The Lady Gaga Fix: How the U.S. Is Rethinking GDP for the 21st Century

The government will soon start counting creative endeavors like songwriting as well as research and development when it measures the economy. It's about time.

ZACHARY KARABELL, MAY 31 2013, 2:59 PM ET – THE ATLANTIC

(Reuters)

This week the government released yet another revision of first-quarter economic growth showing that the U.S. economy grew a tad less than initially reported -- 2.4 percent rather than 2.5 percent. This revision was hardly consequential, but over the summer the Bureau of Economic Analysis will unveil a new way to calculate the overall output of the United States. And that revision will be dramatic.

Over the past few decades, gross domestic product (GDP) has become the *prima inter pares* of economic statistics. It is not only a measure of national economic output, it is a proxy for "the economy." The number exerts substantial influence on what we spend collectively and individually, not just in the United States but throughout the world. China has five-year plans with GDP targets, and the European Union has rigid - albeit loosely enforced - rules about how much debt a government can take on relative to its GDP. It is, in short, a big-deal number.

And it is treated as an accurate gauge of economic activity. That would have come as something of a surprise to its inventors. Simon Kuznets, the economist most responsible in the 1930s for the formation of the national accounts that provide the data for GDP, was always disturbed that domestic work, volunteer work and, of course, transactions in cash are invisible in GDP. The choice to leave those out may have made sense - after all, what is the market price of preparing a family meal? - but it underscores that GDP is not a complete measure.

The BEA is the government agency responsible for compiling U.S. GDP figures, and it is always looking for better ways to measure. Every few years it tweaks its methodology. This time the tweaks will be more than incidental. In fact, not only will they add several hundred billion dollars -- statistically, at least -- of annual output, but they will also begin an overdue transition of these numbers away from the 20th century, when they were invented, and into the 21st, where we now live.

The change is relatively simple: The BEA will incorporate into GDP all the creative, innovative work that is the backbone of much of what the United States now produces. Research and development has long been recognized as a core economic asset, yet spending on it has not been included in national accounts. So, as the *Wall Street Journal* noted, a Lady Gaga concert and album are included in GDP, but the money spent writing the songs and recording the album are not. Factories buying new robots counted; Pfizer's expenditures on inventing drugs were not.

As the BEA explains, it will now count "creative work undertaken on a systematic basis to increase the stock of knowledge, and use of this stock of knowledge for the purpose of discovering or developing new products, including improved versions or qualities of existing products, or discovering or developing new or more efficient processes of production." That is a formal way of saying, "This stuff is a really big deal, and an increasingly important part of the modern economy."

The BEA estimates that in 2007, for example, adding in business R&D would have added 2 percent to U.S. GDP, or about $300 billion. Adding in the various inputs into creative endeavors such as movies, television and music will mean an additional $70 billion. A few other categories bring the total addition to over $400 billion. That is larger than the GDP of more than 160 countries.

The announcement has already received some attention, much of it negative. One website used the headline "U.S. GDP: America is About to Look Richer - But Don't Be Fooled." Criticism ranged from the accusation that the Obama administration is juicing the numbers to burnish its record to the belief that the new calculus only widens the gulf between those doing well and those struggling in today's economy. And because the revision significantly expands the statistical size of the economy, some fear it will be used as a spur to both austerity and complacency about the structural challenges we face.

It's true that simply restating overall output does not make anyone richer. People will have what they had before the numbers reflected it, and will continue not to have it if they didn't. The BEA will, in fact, restate all GDP going back to 1929 under the new methodology, which means that while the overall size of the American economy may increase, the historical ebbs and flows will remain roughly the same.

What's more, critics are partly correct that the new numbers will only accentuate the gap between those benefiting from education and skills that are pegged to the creation of intellectual property and those who do not. It has long been true that the real gulf in employment and opportunities is between those with college educations and skills to navigate in an idea-driven economy and those with skills for a manufacturing- or farming-driven economy. Recognizing the output of intellectual property highlights that. The new numbers may not make anyone richer, but they demonstrate that segments of our economy have done even better than previously thought, which means that those struggling to stay in place have fared even worse in relative terms.

That said, how we measure and what we measure shape our collective sense of how we are doing. The limitations of GDP will not disappear with this revision, but at least the numbers will better reflect the nature of today's economy. When GDP was created in the middle of the 20th century, manufacturing and output of goods was much more central. Our indicators today are very good at measuring mid-20th century industrial nation-states. They are less good at capturing the realities of 21st century economies fueled by ideas and services. This revision is the start of reframing our national numbers to reflect the economy we have rather than the one we had.

The new framework will not stop the needless and often harmful fetishizing of these numbers. GDP is such a simple round number that it is catnip to commentators and politicians. It will still be used, incorrectly, as a proxy for our economic lives, and it will still frame our spending decisions more than it should. Whether GDP is up 2 percent or down 2 percent affects most people minimally (down a lot, quickly, is a different story). The wealth created by R&D that was statistically less visible until now benefited its owners even those the figures didn't reflect that, and faster GDP growth today doesn't help a welder when the next factory will use a robot. How wealth is used, who benefits from it and whether it is being deployed for sustainable future growth, that is consequential. GDP figures, even restated, don't tell us that.

But the revision is still a major step, one that moves our indicators in a new direction. Between globalization of commerce and capital and technology, the nature of economies has shifted radically even as the way we have measured them has not. With the welcome change in how we assess GDP, we are beginning to measure the world we have, and that can only help us navigate it better.

"The Edgy Optimist" column is initially published at Reuters.com, an Atlantic partner site.

http://www.theatlantic.com/business/archive/2013/05/the-lady-gaga-fix-how-the-us-is-rethinking-gdp-for-the-21st-century/276439/