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RETHINKING THE GROSS DOMESTIC PRODUCT AS A MEASUREMENT OF NATIONAL STRENGTH

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERSTATE COMMERCE, TRADE, AND TOURISM

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MARCH 12, 2008

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CONTENTS

RETHINKING THE GROSS DOMESTIC PRODUCT AS A MEASUREMENT OF NATIONAL STRENGTH

WEDNESDAY, MARCH 12, 2008

U.S. SENATE,
SUBCOMMITTEE INTERSTATE COMMERCE, TRADE, AND TOURISM,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:30 p.m. in room 253, Russell Senate Office Building, Hon. Byron L. Dorgan, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. We're going to begin the hearing today. This is a hearing of the Senate Commerce Committee, and we are here today to talk about an interesting issue. So many hearings deal with the immediate and urgent, this issue is an inquiry into something that is interesting to me especially.

But it relates to measurements of our country's economic strength, our country's economic well-being, our country's living standards, and we're here to discuss the performance of something called the "Gross Domestic Product" as a measure of our nation's economic strength.

Forty years ago, Robert Kennedy gave a famous speech. And I remembered some of it because I worked for Robert Kennedy, who served in this U.S. Senate. I worked for his 1968 Presidential Campaign. I was a supporter of his. And he described the conundrum of measurements in a statement he made. I'm going to read a part of that, because it represents my interest in this issue.

This was 1968, March 18. It's interesting, at that point our Gross Domestic Product—"Gross National Product," as he called it back then—was $800 billion a year. Now, of course, I believe it's $13 trillion or $14 trillion. Here's what he said, and I'm quoting Robert F. Kennedy:

"Our Gross National Product now is over $800 billion a year, but that Gross National Product—if we judge the United States of America by that—that Gross National Product counts air pollution and cigarette advertising, and ambulances to clear our highways of carnage. It counts specials locks for our doors and the jails for the people who break them. It counts the destruction of the redwood and the loss of our natural wonder in chaotic sprawl. It counts napalm and it counts nuclear warheads and armored cars for the police to fight the riots in our cities. It counts Whitman's rifle and Speck's knife, and the television programs which glorify violence in order to sell toys to our children.

Yet, the Gross National Product does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages, the intelligence of our public debate, or the integrity of our public officials. It measures neither our wit nor our courage; neither, our wisdom or our learning; neither, our compassion nor our devotion to country.

It measures everything, in short, except much of that which makes life worthwhile. It can tell us everything about America, except why we are proud that we are Americans."

I thought it very interesting in 1968, when I heard Robert Kennedy say this, and I've thought about this a long while, and I'm pleased that we're able to hold a hearing on the public record today on this subject. What is it that measures the well-being of our country?

There's been ample talk in our country over the years of perhaps revising the Gross Domestic Product, which is a derivation of what used to be the Gross National Product, and developing some alternative measures of well-being.

And I might just observe that the GDP was created by a man named Simon Kuznets, who, when he created it, argued that this should not be used as a measure of living standards or well-being. It is pretty typical here in the U.S. Congress, and it's certainly typical in the press, for there to be a story. They describe GDP as if it were the single piece of compelling evidence about how well we're doing in this country.

Of course, that is not the case. It is one measurement, and it measures economic activity and growth in only a certain area. One of our witnesses, Jonathan Rowe, wrote in a 1995 piece on this subject that "GDP is simply a gross measure of market activity, of money changing hands. It makes no distinction whatsoever between the desirable and the undesirable, or the costs and the gain. On top of that, it looks only at the portion of reality that economists choose to acknowledge—the part involved in monetary transactions."

So there's much to talk about with respect to measurements and what it is that represents a valid measurement of well-being in this country—economic strength, and other issues that make life a wonderful life in the United States. So our witnesses today will lay the groundwork for the Congress to have a dialogue about the GDP.

It's clear from the current economic circumstances in our country that we've not been accurately reflecting either the wealth or the stability of our economy. We measure, and we measure a lot, and we certainly report that measurement, but it is not clear to me that it reflects the measurement of the kind of stability or progress that most people are looking to have measured.

We're going to hear from two panels of witnesses. We have Dr. Steven Landefeld, Director of the Bureau of Economic Analysis of the Commerce Department. And then, on the second panel, Dr. Robert Frank, the Professor of Management and Economics at the

Johnson Graduate School of Management at Cornell University; Dr. Karen Davis, the President of the Commonwealth Fund; Dr. Katherine Abraham, Professor of Joint Program in Survey Methodology at the University of Maryland; and Mr. Jonathan Rowe, who I mentioned earlier, Co-Director of West Marin Commons.

I thank all of them for being here. I would like to ask Dr. Steven Landefeld, would you be courteous enough to allow me to bring you up, but also bring the other witnesses up at the same time? I will certainly hear you first, but if you don't mind, I would like to bring the panel up together because I think what we'll want to do is have some exchange between the panel and you.

So if you would come forward and sit on the end here, I'm going to call on you first. And the other panelists, if you would also come forward and just take your seat at the table, I'd appreciate that very much.

Dr. Landefeld, am I pronouncing your name correctly? Is the "E" silent?

Dr. LANDEFELD. Close enough, sir.

Senator DORGAN. OK.

Dr. LANDEFELD. Landefeld.

Senator DORGAN. What is it?

Dr. LANDEFELD. Landefeld.

Senator DORGAN. Landefeld. Dr. Landefeld, you are the Professor of Management and Economics at the Johnson Graduate—excuse me. Dr. Steven Landefeld, you are the Director of Bureau of Economic Analysis of the Commerce Department, and so I'm assuming that much of your life is tied up in these measurement issues, and that's why we've asked you to come today to testify. And we appreciate you doing that. So why don't you proceed?

The statements that will be issued by all of the witnesses will be made a permanent part of the record. The entire statement will be a part of the record. And you may summarize your statement. Dr. Landefeld?

STATEMENT OF DR. J. STEVEN LANDEFELD, DIRECTOR, BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE

Dr. LANDEFELD. Thank you, Mr. Chairman. It's a pleasure to be here, and I appreciate the opportunity to talk about this important topic.

Let me start with a little background. The United States possesses one of the best-developed set of Gross Domestic Product, what used to be GNP, accounts in the world.

These accounts, which are collectively known as the National Income and Product Accounts, have been regularly updated over the years, and have served researchers, the business community, and policymakers alike to measure: long-run growth and productivity, standards of living, short-term business cycles, decomposition of growth into inflation and real output, changes in the composition of output and industrial performance, changes in the size and composition of National Income, and the impact of changes in imports and exports on growth.

However, as you've noted, since their inception in the 1930s, issues have been raised about the scope and structure of these accounts. As you pointed out, Simon Kuznets, who was a Nobel medalist and one of the primary architects of the U.S. accounts, recognized the limitations of focusing on just those market transactions and excluding household production and a broad range of other nonmarket activities and assets that have productive value or yield satisfaction.

Further, the need to better understand the sources of economic growth in the postwar era led to the development—much of it by academic researchers, rather than the government—of various supplemental series, such as investments in human capital and the value of the natural resources.

More recently, a report by Secretary Gutierrez's Advisory Committee on Measuring Innovation called for expanding the scope of the accounts to cover business investments in Research and Development and other intangible assets.

A recent volume, *A New Architecture for the U.S. National Accounts,* edited by Professor Dale Jorgenson of Harvard, William Nordhaus of Yale, and me, reviewed these issues and found that the existing accounts have served the Nation well, but there was a need for further expansion and integration of the accounts which consisted of:

(A) an integration of the accounts that would include a complete production account to improve the analysis of growth and productivity; (B) an expansion of the accounts to cover goods and services that are important to the analysis of growth and productivity, but are not fully captured in the existing accounts, such as mineral resources, human capital, and R&D; and (C) an expansion of the accounts to nonmarket goods and services that are important to the economy, but also have large economic welfare implications, such as environmental and health accounts.

Expansion to these areas, however, will not be easy nor without cost. Past efforts by outside researchers have foundered on the inevitable problems of subjectivity and uncertainty inherent in measuring health, happiness, and the environment. It was feared that the inclusion of such uncertain and subjective values in GDP would seriously diminish the usefulness of the national accounts to financial markets, the Federal Reserve Board, the Treasury, and Congress in measuring and managing the market economy.

Therefore, several National Academy of Sciences studies—including the *Beyond the Market Study* chaired by Professor Abraham, who is appearing next, and the *Natures Numbers* studies, chaired by Professor Nordhaus, who is of note in producing the original study by Tobin and Nordhaus on net economic welfare that actually was the grandfather of a lot of the research that has gone on in this area—those studies, as well as the International Guidelines for Compiling GDP, which are jointly published by the United Nations, the IMF, the OECD, and the EU, all concluded that such an expansion of the GDP accounts should take place in supplemental or satellite accounts that extend the scope of the accounts without reducing the usefulness of the core GDP accounts, in other words, a set of one-off accounts.

They also conclude that such an expansion should focus on the economic aspects of nonmarket and near-market activities, things like the economy's use of energy resources or the impact of investments in healthcare and productivity and economic growth, and not attempt to measure the full welfare effect of such interactions.

Such an expansion would require interdisciplinary research amongst economists and such subject area experts as epidemiologists, geologists, and engineers, requiring cooperation across government agencies and with private sector experts. This kind of collaboration is going to especially be important when we look at things, like what I understand Dr. Davis is going to recommend in terms of a comprehensive accounting for healthcare.

And indeed, some of what we're doing on a set of preliminary satellite accounts on health is being done with a group at Harvard, which includes epidemiologists and doctors and the like.

This expansion would also require, the design, development, and collection of data from new surveys. And even in areas such as income distribution, which Professor Frank will talk about, where we have data, developing a contemporaneous measure which maps into the national accounts will require much more timely and detailed information than we currently have available.

In summary, in an environment of constrained resources, it is critical that any such expansion not occur at the expense of urgently needed funds to maintain, update, and improve the existing GDP accounts.

I thank you for the opportunity. And after we finish, I'd be happy to answer any questions.

[The prepared statement of Dr. Landefeld follows:]

PREPARED STATEMENT OF DR. J. STEVEN LANDEFELD, DIRECTOR, BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE

Mr. Chairman, distinguished members of the Committee, it is a pleasure to be here and I appreciate the invitation to testify today at your hearing on "Rethinking GDP."

The United States possesses some of the best-developed sets of Gross Domestic Product (GDP) and related accounts in the world. These accounts, which are collectively known as the National Income and Product Accounts, have been regularly updated over the years and have served researchers, the business community, and policymakers alike to measure:

- long-run growth, productivity, and standards of living;
- short-term business cycles;
- the decomposition of growth into inflation and real output;
- changes in the composition of output and industrial performance;
- the adequacy of saving and investment; and
- changes in the size and composition of exports and imports and other components of GDP and National Income.

However, since their inception in the 1930s, issues have been raised about the scope and structure of these accounts. Simon Kuznets, Nobel medalist and one of the primary architects of the U.S. accounts, recognized the limitations of focusing on market activities and excluding household production and a broad range of other nonmarket activities and assets that have productive value or yield satisfaction. Further, the need to better understand the sources of economic growth in the postwar era led to the development—much of it by academic researchers—of various supplemental series, such as investments in human capital and the value of natural resources. More recently, a report by Secretary Gutierrez' Advisory Committee on Measuring Innovation in the 21st Century Economy called for expanding the scope of the accounts to cover business investments in Research and Development (R&D) and other intangible assets.

A recent volume, *A New Architecture for the U.S. National Accounts,* edited by Professor Dale Jorgenson of Harvard, William Nordhaus of Yale, and me, reviewed these issues in the context of an assessment of the GDP accounts and found that the existing accounts have served the Nation well through incremental updates and expansions, and that there was no need for a new paradigm. What was called for was a further expansion and integration of the accounts produced by the Bureau of Economic Analysis (BEA), Bureau of Labor Statistics (BLS), and Federal Reserve Board (FRB) in coordination with the U.S. Census Bureau (Census), a primary supplier of source data.

The integration and expansion would consist of: (a) an integration of the accounts to include a complete production account to improve the analysis of growth and productivity; (b) an expansion of the accounts to cover goods and services that are important to the analysis of growth and productivity, but not fully captured in the existing accounts, such as mineral resources, human capital, and R&D; and (c) an expansion of the accounts to nonmarket goods and services that are important to the economy, but also have large economic welfare implications—such as environmental and health accounts.

Expansion to these areas, however, will not be easy nor without cost. Past efforts by outside researchers have foundered on the inevitable problems of subjectivity and uncertainty inherent in measuring health, happiness, and the environment. It was feared that the inclusion of such uncertain and subjective values in GDP would seriously diminish the essential role of the national accounts to financial markets, the Federal Reserve Board, the Treasury, and the Congress in measuring and managing the market economy.

Therefore, several National Academy of Sciences studies, and the United Nations System of National Accounts guidelines for compiling GDP (see References), as well as the *New Architecture* volume, have all concluded that such an expansion of the GDP accounts should take place in supplemental, or satellite, accounts that extend the scope of the accounts without reducing the usefulness of the core GDP accounts. They also conclude that such an expansion should focus on economic aspects of nonmarket and near-market activities—the economy's use of energy resources or the impact of investments in health care costs on productivity and growth—and not attempt to measure the full welfare effect of such interactions.

Finally, such an expansion of work would require interdisciplinary research among economists and such subject area experts as epidemiologists, physicians, geologists, and engineers, requiring cooperation across government agencies and with private sector experts. It would also require the design, development, and collection of data from new surveys. In an environment of constrained resources, it is critical that any such expansion not occur at the expense of urgently needed funds to maintain, update, and improve the existing GDP accounts.

Thank you. I will be pleased to answer any questions you may have.

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Senator DORGAN. Dr. Landefeld, thank you very much. How often have you come to Capitol Hill to testify on the subject of what the GDP means?

Dr. LANDEFELD. Not very often, sir. It's an interesting topic, often dealt with by the press and the academics, but I haven't been up here before, sir.

Senator DORGAN. This is your first time?

Dr. LANDEFELD. Yes, sir. Other than the Appropriations hearings.

Senator DORGAN. Right. What do you think the GDP means? What does it tell your family, for example? Your family knows where you live, correct? And so, they read in the paper that the Labor Department releases information about GDP, what should your family think of that? What's that mean to them? What do you tell them it means to them?

Dr. LANDEFELD. I would tell them that it's one of many measures of the economy's performance. The Bureau doesn't represent—or the Federal Government, I don't think, represents GDP as a single measure of welfare (although I do have an economist in the family, so he may understand). And I, myself, personally have spent a lot of research time trying to expand these sets of accounts.

So I entirely agree with the eloquent comments that you read of Senator Kennedy, that there is a lot more to be measured out there. And the Federal Government does and needs to continue to measure other things. This is just one scorekeeping device that focuses on market transactions.

Senator DORGAN. Yes. This hearing is not to denigrate the GDP; it is what it is. It measures what it measures. But, for example, Secretary Gutierrez said, I believe, in March 2007, that we had a growth rate of 2.5 percent in the previous quarter. And, therefore, we've got good growth in the economy.

It might well have been that you could have a growth rate of 3 percent, or 2.5 percent, and have had used or depleted more than that in the resources of the country, which would mean you have a net 0 contribution to the economy and to the general well-being, but we would report, at least based on this measurement, that we're making progress and growing.

Could that be the case with GDP?

Dr. LANDEFELD. Absolutely. And that was something that Simon Kuznets pointed out in the original sets of accounts; they actually had a depletion allowance originally in the accounts, but they felt it wasn't well-measured. And so, what we have done more recently at the BEA, we developed some integrated environmental economic account, which made exactly that point.

Senator DORGAN. What I'm going to do is I'm going to ask the other contributors to offer their testimony, and then I want to ask you a series of additional questions if you're able to stay. And you're very courteous to allow me to do that. It is typical of the government witness to be alone on a panel, but I thank you for your willingness to sit at the table and allow us to have the back-and-forth discussion.

Dr. LANDEFELD. Thanks for that.

Senator DORGAN. Dr. Frank, you are the Professor of Management and Economics at the Johnson Graduate School of Management at Cornell University, and we appreciate your being here today.

Dr. FRANK. My pleasure.

Senator DORGAN. You may proceed.

STATEMENT OF DR. ROBERT H. FRANK, HENRIETTA JOHNSON LOUIS PROFESSOR OF MANAGEMENT AND PROFESSOR OF ECONOMICS, JOHNSON GRADUATE SCHOOL OF MANAGEMENT, CORNELL UNIVERSITY

Dr. FRANK. I think it's a great thing that you're holding these hearings. It's very important what we measure and use as a standard of well-being. We're accustomed to recalling Ronald Reagan's question, from 1980, "Are you better off now than you were 4 years ago?"

We need a metric by which to answer a question like that, and typically the metric we use is the one that's handiest, and that's GDP or GDP-per-capita, and it does suffer from all the myriad shortcomings that have been pointed out. It's hard, because we don't have a salient measure to compete with, then we tend not to direct our efforts in areas that will produce the most good for the country. So it's a very good thing that we're inquiring into this.

The standard measure suffers from a whole variety of technical problems, the fact that we don't adjust properly for quality changes, the fact that various inflation adjustments don't really capture adequately the true increase of the cost of living. Those have been debated at great length. I think they're mostly minor problems.

The kinds of problems that you touched on in your recitation of Senator Kennedy's passage I think are much, much bigger, the things we leave out or wrongly include as measures of progress in GDP. There's another problem, though, that hasn't been much remarked upon, and that's the fact that the core assumption that economists would use to link GDP to economic well-being is the idea that utility—that's the standard economist construct—the satisfaction people take from their economic resources is just assumed to depend on absolute income and expenditure. So if your house is bigger, that's without question an improvement in your welfare. If your suit is more expensive, that, too, is an improvement in your welfare.

What recent evidence has shown, however, is that satisfaction depends as much or more on relative consumption. This is not a novel idea. It's an old idea. It's not a controversial idea. If you had a car, for example, in 1920 that would eventually reach 60 miles an hour, it would seem to you like a fast car. Today, if your car won't get to 60 miles an hour in under 5 seconds, then it seems a little sluggish.

Similarly, when you ask whether an interview suit is adequate, and your task as a job applicant is to look good when you appear for your interview, what does that mean? Looking good is a quintessentially context-dependent context. It means to look good relative to the other applicants who want the same job you do. If they're all wearing much more expensive, well-tailored suits than you, you're less likely to get the callback.

So relative consumption is hugely important as a measure of welfare. Now, that's nowhere captured in any of the traditional measures of GDP. This was not a terribly big issue throughout much of the post-war decades, 1945 to the mid-1970s. Income was growing at about the same rate for rich, middle, and low-income families alike, about 3 percent a year.

Again, not counting all the adjustments to that that we might want to make, but the rich had bigger houses, which they always did, and they were getting bigger by about the same amount that the middle-class houses were getting bigger. And so everything was growing more or less in balance. Distributional issues were not salient at that time.

Since then, though, there's been a huge shift in the pattern of income growth. From about the mid-1970s onward, virtually all the income growth has gone to people at the top of the income ladder. The top 1 percent now has about three times the real purchasing power of three decades ago. Families in the middle have—the median family has only about 15 percent more than it did at that time. If you go inside the top 1 percent, the pattern repeats—it's the people in the top one-tenth of 1 percent who've captured the lion's share of the gains.

What's happened then is that there's been a big change in the way GDP gets spent. The change has occurred because it's not going evenly in the increments to all families; it's going preponderantly to families at the top. It's very important not to make this a class warfare issue. I think many people point out the things that the wealthy consume and wag their fingers critically at them. Have they lost their moral compass? How can they be consuming such things?

In fact, virtually every part of the income distribution behaves the same way. When its income goes up, they spend more. And that's true of the wealthy, that's true of people in the middle, and people at the bottom. And so, what we know is that when people at the top spend more, they get very little extra happiness from that, because the main effect of building a bigger mansion or having a more expensive coming-of-age party for your children is simply to raise the bar that defines what people like you need to spend on such things.

And so, I think for that reason, if we can't come up with more distribution or sensitive measures of our economic progress, we're going to fail to pick up what's really been the salient pattern the last three decades. So, again, I applaud your effort to open up this question and try to make headway on it.

[The prepared statement of Dr. Frank follows:]

Prepared Statement of Dr. Robert H. Frank, Henrietta Johnson Louis Professor of Management and Professor of Economics, Johnson Graduate School of Management, Cornell University

Is economic well-being accurately captured by traditional economic measures like per-capita income? This has long been a contested issue. Although everyone concedes that income is an imperfect welfare measure, conservative economists have tended to emphasize its virtues, while liberals have been more likely to stress its shortcomings.

This debate is not just of philosophical interest; it also has important policy implications. Recent research findings offer support for specific arguments made on both sides. Mounting evidence suggests, however, that per capita income becomes a much less informative index of economic welfare when income inequality has been rising rapidly, as in recent decades.

First a few words about how economists measure income. The simplest approach might seem to be just to add up everyone's income. But because one person's spending is another person's income, we can also estimate income by adding up how much everyone spends. And because spending turns out to be easier to keep track of than income, the most commonly used income metric is Gross Domestic Product (GDP), the annual market value of all final goods and services produced within a country. Per capita GDP is simply GDP divided by total population. Measured in 2000 dollars, it was $32,833 in 1998 and $37,832 in 2006. The real value of goods and services purchased by Americans in 2006 was thus about fifteen percent higher than in 1998. In purely economic terms, does that mean we were roughly fifteen percent better off in 2006?

Not necessarily. To measure changes in the standard of living over time, it is necessary to adjust for inflation. But as conservatives stress, traditional inflation adjustments may overstate actual inflation because they fail to account adequately for quality improvements. For example, although the current model of Honda's lowest priced car, the Civic, is about the same size as the company's 1998 Accord and is in almost every respect far superior, it sells for only slightly more than the earlier Accord. Inflation adjustments, which are based on price changes for corresponding models, thus overstate the increase in the cost of car ownership, thereby causing per capita GDP to understate the corresponding increase in our standard of living.

Quality changes are not always positive, of course. For example, if you had a question about your health insurance in 1998, you could talk to a real person; today, you are likely to find yourself in an endless phone loop. On balance, however, most consumers would probably prefer to choose from today's overall menu of goods and services than from 1998's.

Inflation adjustments may introduce further bias if people rearrange their spending patterns when prices rise unevenly. When beef prices rise twice as fast chicken prices, for example, people typically eat less beef and more chicken. Because traditional inflation measures fail to take such adjustments fully into account, they overestimate the amount of inflation that has actually occurred. As in the case of failure to control adequately for quality changes, the effect is to cause per capita GDP growth to understate increases in the standard of living.

Liberals, for their part, have long objected that many expenditures included in GDP reflect reductions, not increases, in our standard of living. GDP also fails to include many aspects of life that clearly contribute to well-being. In a speech delivered forty years ago this week, the late Senator Robert F. Kennedy made these points eloquently:

> Too much and too long, we seem to have surrendered community excellence and community values in the mere accumulation of material things. Our gross national product . . . if we should judge America by that—counts air pollution and cigarette advertising, and ambulances to clear our highways of carnage. It counts special locks for our doors and the jails for those who break them. It counts the destruction of our redwoods and the loss of our natural wonder in chaotic sprawl. It counts napalm and the cost of a nuclear warhead, and armored cars for police who fight riots in our streets. It counts Whitman's rifle and Speck's knife, and the television programs which glorify violence in order to sell toys to our children.
>
> Yet the gross national product does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages; the intelligence of our public debate or the integrity of our public officials. It measures neither our wit nor our courage; neither our wisdom nor our learning; neither our compassion nor our devotion to our country; it measures everything, in short, except that which makes life worthwhile. And it tells us everything about America except why we are proud that we are Americans.

