

What GDP Is Not

GDP is the most comprehensive measure of a nation's economic activity. Policymakers use GDP figures to monitor short-run fluctuations in economic activity as well as long-run growth trends. It is worthwhile, however, to recognize important limitations of the GDP concept.

Nonmarket Productive Activities Are Left Out

Because goods and services are evaluated at market prices in GDP, nonmarket production is left out (e.g., noted earlier, for instance, homemaker services). Intercountry comparisons of GDP overstate the gap in production between highly industrialized countries and less-developed nations, where largely agrarian nonmarket production is of greater importance.

The Underground Economy Is Left Out

Also left out of GDP are illegal economic activities and legal activities that are not reported to avoid paying taxes—the *underground economy*. Gambling and the drug trade are examples of the former. Activities not reported to avoid paying taxes take many forms; for example, repairmen who are paid in cash for services may underreport or fail to report the income. It is hard to estimate the size of the underground economy for obvious reasons. Rough estimates for the United States range from 5 to 15 percent of GDP.

GDP Is Not a Welfare Measure

GDP measures production of goods and services; it is not a measure of welfare or even of material well-being. For one thing, GDP gives no weight to leisure. If we all began to work 60-hour weeks, GDP would increase, yet would we be better off?

GDP also fails to subtract for some welfare costs of production. For example, if production of electricity causes acid rain, and consequently water pollution and dying forests, we count the production of electricity in GDP but do not subtract the economic loss from the pollution. In fact, if the government spends money to try to clean up the pollution, we count that too!

GDP is a useful measure of the overall level of economic activity, not of welfare.

GDP and Happiness

If it is not a welfare measure, one would not expect GDP to measure happiness. In recent years, however, there has been a great deal of interest in the relationship, or lack of relationship, between GDP and happiness. Surveys show that GDP and happiness, measured by "life satisfaction," have little relationship. People in Ghana are more satisfied with their lives than people in the United States; those in Nigeria are as satisfied as those in France. Although surveys may be unreliable, other evidence also indicates little relationship between GDP and various measures of happiness. Perhaps relative income in a society is more important than absolute income. Alternatively, income relative to past income may matter. In surveys early in this century, people in the former Soviet republics were least satisfied with their lives. Their incomes had on average declined.

In the Himalayan kingdom of Bhutan, the government has focused on gross national happiness (GNH), not GDP. The United Nations provides indices of social welfare as alternatives to standard measures of GDP. It would take us too far afield to consider these alternatives, but note that happiness is another thing that GDP is not.