good” growth and “bad” growth. Its great virtue, however, remains that it is a single, concrete number. For the time being, we may be stuck with it.

David Pilling is the FT’s Asia editor

Illustrations by Lucas Varela

Photographs: Getty; Bloomberg

It GDP growth appears anemic enough to hurt the stock markets, it will be replaced with an index that will.

Egee84
This is one of the best articles to have appeared in this newspaper.

NeilW@MMT
"we invest them with as much meaning as a priest does his liturgies.”
And for the same reason. It's a belief system.

_astrolavos_ 
I am really impressed by the approach of a really democratically calculated GDP that is being proposed!

FriesWithThat
"Bhutan’s Gross National Happiness looks like an attempt to cover up its poor performance.”
Indeed, it is such a bad idea that David Cameron proposed something similar in 2010.

RiskAdjustedReturn
I’d have been interested in an analysis which focused on GDP metrics as they relate to Debt-to-GDP ratios. For instance, jet engine exports probably help pay for imports, but perhaps housework may not.

minatomirai
I think Pilling could have chased the rabbit down the hole a little further, but given the length it is understandable. Mental health is another component of the bigger picture of human activity which has been woefully neglected by the statisticians.
Just another day in Babylon.

Tarqu1n
I have long ago given up looking at GDP figures concocted by states or National banks. I do so because they are constantly being re-defined, or do not catch up with new forms of economic activity until years after they started, or ignore black markets and other illegal activity. GDP belongs in the lexicon of Humpty Dumpty. It means exactly what you want it to mean, nothing more and nothing less.

My father asked a Treasury economist in the 1970s why - since Britain’s balance of payments had only been positive in 6 years since 1940 - it had not gone bust. He was told the Treasury then estimated Britain's off-shore economic activity to be twice the size of that measurable on-shore.

I have a minor proof of this myself. My business is legal and conducted entirely with companies outside the UK. Though I pay taxes on my income I have never been asked if this derives from exports or domestic trade.

China perhaps the world’s largest economy measures changes in its economy by extrapolation from the change in rail freight traffic. I kid you not.
If prostitution and illegal drugs account for 1 out of every 20 pounds of the British economy, it may be time for those to be conducted under some sort of legal framework - as revolting as that may be.

Then you'd have the Fed and the BoE trying to stimulate them.

In the US, at least, they count all government expenditures (the ones that aren't entitlement programs) as valid GDP. So, borrow $100 Billion, hire a bunch of drug and terror agents, and magic -- more GDP!

I agree that it's a little silly to count, for example, the value of Chinese production while ignoring the attendant negative value of unbreathable air.

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Qatar? The IMF and the CIA rank it #1 when considering GDP per person while The World Bank places Macau on top. No wonder the Chinese like to spend their time there?!

I was talking to a friend of mine about moving to Qatar. I don't know if I would raise its average IQ or increase it where I live now, but according to my companion, I wouldn't increase their per capita GDP at all. Then again, the atmosphere could be a good influence.

For all its flaws GDP is quantifiable in terms of money. That's what people focus on it.

If air and other environmental pollution is to have devastating impact on health should one not account for it by a negative annuity?

It very easy to manipulate with myriad of adjustments by deflators, inflators, weighting factors, suck thumbs and this is why it is popular, likely to be around for a long time.

It is often a marvellous benchmark guidance tool for policy makers. Why should one give it up for something better?

Please excuse me for making a mistake. China's GDP per person, according to the IMF, is $9,844.00.

I checked the IMF most recent stats for GDP per person by nation.

China: $9,944.00
Taiwan: $39,767.00
If this were a horse race, Taiwan would win The Triple Crown. China might just edge out Thailand and Tunisia with Costa Rica a distant second. No wonder China wants to include Taiwan. Their GDP per person would rise. It makes me think of the “briar” or hillbilly who moved from Kentucky to Tennessee, raising the IQ in both states.

Annalisa Burello

Thank you so much for writing this thought provoking article. I have been unhappy and dissatisfied with the way GDP numbers have been misused in so many ‘accepted’ ways. It is time that economists, rating agencies, politicians, international economic organisations and financiers start moving on from GDP as a measure of economic health to decide what a government should or shouldn’t do. As pointed out by this article, GDP is a FLOW, not a stock. It is like assessing a company purely by its GROSS REVENUES without any consideration for its costs of productions and level of indebtedness. No analysts in his/her right mind would do that. Companies are mostly ranked by their net profits and by the health of their balance sheet and so should countries. Their balance sheets should include levels of education, health, freedom, security, crime, natural resources, artistic inheritance, habitability, climate, geological stability and be offset against negative externalities such as pollution and resources depletion, environmental degradation, levels of public debt, balance of payments surplus or deficit, private debt, and so on. It might not be the equivalent of a ‘happiness’ index but it would be much more meaningful to politicians to decide where to spend our money and how.