GDP suffers from another big problem, one that challenges the very foundation of the presumed link between per capita GDP and economic welfare. I refer to the assumption, traditional in economic models, that absolute income levels are the primary determinant of individual well-being.

This assumption is contradicted by consistent survey findings that when everyone's income grows at about the same rate, average happiness levels remain the same. Yet at any moment in time, the consistent pattern is that wealthy people are happier, on average, than poor people. These findings suggest that relative income is a much better predictor of well-being than absolute income.

In the three decades following World War II, the relationship between income distribution and welfare was not a big issue, because incomes were growing at about the same rate for all income groups. Since the mid-1970s, however, income growth has been confined almost entirely to top earners. Changes in per capita GDP, which track only changes in average income, are completely silent about the effects of this distributional shift.

When measuring the economic welfare of the typical family, the natural focus is on median, or 50th percentile, family earnings. Per capita GDP has grown by more than 85 percent since 1973, while median family earnings have grown by less than one-fifth that amount. Changing patterns of income growth have thus caused per capita GDP growth to vastly overstate the increase in the typical American family's standard of living during the past three decades.

Some economists have advanced an even stronger claim—that there is simply no link, in developed countries at least, between absolute spending and well-being. Recent work supports this claim with respect to expenditures in some domains—especially those in which the link between well-being and relative consumption is strongest. Beyond some point, for instance, when the rich spend more on larger mansions or more elaborate coming-of-age parties for their children, the apparent effect is merely to redefine what counts as adequate.

Top earners are not spending more because they are morally deficient. Having received not only the greatest income gains over the last three decades but also substantial tax cuts, they have been building larger houses simply because they have more money. Those houses have shifted the frame of reference for people with slightly lower incomes, leading them to build larger as well. The resulting expenditure cascade has affected families at all income levels.

The median new house in the United States, for example, now has over 2,300 square feet, over 40 percent more than in 1979, even though real median family earnings have risen little since then. The problem is not that middle-income families are trying to "keep up with the Gateses." Rather, these families feel pressure to spend beyond what they can comfortably afford because more expensive neighborhoods tend to have better schools. A family that spends less than its peers on housing must thus send its children to lower-quality schools. Yet no matter how intensively families bid for houses in better school districts, half of all children are destined to attend bottom-half schools. Similarly, when all spend more on interview suits, the same jobs go to the same applicants as before. For these reasons, it has become much more costly for middle-class families to achieve many basic goals.

In many other spending domains, however, greater levels of absolute income clearly promote well-being, even in the richest societies. Thus, the economist Benjamin Friedman has found that higher rates of GDP growth are associated with increased levels of social tolerance and public support for the economically disadvantaged. Richer countries also typically have cleaner environments and healthier populations than their poorer counterparts.

In sum, we have long known that per capita GDP is a imperfect index of economic welfare. But recent work suggests that it is especially uninformative when income inequality has been rising sharply, as it has been in recent decades. A society that aspires to improve needs a better measure of what counts as progress.

Senator DORGAN. Dr. Frank, thank you very much for being with us today. We appreciate your testimony. Next, we will hear from Dr. Karen Davis, President of The Commonwealth Fund. Dr. Davis?

STATEMENT OF KAREN DAVIS, PRESIDENT, THE COMMONWEALTH FUND

Dr. DAVIS. It's a privilege to be here today. I'd like to focus specifically on the healthcare system. Americans value healthcare, maybe more than any other good or service, and yet, when we look at the GDP and see the latest figures, and we see spending going up on consumer goods, on cars, we think, "Oh, good. We're not in a recession; that's the sign of a strong economy."

But when healthcare spending goes up faster than the GDP, there are hearings on the problem of healthcare costs. And so, why is it that spending on healthcare creates alarm? I think it's because it's a sign of a deeply dysfunctional market, and we realize that what we spend on healthcare bears very little relationship to the value of that healthcare.

Upon what the Bureau of——

Senator DORGAN. Dr. Davis, on that point, is the current GDP measuring a heart attack as a benefit?

Dr. DAVIS. Right. And all of the services and tests that come into play, as opposed to looking at—does it reduce the probability of another heart attack? Does it help you live longer? I think what Dr. Landefeld has said that the Bureau of Economic Analysis is trying to move to supplement GDP with national health accounts that would get us a better sense of what we're getting for different diseases or conditions like a heart attack is a good step.

But I think we need something broader than that. And to go immediately to my bottom line, I think we need something parallel to the National Economic Council of the White House, a Council of Health Advisors that's really charged with setting goals for the health system, setting priorities for improvement, monitoring and tracking progress toward the attainment of that, so that we really can begin to have a sound foundation for what we have viewed as to a high-performance health system.

The Commonwealth Fund has established a Commission on a High Performance Health System. We have issued a national scorecard of the performance of the health system. We have noted, for example, that the U.S. spends twice what other countries spend on healthcare per capita. And yet, if you look at a measure, like preventable mortality that's amenable to medical care, the U.S. ranks 19th out of 19 countries.

We also issued, in June of 2007, a state scorecard on performance of the healthcare system. It turned out North Dakota was in the top quartile of states—low spending, high outcomes—so we took our Commission on the High Performance Health System to North Dakota. I'm very pleased that you could join us on teleconference there.

But I think what North Dakota demonstrates is that through medicine, through effective use of pharmacy technicians, nurse practitioners, because there's a shortage of pharmacists, there's a shortage of physicians, that they are able to provide high-quality care at much lower cost. Now, ironically, if every state in the U.S. did what North Dakota did, health spending would go down. And since that's one out of every six dollars in the GDP, the GDP would go down, and we would think we were worse off, when in fact we would be better off.

I think it is important to have this kind of information, much better information, if we're really going to influence policies. But The Commonwealth Fund issued a report in December called *Bending the Curve: Options for Achieving Savings and Improving Value in Health Spending,* and we laid out 15 options.

We found you could save $1.5 trillion. Maybe we can't just go to North Dakota, but you could save $1.5 trillion over 10 years, provide health insurance to everyone, if we'd make the investments in information technology, comparative effectiveness, public health, and really changing our financial incentives to reward better results.

We know there are lots of missed opportunities in the health system. The Institute of Medicine estimates that about 20,000 people die every year because they are uninsured. We lose $65 to $130 billion in economic gains, as well. There are many opportunities to invest in healthy children, including reducing childhood obesity, investing in a healthy workforce, that could have high payoff.

Having said there's a lot of waste in our system, I do want to just conclude by saying there's a lot of value in our health system, and certainly the studies that have been done on care of cardiac conditions show that the amount we spend is far less than the benefit that's gained. So while there's waste, there's also a lot of value that we want to preserve.

So just in conclusion, we need better numbers. We need better data. We need to sort out spending on healthcare. We need to know when spending more means we're getting more, when it doesn't, how much we're paying, whether we're really getting good value for what we're spending, for example, on pharmaceutical care, by negotiating prices or using more cost-effective drugs.

We need to know which services add value, and which ones are duplicative, ineffective, and there just to generate income. So searching for true value, effective treatments, better outcomes, high quality should be the purpose and focus of this new activity. Thank you.

[The prepared statement of Dr. Davis follows:]

PREPARED STATEMENT OF KAREN DAVIS, PRESIDENT, THE COMMONWEALTH FUND

Acknowledgments: This testimony draws on reports prepared by a number of colleagues at The Commonwealth Fund including Cathy Schoen, Vice President for Research and Evaluation; and Sara Collins, Assistant Vice President for the Future of Health Insurance. Comments by Stephen C. Schoenbaum, M.D., Executive Vice President for Programs, and the Research Assistance of Katherine Shea are also gratefully acknowledged. The views expressed, however, are those of the witness and not those of The Commonwealth Fund, its directors, officers, and staff.

Health and Wealth: Measuring Health System Performance

Thank you, Mr. Chairman and members of the Committee, for this invitation to testify today on the measurement of health expenditures in our national accounts. Americans value good health—perhaps more than any other good or service produced in the economy—yet policy officials, business leaders, and experts express alarm when health care spending grows as a percent of the gross domestic product (GDP). If spending more on cars and consumer goods is a sign of a strong economy, why is spending more on health care a sign of a deeply dysfunctional health care market? The answer lies in the broken link between what we pay for health care services and the contribution those services make to longer and healthier lives, relief of pain and anxiety, and quality of life and functioning. Simply put, spending on health care does not reflect the value of health care delivered. Rather there is evidence from other countries—and from some states within the U.S.—that it is possible to have better health outcomes and spend less on health care.

When a sector of the economy that makes up one-sixth of total GDP is not adequately captured in our national accounts and when there is no consensus on what constitutes good performance in the health sector, it is not surprising that the debate over health policy is often stymied. Forty years ago, Robert F. Kennedy noted that "the gross national product does not allow for the health of our children." [1] He called for a better system of national accounts that measures the benefits of investing in health care and other aspects that enhance the quality of life.

An annual report to Congress setting goals for performance of the U.S. health system, priorities for improvement, and monitoring benefits and costs, as well as progress toward achieving value, would lay a sound foundation for public policy deliberations. It would help us shape policies to ensure access to the care essential

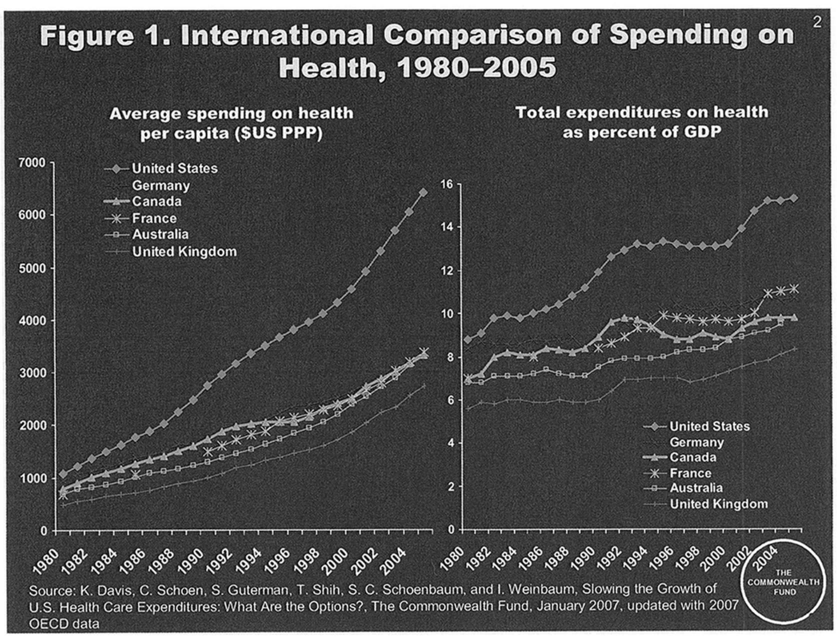
[1] Remarks of Robert F. Kennedy at the University of Kansas, March 18, 1968.

to health and well-being, and to hold the health system accountable for yielding value commensurate to the resources we devote to health care.

Bending the Curve on Health Spending While Enhancing Value

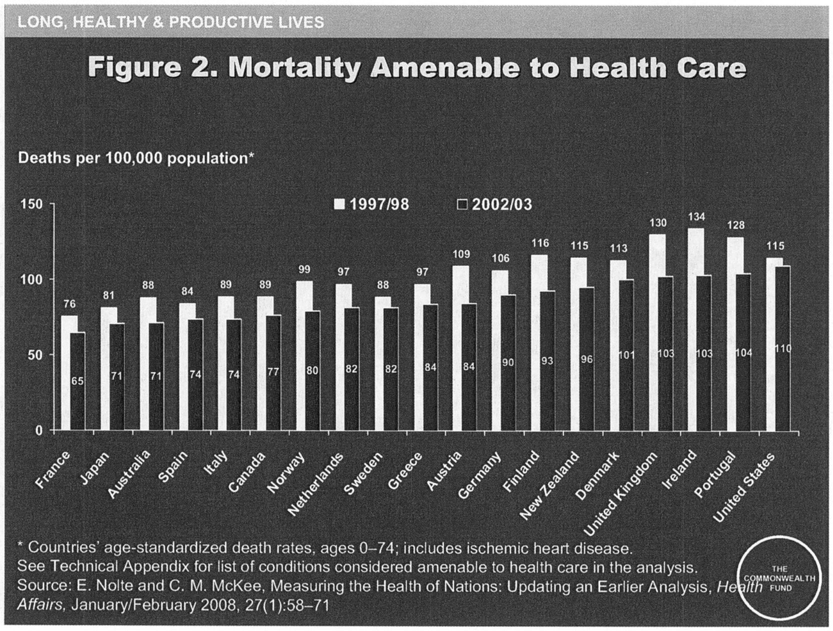
U.S. health care expenditures have risen rapidly in the last 7 years, imposing increasing stress on families, businesses, and public budgets. Health spending is rising faster than the economy as a whole and faster than workers' earnings. In recent years, insurance administrative overhead, in particular, has been rising faster than other components of health spending, while pharmaceutical spending has increased more rapidly than spending on other health care services.[2]

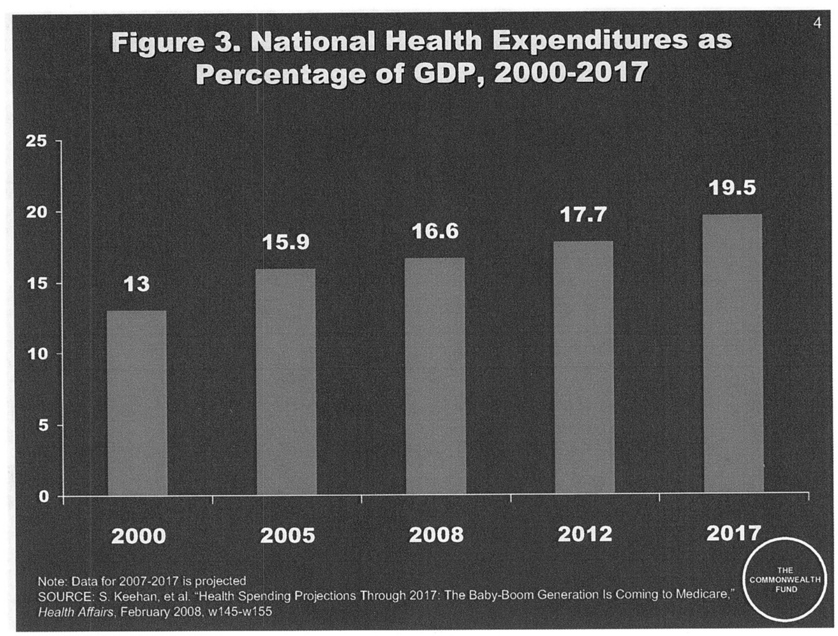
The U.S. spent 16.3 percent of GDP on health care in 2007, compared with 8 percent to 10 percent in most major industrialized nations (Figure 1). On a per capita basis, the U.S. spends twice what other major industrialized nations spend on health care, but ranks 19th out of 19 countries on mortality amenable to medical care (Figure 2). The Centers for Medicare and Medicaid Services (CMS) projects that growth in health spending will continue to outpace GDP over the next 10 years, reaching 19.5 percent of GDP by 2017.[3] (Figure 3) One reason the U.S. experience differs from that of other countries is that the Federal Government does not leverage its purchasing power to achieve lower administrative overhead or negotiate lower prices for prescription drugs and health care services.



[2] K. Davis, C. Schoen, S. Guterman, T. Shih, S.C. Schoenbaum, and I. Weinbaum, *Slowing the Growth of U.S. Health Care Expenditures: What Are the Options?* (New York: The Commonwealth Fund, January 2007).

[3] S. Keehan *et al.*, "Health Spending Projections Through 2017: The Baby-Boom Generation Is Coming to Medicare," *Health Affairs,* February 2008, w145–w155.

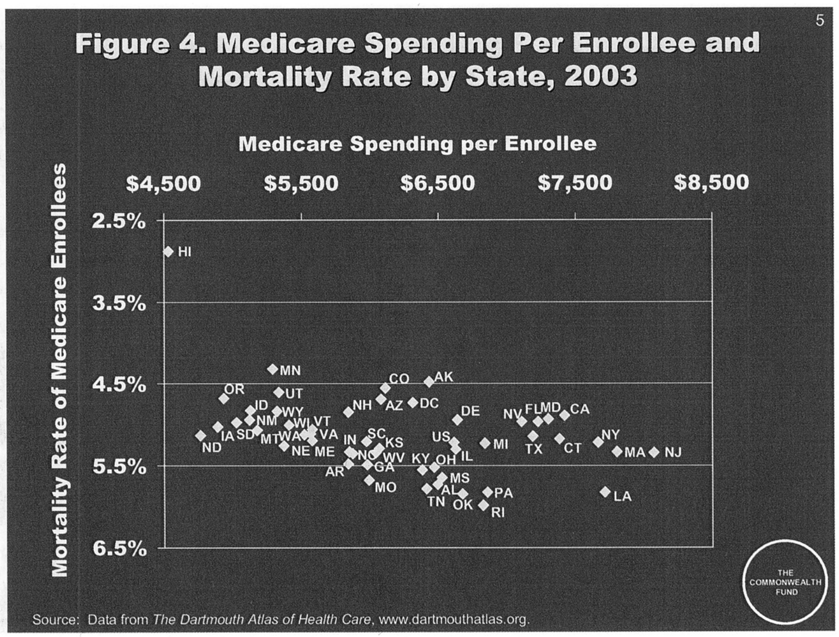




A recent report by the Agency for Healthcare Research and Quality found that health care quality gains are not keeping pace with cost increases. Between 1994 and 2005, the quality of health care improved by an average 2.3 percent a year.

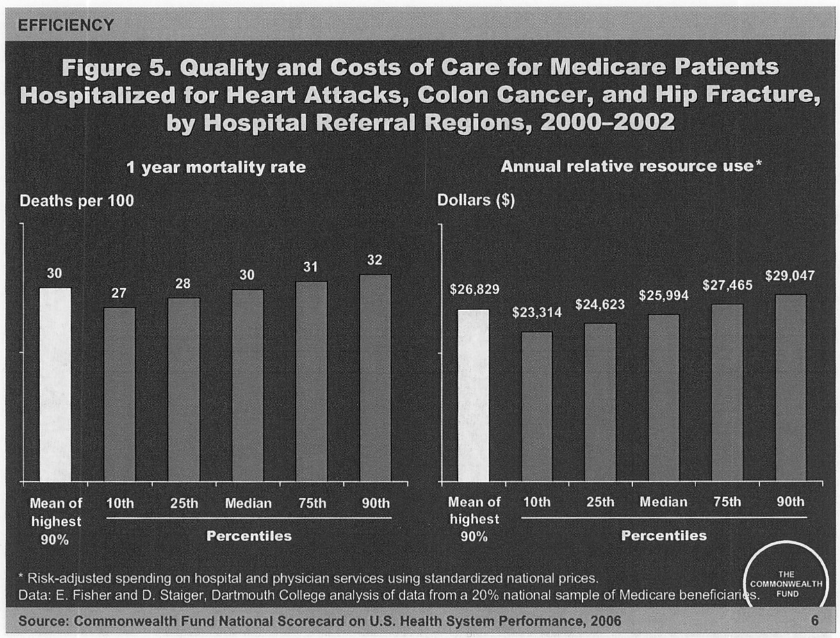
Over the same period, health expenditures rose by 6.7 percent a year.[4] The agency director noted that "these findings about quality underscore the urgency to improve the value Americans are getting for their health care dollars."[5]

There are also wide variations in health care spending across the U.S., indicating opportunities to increase efficiency. For example, the *Dartmouth Atlas of Health Care* shows that Medicare outlays per beneficiary adjusted for area wage costs ranged from $4,530 in Hawaii to $8,080 in New Jersey in 2003 (Figure 4). Yet studies find no systematic relationship between spending more and achieving longer lives or higher quality of care for Medicare beneficiaries. For example, one-year mortality rates for Medicare patients hospitalized for heart attacks, colon cancer, and hip fracture range from 27 percent in the best 10 percent of hospital referral regions to 32 percent in the worst 10 percent. At the same time the total relative resource use ranges from $23,314 in the best 10 percent of areas to $29,047 in the highest cost areas, with no relation between mortality and Medicare spending. (Figure 5)



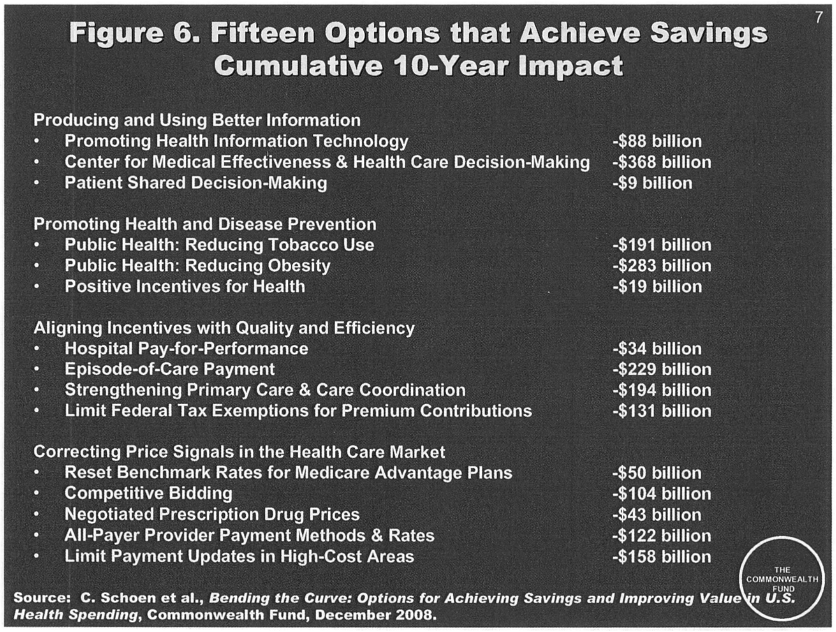
[4] Agency for Healthcare Research and Quality, "Modest Health Care Quality Gains Outpaced by Spending," March 3, 2008. Available: *http://www.ahrq.gov/news/press/pr2008/qrdr07pr.htm,* last accessed March 10, 2008.

[5] M.A. Carey, "Health Care Quality Gains Not Keeping Pace with Cost Increases," *CQ HealthBeat,* March 7, 2008.



