Comments on the criticism regarding the gross domestic product (GDP)

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Key words: Results, concepts, definitions and delimitations of national accounts, especially those concerning the GDP, are often criticized.

A major point of criticism is the fact that the GDP is not suited to measure welfare and prosperity. For example, environmental damages do not cause a decrease in GDP and more leisure time for the citizens does not increase the GDP. Although such criticism is objectively correct, it is not justified. The GDP is not meant to be a welfare indicator and it will never be able to fulfil that function.

There are two major reasons why we are not going to have a generally accepted standard measure of welfare. First, it would be necessary to develop and define – internationally and in consensus – what indicators should be included in such an overall indicator, and whether they should have a plus or minus sign; it is more than unlikely that agreement can be reached here.

The second, and much more serious reason is that – in contrast to measuring economic performance – there is no standard benchmark under which the various sub-indicators (such as negative effects of environmental damage or positive assessment of more leisure time, etc.) could be combined. So far, no-one has succeeded in creating such a benchmark and doing so will probably be even more difficult than inventing the “perpetual motion machine” or “squaring the circle”, simply because personal benefit might possibly be measured in ordinal terms, but never in ratio terms.

None the less the indicator GDP can be further improved, both in terms of concept and practical calculation. A major improvement could directly be implemented by using the **net** domestic product, rather than the gross domestic product, as an indicator of economic performance.

The reason is simple: Since the gross domestic product includes consumption of fixed capital, the economic performance shown is always too high; in Germany by about 15%. Consumption of fixed capital (depreciation) is the value equivalent to the wear and tear and economic obsolescence of the capital stock (machinery, vehicles, buildings, etc.), which means that this value has been consumed and is not part of the new output created.

It is just tradition that the public interest focuses on the gross domestic product. This is because, in the past, consumption of fixed capital was not calculated by all countries, so that only the GDP was available. This has no longer been the case for a long time already, so that it is easily possible to change over to the NDP (net domestic product), which is the better indicator of economic performance.

As there can be no “big solution” to the problem of creating an all-encompassing welfare indicator, it would be more than desirable to achieve at least small improvements in the context of measuring the national economic performance. A consistent changeover from the gross domestic product to the net domestic product would be a first and practical step towards achieving such improvements.