pierre lichterowicz

John Stuart Mill 1848 , chap 1.2

"It is not so with the Distribution (vs production) of wealth. That is a matter of human institution solely. The things once there, mankind, individually or collectively, can do with them as they like. They can place them at the disposal of whomsoever they please, and on whatever terms. Further, in the social state, in every state except total solitude, any disposal whatever of them can only take place by the consent of society, or rather of those who dispose of its active force. Even what a person has produced by his individual toil, unaided by any one, he cannot keep, unless by the permission of society. Not only can society take it from him, but individuals could and would take it from him, if society only remained passive; if it did not either interfere en masse, or employ and pay people for the purpose of preventing him from being disturbed in the possession. The distribution of wealth, therefore, depends on the laws and customs of society. The rules by which it is determined, are what the opinions and feelings of the ruling portion of the community make them, and are very different in different ages and countries; and might be still more different.

MarkGB

GDP may be amoral, but governments are not. If changing the statistics you use, to show the result you want, to justify the agenda you hold is called 'lying', which is what I call it, then governments are immoral.

Governments use the Debt to GDP ratio to obfuscate the real state of the economy. This is done by over-stating nominal GDP and under-stating inflation, which means the nominal figure is falsely deflated in order to produce an over-stated ‘real’ GDP. This masks the relative size of the debt mountain. It also helps governments to encourage higher inflation and to describe this higher inflation as being ‘good for growth’, when what they mean is ‘necessary to avoid collapse’.

Thanks for this article - anything that makes us less easy to fool is a good thing.

Mysterion

GDP is useless for measuring human welfare. The level of life satisfaction in developed countries has been flat for decades despite huge growth. As a diachronic measure of welfare GDP has little correlation.

The attack on the Skidelskys is unfair. Most readers of the FT will take steps to minimise their own exposure, or that of their children, to harmful marketing i.e. that which create cravings which can never be sated, whether they are for shiny sports cars or plastic toys. They implicitly acknowledge that desires can be unhealthy and that there should limits on consumption. Its leisure pursuits and time with friends that most promotes our welfare and yet these unproductive activities tend to reduce GDP. The Skidelskys haven't proposed to audit Diane Coyle's lifestyle, only to persuade her away from consumerism.
The reason GDP has remained the dominant measure of economic activity is precisely because it is not a measure of well-being, but of the employment of remunerated resources, the reason Roosevelt tasked Kuznets with developing it in the first place.

Value added is simply the sum of market wages and profits - the higher it is, the greater the possibility of employing workers and capital (and also taxing them) in the formal economy. Since wage employment and returns on investment (for whatever purpose - war, prostitution, digging and refilling holes) are practically a higher value than other concepts of well-being (or are at least a sine qua non for them given the present capitalist organization of society), GDP is indeed the proper measure, at least in the short term. And full employment is also one of the most powerful means of rectifying inequality.

@ohneeigenschaften Full employment is indeed a means of rectifying inequality. However, it rests on unquestioned assumptions. Why are not most people self-employed? Why are the barriers against self-employment so high?

A further issue is the commodification of labour, which does not receive the full value it adds through its work, which is a further cause of inequality.

The short term is not a good planning horizon. It is only the time horizon of a desperate reaction.

Value added is, by definition, something positive. How can we consider as positive a value created through negatives, such as war, prostitution, drugs (and the capital needed to fight their trade), an unhealthy environment?

The greater the valued added through these negatives, the lesser is the possibility of having a healthy society, which is the ultimate goal of employing people. You can have huge ROI with high employment on the short time and doom a society. Is that our goal?

Full employment at adequate wages (for example wages where the difference between the least and most paid employee is not higher then a certain %) is a mean of rectifying inequality. Full employment alone is not enough.

As an index of national well-being GDP is useless because it says nothing about distribution. Furthermore, negatives like the February floods could lead to an increase in measured GDP because of the cost of the clear-up.

As a target for government policy, aggregate land rental value would be a better measure. It is ascertainable and reflects the overall well-being of the estate of the realm, for example the value of the country’s infrastructure.

@Physiocrat GDP measures the aggregate welfare and that is not useless. There’s other measures that show its distribution.

GDP is utterly useless by itself, but remains needed to find out if the added value (and damages) economies produce are distributed or not and how. It gives us the total; then we have additional tools to analyze it and judge what is really happening, and those findings are much more important clearly than total GDP.
Realist

1. It is fairly common to use a range of indicators when judging the economy of a country or the state of its society, and, depending on the issue, use supplementary indicators / data (thus indicators relating to exports as well as GDP, among others, may be used where national external debt is being considered). GDP serves a useful purpose provided one is aware of its limitations.