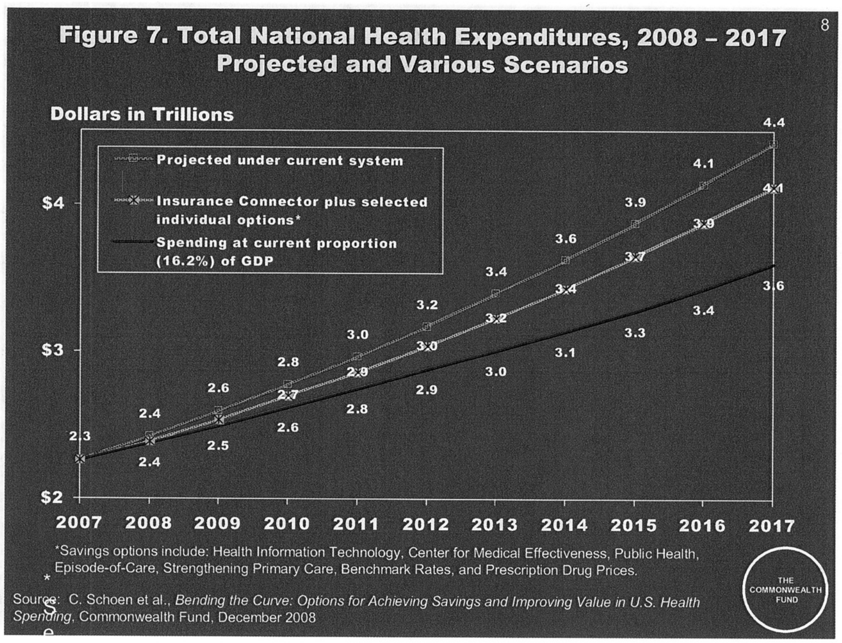
To move the debate forward, a new Commonwealth Fund report provides estimates by the Lewin Group on options for achieving savings in health expenditures while simultaneously enhancing the value of that care.[6] *Bending the Curve: Options for Achieving Savings and Improving Value in Health Spending* analyzes 15 Federal health policy options for their potential to lower spending over the next 10 years and to yield higher value for the Nation's investment in health care (Figure 6). Cost savings can be achieved by the implementation of policies related to health information technology and improving knowledge for clinical decision-making; public health measures such as reducing smoking and obesity and creating positive incentives for health; financial incentives aligned with quality and efficiency such as hospital pay-for-performance and strengthening primary care; and policies that use the health care market to increase efficiency, add value, and reduce costs.

[6] C. Schoen, S. Guterman, A. Shih, J. Lau, S. Kasimow, A. Gauthier, and K. Davis, *Bending the Curve: Options for Achieving Savings and Improving Value in U.S. Health Spending* (New York: The Commonwealth Fund, December 2007).



The report also examines the effects of combining policy options targeted toward slowing health care cost growth with extending affordable health insurance to all. Combining universal coverage with policies aimed at achieving health care savings could have a significant impact because improvements in delivery and financing would apply to a larger number of people, could lower insurance administrative costs, and would lead to a more integrated health care system. Additionally, savings from improved efficiency would substantially offset the Federal cost of expanding coverage.

Currently, health spending in the U.S. is predicted to increase from $2 trillion to more than $4 trillion over the next 10 years, and to consume one of every five dollars of national income, as increases outpace income growth by a wide margin. According to the report's estimates, it is possible to curb health care spending by $1.5 trillion over the next 10 years, and to simultaneously enhance the overall performance of the health care system. (Figure 7) The sooner policy changes addressed at reducing spending are enacted, the greater the cumulative savings for families, businesses, and public health insurance programs. In fact, even modest changes can quickly add up to billions of dollars. However, in order to see real savings and higher value, policies must address overall health system costs and not simply shift cost from one part of the system to another.



Examples of Savings Over 10 Years:

- *Promoting Health Information Technology:* With an initial increase in investment, *$88 billion* could be saved by accelerating health care providers' adoption of health information technology to allow them to share patient health information with other providers involved in the patient's care.
- *Center for Medical Effectiveness and Health Care Decision-Making:* Investing in the knowledge needed to improve health care decision-making; incorporating information about relative clinical and cost effectiveness into insurance benefit design; and including incentives for providers, payers and consumers to use this information could save an estimated *$368 billion* over 10 years.
- *Public Health—Reducing Tobacco Use:* Increasing Federal taxes on tobacco products by $2 per pack of cigarettes, with revenues to support national and state tobacco programs, could yield an estimated *$191 billion* savings over 10 years.
- *Public Health—Reducing Obesity:* Increasing Federal taxes on sugared soft drinks by one cent per 12-ounce drink, with revenues to support national and state obesity programs, could yield an estimated *$283 billion* savings over 10 years.
- *Strengthen Primary Care and Care Coordination:* A "medical home" approach, including improving Medicare reimbursements to primary care physician practices to support enhanced primary care services such as care coordination, chronic care management, and easy access to care, could result in net health system savings of *$194 billion* over 10 years if all Medicare fee-for-service beneficiaries were enrolled. Estimated national savings would be larger if this approach were adopted by all payers.

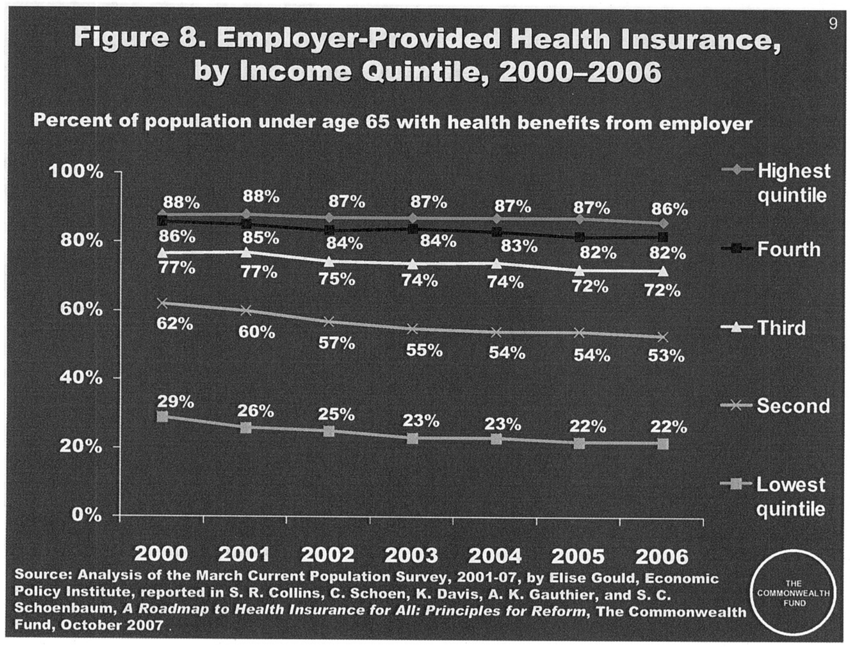
Missed Opportunities to Ensure Healthy and Productive Lives

Not all Americans have access to the benefits of modern medicine. In fact, access to health care has seriously eroded over the last 7 years. In 2006, 47 million people were uninsured, an increase of 8.6 million from 2000.[7] The Institute of Medicine

[7] C. DeNavas-Walt, B.D. Proctor, and J. Smith, *Insurance, Poverty, and Health Insurance Coverage in the United States: 2006* (Washington, D.C.: U.S. Census Bureau, Aug. 2007).

(IOM) has concluded that the most important determinant of access to health care is adequate health insurance coverage.[8]

Loss of health insurance coverage has been most marked among lower-income workers.[9] Only 22 percent of adults under age 65 in families with incomes of $20,000 or less had coverage through an employer in 2006, down from 29 percent in 2000. Employer-based coverage in the next higher income category—under $37,800 annually—declined from 62 percent in 2000 to 53 percent in 2006 (Figure 8).



Failure to provide health insurance to all has a price—to both the health of Americans and to our economy. The IOM estimated that 18,000 deaths of adults ages 25 to 54 in 1999 occurred as a direct consequence of being uninsured.[10] A more recent update of that study by Stan Dorn at the Urban Institute puts the toll in 2004 at 20,000 deaths, making it the fifth leading cause of death in the U.S. for working age adults.[11] (Figure 9) The IOM projected that the aggregate, annualized cost of uninsured people's lost capital and earnings from poor health and shorter life spans falls between $65 billion and $130 billion for each year without coverage.

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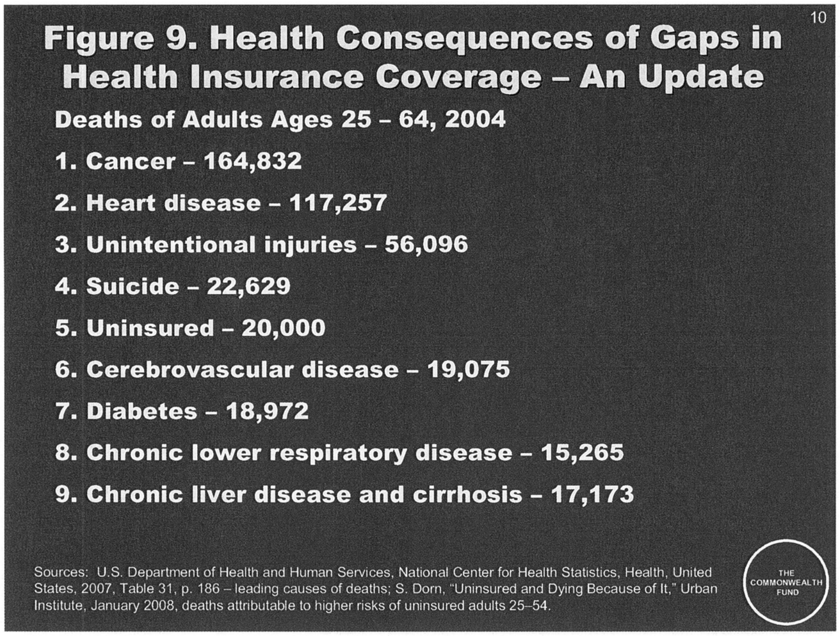
[8] Institute of Medicine, *Hidden Costs, Value Lost: Uninsurance in America* (Washington, D.C.: National Academies Press, June 2003).

[9] S.R. Collins, C. Schoen, K. Davis, A.K. Gauthier, and S.C. Schoenbaum, *A Roadmap to Health Insurance for All: Principles for Reform* (New York: The Commonwealth Fund, October 2007).

[10] Institute of Medicine, *Hidden Costs, Value Lost: Uninsurance in America* (Washington, D.C.: National Academies Press, June 2003).

[11] S. Dorn, *Uninsured and Dying Because of It* (Washington, D.C.: The Urban Institute, January 2008).



A healthy workforce is one of our most important economic assets as a nation. For too long we have focused on only one side of the ledger—the cost to provide health insurance to all Americans and to ensure that everyone receives effective medical services. We have ignored the other side—the costs incurred by having workers too sick to work or function effectively. There are three major sources of lost economic productivity related to health: adults who do not work because of poor health or disability; workers who miss time from work as a result of health problems; and workers who remain present on the job but experience reduced productivity because of their own health problems or concerns about sick family members.

In 2003, an estimated 18 million adults ages 19 to 64—12 percent of all working-age adults—were not working and reported a disability, handicap, or chronic disease, or said they were not working because of health reasons.[12] (Figure 10) Nearly seven of 10 workers (69 percent) reported sick loss days, for a total of 407 million days of lost time at work. Half (55 percent) of workers also reported a time when they were unable to concentrate at work due to their own illness or that of a family member, accounting for another 478 million days a year. Together this "lost labor time" represents lost economic output because of health reasons of an estimated $260 billion per year. Workers without paid time off to see a physician are more likely to report sick loss days and being unable to concentrate at work.

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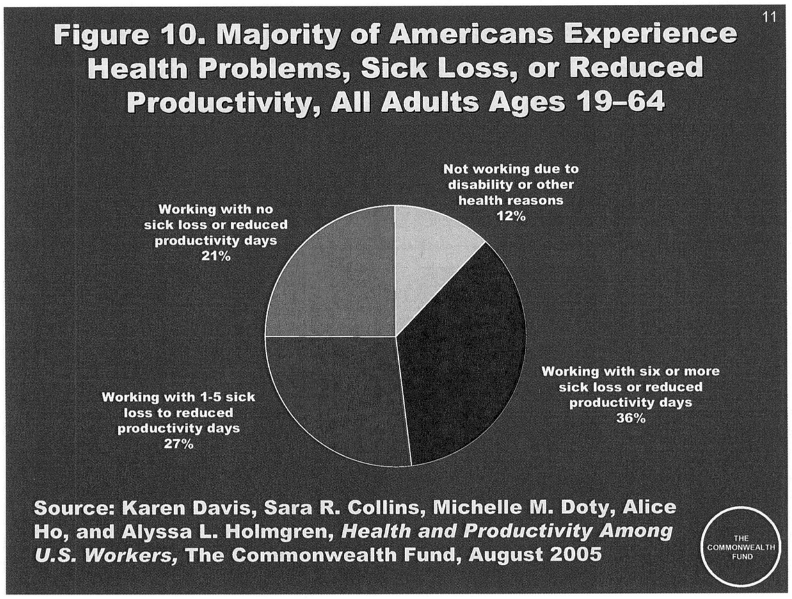
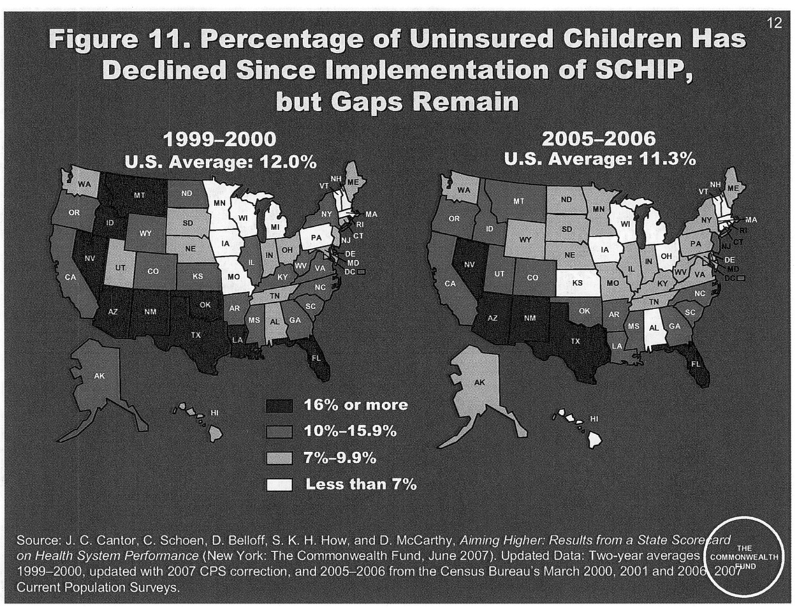
[12] K. Davis, S.R. Collins, M.M. Doty, A. Ho, and A.L. Holmgren, *Health and Productivity Among U.S. Workers* (New York: The Commonwealth Fund, August 2005).

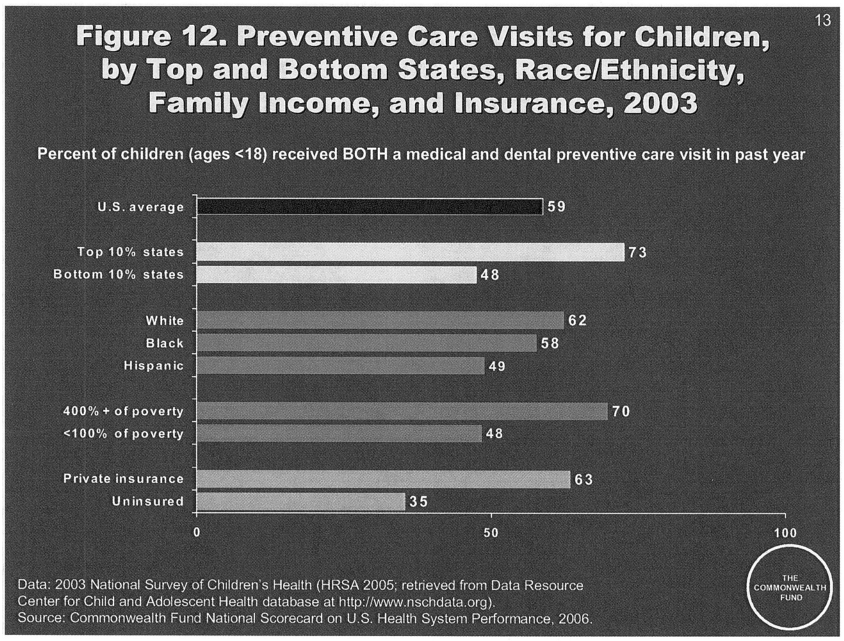


In recent years, the U.S. has improved health insurance coverage for children, primarily through the State Children's Health Insurance Program (Figure 11). Unlike the trend for adults, the proportion of children without health insurance declined from 12 percent in 1999–2000 to 11.3 percent in 2005–2006. However, there are still significant variations across states and 9 million children remain uninsured, nearly three-fourths in families with incomes below twice the Federal poverty level.[13]



[13] K. Schwartz, C. Hoffman, A. Cook, *Health Insurance Coverage of America's Children* (Washington, D.C.: Kaiser Family Foundation, January 2007).

Failure to invest in a healthy start for children can have lifetime consequences in reduced productivity and serious health problems. Uninsured children are much less likely to obtain preventive care (Figure 12). A Commonwealth Fund Commission on a High Performance Health System National Scorecard found that 63 percent of insured children had preventive visits in 2003, compared with 35 percent of uninsured children.[14] Investing in children's health by ensuring access to care and insisting on high standards of care, such as regular screening for developmental and behavioral delays in young children, is important to detecting conditions early and helping children reach school age ready to learn.[15]



Gaps in health insurance coverage and financial barriers to care are the most important reason children and adults fail to receive preventive care. But even insured adults and Medicare beneficiaries often fail to receive beneficial care. Less than half of American adults age 50 and older are up to date with preventive care; the percent ranges from 50 percent in Minnesota to 33 percent in Idaho.[16] If all states reached the levels achieved among the top-ranked states, almost 9 million more older adults would receive recommended preventive care. Control of chronic conditions also varies from state to state. If all states performed at the rate of the best states, almost 4 million more diabetics would receive care to help prevent disease complications. Ensuring that all Americans receive care from a regular source of care that is accountable for ensuring that patients receive all appropriate preventive care and care of chronic conditions would improve health and productivity, as well as reduce disparities in care.[17]

In short, we often fail to realize the benefits of the best of American medicine. Quality of care is highly variable across geographic regions and across different populations. A better data system measuring health system performance by state and by population subgroups would help identify best practices and show where addi-

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[14] The Commonwealth Fund Commission on a High Performance Health System, *Why Not the Best? Results from a National Scorecard on U.S. Health System Performance,* (New York: The Commonwealth Fund, September 2006).

[15] E.L. Schor, "The Future Pediatrician: Promoting Children's Health and Development," *The Journal of Pediatrics,* November 2007 151(5):S. 11–S 16.

[16] J.C. Cantor, C. Schoen, D. Belloff, S.K.H. How, and D. McCarthy, *Aiming Higher: Results from a State Scorecard on Health System Performance* (New York: The Commonwealth Fund Commission on a High Performance Health System, June 2007).

[17] A.C. Beal, M.M. Doty, S.E. Hernandez, K.K. Shea, and K. Davis, *Closing the Divide: How Medical Homes Promote Equity in Health Care: Results From The Commonwealth Fund 2006 Health Care Quality Survey* (New York: The Commonwealth Fund, June 2007).

tional investment could reap high returns—in healthier Americans and greater economic productivity.

The Value of Health

There is no question that Americans value the right to life, liberty, and the pursuit of happiness. William Nordhaus, an economist at Yale, posed the question: "Would you rather have a 1950 economic standard of living and a 2000 health standard of living, or a 2000 economic standard of living and a 1950 health standard of living?"[18] The universal response was a 2000 health standard of living, even at the cost of foregoing all the economic gains of the last half of the 20th century. Nordhaus therefore concluded that advances in health and health care in the last half of the 20th century were more valuable than all the economic productivity gains over those 50 years. By focusing just on economic gains, we are neglecting the far more valuable health gains.

David Cutler, an economist at Harvard, and colleagues have quantified the benefit of health gains, and concluded that they certainly far outweigh the cost of increased spending on health care in recent years.[19] Cutler and McClellan demonstrated that for every $1 spent on care of heart attack patients, the economic gain in longer life alone has been $7, with over 70 percent of the gain in life expectancy between 1974 and 1998 attributable to improved treatment. Similar analyses of improved care for low-birth weight infants, depression, and cataracts found benefits exceeding costs, and for breast cancer patients roughly equaling costs. They summed up their work by concluding that between 1950 and 1990, the present value of per-person medical spending increased by $35,000 and life expectancy by 7 years for a present value gain of about $130,000.

More recent estimates of the value of coronary heart disease care for the elderly between 1987 and 2002 confirm this earlier work.[20] Cutler and colleagues show that improved treatment not only improves longevity following heart attacks but also reduces the incidence of first heart attacks through improved control of risk factors, such as cholesterol and hypertension. They note that only half of elderly people with coronary heart disease are taking statins, beta-blockers, and ACE inhibitors, and that further gains could be achieved if the use of these treatments were increased.

Cutler and colleagues find that investing in the health of infants and children has an especially high payoff.[21] They estimate that from 1960 to 2000 the life expectancy for newborns increased by 6.97 years. The cost per year of life gained was $19,900, with benefits at least five times the costs. Medical care for children at age 15 yields at least a two to one return in benefits to costs. They conclude that although medical spending has increased substantially over this period, the money spent has provided good value. Cutler and his colleagues underscore the importance of a set of National Health Accounts measuring the benefits of medical care on a disease-specific basis.

Path to a High Performance Health System

Whether comparing U.S. performance with international benchmarks of high value or with benchmarks set within the U.S., it is clear there are opportunities to improve the yield we reap given the resources we invest in health care. The U.S. could learn from best practices within the Nation and from other countries. Evidence of extensive variations in costs and quality and studies documenting provision of duplicative, inappropriate, and unnecessary care have led the Commonwealth Fund Commission on a High Performance Health System to conclude that the U.S. health care system could improve quality, access, and cost performance.[22] Five key strategies required to reach high performance include:

1. Extending affordable health insurance to all
2. Aligning financial incentives to enhance value and achieve savings

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[18] W.D. Nordhaus, "The Health of Nations: The Contribution of Improved Health to Living Standards," in Kevin Murphy and Robert Topel, eds., *The Economic Value of Medical Research,* University of Chicago Press, Chicago, 2002.

[19] D.M. Cutler and M. McClellan, "Is Technological Change In Medicine Worth It?" *Health Affairs,* September/October 2001; 20(5): 11–29.

[20] A.B. Rosen, D.M. Cutler, D.M. Norton, H.M. Hu, and S. Vijan, "The Value Of Coronary Heart Disease Care For The Elderly: 1987–2002," *Health Affairs,* January/February 2007; 26(1): 111–123.

[21] D.M. Cutler, A.B. Rosen, and S. Vigan, "The Value of Medical Spending in the United States: 1960–2000," *New England Journal of Medicine* 355, 9:920–7, August 31, 2006.

[22] Commission on a High Performance Health System, *A High Performance Health System for the United States: An Ambitious Agenda for the Next President* (New York: The Commonwealth Fund, November 2007).

