Does High GDP Mean Economic Prosperity?

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Economists traditionally use gross domestic product (GDP) to measure economic progress. If GDP is rising, the economy is in good shape, and the nation is moving forward. If GDP is falling, the economy is in trouble, and the nation is losing ground.

What Is GDP?

GDP is equal to the total monetary value of all final goods and services that have been exchanged within a specific border over a set period of time. For the United States, GDP usually means the dollar-amount value of all purchased goods and services over the course of one year. This includes purchases from private for-profit, non-profit and government sectors. If

you buy a roast chicken for $10, GDP increases by $10.

There is a direct and logical sense in which wealth can measure well-being. All economic value is subjective—free market prices are determined by how much better off individuals believe a good or service can make them. Greater access to wealth literally means greater access to things that can improve your life. On the other hand, those who produce wealth in an honest way have literally created the most value for others, at least in an economic sense.

So, in some sense, a higher GDP should equate to greater human progress, because it means more valuable goods and services have been created. Scratch a little deeper, however, and GDP does not even capture this traditional economic value very well.

How GDP Misses the Mark

GDP can increase after a car accident or a major flood. GDP can grow rapidly during a war or after a terrorist attack. If all of Chicago caught fire once again and burnt to the ground, the rebuilding effort just might boost GDP. This is because GDP is very susceptible to the broken window fallacy — false signals of rising prosperity when obvious destruction has taken place.

However, from the perspective of a citizen living with the day-to-day realities of life, GDP can be rather misleading.This is why the genuine progress indicator (GPI) was created in 1995 by a socially responsible think tank called Redefining Progress. It was developed as an alternative to the traditional GDP measure of a nation's economic and social health. Read on to find out what GDP fails to reveal about a country's economic prosperity and how the genuine progress indicator works to make up this gap.

GPI Variables

Although GPI and GDP calculations are based on the same personal consumption data, GPI provides adjustment factors—variables designed to apply monetary values to non-monetary aspects of the economy. The variables fall into the following general categories:

- *Personal consumption* - As mentioned, this is the same data used to calculate GDP.
- *Income distribution* - GPI is adjusted upward when a greater percentage of the nation's income goes to the poor because an income increase provides a tangible benefit to the poor. GPI is adjusted downward when the majority of a nation's increased income goes to the rich. GDP is only concerned with the sum of all exchanged goods and services, not the distribution of their proceeds. If five individuals each earn $200,000, GDP treats that the same as one individual earning $800,000 and four individuals earning $50,000 each.
- *Housework, volunteering, higher education* - GPI factors in the value of the labor that goes into housework and volunteering. It also factors in the benefit of an increasingly educated populace. (For related reading, see: *How Much Is a Homemaker Worth?*)
- *Service of consumer durables and infrastructure* - Money spent on durable goods is treated as a cost, while the value the purchases provide is treated as a benefit. Long-lasting goods that provide benefits without having to be frequently repurchased are viewed positively. Goods that wear out quickly and drain consumers' wallets when they must be replaced are viewed negatively. GDP, on the other hand, views all expenditures as good news. Infrastructure spending by the government is treated similarly: If spending provides a long-lasting benefit, GPI views it as a positive; if spending drains the government's coffers, GPI views it as a negative. Again, GDP views all spending as positive. If the U.S. government spends $2 billion developing a new jet warplane that never lifts off the ground, GDP treats that the same as a hospital delivering $2 billion of cheap medicine or a tech entrepreneur selling $2 billion worth of new

software.

- *Crime* - Rising crime costs money in legal fees, medical bills, replacement costs and other outlays. GDP views this spending as a positive development. GPI views it as a negative. (For related reading, see: *Something Gross in GDP*.)
- *Resource depletion* - When wetlands or forests are destroyed by economic activity, GDP views the events as good news for the economy; GPI views these events as bad news for future generations.
- *Pollution* - Pollution is good news for GDP. Industry gets paid once for the economic activity that creates pollution and again when money is spent to mitigate the pollution. GPI views pollution as a negative.
- *Long-term environmental damage* - Global warming, nuclear waste storage and other long-term consequences of economic activity are factored into GPI as negatives.
- *Changes in leisure time* - Prosperity should lead to an increase in leisure time. Most modern workers would disagree with this theory. GPI views an increase in leisure as a positive and a decrease in leisure as a negative.
- *Defensive expenditures* - Defensive expenditures refer to medical insurance, auto insurance, health care bills and other expenses that are required to maintain quality of life. GPI views these as a negative. GDP views them positively.
- *Dependence on foreign assets* - When a nation is forced to borrow from other nations to finance consumption, GPI factors in the result as a negative. If the borrowed money is used for investments and benefits the country, it is viewed as a positive.

The Calculations

GPI calculations take all of these variables into consideration, using economic statistics and mathematical formulas to place value on them. That value is then added to or deleted from the GDP figure. For example, expenditures on consumer durables are a negative adjustment.

Data from the National Income and Products Accounts are used to estimate the cost of consumer durables and the figure is subtracted from GDP.

The amount of money that foreigners invest in the United States is subtracted from the amount Americans invest overseas. A five-year rolling average is used to determine whether the U.S. is becoming a lender or a borrower. If our economy is healthy enough that we are a net lender, the resulting number is added to GDP. If we are borrowing to sustain our economy, the resulting number is subtracted.

GPI Is Not Yet Mainstream

While GPI factors in many of the variables that have a direct impact on peoples' quality of life, capitalist economies tend to focus strictly on making money. Because of this, GPI has not yet been widely adopted in such economies, although its proponents note it has been reviewed by the scientific community and recognized for its validity. GPI-type measures are in use in Canada and in some of Europe's small and more progressive nations. Over time, other nations might slowly adopt the concept as environmental concerns move into the public's consciousness. (For related reading, see: *What's the Difference Between GDP and GPI?*)