2. One can see Mr Pilling is developing facility in reporting on economic issues / concepts from a particular perspective, and that is very welcome. The earlier piece on Ha Joon Chang was also a useful one.

DCDonald

Excellent, thoughtful article! Pilling is someone who (like Kay and Tett) can think carefully about a difficult question and share a highly informed and entertaining meditation. This is a welcome relief from the all-too-common FT fare of ideologically or politically-charged buzzwords strung together to rant against the 'evil' countries or grudging praise the 'good' ones.

marmora

Years ago people used to make an appeal to Common Sense notwithstanding Bertrand Russell's judgement that it was the metaphysics of barbarism. By any more favourable verdict of the idea, GDP does not satisfy the concept of Common Sense. In other words, its flaws should be apparent to even the most uneducated economists among us.

There are 3 ways of measuring GDP rejoicing under the names, the income method, the expenditure method and the consumption method. The three methods are inconsistent with each other; they do not take into account the underlying health of a given economy such as composition of imports, exports, credit and earned income as functions of growth qua/aka GDP.

GDP has a mantra quality to it; it is by no means a pejorative term. In fact, increases in GDP are supposed to induce that loving feeling in those exposed to this modern mode of communicating optimism.

Yet for all the reasons indicated here and in the article, it does not really signify anything really meaningful. An increase in GDP is unlikely to make anyone feel better or cure an ailing economy. Reliance upon it must surely be the greatest cop-out by those charged with fixing things since it is meaningless. It can be manipulated by QE for instance.

All those Wilson MacCawbers out there will surely argue that a greater guide to national well-being would be to have enough to live on, and work to produce something needed for wage with a prospect for developing it, refining it and making the business a going-concern unaffected by extraneous factors.

You can a massive balance of trade deficit, balance of payments deficit or a massive budget deficit and still have great GDP numbers. Some therefore instinctively regard it as a lie; a tool for politicians to use before general elections. Just one of a host indignities foisted on ordinary people who are continually patronised and disregarded.

Realist

@marmora

You write: "There are 3 ways of measuring GDP rejoicing under the names, the income method, the expenditure method and the consumption method."

I think when talking of three approaches as in the above quote, you might be referring to production, income and expenditure approaches. I suspect the label "consumption method" is not used and "expenditure" covers this aspect.

marmora

@Realist @marmora

Accepted that the Production Method is the more usual description but I have seen the method described also as the Consumption Method.
This is a very interesting article. It reminds me of the Human Development Index created by the UN which includes longevity and quality of life. As I recall, according to HDI, Japan and most of the Scandinavian countries were higher in rank than America.

You fail to mention GDP per person. I wonder why? Recently, I checked the data.

China: $7 - $8,000.00 per person.
Japan: $36,000.00 per person.
USA: $49,000.00 per person.

Are you avoiding these stats because they are an embarrassment to social engineers who criticize western democracies for the great divide between the rich and the poor? With China, you have a command economy with "Big G" beyond which you could imagine including endless programmes designed to guarantee outcome similar to those which our Leftist friends would advocate. Have you compared China's divide with Japan and America? I'm sure that you would find that Japan is the best place to live and China would come in 3rd.

Annalisa Burello
@thornton If you watch the documentary Manufactured Landscapes directed by Jennifer Baichwal about Edward Burtynsky's photography, you would not want to live in China for all the money in the world, which is exactly the point of this article. How do we measure freedom of speech? or an unbiased justice system? or freedom of movement? or universal vote?

Miss. Linda McDonald
the starting point is different. China will eventually have a higher gdp per capita.. over time.

MariannaNYC
Robert and Edward Skidelsky presented their book here in Berlin last year together with Harald Welzer ("Selbst Denken"). the bookstore presentation area was packed in a way in New York I had only seen a book signing by Tony Curtis! It was extremely interesting, as both books.

While I can understand Coyle's dislike to be told 15 brands of cereals are enough of a breakfast choice, IMO we are constanlty exploited and manipulated by marketing and I welcome the Skidelsky exortation to be a little less gullible and more critical. There should be a limit to amount of stuff we need to fill our life with. Sure having a 16th flavor available is possible, but we need to be more aware of what we are really giving up to have that 16th cereal flavor.

"If, on the other hand, you’re more interested in a combination of high income and education, then the US is the place to be"

Education in the USA? The USA may have most of the best colleges in the world, but, besides the cost, the rate of admission is 5-8%. Everywhere else the situation is below average in the civilized world.

http://www.nytimes.com/2014/06/29/upshot/americans-think-we-have-the-worlds-best-colleges-we-dont.html?_r=0

Like very much the idea of the Better Life Index instead of classic GDP.