3. Organizing the health care system around the patient to ensure that care is accessible and coordinated

4. Meeting and raising benchmarks for high-quality, efficient care

5. Ensuring accountable national leadership and public/private collaboration

To begin, the U.S. should establish a process, such as a Council of Health Advisers parallel to the National Economic Council, charged with establishing national goals for the health system, setting priorities for improvement, and making an annual report to Congress on health system performance, including health outcomes across geographic regions of the U.S. and different population subgroups, access to care, quality of care, efficiency, and our capacity to innovate and improve. Such a report would be an important complement to the Economic Report of the President, and to data reports on economic growth and employment.

The U.S. should shape policies that ensure access to health care for all and policies that enhance value for spending on health care. A series of measures show promise for both slowing the growth in health care outlays while improving access and quality of care. Over 10 years an estimated $1.5 trillion could be saved in health spending while providing health insurance coverage to all, ensuring cost-effectiveness of care rendered, and investing in public health and modern information technology. Investing in the health of children and reducing childhood obesity are particularly urgent needs, and should involve not only health insurance but a medical home for every child, and developmental and preventive services for young children to ensure a healthy start in life.

These steps would take us a long way toward ensuring that the U.S. has a high-performing health system worthy of the 21st century. Thank you very much for the opportunity to join this panel. I look forward to learning from my fellow panelists and answering any questions.

Senator DORGAN. Dr. Davis, thank you very much. Next, we'll hear from Dr. Katharine Abraham, the Professor of Joint Program and Survey Methodology at the University of Maryland. Dr. Abraham, thank you for joining us.

STATEMENT OF DR. KATHARINE ABRAHAM, PROFESSOR OF SURVEY METHODOLOGY, UNIVERSITY OF MARYLAND

Dr. ABRAHAM. Thank you very much. I appreciate the opportunity to be here. I would like to begin by saying something that I think you've said already, which is that the development of the national income and product accounts was a great accomplishment. And the existence of those accounts is a real asset to anyone concerned with managing the economy. So I'm not here to criticize the work of the Bureau of Economic Analysis in any way. I think they do a great job.

Having said that, as you also noted in your opening remarks, the national income and product accounts are incomplete. They cover market activity. They leave out everything that goes on outside of the market. In addition, they don't always handle things in the right way. There are things they treat as consumption that really are an investment in our future. The value of the national income and product accounts could be substantially enhanced if they were to be supplemented with satellite accounts that would look at non-market activity in a number of areas.

Just to give a flavor for the sort of thing that I'm talking about—and I might note that my testimony today draws heavily on work that I did as the Chair of a National Academy of Sciences panel that was charged to look into these issues—it is well known that there has over time been a big increase in the number of women who are in the labor force. In putting together the national income and product accounts, we count what those women do when they're working for pay as output. We don't count what they do at home as output. So as there has been a big shift of women from home into the workplace, all of that added output in the workplace is counted as a gain. None of the loss of production at home that may have occurred as that shift took place gets counted as a loss. So the picture that we get is likely to be misleading.

To give another example of the kind of thing that I'm concerned about, our measure of investment focuses primarily on equipment, structures, physical things. But in today's economy, a lot of the investing that we do isn't in physical things. It's in less tangible things. Much of the investing we do is investment in the human capital of our population. And we're not reflecting that in the national income and product accounts.

The National Academies panel that I chaired came up with a set of recommendations to begin to address some of these issues. Even when you're taking the national income and product accounts on their own terms, thinking about trying to measure output properly, not about trying to measure well-being, but to measure output, we could benefit from the development of supplemental accounts in at least five areas.

Our report proposed measures of household production; a supplemental account that would look more closely at the activities of the nonprofit sector, where there's a lot of volunteer labor that isn't currently reflected in the accounts; an education account that would track investments of time and money in the human capital of our population; the development of a health account, very much along the lines of what Dr. Davis has recommended; and the development of supplemental accounts to track environmental assets and services.

From my previous experience as Commissioner of the Bureau Labor Statistics, which has some related responsibilities, I know that just recommending the development of these kinds of measures is easier said than actually done. There are a whole set of technical issues that you would have to work through in order to accomplish this, but I do feel confident those could be resolved.

Having said this, a key ingredient to doing a lot of what we were talking about is the availability of information on how people spend their time. That's our metric for activity in a lot of these non-market areas. We have good data at this moment on how Americans spend their time. Since 2003, there has been a survey done by the Bureau of Labor Statistics called the American Time Use Survey, which provides exactly the sort of information that's required to make progress in these areas.

Unfortunately, the budget that the President has proposed for Fiscal Year 2009 eliminates the funding for that survey, and it is my hope that the Congress will recognize the value of that information and decide that the survey should be continued.

[The prepared statement of Dr. Abraham follows:]

PREPARED STATEMENT OF KATHARINE G. ABRAHAM, PROFESSOR OF SURVEY METHODOLOGY, UNIVERSITY OF MARYLAND

Mr. Chairman and Members of the Committee, I would like to begin by thanking you for the opportunity to appear before you this afternoon. My testimony will discuss how the national income and product accounts (NIPAs)—the source of the Gross Domestic Product (GDP) measurement that is the subject of today's hearing—might be supplemented with information about non-market activity to provide a more complete picture of national output and the sources of economic growth. My testimony draws heavily on the work of a recent National Academy of Sciences panel that I chaired. The panel was charged with making recommendations about whether and how our accounting of non-market activity might best be expanded and a more in-depth discussion of this topic can be found in the panel's published report (Abraham and Mackie, 2005; see also Abraham and Mackie 2006).

Concern that the NIPAs are incomplete and thus potentially misleading is not new—these concerns data back to the 1930s when the first U.S. economic accounts were developed by Simon Kuznets (Kuznets 1934). The development of these accounts rightly has been hailed as a major accomplishment. The NIPAs meet rigorous standards and enjoy broad acceptance among data users seeking to track economic activity. They are, however, primarily market-based and, by design, shed little light on production in the home or in other non-market contexts. Further, even where activity is organized in markets, important aspects of that activity may be omitted from the NIPAs. Unpaid time inputs and associated outputs often are critical to production processes but, because no market transaction is associated with their provision, they are not reflected in the accounts. One illustration is provided by estimates (LaPlante *et al.,* 2002) suggesting that the value of in-home long-term care services provided by family and friends is greater than the value of similar market-provided services.

In other cases, because it cannot be bought and sold, the output resulting from market-based production may be incorrectly characterized or valued. There is wide agreement, for example, that the output of the education sector properly should be considered investment rather than consumption, and that its value should be assessed in terms of the returns on that investment rather than the cost of the inputs used in its production, but this is not how education presently is treated. The conventional accounts do not account for the asset value of human capital production associated with education, or for that associated with health care and other personal investment activities. Available estimates are rough, but suggest that the value of the human capital stock may be as large as that of the physical capital stock (see Kendrick, 1976, and, for a discussion in the context of analyzing economic growth, Mankiw *et al.,* 1992).

Although the importance of non-market—but productive—endeavors has long been recognized, few attempts have been made to provide systematic information about even the most quantitatively significant of them. The state of non-market accounting today resembles the situation for market-based accounting in the 1920s and 1930s before the creation of the NIPAs. Economic accounting need not, and arguably should not, extend to all non-market activities, but there are certain areas in which non-market accounts, designed to supplement the NIPAs, could make particularly important contributions.

Extending the Nation's accounting systems to better incorporate non-market production promises substantial benefits to policymakers and researchers. For example, intangible investments seem certain to have accounted for a very large portion of the advance in living standards over time. But researchers who study economic growth have been forced to supplement data from the national accounts with rough-and-ready estimates from other sources in order to identify the contributions of factors such as investment in research and development or investment in human capital to growth. In this regard, the Bureau of Economic Analysis should be commended for the work it has done to develop a supplemental account that focuses on investments in research and development, but no comprehensive accounting of other intangible investments, most especially investments in our human capital, are available.

Non-market accounting also would illuminate the processes whereby inputs are transformed into outputs in particular sectors. Consider, for example the production of health. In contrast to currently constructed health *expenditure* accounts, which track market payments but do not identify the outputs in a way that is useful for measuring price change or productivity, a health account would relate health improvements—the real "good" that is produced—to medical treatments, as well as to a wide range of other inputs, including diet, the environment, exercise, and research and development. By most measures, improvements in health have outpaced increases in spending on medical care. Since medical care interacts with these interrelated factors, however, we do not know with any certainty the productivity of resources directed toward health care (Cutler and Richardson, 1997; Cutler 2004). Optimally, expenditures and outcomes would be tracked so that changes in well-being associated with different actions could be monitored; in turn, this information could support better management of expenditures (both private and public) to achieve desired outcomes.

To take another example, education accounts might be designed to relate improvements in skill capital—the output—to the various inputs to the educational process. As in the health case, schooling is characterized by a mix of market and non-market inputs and outputs. The value of time students spend in school—the key non-market input—is likely to be at least comparable to the expenditures on marketed inputs. The *2003 Statistical Abstract* shows that, in 2000, school expenditures on primary and secondary education amounted to approximately $400 billion and that just over 47 million students were enrolled in primary and secondary schools. Assuming 180 days at 6 hours a day, plus an hour of commuting time and 2 hours of homework per student, students in these grades devoted more than 75 billion hours to their education. If students' time were valued at the then-current minimum wage of $5.15 per hour (purely for illustrative purposes), the value of unpaid student time would have been almost as large as the expenditures measured in the conventional accounts.

The inherent limitation of the NIPAs—that they fail to consider the full array of the economy's productive inputs and outputs—might be less important if market and non-market activities trended similarly, but there is little evidence to suggest that they do. To take one frequently cited example, failing to account for the output produced within households may yield misleading comparisons of economy-wide production, as conventionally measured. To the extent that the entry of women into paid employment has reduced effort devoted to household production, the long-term trend in output as measured by GDP may exaggerate the true growth in national output (Landefeld and McCulla, 2000). Similarly, the relatively smaller portion of total output attributable to home production in the United States as compared to many developing countries surely exaggerates its national output relative to theirs.

Perhaps less well recognized are potential problems with the measurement of national output over the business cycle. If people who lose their jobs during cyclical downturns take advantage of their absence from paid employment to increase the effort they devote to home production, the short-term decline in national output may be dampened relative to that measured by GDP. Knowing more about the level and distribution of non-market activity could be important for other purposes as well. Such information could, for example, change perceptions of the extent of economic inequality among U.S. households and how that has changed over time. This, in turn, could affect where welfare and poverty lines are drawn (Michael 1996).

Different observers looking at the limitations of the existing NIPAs and thinking about how they might most fruitfully be expanded might come to somewhat different conclusions about the relative priority of extensions in different directions. The National Academies panel in which I participated recommended that work to develop measures in five areas be prioritized:

- Household production.
- Investments in formal education and the resulting stock of skill capital.
- Investments in health and the resulting stock of health capital.
- Selected activities of the nonprofit and government sectors, and
- Environmental assets and services.

Each of these areas involves productive activity that is substantial in magnitude, so that focusing attention on the activity should improve our understanding of the Nation's total output; is sufficiently "market-like" in its character that it would fit naturally into an expanded accounting framework that builds on the national income and product accounts; and satisfies a feasibility constraint, meaning that it seems possible to develop sensible approaches to quantifying and valuing the inputs and outputs that the expanded accounting of activity in the area would record.

Just to be clear, I am not recommending that the core National Income and Product Accounts be changed to incorporate the expanded measurement of non-market activity that I am envisioning. Rather, I am proposing that this information be incorporated into a set of satellite accounts that would augment rather than replace the existing accounts. To be useful, however, these satellite accounts should be produced on a regular schedule so that users of the data can count on its being available.

I should also acknowledge that there are a variety of technical and methodological questions that remain to be addressed in order to produce the satellite accounts I am recommending. Many of these questions are considered at some length in the report to which I alluded earlier. Without dismissing their significance, however, I do not believe this to be the proper forum in which to take them up, other than to say that I am confident that, with some effort, appropriate answers to them can be found.

An essential building block for carrying out much of the work to build a system of non-market satellite accounts that the National Academies panel has recommended is the availability of data on how Americans spend their time and, in particular, the time they devote to productive non-market activity. Data on time use are needed to measure the time devoted to household production, to track the time devoted to investments in education and health, and to provide a complete picture of time spent on productive activities in the nonprofit sector, including volunteer as well as paid labor. One reason for the optimism of the National Academies panel regarding the prospects for progress to develop useful non-market satellite accounts was the advent of the American Time Use Survey (ATUS), which in 2003 began to produce exactly the sort of information that is needed on how people allocate their time. Indeed, one of the panel's central recommendations was as follows:

> *Recommendation 2.1.* The American Time Use Survey, which can be used to quantify time inputs into productive non-market activity, should underpin the construction of supplemental accounts for the United States. To serve effectively in this role, the survey should be ongoing and conducted in a methodologically consistent manner over time.

Given the importance of the ATUS for addressing the recognized limitations of the GDP as a measure of national output, I was dismayed to learn recently that the budget the President has proposed for FY 2009 eliminates funding for these important data. Without the ATUS, much of the work envisioned by the National Academies panel on non-market accounting and others interested in developing a comprehensive set of supplemental accounts to complement the existing GDP measure, as well as other important research on the quality of our lives more broadly, will not be possible. Put simply, the ATUS is needed to expand our horizons beyond merely charting where dollars go, to charting where time goes too. Even beyond a more complete accounting of output and productivity, anyone who wants to understand the changing lives of American families, to monitor the well-being of the American population, or to make informed social policy decisions needs information on how our population spends its time.

The loss of the ATUS would make it much more difficult if not impossible to address the limitations of the GDP as a measure of national output that we are discussing here today. For that reason, I would like to express the hope that the Congress will find a way to preserve the funding for this important survey. I am not alone in this view—more than 1,500 economists and other researchers, including four Nobel laureates, have signed a letter in support of continued funding for the American Time Use Survey.

In summary, the existing National Income and Product Accounts have great value, but their value would be enhanced by the addition of satellite accounts to track important areas of non-market activity and their contribution to growth. I would be happy to answer any questions you might have about my testimony in this regard.

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Senator DORGAN. Dr. Abraham, thank you very much. Finally, we will hear from Mr. Jonathan Rowe, Co-Director of the West Marin Commons. You may proceed.

STATEMENT OF JONATHAN ROWE, CO-DIRECTOR, WEST MARIN COMMONS

Mr. ROWE. Thank you. You know, usually up here, people—oh, I'm sorry. Is that on? OK, thank you. Usually, up here, people are staring at the movie that is playing on the movie screen. What you're doing today is taking us back to the projection room and looking at the lens through which the movie is projected, and shapes what we see.

It's really, really important. We aren't just talking about a technical measure here. We're talking about what you mean, what Congress means, what the media means when we talk about the economy. We're going to stimulate the economy. We're going to incentivize the economy. This is the content of that term "the economy."

This is what you're looking at when you say, "Let's make it grow. Let's incentivize it. Let's stimulate it." And how often, how often do people step back and ask the question that is begging to be asked? What exactly is it that we're stimulating? Why is that when we get into this arena that we call "economics," the mind drifts into abstraction, and it stays there?

So what we're talking about is not just a technical measure. It's a shame that there are not more people from the media here today, because in my experience, it's the media that more than anything is the megaphone for the fallacies that we're talking about here. And I've had some experience with that on both sides. But I want to use my time to suggest to you four categories of things that we need to be looking at more.

And I agree that there is a use for the GDP accounts as they exist today. You need to know about the monetary flows through the economy. You need to know about that for purposes of taxation, for trade, all those things. There's a lot more you need to know.

One is, as numerous people have mentioned here already, all those economic functions that take place outside the realm of monetized exchange, in both the ecosystem and the social system. It's like we're driving a car that has two dials on the dashboard; one is for gas, and the other is for oil. The gas is our natural resources; the oil is our social resources. And they both go up the more we burn them down.

Number two, time matters. How many parents looking back wouldn't pay any amount of money to have been able to spend more time with their kids? Time is wealth. And yet, we don't count that. If two parents are working 10 hours a day, and have no time with their kids, the time that has been subtracted from their home life is invisible. It doesn't count.

Simon Kuznets said in his report to Congress, "We should go further. We should count the wear and tear on workers. We count depreciation for buildings. We count depreciation for machinery. How about depreciation of our own bodies? Our own psyches?"

I've just got a few more minutes, and I'm going to jump ahead to—less than minute—and I'm going to jump ahead to the one thing that I think is probably the most important, and this encompasses not just the GDP, but also the way you think about productivity. We measure performance in this economy not by performance; we don't look at results; we look at supposed means to the result, but we don't look at the result.

We look at the productivity of the medical system, as was just mentioned, by the pills that we sell. We measure the productivity of the automobile industry by the cars that they turn out per hour worked. Really, it's a transportation business. We should be measuring the transportation that results from all this output. We should be measuring the health that results from all this output.

And again, I really appreciate the opportunity to be here, and that you're holding these hearings.

[The prepared statement of Mr. Rowe follows:]

PREPARED STATEMENT OF MR. JONATHAN ROWE, CO-DIRECTOR, WEST MARIN COMMONS

Mr. Chairman and Members of the Committee:

Let's suppose that the head of a Federal agency came before this Committee and reported with pride that agency employees had burned 10 percent more calories in the workplace than they did the year before. Not only that—they had spent 10 percent more money too.

I have a feeling you would want to know more. What were these employees doing when they burnt those calories? What did they spend that money on? Most important, what were the *results?* Expenditure is a means not an end; and to assess the health of an agency, or system, or whatever, you need to know what it has accomplished, not just how much motion it has generated and money it has spent.

The point seems obvious. Yet Congress does this very thing every day, and usually many times a day, when it talks about this thing called "the economy." The administration and the media do it too. Every time you say that the "economy" is up, or that you want to "stimulate" it, or get it going again, or whatever words you use, this is what you actually are saying. You are urging more expenditure and motion without regard to what that expenditure is and what it might accomplish—and without regard to what it might crowd out or displace in the process.

That term "the economy": what it means, in practice, is the Gross Domestic Product or GDP. It's just a big statistical pot that includes all the money spent in a given period of time. (I'm simplifying but that's the gist.) If the pot is bigger than it was the previous quarter, or year, then you cheer. If it isn't bigger, or bigger enough, then you get Bernanke up here and ask him what the heck is going on.

The *what* of the economy makes no difference in these councils. It never seems to come up. The money in the big pot could be going to cancer treatments or casinos, violent video games or usurious credit card rates. It could go toward the $9 billion or so that Americans spend on gas they burn while they sit in traffic and go nowhere; or the billion plus that goes to drugs such as Ritalin and Prozac that schools are stuffing into kids to keep them quiet in class.

The money could be the $20 billion or so that Americans spend on divorce lawyers each year; or the $5 billion on identity theft; or the billions more spent to repair property damage caused by environmental pollution. The money in the pot could betoken social and environmental breakdown—misery and distress of all kinds. It makes no difference. You don't ask. All you want to know is the total amount, which is the GDP. So long as it is growing then everything is fine.

We aren't here today to talk about an obscure technical measure. This isn't stuff for the folks in the back room. We are talking about what you mean when you use that term "the economy." Few words induce such a reverential hush in these halls. Few words are so laden with authority and portent. When you say "the economy" is up then no news is brighter. When you argue that a proposal will help the economy or hurt it, then you have played the ultimate trump card in your polemical decks, bin Laden possibly excepted.

As I said it isn't just you. The President does it, the media, the reporters sitting at that table over there. They do it too. How many of them, or of you, asked during the recent debate over the "stimulus" package, exactly what it was that would be stimulated. How many of them say, when Bernanke comes up here to report on the Nation's growth, "Hey wait a minute. What exactly are we talking about here?"

Doesn't it matter whether it is textbooks or porn magazines, childbirths or treatments for childhood asthma born of bad air? Doesn't it matter whether the expenditure comes from living within our means or from going into financial and ecological debt? Don't we need to know such things before we can say whether the increase in transactions in the pot—what we call "growth"—has been good or not?

This is not an argument against growth by the way. To be reflexively against growth is as numb-minded as to be reflexively for it. Those are theological positions. I am arguing for an empirical one. Let's find out what is growing, and the effects. Tell us what this growth is, in concrete terms. Then we can begin to say whether it has been good or not.

The failure to do this is insane, literally. It is an insanity that is embedded in the political debate, and in media reportage; and it leads to fallacy in many directions. We hear for example that efforts to address climate change will hurt "the economy." Do they mean that if we clean up the air we will spend less money treating asthma in young kids? That Americans will spend fewer billions of dollars on gasoline to sit in traffic jams? That they will spend less on coastal insurance if the sea level stops rising?

There is a basic fallacy here. The atmosphere is part of the economy too—the real economy that is, though not the artificial construct portrayed in the GDP. It does real work, as we would discover quickly if it were to collapse. Yet the GDP does not include this work. If we burn more gas, the expenditure gets added to the GDP. But there is no corresponding subtraction for the toll this burning takes on the thermostatic and buffering functions that the atmosphere provides. (Nor is there a subtraction for the oil we take out of the ground.)

Yet if we burn less gas, and thus maintain the crucial functions of the atmosphere, we say "the economy" has suffered, even though the real economy has been enhanced. With families it's the same thing. By the standard of the GDP, the worst families in America are those that actually function as families—that cook their own meals, take walks after dinner and talk together instead of just farming the kids out to the commercial culture.

Cooking at home, talking with kids, talking instead of driving, involve less expenditure of money than do their commercial counterparts. Solid marriages involve less expenditure for counseling and divorce. Thus they are threats to the economy as portrayed in the GDP. By that standard, the best kids are the ones that eat the most junk food and exercise the least, because they will run up the biggest medical bills for obesity and diabetes.

This kind of thinking has been guiding the economic policy minds of this country for the last sixty years at least. Is it surprising that the family structure is shaky, real community is in decline, and kids have become Petri dishes of market-related dysfunction and disease? The nation has been driving by a instrument panel that portrays such things as growth and therefore good. It is not accidental that the two major protest movements of recent decades—environmental and pro-family—both deal with parts of the real economy that the GDP leaves out and that the commercial culture that embodies it tends to erode or destroy.

How did we get to this strange pass, in which up is down and down is up? How did it happen that the Nation's economic hero is a terminal cancer patient going through a costly divorce? How is it that Congress talks about stimulating "the economy" when much that actually will be stimulated is the destruction of things it says it cares about on other days? How did the notion of economy become so totally uneconomic?

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It's a long story, but for the present purpose it probably starts in Ireland in the 1640s. British troops just had repressed another uprising there, and the Cromwell government had devised a final solution to put its Irish problem to rest. The government would remove a significant portion of the populace—Catholics in particular—to a remote part of the island. Then it would redistribute their lands to British troops, thus providing compensation to them, and also an occupational presence for the benefit of the government in London.

The task of creating an inventory of the lands went to an army surgeon by the name of William Petty. Petty was a quick study, and also a man with an eye for the main chance. He classified much land as marginal that actually was quite good. Then he got himself appointed to the panel that made the distributions, and bestowed much of that land upon himself.

Petty's survey was the first known attempt in Western history to create a total inventory of a nation's wealth. It was not done for the well-being of the Irish people, but rather to take their lands away from them. It was an instrument of government policy; and this has been true from that time to the present. Governments have sought to catalogue the national wealth for purposes of taxation, confiscation, planning and mobilization in times of war. They have not designed these catalogues to be measures of national well-being or of quality of life.

