# GDP Is a Tool of Politics, Not Economics

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[*GDP: A Brief but Affectionate History* by Diane Coyle.]

GDP is undoubtedly the most known and widely used metric of macroeconomic performance. As a former economic advisor to the English Government, Diane Coyle is able to masterfully recount known problems and complications with measuring GDP while highlighting some new concerns pertinent to any student of economics. Unfortunately, the valuable insights in the book are scattered throughout sporadic, sometimes partisan, chapters that read more like a casual history of world events than a history of GDP.

Like many historical events, it is hard to attribute the rise of national income accounting to a single person, place or moment in time. Coyle argues that an interest in national income accounting gained a critical mass in the late nineteenth century. Specifically, the rapid economic growth during the industrial revolution gave rise to an interest in measuring the economy (p. 12).

While the industrial revolution may have sparked an interest in national income accounting, ultimately political forces and world economic events shaped modern GDP. During the Great Depression, British economist Colin Clark and American economist, Simon Kuznets, were charged with producing national income accounts. Kuznets' numbers showed an economy that had been cut in half between 1929 and 1932. President Roosevelt cited the figures in announcing the new recovery program and subsequently used supplemental figures for in budget proposals. According to Coyle, the GDP numbers validated FDR's desire to act (p. 13).

Though Kuznets is credited with generating the first national income accounts, they did not reflect a method he desired to use. Kuznets wanted to create a measure that could be used to understand welfare, not simply output. He thought advertising, financial industries, speculative activities, subways, and certain types of expensive urban housing, among other things, including government spending ought not be included (p. 14). However, these original definitions of national income would show the economy shrinking if private output available for private consumption was used for government action. "The Office of Price Administration and Civilian Supply, established in 1941, found that its recommendation to increase government expenditure in the subsequent year was rejected on this basis" (p. 14).

Hence national income, from its inception, was created and defined with political motives; that is to serve an interventionist, Keynesian ideology. Since the definition of 'national income' is defined by economists, what constituted 'income,' 'output,' etc., were determined based on the intellectual climate of the time along with the political and military needs of the moment (p. 11). Ultimately, "Kuznets lost and wartime realpolitik won," giving birth to a practical tool that upholds and economic and political legacy to this day (p. 16)

Coyle reminds us that Keynes himself advocated for national income accounts: Keynes wrote, "Every government since the last war has been unscientific and obscurantist, and has regarded the collection of essential facts as a waste of money" (Keynes, 1940). Inspired by Keynes's writings on the matter, UK economist Austin Robinson commissioned his government to collect more statistics (p. 18). National Accounts, the rise of econometrics, and Keynesian ideas were all mutually enforcing, and they all served to solidify the importance of collecting information for GDP and to justify calculating GDP as a measure of output—which ought to include government activity since it acts as a stimulus on an economy prone to demand deficiencies. "The availability of national accounts statistics made demand management seem not only feasible but also scientific" (p. 20).

The new scientific status of both GDP and Keynesian economics encouraged widespread use and improvement of national income accounting. The UN, IMF, and World Bank came to depend on GDP numbers as key indicators of development and key indicators regarding the necessity of aid. Since GDP became the gold standard as a development metric, it is no surprise that many developing countries resisted attempts to improve GDP on political grounds if the improvements would make those countries appear richer, and thus ineligible for aid. Coyle describes one case in which China debated a revised GDP figure (revised to take account for the purchasing power of Chinese citizens using a PPP conversion) with the World Bank—ultimately convincing the World Bank to lower China's GDP per capita below the threshold level for concessional loans (p. 53).

Coyle's book documents several methodological changes to GDP calculations and their political implications. The following are some of the most striking: "Ghana between 5 and 6 November 2010, its GDP increased by 60 percent overnight, turning it officially into a "low-middle-income" country. The reality had not changed, but the GDP statistics had, because the country's statistical agency had updated the weights used in calculating the price index, and consequently real GDP, for the first time since 1993" (p. 31). After similar adjustments, Nigeria added a whopping 89 percent to GDP overnight in 2014, and Kenya added 25 percent (p. 32). Of course, there is no 'objective' platonic ideal of GDP nor how one ought to calculate it. Any definition can be justified depending on one's worldview; hence, the politically expedient options seem to be chosen.

These methodological changes and simple revisions to previous GDP calculations can be the source of major political and economic events. As an example, Coyle cites the 1976 crisis in the UK. Chancellor of the Exchequer Denis Healey abruptly requested an emergency loan from the

IMF. Upon a simple revision of the GDP numbers, Healey commented, “If we had had the right figures, we would never have needed to go for the loan.” Based on these comments, Coyle speculates: “Who knows whether Mrs. Thatcher would have won the same kind of election victory if her predecessors in power had not had to bring in the IMF?” (p. 37).