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Kuznets vision of GDP made much more sense. It allowed us to have an idea of what things we produced which we good (or at least non harmful) for us. A GDP which does not consider that is quite pointless. Who would be reassured by of living in a country where GDP is high because arms, oil and healthcare are supporting the entire system?

"The medical industry is another example. [...].... the US might be better off if healthcare spending contributed less to GDP, not more."

I could not agree more and I was saying the same thing last week on an article of Robin Harding.

http://www.ft.com/intl/cms/s/2/c1149eda-fd39-11e3-8ca9-00144feab7de.html#axzz36XGppug

The example about "unemployed" working at home women with GDP increasing overnight if they worked next door for money doing exactly the same thing, is excellent !

"If we have the wrong metrics, we will strive for the wrong things," they concluded."... Exactly.
**Sovavia**

"While the GDP and the rest of the national income accounts may seem to be arcane concepts, they are truly among the great inventions of the twentieth century."

Please do not conflate (a) the measurement of an economy according to national accounts (including GDP, which is only one concept among many others) with (b) the use and misuse of economic statistics by powerful interests (informed or otherwise).

Imagine the following thought-experiment. If there were no GDP, what kind of rational response would there have been during the last crisis? Are we not better off with national income accounting than compared to the kind of response during the 1930s?

The existence of books is not responsible for illiteracy, just as the imperfect measurement of the economy is not the root cause of the public's economic and financial illiteracy.

In Japan, for example, nominal GDP (excluding unpaid housework) is an indispensable tool of economic analysis, especially in the aftermath of a financial crisis. What is so terribly wrong about using real GDP per capita in order to understand the case of Japan?

**RiskManager**

...and, calculate relative poverty on a global scale and no one in the West is in poverty at all.

**RiskManager**

Good article spoiled by an ever popular claim to poverty

"A fifth of British people lived below the poverty line. He said."

Yes, that would be the relative poverty statistic, not the absolute poverty that many in the world suffer. Relative poverty is really another way of expressing income inequality so poverty as a concept is debased by always confusing the two. A shame to see the usual thoughtlessness in an otherwise thoughtful piece.

**Lowmetal**

GDP is what ever the accountant says it is. Things that can be easily measured has to be meaningless because of market efficiency.

**Old School Canuck**

I agree with "UpDown"--more of this kind of economic discussion, please. Fundamental--and all the more interesting for being so. The calibre of the commentaries has also been first-rate (not always a given on FT lately, I'm afraid).

**Woorde**

Brilliant! Now... what alternative measure should we adopt...to measure what...and why.

**Clive Lord**

Wow! An article mentioning Robert Skidelsky's advocacy of a (Citizens')Basic Income! It was in the usual context of reducing inequality, yet only a few lines away, the two Skidelskys are quoted discussing whether growth is a good thing anyway. I have discussed the Cits BI in this, more important, context: clivelord.wordpress.com
Diane Coyle may be right that GDP could be fixed, and there are two basics which will always have to be addressed: how to raise taxes, and how to cope with or avoid loss of competitive ability. Both these can be achieved without growth, but either the Cits BI, or some better idea that no one has yet thought of will be necessary.

GDP is an abstraction of the everyday lived experiences of individuals as a "single, concrete number". In other words, it is another example of humanity’s obsession with missing the whole by narrowing our focus to easy to understand abstractions.

In this case it is GDP, but the same applies to most news stories, including anything about political posturing, nationalism or history, all of which are other abstractions that we think of as concrete.

There used to be the concept of net national, or domestic, product. Basically it was the total exchange of goods and services in monetary units less inflation. Not complete but corrected for inflation. Perhaps were it to be reincarnated and allowing for depletion of resources, say, and other “things” as well that were mentioned and unmentioned, might we have a clearer idea of how we stand now vs the past? Whatever happens, trying put a single data point on economic activity will still be an anomalous activity.

@Hunter net national product is still calculated. Note that real GDP (which is adjusted for inflation and changes in product quality) is the headline number that we talk about when we talk about GDP. Net national product adjusts for fixed capital consumed to allow production.

http://www.bea.gov/scb/account_articles/national/0398niw/maintext.htm

We use GDP as a rough measure to tell us about the extent of the tax burden and the size of the government in overall economic activity.

Great article David. And we moderns think God was ambiguous. Apprently, our new god is even more so!

There never can be a perfect measure of relative prosperity/ happiness of nations. All indices can only be approximations. GDP in spite of all shortcomings is probably the best measure so far. Like so many other things in this life, it may not be good enough, but the best there is.