Yet that is how the national wealth inventories have come to be used, and especially the GDP. Somehow, a means of policy has become the end of policy. The tool has become the task. This part of the story begins with the Great Depression.

In the early 1930s, as the U.S. sank deeper into an economic slough, Congress faced an absence of data to help guide the way out. It didn't really know exactly what was happening, and where. There were no systematic figures on unemployment or production. Then-President Hoover had dispatched six employees from the Commerce Department to travel around the country and file reports. These were anecdotal and tended toward the Hoover view that recovery was just around the corner.

Members of Congress wanted more. Senator Robert LaFollette, a Republican, introduced a resolution to require the Commerce Department to develop a spreadsheet—as we would call it today—of economy with its component parts. LaFollette was a Progressive in the original sense. He believed in "scientific management and planning;" and the resolution was to produce a tool to that end. It passed on June 8, 1932, and the work fell to one Simon Kuznets, a professor at the University of Pennsylvania who was working at the National Bureau for Economic Research in New York.

Kuznets was clear that he was producing a policy tool, and not a measure of living standards or well-being. As he put it later in his clinical prose, the goal was to help understand the "relations and relative importance of various parts of the productive system and their responsiveness to various types of stimulae as shown by their changes in the past."

The project was a marvel by today's standards. Kuznets had virtually no budget, and a tiny staff. Data sources were fragmentary. But about a year and a half later, Kuznets submitted his report to Congress. It is Senate Document 124, 73rd Congress, 2nd Session, January 4, 1934, and I urge you to read it. The national accounts were a first, but even more remarkable was the report that came with them. With a brevity and candor that are rare today, Kuznets laid out for Congress the limitations of the accounts he had constructed. He took particular pains to tell you why you should not use these accounts the way you—and the media—have come to use them.

For one thing, the national accounts leave out a crucial dimension of the economy—namely, the part that exists outside the realm of monetary exchange. This includes both the ecosystem and the social system—the life-supporting functions of the oceans and atmosphere for example, and work within families and communities that isn't done for money. The GDP takes no account of these. The result is that when the monetized economy displaces them—as when both parents have to work, or when forest clearing eliminates the cleansing function of trees—the losses are not subtracted against the market gain.

Kuznets was under no such illusion. "The volume of services rendered by housewives and other members of the household toward the satisfaction of wants must be imposing indeed," he writes. There's also the question of what he called "odd jobs," or what we would call the "underground economy." He knew that these played a large role in the economy. He also grasped, more broadly, that the quality and importance of a function does not depend upon the amount of money paid for it—or whether any money was paid at all. The care of a mother or father is not inferior to that of a day care worker just because they do not charge a price for their services.

This recognition undercuts a basic assumption behind the GDP—namely, that the contribution of an activity can be gauged solely from its market price. But there's a practical problem, Kuznets observed. Accounts require data; and there is by definition little data on the underground economy and on non-market exchange. As a result, the national accounts include only the slice of economic reality that falls within the bandwidth that economists are able to grasp—that is, recorded expenditures of money.

Then there's the thorny question of constructive versus destructive activities within the realm of monetized exchange. Once you have decided to count only that which is transacted through money, do you make the further assumption that everything transacted for money counts on the plus side of the ledger? Is something beneficial just because money changes hands when it passes from a seller to a buyer?

The mentality that lies behind the GDP assumes that it does. We all are "rational," and so any choice we make in the market is by definition one that makes our lives better. Kuznets focused on one obvious exception: activities that are illegal, such as gambling (when it is) and drugs. To assume that such expenditures add to the national well-being would undercut the rationale for making them illegal in the first place. The GDP is an instrument of the state, after all, and so Kuznets drew the line there.

He was aware of how arbitrary this is from an economic standpoint. Why exactly does legal gambling add to well-being if the illegal kind does not? Or what about alcohol? Given the assumption that legality confers benediction, the economy had a huge boost at the end of Prohibition, simply because the drinking that formally was illegal now was deemed OK. But booze still was booze. If the government can increase the growth rate by jiggering the metrics in this way, that does not increase confidence in the validity of measure.

But legality is the easy part. Just beneath it lies a deeper issue—namely, the assumption that every purchase is beneficial simply because someone has paid the purchase price. The exclusion of illegal activities, Kuznets said, "does not imply . . . that all lawful pursuits are necessarily serviceable from the social viewpoint." He left the question there, a chasm that an honest inquiry has to address.

There are so many examples of expenditure that goes into the GDP that has a questionable claim to the stature of growth and good, even from the standpoint of those who make it. For example, much consumption is compulsory, in that buyers have little choice. There is fraud, such as the way seniors are cheated in reverse mortgage scams. There's also products that are designed to lock buyers into an endless stream of high-priced replacements, such as inkjet printer cartridges that are designed to resist refilling.

Or what about car bumpers that are designed not to bump, so that a mild fender bender turns into a $5,000 repair bill? Or the usurious charges and fees that are built into credit cards. Not all Americans confronted with these regard them as "consumption choices" that propel them further up the mountain of more.

The toughest case for the economic mind is addiction. The GDP assumes, as most economists do, that people are inherently "rational." What they buy is exactly what they want, and so their purchases must make them happy in exact proportion to the prices paid. Yet addiction has become pervasive. It has metastasized far beyond the usual suspects—gambling, tobacco, drink and drugs—and come to roost on such things as eating, credit cards, and shopping itself.

How can anyone assume that buying makes people feel better when those very people are engaged in a mighty struggle to do less of it? Kuznets didn't explore all of these problems. But as I said, the terse language of his report suggested an awareness of them. It's another reason that the national accounts bear little relationship to a tally of economic well-being.

Yet another reason is what economists call "distribution." The GDP makes no distinction between a $500.00 dinner in Manhattan and the hundreds of more humble meals that could be provided for that same amount. An Upper East Side socialite who buys a pair of $800.00 pumps from Manolo Blahnik, appears to contribute forty times more to the national well-being than does the mother who buys a pair of $20.00 sneakers at Payless for her son. "Economic welfare cannot be adequately measured unless the personal distribution of income is known."

As included in the national accounts, an accretion of luxury buying at the top covers up a lack of necessary buying at the bottom. As the income scale becomes more skewed, as it has in the U.S., the cover up becomes even greater. In this respect the GDP serves as a statistical laundry operation that hides the suffering at the bottom—when used as a measure of national well-being.

Another problem has to do with work, and the toll it takes on those who do it. Kuznets called this the "reverse side of income, that is, the intensity and unpleasantness of effort going into the earning of income." That earning comes at a cost of wear and tear upon the body and psyche. If the GDP subtracts depreciation on buildings and equipment, should there not be a corresponding subtraction for the wearing out of people?

What about the loss in the value of their skills as one technology displaces another? In the current accounting, this toll often gets added to the GDP rather than subtracted, in the form of medications, expenditures for retraining, and day care for children as parents work longer hours. Most workers would regard such outlays as costs not gains.

Had Kuznets been writing today, moreover, he probably would have added another kind of depletion—that of natural resources. It sounds incredible, but when this Nation drills its oil and mines its coal, the national accounts treat this as an addition to the national wealth rather than a subtraction from it. The result is like a car with a gas gauge that goes up as the fuel tank gets lower. The national accounts portray a nation getting richer, when in fact it is draining itself dry.

Kuznets concluded his report with words that ought to be inscribed on the walls in every office on Capitol Hill, and over every computer screen within a twenty mile radius. "The welfare of a nation can, therefore, scarcely be inferred from a measurement of national income as defined above."

I'm going to repeat that in case anyone missed it:

> *"The welfare of a nation can, therefore, scarcely be inferred from a measurement of national income as defined above."*

That's what the man who invented the GDP—its predecessor, more precisely—told Congress regarding the use of his invention. Yet Congress has done exactly what Kuznets urged it not to do. Congress and everybody else.

How exactly that came about is another long story. It began with the gradual seep of the new accounts into the political arena. In his 1936 re-election campaign, Franklin Roosevelt noted that the economy—as defined by the national accounts—had increased under his watch. It was a number: who could resist? The likely source was FDR's close advisor Harry Hopkins, whose office was a hub for the young economists who came to Washington to join the New Deal. But in the passage across 15th Street from the Commerce Department to the White House, Kuznets' numbers were turning in to precisely what he said they shouldn't be.

Then came World War II, when the national accounts played a central role in the mobilization effort. A bitter debate erupted in Washington over the Nation's production goals. Corporate leaders insisted that the mobilization must come out of the existing level of production They didn't want to be stuck with excess capacity when the war was over. Kuznets and others argued to the contrary that the U.S. had vast troves of untapped capacity; and they used the national accounts to prove it.

FDR sided with the "all-outers" as this group was called. They appealed to his belief in the energizing effects of challenges; Roosevelt took their high estimates and made them even higher, the better to make his point. (The planners then had to shift gears argue the case for system limits, which the national accounts also helped them do.) Then the accounts helped to coordinate the war production so as to prevent bottlenecks and snafus. By 1944 war production alone had surpassed the Nation's entire output just 10 years before.

It was as close as the Nation ever has come to pure economic planning; and though much reviled, it helped to win the war. Post-war surveys revealed that Germany had no such planning tool, and Hitler's production program had been greatly hindered as a result. America had become the "arsenal of democracy" in part through a top-down approach made possible by the national accounts. A paper published by the Russell Sage Foundation called the use of these "one of the great technical triumphs in the history of the economics discipline."

This was heady stuff, and it was just a start. As the war was winding down, the accounts served again to guide the shift back to a peacetime basis without relapse into the dreaded Depression. Consumption was the key; the Cold War, with its Pentagon spending, was not yet in prospect. As war production diminished, shoppers would have to pick up the slack. The national accounts showed exactly how it could be done. As John Kenneth Galbraith put it in a series of articles for *Fortune Magazine,* "One good reason for expecting prosperity after the war is the fact that we can lay down its specifications."

The new Keynesian economists such as Galbraith were now the Merlins of prosperity, and the national accounts were their magic wand. Consumption itself was taking on a heroic stature; the returning troops were handing off the mantle of national purpose to the shoppers who would replace them in keeping the industrial machinery in motion. (The heroic imagery persists in media accounts today, as when we read that consumers will provide the "engine" for recovery, or that they will "pull" the Nation out of its recession.)

In this atmosphere, it was perhaps inevitable that the map of the Nation's capacity would become a totem to its economic success. But Simon Kuznets watched it happen with increasing dismay. (Galbraith came to have second thoughts as well.) Kuznets was a quiet academic who was loathe to mount a soapbox. But he asserted over and over that those who had seized upon his handiwork had missed the point.

In 1962 he wrote an article in the *New Republic* magazine on the question of growth. In evaluating growth, he said, "distinctions must be kept in mind between quantity and quality of growth, between its costs and return, and between the short and the long run."

Kuznet's continued, "goals for 'more' growth should specify more growth of what and for what. It is scarcely helpful to urge that the over-all growth rate be raised to x percent a year, without specifying the components of the product that should grow at increased rates to yield this acceleration." If you are going to "stimulate" the economy, in other words, could we at least have a little debate over what exactly you are going to stimulate?

That is the challenge that you face today. You might think of it as a broken feedback loop. If you had a gas gauge that went up as you drove, eventually you would run out of gas. If you have an index of economic well-being that goes up as families and communities cease to function, then you will keep doing the things that cause this dysfunction to increase. If your measures portray resource depletion as wealth increase, then you will continue to borrow from the future and to drain America first.

Better measures will help lead to better results not by way of top down planning, but through the feedback they provide regarding when current policy is going off the tracks. I doubt that it is possible to include all the needed information into one single indicator. There are too many apples and oranges. To value a parent's work in the home at the going market price, for example, is both insulting to parents, and an exercise in self-parody for an economics profession that cannot see beyond the realm of market price.

But at the very least there needs to be an array of indicators that connects such hidden forms of economic function to a larger economic whole. Here are some principles you might find useful.

1. The Future Matters

Herman Daly, the economist, says that the national accounts look at America as a "business in liquidation." The more we drain our natural resources, and the more we burden the natural dump space in the air and sky, the better we say we are doing. The same goes with the financial debt we are heaping upon the future and therefore upon our kids. You must weigh the burden these activities impose upon our kids and grandkids, against the temporary gains—if gains they are—they yield for us today.

2. Time Matters

Time is perhaps the most basic form of wealth. Yet Americans, for all their wealth, are the most time-impoverished people on earth. The time they spend both working and consuming—that is, the time absorbed into the market—comes out of the time available for their families and communities; and both are going wanting as a result.

Time is a finite resource, just as coal and oil and dump space in the sky are finite resources. To take more of it for work or consumption is to take it from someplace else. You need to look not just at the money and stuff that people have, but also at the time they have.

3. The Non-Market Economy Matters

Most of the crucial life-supporting functions take place outside the realm of monetized exchange. They are not part of the market or the government—both of which function through money—but rather occur through natural or social process. The help and care of parents and neighbors; the cooling and cleansing functions of trees; woods in which to hike and hunt; clean water in which to fish and swim; these all are off the books. They do not register in the GDP until something destroys them and people have to buy substitutes in the market.

This is insane. A tally of economic well-being needs to reflect reality, not just the portion of it that is convenient for economists to measure.

4. Distinguish Positives From Negatives

This is tricky but there is no avoiding it forever. Not everything that is called "consumption" represents advance up the mountain of more. Here are a few examples:

- Compulsory expenditures that are built into products, such as cars designed to cost a fortune to repair, and inkjet printer cartridges designed to resist refilling.
- Fraud and abuse, such as exorbitant fees built into credit cards that issuers increase whenever they want.
- Medical bills incurred because of other activities that increase the GDP but degrade the environment. An example is medical bills to treat asthma in children brought on by bad air.
- Addictive consumption, which is shopping that the shoppers themselves wish they could drop. It is hard to see how this could add to well-being, when the people are doing it thinks it adds to their own misery instead.
- Defensive consumption, such as the double-pane windows that city dwellers buy to keep out noise from boom box cars and the like on the street.

It is not possible to parse out every single expenditure for its plusses and minuses. But neither is it tenable to assume that every expenditure represents a plus for the individual and society, just because somebody has made it. Yet the GDP starts with just that assumption; or more precisely, the people who interpret the GDP that way do. It is time to begin to make distinctions.

5. Measure Results Not Expenditures

This is the most important thing. The purpose of an economy is to meet human needs in such a way that life becomes in some respect richer and better in the process. It is not simply to produce a lot of stuff. Stuff is a means, not an end. Yet current modes of economic measurement focus almost entirely on means.

For example, an automobile is productive if it produces transportation. Yet today we look only at the cars produced per hour worked. More cars can mean more traffic and therefore a transportation system that is less productive. The medical system is the same way. The aim should be healthy people, not the sale of more medical services and drugs. Yet today, we assess the economic contribution of the medical system on the basis of treatment rather than results.

Economists see nothing wrong with this. They see no problem that the medical system is expected to produce 30–40 percent of new jobs over the next 30 years. "We have to spend our money on something," shrugged a Stanford economist to the *New York Times.* This is more insanity. Next we will be hearing about "disease-led recovery." To stimulate the economy we will have to encourage people to be sick so that the economy can be well.

These hearings could help to prevent that fate from befalling us. They are a big step. Thank you.

Senator DORGAN. Mr. Rowe, thank you very much. Let me ask Dr. Landefeld, you know what we do measure, you've described it, and I think the panel has indicated it is not a worthless enterprise for us to know what is the classically defined GDP. We know what that measures.

But it occurs to me that, for example, when we next hear the quarterly GDP, it will tell us the measurement of either growth or retraction in the economy. My guess is—let's assume that the next quarterly GDP would be a 3 percent growth. It won't be, but let's assume it would be 3 percent growth. That number could exist as growth even if there was substantial reduction in the value of the housing stock owned by American families. Is that correct?

Dr. LANDEFELD. That's correct.

Senator DORGAN. So let's now take a more realistic view. We use the GDP to evaluate whether we are in a recession." And that's just a trigger, or some sort of switch, a recession. We measure that by two successive quarters of negative growth, and therefore, ergo, we are in an economic recession. Is that correct?

Dr. LANDEFELD. That's a commonly used definition.

Senator DORGAN. Let's assume the next quarter—we've had one now, I believe—the next quarter gives us negative growth of one-half of 1 percent. Wouldn't it be the case that it is really much greater than that in terms of negative growth because we've had a dramatic reduction in the value of housing that bubble bursts the assets owned by the American people, and in most cases, the most significant asset is the home which is now, in most parts of the country, worth less?

And that diminished value does not show up in the GDP?

Dr. LANDEFELD. I think, as I said at the outset, it's important to have a multiplicity of numbers. And we publish all the Federal Reserve reports that are integrated in this volume I talked about.

And there is a measure of what's happened to the housing wealth, and we publish that as part of our sets of accounts as a one-off, but because I think it's important to keep what's happening to wealth separate from what's happening to current production, and capital gains and losses from current income and current production.

Again, illustrating that I think you need to look at the full picture, but I think it's also important that you keep the components separate.

Senator DORGAN. That's a fair point, and I think the point that Jonathan Rowe made is that as is the case with so many things, the location of the GDP and the timing of it gives our 24/7 press an opportunity to say, "Here's a definitive all-being, all-knowing, all-seeing evaluation of life in America," which, of course, is not what the GDP is about in any event.

What would be the consequences if we developed supplemental accounts of some type? You indicate we have those now, by evaluating housing stock and so on, but Dr. Davis is talking about a supplemental account with respect to healthcare.

Tell me about the consequences of that, and what kind of discussions have existed in your agency on that issue.

Dr. LANDEFELD. I think outside of the Federal Reserve balance sheets and some other accounts, we don't have those kinds of satellite accounts. But that's one thing we are working on.

Because, to answer the question Dr. Davis asked about the efficacy of healthcare, we really think the current system is deficient; because a lot of what we measure as an increased cost really isn't an increased cost. We believe we are missing, for example, the substitutions, from expensive talk therapy to lower-cost drug therapy. Substitution from bypass therapy to drug therapies appear to be missed in current measures.

And so, one of our proposals, which we've done some work on, is to look at the cost of an episode of disease, more focused, as some of the panelists have talked about, outcome-type measures for health. Another reason that we need a satellite account is that we measure healthcare spending on hospitals, physicians, each type of service we think of economically, but we don't do that by disease category.

If we're interested in tracking what's happening to the cost of disease, we need to begin to look at it not only by type of service, but by types of diseases that are the cost drivers. So that's an example of one satellite account that we would be working on: that we think would begin to focus more on the type of outcomes that I think we need to measure to go beyond the GDP-type measures we have now.

Senator DORGAN. Dr. Frank, and others on the panel who wish to comment, again, I don't wish to denigrate the GDP, because it is what it is, but isn't it the case that GDP would measure prostitution rings, pornography, and heart attacks as a net benefit to the economy? Or, at least, a net contributor to the GDP growth?

Dr. FRANK. Well, illegal activities sometimes don't make it onto the books and get counted, but if everything got counted, yes, it'd be counted alongside everything else. That's part of the GDP.

Senator DORGAN. And so, Dr. Landefeld, does your family really count these things as a contribution to the economic well-being and say, "Yes, but it's not a perfect measurement"?

Dr. LANDEFELD. Yes.

Senator DORGAN. It's an easy criticism of the GDP, and I understand that. The question, I think, is what really should be an evaluation or some sort of set of measurements that describe what kind of place this is in which to live, and how are we doing? Some of the Scandinavian countries have very different measurements.

Who could describe some of what was happening in the Scandinavian countries or in other countries in the evaluation of economic growth or well-being? Who has a summation of that?

Dr. FRANK. I'll mention one small example. The tiny Himalayan Kingdom of Bhutan has recently adopted a gross national happiness measure. They've attempted to assess the happiness of members of the population by direct assessment, and then keep track of that over time, in the belief that if they measure that and publicize that, that will focus their attention on trying to do—adopt policies that will improve that measure.

Senator DORGAN. We have—and anyways, we have a similar measurement in this country with respect to the economic side of things. We measure what is called consumer confidence, and that measurement has actually some impact out there. It kind of describes where things are heading in terms of how people see the future.

And the economy itself, as most of us know, this is not the engine room of a ship with dials and knobs and gauges and you just adjust them all correctly and the economy works. In most cases, the economy is about confidence. If people are confident in the future, they do things that manifest their confidence.

They buy a boat, buy a truck, buy a house, take a trip, they do all those things because they're confident about the future. They have their job, they're secure. If they're not, exactly the opposite of that, is they defer the purchase, they defer the trip. And so, we have—that's—the first part is expansion. The second part is contraction.

So we all—we have measurement, not of happiness, but we have a measurement of consumer confidence.

Dr. FRANK. Now, that, and we also have a measure of happiness. They're not necessarily a government measure—perhaps there are also government measures—but there have been various surveys since World War II that have asked American citizens, all things considered, how satisfied are you with your life these days? And that's been tracked over the decades.

Senator DORGAN. I thought you were going to say the aggregate tickets to Disneyland or something like that. Well, Mr. Rowe, what do you think we should do? We have a measurement now. We all acknowledge that it doesn't necessarily measure the right things; it measures what it does measure.

The press reports it that way. The policymakers rely on it in that way. What should we be doing to add to this measurement?

Mr. ROWE. Well, it would helpful to go back and look at what happened in 1932, when what we now call the GDP came into being. We know that it was at the beginning of the Depression. Congress and the government had absolutely no data. There was no real data on employment and unemployment, in production, in different parts of the country.

Then-President Hoover dispatched six people from the Commerce Department to go around the country and file reports, and those reports, not surprisingly, said that recovery was just around the corner. And so, Congress, and the person, then-Senator Robert LaFollette, introduced a resolution under which the Department of Commerce would develop a systemic set—what today we would call a spreadsheet—of national accounts.

The concern back then was just to get the economy going. And so, naturally, they were focused primarily on what is now included in the GDP. We have a much more complicated situation, but I think we can learn from that approach. It's going to take the initiative of somebody here in the Senate to introduce a resolution like that, or a law, or whatever, and get people working.

It's probably going to take a lot of trial and error, but it's going to take some initiative to develop the kinds of approaches and accounts. Most of the statistic-gathering system of the Federal Government today is geared to the indicators that we now have. Until we start having some new indicators and taking them seriously, we aren't going to develop the statistic and data-gathering necessary to carry those out.

Senator DORGAN. Dr. Davis, you wanted to comment.

Dr. DAVIS. Well, I think Mr. Rowe is right, that policy is geared to what we measure and what we have data on. One of the measures of health system performance, first of all, is to the Eurobarometer survey of public satisfaction. Denmark has the highest rating of public satisfaction with the health system of any country in Europe.

And when you really probe why that is, it's easy access to a family physician. You can get in at eight o'clock in the morning. There's an off-hours system that when you call, the doctor answers—a doctor answers the phone from 4 p.m. to 8 a.m. at night and on weekends.

So we can do that as something comparable to consumer confidence in terms of public satisfaction with healthcare. Another measure that's used a lot in other countries is preventable mortality amenable to medical care. That's now used by the Europeans. We don't use it in the U.S. We've actually funded, at The Commonwealth Fund, work to construct those indicators. But they ought to be part of standard government reporting.