Coyle argues that one of the most consequential defects of modern GDP is the metric’s inability to account for innovation. Economists have known that there is a ‘quality bias’ in GDP figures: increases or decreases in prices are often divorced from the change in quality of a product. Some products have gone up in price, and GDP has subsequently gone up, but the quality of these products has increased faster than their prices. Conversely, some products have dropped in price while their quality has increased exponentially; some products carry a zero price. The inaccuracies in GDP as a result of innovation are likely significant. Consider: software, TV, and other parts of the information sector have made up only 4 percent of GDP for the past 25 years while zero price Google search gives consumers an estimated $150 billion of value annually (p. 135).

Coyle tells a rich and compelling story about the history of GDP. Unfortunately, the book seeks to answer a history of thought question using the chronological history of macroeconomic events in the past century. Coyle obviously believes this is acceptable since, “the story of GDP since 1940 is also the story of macroeconomics” (p. 20). This author doubts the link is as clear as Coyle claims; her formatting does a disservice to her research and readers for two principal reasons.

Firstly, by telling the history of macroeconomic events, Coyle is forced to rush through a century of events and concepts which lead her to explain and opine on several topics unrelated to the core of the book. Her explanations are often brief, and the short opinions offered during historical explanations are controversial to say the least. For example, pertaining to the financial crisis, “the arrogance was the triumphalism about the prevailing model of economic growth. It was based on technological innovation, of course, but also on financial market deregulation and the broader ideology of 'free markets, and the globalization of finance and trade" (p. 95). Coyle remarks that the crash can be blamed on those who forgot the "purpose of business" (p. 97). The format Coyle chose for telling valuable history on GDP is handicap, but we will not consider such orthogonal issues in a review on GDP.

Secondly, writing about GDP via a chronology of macroeconomic events requires Coyle to put the history of GDP into a boom-bust narrative: From inception to the 1970s are labeled the 'golden years' and again from 1995–2005 there is a period of expansion followed by an economic crisis. Certainly GDP influenced these events, but the reader cannot determine from the evidence presented in this book that these historical events were the principal drivers of economic thinking as they relate to GDP. This author has little doubt that since GDP was ultimately conceived in the political arena, world macroeconomic events will play a role in its historical development, but the link between all macroeconomic events and GDP, as this book suggests, seems exaggerated—at least in the 150 pages Coyle devotes to the topic.

While Austrian economists will certainly disagree with much of Coyle's commentary in the book, we can agree with many of her conclusions regarding government use of GDP over the past century. Coyle writes, "they overlooked the fact that by design GDP would increase when those policy levers were operated, at least in the short term. The definition of GDP was constructed around Keynes's model of how the economy works" (p. 65). The GDP measure is defined to support a certain school of thought. Coyle is also concerned about sustainability issues, which are absent from GDP; here, again, Austrians can sympathize since the measure makes no distinction of the trade-off between present and future consumption—boosting GDP requires increasing present production and consumption. GDP figures do not account for the long run sustainability of production—

capital is homogenous and thus perfectly substitutable so far as GDP is concerned.

Austrians have long been critical of how increased government spending may very well stimulate the economy, and boost GDP numbers, but at the cost of malinvestment. Coyle explains a similar mechanism is at play in the financial sector:

UN System of National Accounts introduced the concept of "financial intermediation services indirectly measured," or FISIM. This current measure compares banks' borrowing and lending rates on their loan and deposit portfolios to a risk-free "reference rate" such as the central bank's policy rate, and multiplies the difference by the stock of outstanding balances in each case (p. 102).

Hence, banks that take on more risk contribute more to GDP; Coyle points out that so far as GDP is concerned, more risk is counted like more growth. Therefore, current GDP methodology not only encourages malinvestment by only considering present spending, but also encourages malinvestment by favoring risky investments.

After reading Coyle's book, any reader will be more skeptical about our ability to understand macroeconomic health or fluctuations from GDP data. Upon further reflection it is unclear that GDP can simply be improved. After all, GDP is a measure of aggregates that are the outcome of a complex and spontaneous market process; those aggregates cannot be directly acted upon. Any attempt to boost those aggregates will only distort what they were originally proximate measurements of.

Coyle disagrees. Despite documenting 150 pages worth of the measure's shortcomings, she concludes that GDP is superior to all currently available alternatives; she even writes, "GDP, for all its flaws, is still a bright light shining through the mist" (p. 145). This is of course a *non sequitur*: regardless as to whether GDP is the 'best' measure we have, that is not a reason for continuing to use it.