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Don't Ditch the GDP

By Justin Fox

On the last day of April, the folks at the Commerce Department's Bureau of Economic Analysis will announce how much they think the U.S. economy grew--or didn't--in the first quarter of this year. This "advance" estimate of gross domestic product (GDP) will stand as the clearest indicator yet of whether the U.S. has fallen into a recession.

Until May 29, that is, when Commerce releases a revised "preliminary" GDP number. On June 26 comes the "final" first-quarter GDP, but even that won't really be final: in a few years there will be a "benchmark revision" that changes everything yet again.

This is not a tale of bureaucratic bungling. It's just evidence that compiling a reliable measure of all the economic activity in a country as big as this one is hard. Which is something to consider whenever you hear somebody arguing that GDP ought to be shelved in favor of some more holistic measure of economic well-being. Somebody like, say, French President Nicolas Sarkozy, who early this year appointed a high-powered task force--boasting not just one but two economics Nobelists, Amartya Sen and Joseph Stiglitz--to devise a GDP replacement. Similar "ditch-GDP" noises can be heard frequently from enlightened sorts who care a lot about the environment, health care, education and happiness.

Now, there certainly are measures of economic and societal success that we ought to pay more attention to. But ditch GDP? Perish the thought.

The measure has its roots in the Great Depression and World War II. First the priority was tracking the ups and downs (mostly downs) of the business cycle in the 1930s. Then military planners needed a better way to assess production capacity. The result was gross national product (GNP), which after the war soon became the standard means of keeping economic score. It was replaced in 1991 by GDP, which measures production in the U.S. as opposed to production by Americans, but the basic idea is the same. The concept conquered the world--with Germany deserving special mention as surely the only country ever to have produced a chart-topping pop song about GNP (Geier Sturzflug's Bruttosozialprodukt, in 1983).

Over the years, GNP and GDP have proved spectacularly useful in tracking economic change--both short-term fluctuations and long-run growth. Which isn't to say GDP doesn't miss some things.

Let's start with the pet concerns of Sarkozy's star advisers. Sen, a development economist at Harvard, has long argued that health is a big part of living standards--and in 1990 he helped create the United Nations' Human Development Index, which combines health and education data with per capita GDP to give a more complete view of the wealth of nations (the U.S. currently comes in 12th, while on per capita GDP alone, it ranks second). Stiglitz, a Columbia professor and former World Bank chief economist, advocates a "green net national product" that takes into account the depletion of natural resources. Also sure to come up in the French discussion is the currently fashionable idea of trying to include happiness in the equation.

The issue with these alternative benchmarks is not whether they have merit (most do) but whether they can be measured with anything like the frequency, reliability and impartiality of GDP. A National Academy of Sciences panel recommended in 2005 that the U.S. look into measuring household work, investments in education and health care and environmental assets--but as satellite accounts, not part of GDP. Says Katharine Abraham, a University of Maryland professor and former Bureau of Labor Statistics chief, who headed up that effort: "One problem with these expanded measures--why I wouldn't want to see them replace GDP--is the information you base them on is too tenuous."

As for happiness, much of the interest in it stems from the 1974 discovery by University of Southern California economist Richard Easterlin that the happiness of a nation's inhabitants didn't necessarily rise with its GDP. But the recent explosion in happiness surveys has enabled a soon-to-be-published reappraisal by the University of Pennsylvania's Betsey Stevenson and Justin Wolfers, who find that happiness tracks per capita GDP pretty closely. Money really does matter. GDP does too.

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