In our national scorecard on health system performance, we have 37 indicators. For the first time, we actually calculated what percent of adults are up to date with recommended preventive care. Only half of adults are up to date. What percent of people with chronic conditions, like hypertension or diabetes, have them adequately controlled? There's really no standard in reporting that. We need to have measures like that.

We do have things like the quality in the hospital care for heart attack, congestive heart failure, and pneumonia. But we really need to broaden that to include much broader measures. And then, we need to know how well our care is coordinated. The big problem with the U.S. healthcare system is people fall through the cracks. They're discharged from the hospital, and nobody takes care of them immediately afterwards.

They don't have an appointment with their own doctor to follow up, and so we have high rates of hospital readmissions, patients coming back in within 30 days because they don't know how to take care of themselves when they go home, or who to call when something is troubling.

Senator DORGAN. Dr. Abraham, what alternative measurements do you think are necessary?

Dr. ABRAHAM. I've already mentioned supplemental accounts in the areas of home production, health accounts, and education accounts. But the thing that I keep coming back to, I guess, and something that Jonathan Rowe mentioned, is the importance of time.

It's hard to think that we can do a good job of evaluating how well off we are as a society if, in addition to information on jobs and incomes and so on, we don't also have good information on how people are spending their time. Do people have time to spend with their families? What time do parents spend with their children? What time do people spend caring for older people?

It's interesting to me. I think it's correct, again picking up on something Jonathan Rowe said, that the priority in the statistical system currently is on the economic statistics that have been around for a long time, and are rightly viewed as important measures. New things tend to get lower priority. That was the reason given for eliminating funding for the American Time Use Survey, and I think it's a big mistake.

Senator DORGAN. Dr. Landefeld, do the measurements we now have with the Gross Domestic Product reflect increase in indebtedness?

Dr. LANDEFELD. In—oh, in debt? As a—the same situation with respect to wealth, certainly yes, the net worth of consumers and how it's changed is presented alongside our numbers. But I think you make a valid point. It's more of a background set of numbers.

And I think there is more that we can do to bring those numbers up front in our monthly personal income or personal consumption reports. It certainly is a very valid point that we can do more, and I think the press has critiqued us on that, rightfully so, that we can do more to bring those changes in debt and net wealth up front.

If I may, just one point on other countries' measure of happiness: happiness is a real tough thing to measure. And when you look over time at most developed economies, they all bunch together, and they don't change over 20, 30, 40 year time horizons. The reason is, people adapt to different circumstances. Studies have shown, that while you may think that would make a big difference in people's happiness whether they're blind or not blind. It doesn't.

So there's this current interest in measuring happiness in place of a gross—GDP type of numbers, and I think there's a lot that can be done, but some of it is more difficult because it's not——

Senator DORGAN. The reason I ask about the debt offset or the question of debt is that there's a parable offered by Warren Buffet—I guess now probably the richest man in the world—I think it was just recently declared. He has a really interesting parable describing two groups of people living on two islands.

One is Thriftville, and the other Squanderville. And one is very thrifty and productive, and the other essentially consumes and spends a lot. And you could, for Squanderville, I won't go through the parable with you, but you could make a pretty good case if we take this measurement that we have now called "Gross Domestic Product."

Even if Squanderville is consuming at a rate greater than its production, and therefore squandering its future opportunities, this measurement would measure Squanderville's progress as having growth, despite the fact that it is consuming its future and mortgaging its very assets to consume above its production.

And so, it seems to me we could take a look at what's happening in our economy today with the subprime loan scandal and see the unbelievable amount of leverage and speculation, and then report whatever the growth figure might be the next quarter. Let's say it's positive. That positive figure probably has no reality and no attachment at all to what is really happening in the economy.

The dramatic growth of the bubble of risk, dramatic reduction in home values, and so on—can that be the case, Dr. Landefeld?

Dr. LANDEFELD. Yes. I think that the Federal Reserve Board, as I said, does produce these numbers, and we try and bring them out, but I think they become disconnected from the GDP number that comes out in our economic reporting of these data. And so, therefore, I think this is one of the reasons why we do need to do a better job integrating our various economic statistics we produce, because the accumulation of debt is a very important thing in terms of wealth effects and household spending.

Even if you only care about the economy, you should care about those kind of things, as well.

Senator DORGAN. Could you have growth of economic activity and net reduction in wealth?

Dr. LANDEFELD. Actually, we have a measure called Net Domestic Product, which tries to measure exactly that, which looks at what we're consuming relative to what we're putting aside in depreciation through the future. And Net Domestic Product has, at times, been negative when Gross Domestic Product was positive.

But once again, it's sort of one of those below-the-line numbers that people don't pay a lot of attention to. There are times, like hurricanes and other events, when you lose a lot of property. Sometimes we do have Net Domestic Product negative, while GDP is positive.

Senator DORGAN. The purpose of this inquiry is to at least begin to talk about what we are measuring and what do we accomplish and what we understand with that measurement.

And, perhaps you won't admit it today, but perhaps there are some people at your agency who would look at an inquiry of whether the GDP is a useful measurement because it measures, as I said, a heart attack, as a major asset and contributor to growth, and pornography as a contributor to growth. Is it a reasonable measurement?

Some people would view this inquiry as fanciful and kind of oddball and really nutty. How do you view it?

Dr. LANDEFELD. I don't think so at all, and indeed, I think as we've heard today, as far back as the founding of our accounts, we've been aware of that problem. But a lot of it comes back to we are economists. We feel comfortable in using market transactions. We know they have externalities and problems. But we don't feel comfortable making some of those subjective assessments one would have to make to develop these sets of accounts.

Senator DORGAN. That's a perfectly logical position, and I understand it. I would not want you to go off and try to measure happiness. I mean, who knows? Who knows what happiness is at any given moment?

But I think the question is, for me, how do you measure progress? And what is progress? And progress might be all kinds of subjective notions about my personal environment or my ability to enjoy life, and all the things that surround me personally, and our society. Some of it is economic. Some of it has nothing to do with dollars and cents.

How do we measure progress in this country? People work longer hours and have less time. You're probably familiar with the essay and then the book by Putnam, *Bowling Alone.* And *Bowling Alone* was a description of both parents now working in the workplace, working longer hours, coming home completely exhausted, really unable anymore to join a mixed bowling league. Right?

So Putnam took a look at reductions in the number of people participating in league bowling, and reductions in the number of people joining fraternal organizations, and described it back to the differences in our economy with both people working and struggling just to try to make ends meet.

And that would all be viewed, in most cases, as a positive in our GDP numbers because we have two people in the workplace that are producing product, they're making income which we measure. But in the *Bowling Alone* description, obviously, it's net negatives in terms of the time available to do the things that they used to do to recreate. Right?

So the question for me is, what can we do to better measure progress in our country? Making progress in a wide range of ways? And again, I'm not ever—nor would I, nor do I think that my colleagues would want you to start running off and measuring happiness.

But I think, at least from the descriptions today, the suggestion is not that we would stop using a GDP measurement, but that we would better describe exactly what it contributes to the knowledge base here in this country, and hopefully instead create other indices or create other measurements, I should say, or find better ways to create measurements that measure the things that are left out of GDP.

Does that sound reasonable to anybody?

Dr. FRANK. There are simple adjustments, too, that I think we could make. If you think about the cost of achieving basic goals for families, a typical middle-class family, if you look at the middle earners, their goal is going to be to send their children to schools of at least average quality for—in which they live, it would be an unusual parent who didn't aim at least that high.

And we'd have to ask, how much does it cost now for a family in that position to meet that goal compared to what it did three decades ago? And I think the answer turns out, from the evidence we have, to be much—it's much more expensive to meet that goal relative to the new environment.

And that's primarily because, I think, the expenditure cascade that's been launched by higher spending, launched in turn by higher incomes at the top, has had an effect on the average-sized house in the community. It's now about 2,300 square feet, a median new house built in the U.S. In 1979, it was about 1,600 square feet, so a big jump.

Not because the middle family has more income now than it did then. It doesn't have much more real income than before. It needs to buy a 2,300 square foot house now in order to send its children to an average-quality school, and it can't afford to do that. So the measure of what it must spend to achieve that goal relative to its income indicates an increased level of economic stress.

Senator DORGAN. Well, now you're talking about geography of the school and the house. Right?

Dr. FRANK. Yes. If the good schools are in the more expensive neighborhoods, and then people at the top build bigger, yes, the people in the middle don't seem to care. They don't copy the people at the top. But people just below the top are influenced by what the people at the top do. Maybe now it's the custom to have the daughter's reception in the home, if you're in that circle.

So they—the people just below the top build bigger, others just below them build bigger, too, and so on.

Senator DORGAN. I mean, we not only have bigger houses, but smaller families.

Dr. FRANK. Exactly. So, for me, as the median, in order to send my children to a school of average quality, I've got to spend substantially more than in the past, and I don't have more money. So that's something you can measure and try to adjust for, I think, in the data.

Senator DORGAN. So let me ask another question that's probably obvious. In our current measurement, let's say that a car accident is a net contributor to GDP. Is that correct?

Dr. LANDEFELD. Well, with the correction of the problems caused by the car accident.

Senator DORGAN. Well, but a car accident is going to require a car to be taken to a repair shop, and a $2,000 bill, and labor and so on. Right?

Dr. LANDEFELD. No question. I was just making a point that from the viewpoint of the consumer who's had the accident, that they're glad to have the repair of the car.

Senator DORGAN. But the costs that are not covered, and all of us have experienced these costs, almost all of us—the dramatic amounts of time, the loss of the availability of the car while it's being repaired, the time to go get the estimates, all of the things that are an unbelievable nuisance and that detract in terms of time for the person involved—the car accident contributes to the GDP, but one of the problems with this measurement is we don't extract the negative consequences.

And that's one of the reasons I was thinking about this issue and trying to understand, how can we at least somewhat better portray to the American people—with all the numbers we have and all the capability of making judgments—how can we portray progress? Are we progressing? And if so, how?

Dr. LANDEFELD. If I could, you know, we've had some setbacks, I'm optimistic—there are some very doable things that with leadership and resources, we can do. We have the data on distribution of income. We could try and bring that up to date, and more prominently feature it.

We have the American Time Use Survey, which provides data on household products and I've done some work on how it would change our GDP estimates. That is available to us. We're working with a number of people at other agencies on a set of healthcare accounts.

So while some of the more subjective problems you pose, such as an accident are harder, it is something we'd rather not have, but still, it's a market transaction and we have to count it. Some of those problems are more difficult, and it would be difficult to make progress in my view.

But I'm rather optimistic about the range of things which have been put forth, and we can make progress on them as long as we have leadership and some resources to deal with them.

Senator DORGAN. I'm going to have to be at another briefing in awhile, but I want to make sure that all of you have had the opportunity to say what you want to say. And I'm also going to mention that we will keep the record open and take additional statements that you or others who might be aware of this hearing wish to contribute because we don't do a lot of hearings like this.

Most of our hearings, as you know, are in hot pursuit of some urgent issue that we have to have a hearing on today. This is more of a hearing that tries to think through how we're measuring progress in this great country. But I want to know, Mr. Rowe, do you have anything that you wish to add at the conclusion of the hearing?

Mr. ROWE. Not—probably not briefly. But thanks.

Senator DORGAN. Well, if it's not briefly, would you submit all of it for the record, and we will make it a part for the——

Mr. ROWE. Well, I'll just say this. I'll just say this. As you know, Senator, my wife comes from a small village in the Philippines. And the people there are amazingly content. And I've never seen—there are two things I've never seen in that village: a wastebasket and a clock.

And I think that if we were to trace back those two things—the wastebasket and the clock—and trace those two phenomena through the economy, we would have some of the answer that we're looking for.

Senator DORGAN. I understand fully the clock. Describe for me the wastebasket.

Mr. ROWE. Well, if you have pigs, you don't need a wastebasket. The idea is, all those activities that produce waste——

Senator DORGAN. Consumable.

Mr. ROWE. Yes.

Senator DORGAN. OK.

Mr. ROWE. Yes.

Senator DORGAN. Well, all right. I'm probably the only one in this room that really understands pigs because I grew up in circumstances where we raised livestock and butchered. Dr. Davis?

Dr. DAVIS. I think we could augment the activities of our National Center for Health Statistics that does put out things like injuries and car accidents, so we would know whether we're getting better or not. We could augment the activities of our Agency for Healthcare Research and Quality that does issue a national health quality report.

But I think what we don't have, and one of the reasons I called for a Council of Health Advisors with a national health system performance report, is how to target our spending on the high value, high payoff activities. So what is the cost-effectiveness of one drug versus another, if we pay twice as much for any drug? It doesn't mean it's twice as good; it may be equally good or even less good.

So that's where I think we need our investment, a really comprehensive look at health system performance, and at the cost effectiveness, and the value that we're getting for what we spend.

Senator DORGAN. Thank you. Dr. Abraham? Do you have anything to add?

Dr. ABRAHAM. I agree with things that other people have said. My priority would be ensuring that we find a way to continue to be able to look not only at money, but at time.

Senator DORGAN. An excellent point. Dr. Frank?

Dr. FRANK. I would say there's one very cheap thing that we could do, and that would be to put more emphasis on GDP per hour, rather than GDP per person. The idea that you're worse off if you work 2 hours fewer in the day somehow is communicated by focusing on GDP per person.

France has a higher GDP per hour than we do, I was surprised to learn, and it seems to me that they make good use of the extra hours of leisure that they take, and it should not be in any way a prejudiced view that their decision to take additional output in the form of leisure that way means they've somehow done less well economically than we have on that particular metric.

And so I think if we emphasize output-per-hour more, we would be more inclined to think in terms of the value of time, as Professor Abraham suggested.

Senator DORGAN. Interesting point. Dr. Landefeld?

Dr. LANDEFELD. I have nothing to add, but thank you very much for having this hearing and opening this dialogue.

Senator DORGAN. Well, thank you very much. And, Dr. Landefeld, thanks for the courtesy of allowing me to put the two panels together.

As I said, we will keep the hearing record open. This is an opportunity to begin the seeds of discussion on something that I think is very interesting for this country, and we appreciate all of you being here. This hearing is adjourned.

[Whereupon, at 2:42 p.m., the hearing was adjourned.]

APPENDIX

Atlantic Monthly, October 1995

IF THE GDP IS UP, WHY IS AMERICA DOWN?

WHY WE NEED NEW MEASURES OF PROGRESS, WHY WE DO NOT HAVE THEM, AND HOW THEY WOULD CHANGE THE SOCIAL AND POLITICAL LANDSCAPE

by Clifford Cobb, Ted Halstead, and Jonathan Rowe

Throughout the tumult of the elections last year political commentators were perplexed by a stubborn fact. The economy was performing splendidly, at least according to the standard measurements. Productivity and employment were up; inflation was under control. The World Economic Forum, in Switzerland, declared that the United States had regained its position as the most competitive economy on earth, after years of Japanese dominance.

The Clinton Administration waited expectantly, but the applause never came. Voters didn't feel better, even though economists said they should. The economy as economists define it was booming, but the individuals who compose it—or a great many of them, at least—were not. President Bill Clinton actually sent his economic advisers on the road to persuade Americans that their experience was wrong and the indicators were right.

This strange gap between what economists choose to measure and what Americans experience became the official conundrum of the campaign season. "PARADOX OF '94: GLOOMY VOTERS IN GOOD TIMES," *The New York Times* proclaimed on its front page. "BOOM FOR WHOM?" read the cover of *TIME* magazine. Yet reporters never quite got to the basic question—namely, whether the official indicators are simply wrong, and are leading the Nation in the wrong direction.

The problem goes much deeper than the "two-tiered" economy—prosperity at the top, decline in the middle and at the bottom—that received so much attention. It concerns the very definition of prosperity itself. In the apt language of the nineteenth-century writer John Ruskin, an economy produces "illth" as well as wealth; yet the conventional measures of well-being lump the two together. Could it be that even the upper tier was—and still is—rising on the deck of a ship that is sinking slowly into a sea of illth, and that the Nation's indicators of economic progress provide barely a clue to that fact?

Ample attention was paid to the symptoms: People were working longer hours for less pay. The middle class was slipping while the rich were forging ahead. Commutes were more harried. Crime, congestion, and media violence were increasing. More families were falling apart. A *Business Week/Harris* poll in March imparted the not surprising news that more than 70 percent of the public was gloomy about the future.

Sounding much like the guidance department of a progressive New York grammar school, the Clinton Administration said that Americans were simply suffering the anxieties of adjustment to a wondrous new economy. Speaking in similar terms, Alan Greenspan, the chairman of the Federal Reserve Board, told a business gathering in San Francisco this past February that "there seemingly inexplicably remains an extraordinarily deep-rooted foreboding about the [economic] outlook" among the populace.

Those silly people. But could it be that the Nation's economic experts live in a statistical Potemkin village that hides the economy Americans are actually experiencing? Isn't it time to ask some basic questions about the gauges that inform expert opinion, and the premises on which those gauges are based? Economic indicators are the main feedback loop to national policy. They define the economic problems that the political arena seeks to address. If the Nation's indicators of economic progress are obsolete, then they consign us to continually resorting to policies that cannot succeed because they aren't addressing the right problems.

Today the two political parties differ somewhat in regard to means, but neither disputes that the ultimate goal of national policy is to make the big gauge—the gross domestic product—climb steadily upward. Neither questions that a rising GDP will wash away the Nation's ills: if Americans feel unsettled despite a rising GDP, then clearly even more growth is needed.

This was clear in the months after the election, as the media continued to report economy up, people down stories that never quite managed to get to the crucial question: What is "up," anyway? In July, *Business Week* ran a cover story called "The Wage Squeeze" that got much closer than most. The article showed remarkable skepticism regarding the conventional wisdom. But the magazine's editorial writers retreated quickly. Why aren't workers doing better even as corporate profits and "the economy" are up? "America just may not be growing fast enough," they said.

Furthermore, the GDP and its various proxies—rates of growth, expansion, recovery—have become the very language of the Nation's economic reportage and debate. We literally cannot think about economics without them. Yet these terms have increasingly become a barricade of abstraction that separates us from economic reality. They tell us next to nothing about what is actually going on.

The GDP is simply a gross measure of market activity, of money changing hands. It makes no distinction whatsoever between the desirable and the undesirable, or costs and gain. On top of that, it looks only at the portion of reality that economists choose to acknowledge—the part involved in monetary transactions. The crucial economic functions performed in the household and volunteer sectors go entirely unreckoned. As a result the GDP not only masks the breakdown of the social structure and the natural habitat upon which the economy—and life itself—ultimately depend; worse, it actually portrays such breakdown as economic gain.

Yet our politicians, media, and economic commentators dutifully continue to trumpet the GDP figures as information of great portent. There have been questions regarding the accuracy of the numbers that compose the GDP, and some occasional tinkering at the edges. But there has been barely a stirring of curiosity regarding the premise that underlies its gross statistical summation. Whether from sincere conviction or from entrenched professional and financial interests, politicians, economists, and the rest have not been eager to see it changed.

There is an urgent need for new indicators of progress, geared to the economy that actually exists. We are members of Redefining Progress, a new organization whose purpose is to stimulate broad public debate over the nature of economic progress and the best means of attaining it. Accordingly, we have developed a new indicator ourselves, to show both that it can be done and what such an indicator would look like. This new scorecard invites a thorough rethinking of economic policy and its underlying premises. It suggests strongly that it is not the voters who are out of touch with reality.

A Brief History of Economic (Mis)measurement

The GDP has been the touchstone of economic policy for so long that most Americans probably regard it as a kind of universal standard. (In 1991 the government switched from the old GNP to the GDP, for reasons we will discuss later.) Actually the GDP is just an artifact of history, a relic of another era. It grew out of the challenges of the Depression and the Second World War, when the Nation faced economic realities very different from today's. Through history economic measurement has grown out of the beliefs and circumstances of the era. As Western economies went from agriculture to manufacturing to finance and services, modes of measurement generally evolved accordingly. But during this century, and especially since the war, the evolutionary process has slowed to a crawl. The market economy has continued to change radically. In particular it has penetrated deeper and deeper into the realms of family, community, and natural habitat that once seemed beyond its reach. But even as this change has accelerated, the way we measure economic health and progress has been frozen in place.

The first estimates of national accounts in the Western world were the work of one Thomas Petty, in England in 1665. Petty's scope was fairly broad; he was trying to ascertain the taxable capacity of the Nation. In France, however, a narrower focus emerged. The prevailing economic theory was that of the Physiocrats, who maintained that agriculture was the true source of a nation's wealth. Not surprisingly, their economic measurement focused on agricultural production. There was a great diversity of viewpoint, however, even in France. In England, a more industrial country, Adam Smith articulated a broader theory of national wealth that included the whole swath of manufacturers as well.

But one of many important points overlooked by his ardent followers is that Smith excluded what we today call the entertainment and service economies, including government and lawyers. Such functions might be useful or not, he said. But all are ultimately "unproductive of any value," because they don't give rise to a tangible product. That view was certainly debatable. But Smith was asking a crucial question—one that has pretty much disappeared from economic thought. Is there a difference between mere monetary transactions and a genuine addition to a nation's well-being?

By the end of the nineteenth century England's economic center of gravity had shifted significantly from manufacturing to trade and finance. In this new economy Smith's views on national wealth began to pinch. Alfred Marshall, who articulated what is now called neoclassical economics, declared that utility, rather than tangibility, was the true standard of production and wealth. Lawyers' fees, commissions, all the paper shuffling of an abstracted commercial economy, were essentially no different from sacks of potatoes or carloads of iron. The economic significance of a thing lay not in its nature but simply in its market price.

This yoking of national accounting to the lowest common denominator of price was to have large implications. It meant that every item of commerce was assumed to add to the national well-being merely by the fact—and to the extent—that it was produced and bought. At the same time, it meant that only transactions involving money could count in the national reckoning. This left out two large realms: the functions of family and community on the one hand, and the natural habitat on the other. Both are crucial to economic well-being. But because the services they perform are outside the price system, they have been invisible in our national accounting.

Long ago this omission was understandable. In Adam Smith's day the portion of life called "the market" occupied a very small part of physical and social space. The habitat seemed to have an infinite supply of resources, and an infinite capacity to absorb such wastes as the industry of the day might dump. The social structure seemed so firmly anchored in history that there was little thought that a growing market could set it adrift.

During this century, however, those assumptions have become increasingly untenable. It is not accidental that both the habitat and the social structure have suffered severe erosion in recent decades; these are precisely the realms that eighteenth- and nineteenth-century assumptions precluded from the reckoning of national well-being—in capitalist and socialist economies alike. This erosion has been mainly invisible in terms of economic policy because our index of progress ignores it; as a result, the Nation's policies have made it worse. To understand how the national accounts became trapped in the assumptions of a bygone era, it is useful to study the era in which the current form of economic accounting was wrought.

In 1931, a group of government and private experts were summoned to a Congressional hearing to answer basic questions about the economy. It turned out they couldn't: the most recent data were for 1929, and they were rudimentary at that. In 1932, the last year of the Hoover Administration, the Senate asked the Commerce Department to prepare comprehensive estimates of the national income. Soon after, the department set a young economist by the name of Simon Kuznets to the task of developing a uniform set of national accounts. These became the prototype for what we now call the GDP.

