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OPINION

Dead Rats Can Raise GDP, Economists Have Lowered It

By Vladimir Popov and Jomo Kwame Sundaram |

BERLIN and KUALA LUMPUR, Jul 21 2020 (IPS) - GDP has been increasingly challenged on many grounds as a measure of economic and social progress. Clearly, GDP does not take account of other dimensions of wellbeing, natural resource depletion or environmental damage.

What increases GDP?

There is a humourous economic fable instructive about money-metric measures of economic progress. Two economic professors find a dead rat while on a long stroll. In disgust, the older don dares his younger colleague: "if you eat it, I'll pay you $10,000". The younger economist makes a quick cost-benefit analysis in his head, then accepts the challenge, to his colleague's surprise.

Vladimir Popov

Sometime later, realizing the enormity of his financial loss, the older man offers to reciprocate to get his money back. Feeling ashamed of being the only one to eat a dead rat, his younger colleague quickly agrees.

A few days later, feeling quite foolish about what happened, the younger don laments: "Looks like we both ate dead rats for nothing". The more senior professor reassures him, "Yes, but remember we increased GDP by $20,000".

Did gross domestic product (GDP) really increase? From a national income accounting perspective, the two 'meals', requested and paid for by the other, constitute paid services unlike, say, much care work by family members which goes unremunerated.

Indeed, there are many other controversies over measuring GDP.

Lower GDP better?
At the end of the 20th century, similar arguments were made regarding 'transformational recessions', i.e., the deep and protracted GDP contractions with the transition in former communist countries from largely collectively owned, centrally planned to much more privately-owned market economies in the 1990s.

The sharp declines were unprecedented in peacetime. The recessions lasted several years, and output fell by more than half in some countries!

'Shock therapy' was said to be necessary to overcome interrelated obstacles to progress in one fell swoop. Slogans such as 'no pain, no gain' were bandied around to justify and explain the hardship caused.

Jomo Kwame Sundaram

However, for some economists in the West, such falling 'redundant output', e.g., of tanks and Lenin statues, did not adversely affect the populations' welfare.

If only such redundant output was excluded from GDP measures, it could be shown that welfare did not decline.

Thus, for Åslund, the actual output decline was much less as "Socialism was a system of waste. Soviet production usually needed three times more inputs than a Western factory since costs were irrelevant to managers. Some of these losses represented inefficiency, others theft … The investment that was sheer waste should preferably be deducted from GDP".
Similarly, Gaddy and Ickes insisted that "value added can rise…even as domestic consumption, investment, and standards of living appear to decline". They argued that "measured GDP" in transition economies should, but do not accurately reflect "true value produced in the economy".
Military spending, armaments production
Åslund dismissed the recorded output contractions during the transformational recessions as "a myth", partly due to the unusually high share of defence spending in many 'socialist' countries (estimated at 15~17% of Soviet GDP in the 1980s), and its reduction during the transitions.

With the transitions, these shares were brought down closer to the "internationally normal level of about 3 percent of GDP". Åslund therefore recommended deducting 10% of GDP from statistical output losses due to transformational recessions.

For Gaddy and Ickes, less measured output due to lower defence spending represents a welfare gain, not loss, at least in such 'communist' economies: "This is an output fall, but welfare is certainly higher with lower defence production".

Åslund invokes a variant of this logic to recommend deducting the excess over "the internationally normal level of about 3 percent of GDP" from total output.

As these methodologies are quite arbitrary, one may well ask why not zero or the newly recommended 2% of GDP threshold for NATO member countries? And what about military spending and armaments production in other economies?

Defence spending has long been counted as part of GDP. Defence expenditure's share of GDP in the US was 40% in 1945 at the end of the Second World War, 15% in 1953 during the Korean War, and 10% in 1968 during the Vietnam War.

Arbitrary criteria

Soviet production may well have been inefficient, but so is most protected economic activity throughout the world. Soviet monuments may be dismissed as value subtracting, but what about those erected elsewhere, whether or not politically controversial?

Such arguments also largely ignore evidence of welfare declines due to such transformational recessions, e.g., of much reduced life expectancy.

Also, unlike much else produced in the former Soviet Union, armaments were among the few internationally competitive exports, bringing in valuable foreign exchange.

Excluding some economic activities, but not others, when calculating a country's national income is also problematic as it is difficult to agree on what economic activities should be included to enhance welfare.

Clearly, setting criteria for what to include or exclude when calculating national income is typically a quite arbitrary exercise.

Measuring progress

Unsurprisingly, there is now a large and growing literature on the shortcomings of national income accounting, proposing many alternative indicators of economic and social progress.

Interestingly, US and European statistical offices only started national income accounts after the Second World War using Simon Kuznets' pioneering work for the Roosevelt administration.

The Soviet Union had introduced an accounting system in the 1920s to compute its national income. This differed from GDP, e.g., by not recognizing value added by services, or by not depreciating fixed capital stock, but otherwise included data needed for computing GDP.

Undoubtedly, GDP related measures have long been criticized, and we should strive to do better to measure and improve human progress. After all, as Robert F. Kennedy famously quipped over half a century ago, GDP "measures everything, except that which makes life worthwhile".