

National Income and Its Discontents

By N. Gregory Mankiw

Other things equal, would you prefer more income or less? Unless you are one of the lucky few who have reached satiation, you would probably prefer more. A higher income would allow you to buy more of whatever it is you happen to enjoy: books, video games, fine dining, etc. That more income is better than less is almost axiomatic.

For much the same reason, when macroeconomists study the economy as a whole, the most important statistic in their toolbox is Gross Domestic Product (GDP), which measures a society's total income and its total expenditure on newly produced goods and services. This profoundly important measure is the focus of Ehsan Masood's new book, *The Great Invention: The Story of GDP and the Making and Unmaking of the Modern World*.

During the Great Depression of the 1930s, in response to requests from policymakers to figure out what was going on, economists including Simon Kuznets and Richard Stone began drawing together a variety of disparate data sources to summarize the state of the economy in a single number. Given the complexity of modern society, it was a Herculean task. Kuznets and Stone would go on to win Nobel prizes in 1971 and 1984, respectively, for their efforts.

Masood devotes most of the book to a discussion of the outsized role that GDP has come to bear on policy. In the view of Masood and a number of other critics of GDP, there are too many things that this metric leaves out.

One of the missing elements is inequality. For example: A society in which 10 people earn \$20,000 a year and 2 earn \$200,000 has the same GDP as one in which all 12 people earn \$50,000. Yet no one would view those economies as equivalent.

Also omitted are quality of life factors that aren't reflected in monetary measures. Two nations can have the same GDP per person, but if one has greater literacy and longer life expectancy, most would agree that we should rank that one higher than the other.

A third element missing from GDP is the environment: If an economy produces its in-

come by dirtying the air and water or threatening endangered species, it would make sense that those costs should be debited when gauging a nation's overall prosperity.

Masood expresses great admiration for those who have tried to transcend GDP by developing more inclusive measures. The United Nations, for example, has introduced a Human Development Index, which is essentially a weighted average of income per person, literacy, and life expectancy. Similarly, some "ecological economists" have tried to add to GDP an imputed dollar value of the benefits we derive from a healthy environment. Most radically, the nation of Bhutan has focused its attention on Gross National Happiness, which is less a metric than a philosophy which asserts that policy should be attuned to spiritual values and not just to the material standard of living.

So what do mainstream economists make of these efforts? (Disclosure: I am one of them.) We tend to have three reactions. First, we agree that GDP is an incomplete gauge of well-being. Second, we point out that although it is far from perfect, GDP does, in fact, correlate with many non-monetary features of society that people care about. Higher-income nations can, for instance, afford more schooling and better healthcare. Third, we are skeptical that any single statistic can capture everything, but we tend to believe that national leaders are usually smart enough not to focus on a single statistic when choosing among alternative policies.

Let's return to your personal situation. You prefer more income to less, but remember that pesky phrase "other things equal." You might turn down a pay hike if it required taking a dangerous or unpleasant job. You might choose not to increase your income by working longer hours if it meant spending less time with your family. To make the right decisions, you don't need one number that somehow incorporates your income, your job's attributes, and the quality of your family relations. Producing such a measure would require many questionable judgments, and having one in hand would not make it any easier to face life's inevitable tradeoffs.

The same is true of GDP. It is a key gauge of national prosperity, but no single statistic can capture everything that matters about a

The Great Invention
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Ehsan Masood
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society. Masood is on the wrong track when he yearns for a single new metric that will supersede the current measure. But his highly readable book is a useful reminder of what GDP is and what it isn't.

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