As the thirties wore on, a new kind of economic-policy thinking started to take hold among some New Dealers. In their view the role of the Federal Government was not to coordinate industry or to prevent industrial concentrations, as the New Deal had initially done. Rather, the government should serve as a kind of financial carburetor to keep a rich mixture of spending power going into the engine, through deficits if necessary.

This theory is generally attributed to John Maynard Keynes, of course, but numerous New Dealers had earlier approximated it in an instinctive and practical way. Since Keynesian management worked through flows of money rather than through bureaucratized programs, the new national accounts were essential to it. The Nobel Prize-winner Robert Solow, of MIT, has called Kuznets's work the "anatomy" for Keynes's "physiology."

The two formally came together during the Second World War, and in the process the GNP became the primary scorecard for the Nation's economic policy. The degree to which the GNP evolved as a war-planning tool is hard to exaggerate. Keynes himself played a central role in Britain's Treasury during both world wars. At the start of the second he co-authored a famous paper called "The National Income and Expenditure of the United Kingdom, and How to Pay for the War," which provided much conceptual groundwork for the GDP of today.

In the United States the Manhattan Project got much more glory. But as a technical achievement the development of the GNP accounts was no less important. The accounts enabled the Nation to locate unused capacity, and to exceed by far the production levels that conventional opinion thought possible. To their great surprise, American investigators learned after the war that Hitler had set much lower production targets, partly for lack of sophisticated national accounts.

Having helped win the war, the Keynesians were giddy with confidence. The specter of the Depression still haunted the United States; but these economists thought they had found the keys to the economic kingdom. With proper fiscal management and detailed knowledge of the GNP, they could master the dreaded "business cycle" and ensure prosperity indefinitely. When John Kenneth Galbraith joined the staff of *Fortune* magazine, his first project was to prepare a blueprint for America's transition to a postwar economy. The article was based on projections from the GNP accounts. "One good reason for expecting prosperity after the war is the fact that we can lay down its specifications," the article said. "For this we can thank a little-observed but spectacular improvement in the statistical measures of the current output of the U.S. plant."

The Employment Act of 1946 turned the GNP and the theory it embodied into official policy. It established a Council of Economic Advisers as "the high priests of economic management," as Allan J. Lichtman, a professor of history at the American University, has recently put it, and the GNP as their catechism. The production frenzy that had pulled the Nation out of the Depression and through the war was now the model for the peace as well.

These developments set the course for economic policy and reportage for the next fifty years. The ironies have been many. If it is odd that liberal Democrats would turn the principles of a war economy into the permanent template for government, it is no less so that Republicans would latch fervently onto a measure of well-being that was basically a tool of central government planning.

There have been a number of consequences that few saw clearly at the time. One was that economists became the ultimate authorities on American public policy. Before the war, economists were rarely quoted in news stories except in some official capacity. Now their opinions were sought and cited as canonical truth. Moreover, as the party that nurtured these economists, the Democrats became adherents of technocratic top down management that purported to act for the people, even if in ways beyond their ken.

But the biggest change was in who "the people" now were. Because the Keynesian approach saw consumption as the drive train of prosperity, Washington collectively looked at the public in those terms as well. They were no longer primarily farmers, workers, businesspeople—that is, producers. Rather, they were consumers, whose spending was a solemn national duty for the purpose of warding off the return of the dreaded Depression. Our young men had marched off to war; now Americans were marching off to the malls that eventually covered the land.

In this atmosphere the GNP, the measure and means of policy, rapidly became an end of policy in itself. The nation's social cohesion and natural habitat, which the GNP excluded, were taken for granted. Each week the host of General Electric Theater, Ronald Reagan, declared to the Nation that "progress is our most important product." Products were progress, and therefore the GNP was progress too.

The GDP Today: How Down Becomes Up

If the chief of your local police department were to announce today that "activity" on the city streets had increased by 15 percent, people would not be impressed, reporters least of all. They would demand specifics. Exactly what increased? Tree planting or burglaries? Volunteerism or muggings? Car wrecks or neighborly acts of kindness?

The mere quantity of activity, taken alone, says virtually nothing about whether life on the streets is getting better or worse. The economy is the same way. "Less" or "more" means very little unless you know of what. Yet somehow the GDP manages to induce a kind of collective stupor in which such basic questions rarely get asked.

By itself the GDP tells very little. Simply a measure of total output (the dollar value of finished goods and services), it assumes that everything produced is by definition "goods." It does not distinguish between costs and benefits, between productive and destructive activities, or between sustainable and unsustainable ones. The nation's central measure of well-being works like a calculating machine that adds but cannot subtract. It treats everything that happens in the market as a gain for humanity, while ignoring everything that happens outside the realm of monetized exchange, regardless of the importance to well-being.

By the curious standard of the GDP, the Nation's economic hero is a terminal cancer patient who is going through a costly divorce. The happiest event is an earthquake or a hurricane. The most desirable habitat is a multibillion-dollar Superfund site. All these add to the GDP, because they cause money to change hands. It is as if a business kept a balance sheet by merely adding up all "transactions," without distinguishing between income and expenses, or between assets and liabilities.

The perversity of the GDP affects virtually all parts of society. In 1993 William J. Bennett, who had been the Secretary of Education in the Reagan Administration, produced a study of social decline. He called it "The Index of Leading Cultural Indicators," a deliberate counterpoint to the Commerce Department's similarly named regular economic report. His objective was to detail the social erosion that has continued even as the Nation's economic indicators have gone up.

The strange fact that jumps out from Bennett's grim inventory of crime, divorce, mass-media addiction, and the rest is that much of it actually adds to the GDP. Growth can be social decline by another name. Divorce, for example, adds a small fortune in lawyers' bills, the need for second households, transportation and counseling for kids, and so on. Divorce lawyers alone take in probably several billion dollars a year, and possibly a good deal more. Divorce also provides a major boost for the real-estate industry. "Unfortunately, divorce is a big part of our business. It means one [home] to sell and sometimes two to buy," a realtor in suburban Chicago told the *Chicago Tribune.* Similarly, crime has given rise to a burgeoning crime-prevention and security industry with revenues of more than $65 billion a year. The car-locking device called The Club adds some $100 million a year to the GDP all by itself, without counting knock-offs. Even a gruesome event like the Oklahoma City bombing becomes an economic uptick by the strange reckonings of the GDP. "Analysts expect the share prices [of firms making anti-crime equipment] to gain during the next several months," *The Wall Street Journal* reported a short time after the bombing, "as safety concerns translate into more contracts."

Bennett cited the chilling statistics that teenagers spend on average some 3 hours a day watching television, and about 5 minutes a day alone with their fathers. Yet when kids are talking with their parents, they aren't adding to the GDP. In contrast, MTV helps turn them into ardent, GDP-enhancing consumers. Even those unwed teenage mothers are bringing new little consumers into the world (where they will quickly join the "kiddie market" and after that the "teen market," which together influence more than $200 billion in GDP). So while social conservatives like Bennett are rightly deploring the Nation's social decline, their free-marketeer counterparts are looking at the same phenomena through the lens of the GDP and breaking out the champagne.

Something similar happens with the natural habitat. The more the Nation depletes its natural resources, the more the GDP increases. This violates basic accounting principles, in that it portrays the depletion of capital as current income. No businessperson would make such a fundamental error. When a small oil company drains an oil well in Texas, it gets a generous depletion allowance on its taxes, in recognition of the loss. Yet that very same drainage shows up as a gain to the Nation in the GDP. When the United States fishes its cod populations down to remnants, this appears on the national books as an economic boom—until the fisheries collapse. As the former World Bank economist Herman Daly puts it, the current national accounting system treats the Earth as a business in liquidation.

Add pollution to the balance sheet and we appear to be doing even better. In fact, pollution shows up twice as a gain: once when the chemical factory, say, produces it as a by-product, and again when the Nation spends billions of dollars to clean up the toxic Superfund site that results. Furthermore, the extra costs that come as a consequence of that environmental depletion and degradation—such as medical bills arising from dirty air—also show up as growth in the GDP.

This kind of accounting feeds the notion that conserving resources and protecting the natural habitat must come at the expense of the economy, because the result can be a lower GDP. That is a lot like saying that a reserve for capital depreciation must come at the expense of the business. On the contrary, a capital reserve is essential to ensure the future of the business. To ignore that is to confuse mere borrowing from the future with actual profit. Resource conservation works the same way, but the perverse accounting of the GDP hides this basic fact.

No less important is the way the GDP ignores the contribution of the social realm—that is, the economic role of households and communities. This is where much of the Nation's most important work gets done, from caring for children and older people to volunteer work in its many forms. It is the Nation's social glue. Yet because no money changes hands in this realm, it is invisible to conventional economics. The GDP doesn't count it at all—which means that the more our families and communities decline and a monetized service sector takes their place, the more the GDP goes up and the economic pundits cheer.

Parenting becomes child care, visits on the porch become psychiatry and VCRs, the watchful eyes of neighbors become alarm systems and police officers, the kitchen table becomes McDonald's—up and down the line, the things people used to do for and with one another turn into things they have to buy. Day care adds more than $4 billion to the GDP; VCRs and kindred entertainment gear add almost $60 billion.

Politicians generally see this decay through a well-worn ideological lens: conservatives root for the market, liberals for the government. But in fact these two "sectors" are, in this respect at least, merely different sides of the same coin: both government and the private market grow by cannibalizing the family and community realms that ultimately nurture and sustain us.

These are just the more obvious problems. There are others, no less severe. The GDP totally ignores the distribution of income, for example, so that enormous gains at the top—as were made during the 1980s—appear as new bounty for all. It makes no distinction between the person in the secure high-tech job and the "downsized" white-collar worker who has to work two jobs at lower pay. The GDP treats leisure time and time with family the way it treats air and water: as having no value at all. When the need for a second job cuts the time available for family or community, the GDP records this loss as an economic gain.

Then there's the question of addictive consumption. Free-market fundamentalists are inclined to attack critics of the GDP as "elitists." People buy things because they want them, they say, and who knows better than the people themselves what adds to well-being? It makes a good one liner. But is the truth really so simple? Some 40 percent of the Nation's drinking exceeds the level of "moderation," defined as two drinks a day. Credit-card abuse has become so pervasive that local chapters of Debtors Anonymous hold forty-five meetings a week in the San Francisco Bay area alone. Close to 50 percent of Americans consider themselves overweight. When one considers the $32 billion diet industry, the GDP becomes truly bizarre. It counts the food that people wish they didn't eat, and then the billions they spend to lose the added pounds that result. The coronary bypass patient becomes almost a metaphor for the Nation's measure of progress: shovel in the fat, pay the consequences, add the two together, and the economy grows some more.

So, too, the O.J. Simpson trial. When *The Wall Street Journal* added up the Simpson legal team ($20,000 a day), network-news expenses, O.J. statuettes, and the rest, it got a total of about $200 million in new GDP, for which politicians will be taking credit in 1996. "GDP of O.J. Trial Outruns the Total of, Say, Grenada," the *Journal's* headline writer proclaimed. One begins to understand why politicians prefer to talk about growth rather than what it actually consists of, and why Prozac alone adds more than $1.2 billion to the GDP, as people try to feel a little better amid all this progress.

The Politics of Permanence

Simon Kuznets had deep reservations about the national accounts he helped to create. In his very first report to Congress, in 1934, he tried to warn the Nation of the limitations of the new system. "The welfare of a nation," the report concluded, can "scarcely be inferred from a measurement of national income as defined above."

But the GNP proceeded to acquire totemic stature, and Kuznets's concerns grew deeper. He rejected the a priori conceptual schemes that govern most economic thought. As an economy grows, he said, the concept of what it includes must grow as well. Economists must seek to measure more and different things. By 1962 Kuznets was writing in *The New Republic* that the national accounting needed to be fundamentally rethought: "Distinctions must be kept in mind between quantity and quality of growth, between its costs and return, and between the short and the long run," he wrote. "Goals for 'more' growth should specify more growth of what and for what" (emphasis added).

To most of us, that would seem to be only common sense. If the government is going to promote something, surely the voters should know what that something is. But in the view of most economists, Kuznets was proposing a pipe bomb in the basement. Once you start asking "what" as well as "how much"—that is, about quality instead of just quantity—the premise of the national accounts as an indicator of progress begins to disintegrate, and along with it much of the conventional economic reasoning on which those accounts are based.

Unsurprisingly, the profession did not seize eagerly upon Kuznets's views. Though he won a Nobel Prize in 1971, many economists dismissed him as a kind of glorified statistician. Most are aware of at least some of the basic shortcomings of the GDP. But rather than face those shortcomings squarely, they have either shrugged their shoulders or sought to minimize the implications for their underlying models. In his ubiquitous economics text Paul Samuelson and his co-author William Nordhaus devote a few pages to possible revisions to the GDP to reflect environmental and other concerns. But this is more in the spirit of a technical adjustment than a questioning of the underlying premise.

The effects of the GDP fixation can be seen perhaps most vividly in what are called "developing nations" (a term that is itself defined mainly in terms of GDP)—specifically in the policies of the World Bank, which is a kind of development czar for the nations of the South. Decades ago Kuznets tried to point out the absurdity of using such a measure to assess the economies of less-developed nations, where much production takes place in the household economy and is therefore beyond the ken of the GNP. A development strategy based on raising the GNP might undermine this household economy and therefore diminish the well-being of the Nation's people, while devastating the habitat to boot.

In 1989 Barber Conable, then the president of the World Bank, acknowledged the problem with respect to environmental issues. "Current calculations ignore the degradation of the natural-resource base and view the sales of nonrenewable resources entirely as income," he wrote. "A better way must be found." Yet on the floors beneath him the bank's economists continued churning out loan strategies aimed at boosting GDP. One recent World Bank publication reaffirmed it as the "main criterion for classifying economies."

And a wrongheaded one. In a groundbreaking study of Indonesia in 1989, the World Resources Institute, of Washington, D.C., explored the implications for natural resources. Since the 1970s Indonesia had been a success story for the conventional development school, achieving an exceptional growth rate of 7 percent a year. But such an amphetamine pace cannot be sustained forever. Indonesia is selling off precious nonrenewable mineral wealth. Clear-cutting its forests and exhausting its topsoil with intensive farming, it is in effect robbing the future to finance the current boom. After adding in these and other factors, the institute found that the country's real, sustainable growth rate was only about half the official rate. And that wasn't counting the broader spectrum of environmental and social costs, which would have brought the growth rate down even more.

Here was another warning for those disposed to heed it. Yet the international development establishment did nothing of the sort. In fact, what is being measured has grown more partisan than ever. Specifically, in 1991 the GNP was turned into the GDP—a quiet change that had very large implications.

Under the old measure, the gross national product, the earnings of a multinational firm were attributed to the country where the firm was owned—and where the profits would eventually return. Under the gross domestic product, however, the profits are attributed to the country where the factory or mine is located, even though they won't stay there. This accounting shift has turned many struggling nations into statistical boomtowns, while aiding the push for a global economy. Conveniently, it has hidden a basic fact: the nations of the North are walking off with the South's resources, and calling it a gain for the South.

The more basic defects of the GDP have not gone unnoticed among the nations of the world. In France a parliamentary report has called for new indicators of progress; the Treasury of Australia has done so as well. Both the U.N. and the European Parliament have taken up the issue, and there are ripples even at the World Bank.

But in the United States change will not come easily. The quarterly release of the GDP figures has become a Wall Street ritual and metronome for the national media, setting the tempo and story line for economic reportage. For the media in particular, the GDP serves deep institutional cravings, combining the appearance of empirical certitude and expert authority with a ready-made story line. It also serves the industries that thrive on the kind of policies it reinforces; those inclined to deplete and pollute are especially pleased with an accounting system that portrays these acts as economic progress. This came to light clearly last year when the Clinton Administration proposed, sensibly, that resource depletion be subtracted from GDP (albeit only in a footnote) instead of added to it.

The idea had been kicking around the Commerce Department for years, and the Administration's actual proposal was modest in the extreme. Still, at a House Appropriations Committee hearing in April 1994 two representatives from coal states pounced on the department staff. After a series of jabberwocky exchanges that illustrated why Members of Congress usually leave technical issues to their staffs, Congressman Alan Mollohan, of West Virginia, finally got to the heart of the matter. If the national accounts were to include the depletion of coal reserves and the effects of air pollution (which would be added eventually), he said, "somebody is going to say . . . that the coal industry isn't contributing anything to the country." Better to keep depletion and pollution hidden under the accounting rug called "growth." The committee demanded an expensive outside review, effectively delaying the project. In the Republican Congress its fate is by no means assured.

A Genuine Progress Indicator

Economists have couched their resistance to new indicators mainly in philosophical terms. A measure of national progress must be scientific and value-free, they say. Any attempt to assess how the economy actually affects people would involve too many assumptions and imputations, too many value judgments regarding what to include. Better to stay on the supposed terra firma of the GDP, which for all its faults has acquired an aura of hardheaded empirical science.

Aura notwithstanding, the current GDP is far from value-free. To leave social and environmental costs out of the economic reckoning does not avoid value judgments. On the contrary, it makes the enormous value judgment that such things as family breakdown and crime, the destruction of farmland and entire species, underemployment and the loss of free time, count for nothing in the economic balance. The fact is, the GDP already does put an arbitrary value on such factors—a big zero.

Conventional economic thinking follows a simple premise in this regard: As Paul Samuelson puts it in his textbook, "economics focuses on concepts that can actually be measured." If something is hard to count, in other words, then it doesn't count. Of course, there will never be a way to assign an exact dollar value to our family and community life, our oceans and open spaces. This doesn't mean they don't have value. It means only that we don't have a way to register their value in a form comparable to market prices. Given that, the challenge is simply to start to develop values that are more reasonable than zero; it is to stop ignoring totally that which is crucial to the Nation's economic and social health. An approximation of social and habitat costs would be less distorting and perverse than the GDP is now; a conservative estimate of, say, the costs of family breakdown and crime would produce a more accurate picture of economic progress than does ignoring such costs entirely.

We have a rough sketch of such a picture. On a limited budget, using data that the Federal Government and other institutions already collect, we have developed estimates for the kinds of factors that the economic establishment ignores. The result is a new index that gets much closer—not all the way, but closer—to the economy that people experience. We call it the "genuine progress indicator" (GPI), and it provides substance to the gap between the economy limned by the commentators and the one that has brought increasing apprehension and pain to so many others. It also begins to suggest the kinds of measurements that the Federal Government, with its enormous statistical resources, could construct.

The GPI includes more than twenty aspects of our economic lives which the GDP ignores. We based this list on available data and on common sense. A family does not count every dollar spent as a step forward. Rather, it tries to sort out the different kinds of expenditures—and that's basically what we did with the national accounts. We started with the same consumption data that the GDP is based on, but revised them in a number of ways. We adjusted for some factors (such as income distribution), added certain others (such as the value of housework and community work), and subtracted yet others (such as pollution costs and the like). The result is a balance sheet for the Nation that starts to distinguish between the costs and benefits of "growth."

Here are some of the factors we included:

The household and volunteer economy. Much of the Nation's most important work—and the work that affects our well-being most directly—gets done in family and community settings. Taking care of children and the elderly, cleaning and repairing, contributing to neighborhood groups—all of these are totally ignored in the GDP when no money changes hands. To overcome this problem, we included, among other things, the value of household work figured at the approximate rate a family would have to pay someone else to do it.

Crime. The GDP counts as progress the money people spend deterring crime and repairing the damage it causes. However, most people would probably count those costs as necessary defenses against social decline, and that's how the GPI counts them too. We included hospital bills and property losses arising from crime and the locks and electronic devices that people buy to prevent it.

Other defensive expenditures. Crime-related costs are just one kind of expenditure that seeks to repair past or present damage, as opposed to making people better off. We also incorporated the money spent on repairs after auto accidents and what households pay for water filters, air purification equipment, and the like to defend against the degradation of their physical environment.

The distribution of income. A rising tide of GDP doesn't necessarily lift all boats—not if the growth of income is mainly at the top. It was in the 1980s: the top 1 percent of households enjoyed a growth in income of more than 60 percent, while the bottom 40 percent of households saw their incomes drop. To take account of this uneven tide, we adjusted the GPI for the extent to which the whole population actually shared in any increase.

Resource depletion and degradation of the habitat. As the Nation uses up oil and other minerals, this should appear as a cost on the national accounts, just as it does on the books of a private business; yet the GDP treats it as a gain. We reversed that in the GPI. Similarly, the pollution of our air and water represents the using up of nature's capacity to absorb humanity's waste. Therefore we included, among other things, the damage to human health, agriculture, and buildings from air and water pollution, along with such recreational losses as beaches fouled by sewage or medical debris.

Loss of leisure. If people have to work two jobs or longer hours just to stay even, then they aren't really staying even. They are falling behind, losing time to spend with their families, to further their education, or whatever. The GDP assumes that such time is worth nothing. We included it at an average wage rate.

To include such factors is to begin to construct a picture of the economy that most Americans experience. It clarifies greatly the "paradox" that permeated the reportage during last year's Congressional campaigns. The GDP would tell us that life has gotten progressively better since the early 1950s—that young adults today are entering a better economic world than their parents did. GDP per American has more than doubled over that time. The GPI shows a very different picture: an upward curve from the early fifties until about 1970, but a gradual decline of roughly 45 percent since then. This strongly suggests that the costs of increased economic activity—at least the kind we are locked into now—have begun to outweigh the benefits, resulting in growth that is actually uneconomic.

Specifically, the GPI reveals that much of what we now call growth or GDP is really just one of three things in disguise: fixing blunders and social decay from the past, borrowing resources from the future, or shifting functions from the traditional realm of household and community to the realm of the monetized economy.

Many readers might think of additions to the list of factors that the GPI ought to include—thus corroborating both the underlying concept and the conservative nature of our calculations. We left out, for example, the phenomenon of addictive consumption, which is spending that consumers themselves say they wish they didn't do. We also left out the destruction of species, since there is not a satisfactory way to reckon such loss in economic terms.

The GPI has been several years in the making, and we will continue to refine it. But already it appears to have touched a nerve in the economics profession and beyond. More than 400 economists and a growing number of opinion leaders, including Robert Eisner, the former president of the American Economic Association, and Alvin Toffler, Newt Gingrich's favorite futurist, have endorsed it as an important step toward the new kinds of indicators that are urgently needed. Research institutes in Germany and the United Kingdom have sought to replicate it for their countries. Economic measurement is due for a radical change, and we hope that the GPI will speed up the process. But measurement is a means, not an end. The more important question is how an honest set of economic books would change the Nation's economic debate and force our leaders out of their Potemkin village.

From Scorecards to Policies

Imagine Peter Jennings on the network news tonight reciting the latest Commerce Department figures with his polished gravity. Instead of the GDP, however, he is reporting something more like the GPI. The nation's output increased, he says, but parents worked longer hours and so had less time with their kids. Consumer spending was "up sharply," but much of the difference went for increased medical costs and repairing the rubble left by hurricanes and floods. Utility receipts were up, but resources declined, meaning that part of today's prosperity was taken from our grandchildren. And so on down the line.

Reports of that kind would have a radical effect. They would break through the hermetic economy portrayed by economists and Wall Street analysts which dominates the news today—the abstractions that serve as a conceptual phalanx against reality. Suddenly reporters and politicians alike would have to confront the economy that people actually experience. There would be some genuine accountability in Washington, a better sense of cause and effect between what Congress does and what happens in our lives. New indicators would blast away the obfuscatory polemics of growth—and the devious politics that goes along with it. Politicians could no longer get away with glib assurances that the Nation can grow its way out of family breakdown and environmental decay, inequity and debt, when in many cases the Nation has been growing its way into them.

Such assurances have become a kind of political perpetual-motion machine. Newt Gingrich rhapsodizes about the entertainment economy and the 500 cable channels it will bring to the American living room. (When Gingrich and like-minded politicians extol "growth," entertainment is one of the things they are talking about; since 1991 it grew twice as fast as consumer spending generally.) But when these channels flood the family living room with sex and violence, and kids spend more time watching TV than they do with their parents or their homework, he blames "McGovernik liberals" for the breakdown in traditional family values. At the same time, he's only too happy to count the new tax revenues that arise from that family breakdown toward balancing the Federal budget.

Honest accounting would blow the whistle on these political games. It would also bring a new clarity and rigor to any number of policy debates—those over trade agreements being a prime example. In the recent past these debates have been framed largely in terms of the GDP. The General Agreement on Tariffs and Trade means "percentage points . . . of U.S. GDP growth," exclaimed Bill Frenzel, a former Congressman from Minnesota and a congressional representative to GATT negotiations. "It means trillions of dollars in increased world trade." This kind of talk was typical. In fact the increase means very little—only that more things will pass back and forth between nations. Will families and communities suffer continuing disruption? Will the increased traffic back and forth simply burn up more energy, the price of which is kept artificially low by tax subsidies and the like? Will America lose a measure of control over decisions that affect the lives of its own citizens?

There were efforts to raise such issues in the trade debates. But the polemical playing field was tilted sharply against them by the GDP. The result was a perpetuation of free-trade dogma that is based on the economy of 200 years ago. Better accounting would not in itself dictate a different conclusion. But at least it would level the field, and include many factors that now get left out. It would, for example, reflect some of the numerous benefits of local production that don't show up in the GDP—social stability, job security, energy savings, and the like. Free-trade dogma dismisses such thoughts as primitive and benighted.

Better indicators would also strengthen the role of family and community values in our policy debates. Rarely does anyone point out how the market itself can undermine family values in the name of growth. When regional shopping centers replace traditional Main Streets, the matrix of community activity is significantly undermined as well. Similarly, when mass media replace the storytelling of parents and grandparents, the GDP goes up while the role of families declines.

If factory jobs migrate to low-wage nations, it means cheaper products and more efficiency. But it also means severe family disruption, and the decline of the informal safety net of churches and union halls that once flourished in factory towns and helped families in need. The government obscures the impact of such policies by in effect keeping two sets of books—a visible one for the market and an invisible one for everything else. New indicators would bring the two together, and better policy just might result.

The effect would perhaps be especially direct on tax policy. The current tax system is deeply perverse, but not for the reasons that economists generally cite. Purveyors of conventional wisdom say that the tax system retards growth, by which they mean GDP. But this makes no distinction at all between muscle and bloat. They want capital-gains tax breaks, but for what? Pop art? Overseas investment funds? They urge taxes on consumption. But what kinds do they mean? Work shoes as well as Guccis? Recycled paper along with that made from ancient forests?

Meanwhile, the left argues for "progressive" taxes based entirely on income, as if income and the activities that produce it were inherently worthy of censure, regardless of what those activities are. Better accounting would define the issue along an entirely different spectrum.

For example, the current system taxes heavily that which should be encouraged—enterprise and human labor. Meanwhile, it taxes lightly or even subsidizes the use of the natural resources that humanity needs to husband and conserve. Employers pay a heavy fine, in the form of Social Security taxes, workers' compensation, and the rest, when they hire somebody. But they get big write-offs when they help to drain the world's natural resources. New accounting would expose this perversity, and point toward a new tax system that defied the stereotyped categories of left and right.

To put it simply, the Nation would cut—or if possible eliminate—taxes on work and enterprise and replace them with increased taxes on the use of natural resources. Such a system would diminish the need for environmental regulation, by building a semblance of environmental accounting right into the price system. Prices would include environmental and social costs. This approach would also be a spur to enterprise and employment. With reduced income taxes, the entire economy would become a kind of enterprise zone, and the Nation's entrepreneurial energies would be deployed much more toward solving environmental and social problems than toward creating them. Moreover, by doing away with the corporate income tax, we could get rid of the whole loophole culture that corrupts the Nation's politics and is a primary source of corporate subsidy and waste.

Closely related is the issue of cost-benefit analysis, which was one of the hot topics in Washington this year. Republicans argue, sensibly, that environmental and other regulations should bring benefits commensurate with the costs involved. But that just begs the crucial question: What goes into the accounting? If the GDP defines the framework, then cost-benefit analysis becomes a made-in-heaven deal for polluters and those who cause social disruption. If nothing counts other than what is conventionally counted, then tangible increases in production will win out over the less easily quantified—but no less real—harm to the natural and social spheres. To broaden the reckoning, however, could produce results quite the opposite of what the current advocates of cost-benefit analysis intend.

The New Politics of Progress

It has become almost obligatory in a context such as this to invoke the concept of a "paradigm shift," to use Thomas Kuhn's much-cited formulation, laid out in *The Structure of Scientific Revolution.* But there is a side to this that is generally overlooked—namely, the central role of generational divides. Kuhn quotes the physicist Max Planck: "A new scientific truth does not triumph by convincing its opponents and making them see the light, but rather because its opponents eventually die."

One would wish for a more ceremonious process. But no field has grown more tightly shut than economics, whose basic orthodoxies have persisted for at least a hundred years. Unless history stops cold, these, too, will eventually yield, and the time is now propitious. The generation that developed the GDP, and for which the GDP distilled an entire world view, is now mainly retired. The students and disciples of that generation are well into their middle years, rumbling along on mental capital from long ago. For the generation that is replacing them, the defining traumas were not the Depression and the Second World War but rather the material glut and environmental and social disintegration of which many in the old guard served as unwitting boosters and engineers.

To be sure, the old order does not lack acolytes. But for a growing number of economists, the conceptual tools and measurements of the neoclassical model—Keynesian twists included—are no longer adequate. These economists are demanding that their profession start to take account of the larger economy in which the market is grounded—the natural and social spheres, which they have in the past dismissed as the netherworlds of externality. In a survey in the 1980s of economists at fifty major universities two-thirds acknowledged a sense of "lost moorings" in the profession.

In recent decades this kind of critique has been associated mainly with the ecological camp. Herman Daly, Hazel Henderson, Kenneth Boulding, and other writers have pointed out that in a world of finite physical resources the possibility of endless material expansion is not something we should count on. What is new today is that a similar argument is coming from certain quarters on the right: specifically that the pursuit of GDP has been undermining traditional values and social cohesion, much as it has been destroying the natural habitat.

Americans are conditioned to see ecology and social conservatism as occupying opposite ends of the political spectrum. But that is largely an optical illusion, reinforced by an antiquated national accounting system. The fact is that adherents at both ends deplore the way the pursuit of GDP can undermine the realm of their concern. Much as this pursuit turns ancient forests into lumber and beaches into sewers, so it turns families into nodes of consumption and the living room into a marketing free-fire zone. Both camps speak from the standpoint of values against the moral relativism and opportunism of the market. "If you read the New Testament or the Pope's encyclical, it's no cheers for socialism and one and a half or two for capitalism," William Bennett, who was Reagan's Secretary of Education, observes. "Socialism treats people as a cog in the machine of the state; capitalism tends to treat people as commodities."

This strain of conservatism, partly rooted in traditional Christian teachings, was largely dormant during the Cold War, when the greater enemy communism predominated. But with the fall of the Soviet bloc it has reawakened, and the result has been a widening gap on the right between social conservatives and libertarian free-marketeers. This gap was easily overlooked in the Republican triumph last November, but it may well become as important as the one between the Republicans and the Democrats they replaced.

It can be seen, for example, in the diverging views of that archetypal Republican era, the Reagan eighties. Martin Anderson, who was Reagan's domestic-policy adviser, gave the rapturous libertarian view in his book *Revolution* (1988). "It was the greatest economic expansion in history," Anderson wrote. "Wealth poured from the factories of the United States, and Americans got richer and richer."

But does richer mean better—even assuming that all Americans shared in this bounty, which they didn't? For libertarians, as for many Keynesian liberals, the question isn't relevant. For social conservatives, however, it is the question. Bennett does not disparage the economic achievements of the Reagan years. Nor does he dispute that more family income can mean better schooling, medical care, and the like. But recently he has been calling attention to the social decay that has continued despite (and often in the name of) economic growth. "Would you rather have kids raised by rich people with lousy values, or by good people who just don't have much money?" he asks. "A lot of us would say we want the values right."

What the right calls "family values" is one arena in which the latent conflict between market and nonmarket values is coming out into the open. In a long article in *The Washington Post* last November, Edward Luttwak, of the Center for Strategic and International Studies, a conservative think tank in Washington, D.C., pointed out that much family disruption today arises from the "creative destruction" of the market that free-market economists adore. The failure to acknowledge this, Luttwak wrote, is "the blatant contradiction at the very core of what has become mainstream Republican ideology."

In an interview Luttwak argued that people need stability more than they need much of the new stuff that makes the GDP go up. Yet economists talk about stability "in entirely negative terms," he said. Conservation becomes a dirty word. One would think that conservatives would be the first to point this out; stability, after all, is what families and communities are for. But the political right is muzzled on these issues, Luttwak said, by the economic interests of its major funders. "Any conservative who wishes to conserve will not be funded."

This split has a distinct similarity to the tension that arose in the Democratic Party in the seventies between environmentalists and the growth-boosting Keynesian mainstream. It could betoken the beginning of a new politics in which the popular currents represented by social conservatives and environmentalists increasingly find common cause. Some writers have made the connection already. For example, Fred Charles Ikle, who was an undersecretary of defense in the Reagan Administration, wrote an article for the *National Review* in which he criticized the "growth utopians" of the right. "Citizens who fear for our vanishing patrimony in nature," Ikle wrote, "drink from a wellspring of emotions that nourishes the most enduring conservative convictions." (He also tweaked the magazine's right-wing readers by pointing out that economic growth almost invariably leads to bigger government.)

Just a few years ago a confluence of the environmental and social conservative impulses would have seemed unlikely. But the political seas are changing rapidly. The coalition that came together to oppose NAFTA and GATT—environmentalists and anti-corporate populists like Ralph Nader on the one hand, and social conservatives like Pat Buchanan on the other—seemed an oddity to most pundits. But something similar happened when the Walt Disney Company proposed a new theme park near the Civil War battlefield in Manassas, Virginia. Buchanan and numerous other tradition-minded conservatives joined environmentalists in blasting the proposal. In his syndicated newspaper column Buchanan demanded, "Conservatives who worship at the altar of an endlessly rising GNP should tell us: What is it they any longer wish to conserve?"

The two camps have converged in opposing the so-called "takings" bills, which would require the taxpayers to compensate property owners for restrictions on the use of their property. The Reverend Donald E. Wildemon, the president of the American Family Association, in Tupelo, Mississippi, has called such a proposal in his state the "porn owners' relief measure," because it could restrict the ability of local governments to control such things as topless bars.

Environmentalists of course worry about the implications for the protection of wetlands, open space, and the like. The two camps agree that "growth" is not an end in itself but must serve larger values that are not economic in the usual sense.

We may be witnessing the opening battles in a new kind of politics that will raise basic questions about growth—questions that defy the conventional left-right divide. Where the old politics was largely concerned with the role of government—with the relation between public and private sectors—the emerging one will be more concerned with such issues as central versus local, market culture versus family and community culture, material accretion versus quality and values. The new politics will not be anti-growth, because to be categorically against growth is as nonsensical as to be categorically for it. Rather, it will begin with Luttwak's sane observation that when your goal is simply to increase GDP, then "what you increase isn't necessarily good." It will insist that growth—and economics generally—must be a means to an end, and not an end in itself.

This is not to suggest that such a new alliance is around the corner. But although the differences between the social-conservative and environmentalist camps are still large, they are probably etched more sharply among leaders in Washington than in the Nation as a whole. These groups are converging on one crucial issue—namely, the ends of economic life. In their different ways they are expressing the feeling, widespread among the public, that the pronouncements from economic experts are fundamentally out of sync with the experience of their own lives; that economics must be about more than just the production and consumption of stuff; and that we need larger goals and better ways to measure our achievements as a nation.

Of course, this instinct could play out in many ways. But at least one thing is clear: boosting the GDP is no longer a sufficient aim for a great nation, nor one that America can continue to endure.

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REMARKS OF ROBERT F. KENNEDY AT THE UNIVERSITY OF KANSAS, MARCH 18, 1968

This text was transcribed for the convenience of readers and researchers from a recording in the library's holdings. It reflects Robert F. Kennedy's speaking rhythms, the starts and stops and repetitions of his oral performance. It is not an exact setting down of every utterance Robert F. Kennedy made on the occasion, which would include the "ers" and "ums" and other delay sounds that are an inevitable part of an individual's speech patterns. Furthermore, as with any transcription, there is an unavoidable element of interpretation. Interested researchers are invited and encouraged to come in and listen to the recording themselves.

Thank you very much. Chancellor, Governor and Mrs. Docking, Senator and Mrs. Pierson, ladies and gentlemen and my friends, I'm very pleased to be here. I'm really not here to make a speech I've come because I came from Kansas State and they want to send their love to all of you. They did. That's all they talk about over there—how much they love you. Actually, I want to establish the fact that I am not an alumnus of Villanova.

I'm very pleased and very touched, as my wife is, at your warm reception here. I think of my colleagues in the U.S. Senate, I think of my friends there, and I think of the warmth that exists in the Senate of the United States—I don't know why you're laughing—I was sick last year and I received a message from the Senate of the United States which said: "We hope you recover," and the vote was forty-two to forty.

And then they took a poll in one of the financial magazines of five hundred of the largest businessmen in the United States, to ask them, what political leader they most admired, who they wanted to see as President of the United States, and I received one vote, and I understand they're looking for him. I could take all my supporters to lunch, but I'm—I don't know whether you're going to like what I'm going to say today but I just want you to remember, as you look back upon this day, and when it comes to a question of who you're going to support—that it was a Kennedy who got you out of class.

I am very pleased to be here with my colleagues, Senator Pierson, who I think has contributed so much in the Senate of the United States—who has fought for the interests of Kansas and has had a distinguished career, and I'm very proud to be associated with him. And Senator Carlson who is not here, who is one of the most respected members of the Senate of the United States—respected not just on the Republican side—by the Democratic side, by all of his colleagues—and I'm pleased and proud to be in the Senate with Senator Carlson of the State of Kansas.

And I'm happy to be here with an old friend, Governor Docking. I don't think there was anyone that was more committed to President Kennedy and made more of an effort under the most adverse circumstances and with the most difficult of situations than his father, who was then Governor of the State of Kansas—nobody I worked with more closely, myself, when I was in Los Angeles. We weren't 100 percent successful, but that was a relationship that I will always value, and I know how highly President Kennedy valued it and I'm very pleased to see him—and to have seen his mother, Mrs. Docking today also, so I'm very pleased to be in his State.

And then I'm pleased to be here because I like to see all of you, in addition.

In 1824, when Thomas Hart Benton was urging in Congress the development of Iowa and other western territories, he was opposed by Daniel Webster, the Senator from Massachusetts. "What," asked Webster, "what do we want with this vast and worthless area? This region of savages and wild beasts. Of deserts of shifting sands and of whirlwinds. Of dust, and of cactus and of prairie dogs."

"To what use," he said, "could we ever hope to put these great deserts? I will never vote for one-cent from the public treasury, to place the west one inch closer to Boston, than it is now." And that is why, I am here today, instead of my brother Edward.

I'm glad to come here to the home of the man who publicly wrote: "If our colleges and universities do not breed men who riot, who rebel, who attack life with all the youthful vision and vigor, then there is something wrong with our colleges. The more riots that come out of our college campuses, the better the world for tomorrow." And despite all the accusations against me, those words were not written by me, they were written by that notorious seditionist, William Allen White. And I know what great affection this university has for him. He is an honored man today, here on your campus and around the rest of the Nation. But when he lived and wrote, he was reviled as an extremist and worse. For he spoke, he spoke as he believed. He did not conceal his concern in comforting words. He did not delude his readers or himself with false hopes and with illusions. This spirit of honest confrontation is what America needs today. It has been missing all too often in the recent years and it is one of the reasons that I run for President of the United States.

For we as a people, we as a people, are strong enough, we are brave enough to be told the truth of where we stand. This country needs honesty and candor in its political life and from the President of the United States. But I don't want to run for the presidency—I don't want America to make the critical choice of direction and leadership this year without confronting that truth. I don't want to win support of votes by hiding the American condition in false hopes or illusions. I want us to find out the promise of the future, what we can accomplish here in the United States, what this country does stand for and what is expected of us in the years ahead. And I also want us to know and examine where we've gone wrong. And I want all of us, young and old, to have a chance to build a better country and change the direction of the United States of America.

This morning I spoke about the war in Vietnam, and I will speak briefly about it in a few moments. But there is much more to this critical election year than the war in Vietnam.

It is, at a root, the root of all of it, the national soul of the United States. The President calls it "restlessness." Our cabinet officers, such as John Gardiner and others tell us that America is deep in a malaise of spirit: discouraging initiative, paralyzing will and action, and dividing Americans from one another, by their age, their views and by the color of their skin and I don't think we have to accept that here in the United States of America.

Demonstrators shout down government officials and the government answers by drafting demonstrators. Anarchists threaten to burn the country down and some have begun to try, while tanks have patrolled American streets and machine guns have fired at American children. I don't think this a satisfying situation for the United States of America.

Our young people—the best educated, and the best comforted in our history—turn from the Peace Corps and public commitment of a few years ago—to lives of disengagement and despair—many of them turned on with drugs and turned off on America—none of them here, of course, at Kansas—right?

All around us, all around us—not just on the question of Vietnam, not just on the question of the cities, not just the question of poverty, not just on the problems of race relations—but all around us, and why you are so concerned and why you are so disturbed—the fact is, that men have lost confidence in themselves, in each other, it is confidence which has sustained us so much in the past—rather than answer the cries of deprivation and despair—cries which the President's Commission on Civil Disorders tells us could split our Nation finally asunder—rather than answer these desperate cries, hundreds of communities and millions of citizens are looking for their answers, to force and repression and private gun stocks, so that we confront our fellow citizen across impossible barriers of hostility and mistrust and again, I don't believe that we have to accept that. I don't believe that it's necessary in the United States of America. I think that we can work together—I don't think that we have to shoot at each other, to beat each other, to curse each other and criticize each other, I think that we can do better in this country. And that is why I run for President of the United States.

And if we seem powerless to stop this growing division between Americans, who at least confront one another, there are millions more living in the hidden places, whose names and faces are completely unknown—but I have seen these other Americans—I have seen children in Mississippi starving, their bodies so crippled from hunger and their minds have been so destroyed for their whole life that they will have no future. I have seen children in Mississippi—here in the United States—with a gross national product of $800 billion—I have seen children in the Delta area of Mississippi with distended stomachs, whose faces are covered with sores from starvation, and we haven't developed a policy so we can get enough food so that they can live, so that their children, so that their lives are not destroyed, I don't think that's acceptable in the United States of America and I think we need a change.

I have seen Indians living on their bare and meager reservations, with no jobs, with an unemployment rate of 80 percent, and with so little hope for the future, so little hope for the future that for young people, for young men and women in their teens, the greatest cause of death amongst them is suicide.

That they end their lives by killing themselves—I don't think that we have to accept that—for the first American, for this minority here in the United States. If young boys and girls are so filled with despair when they are going to high school and feel that their lives are so hopeless and that nobody's going to care for them, nobody's going to be involved with them, and nobody's going to bother with them, that they either hang themselves, shoot themselves or kill themselves—I don't think that's acceptable and I think the United States of America—I think the American people, I think we can do much, much better. And I run for the presidency because of that, I run for the presidency because I have seen proud men in the hills of Appalachia, who wish only to work in dignity, but they cannot, for the mines are closed and their jobs are gone and no one—neither industry, nor labor, nor government—has cared enough to help.

I think we here in this country, with the unselfish spirit that exists in the United States of America, I think we can do better here also.

I have seen the people of the black ghetto, listening to ever greater promises of equality and of justice, as they sit in the same decaying schools and huddled in the same filthy rooms—without heat—warding off the cold and warding off the rats.

If we believe that we, as Americans, are bound together by a common concern for each other, then an urgent national priority is upon us. We must begin to end the disgrace of this other America.

And this is one of the great tasks of leadership for us, as individuals and citizens this year. But even if we act to erase material poverty, there is another greater task, it is to confront the poverty of satisfaction—purpose and dignity—that afflicts us all. Too much and for too long, we seemed to have surrendered personal excellence and community values in the mere accumulation of material things. Our Gross National Product, now, is over $800 billion a year, but that Gross National Product—if we judge the United States of America by that—that Gross National Product counts air pollution and cigarette advertising, and ambulances to clear our highways of carnage. It counts special locks for our doors and the jails for the people who break them. It counts the destruction of the redwood and the loss of our natural wonder in chaotic sprawl. It counts napalm and counts nuclear warheads and armored cars for the police to fight the riots in our cities. It counts Whitman's rifle and Speck's knife, and the television programs which glorify violence in order to sell toys to our children. Yet the gross national product does not allow for the health of our children, the quality of their education or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages, the intelligence of our public debate or the integrity of our public officials. It measures neither our wit nor our courage, neither our wisdom nor our learning, neither our compassion nor our devotion to our country, it measures everything in short, except that which makes life worthwhile. And it can tell us everything about America except why we are proud that we are Americans.

If this is true here at home, so it is true elsewhere in world. From the beginning our proudest boast has been the promise of Jefferson, that we, here in this country would be the best hope of mankind. And now, as we look at the war in Vietnam, we wonder if we still hold a decent respect for the opinions of mankind and whether the opinion maintained a decent respect for us or whether like Athens of old, we will forfeit sympathy and support, and ultimately our very security, in the single-minded pursuit of our own goals and our own objectives. I do not want, and I do believe that most Americans do not want, to sell out America's interest to simply withdraw—to raise the white flag of surrender in Vietnam—that would be unacceptable to us as a people, and unacceptable to us as a country. But I am concerned about the course of action that we are presently following in South Vietnam. I am concerned, I am concerned about the fact that this has been made America's War. It was said, a number of years ago that this is "their war" "this is the war of the South Vietnamese" that "we can help them, but we can't win it for them" but over the period of the last 3 years we have made the war and the struggle in South Vietnam our war, and I think that's unacceptable.

I don't accept the idea that this is just a military action, that this is just a military effort, and every time we have had difficulties in South Vietnam and Southeast Asia we have had only one response, we have had only one way to deal with it—month after month—year after year we have dealt with it in only one way and that's to send more military men and increase our military power and I don't think that's what the kind of a struggle that it is in Southeast Asia.

I think that this is a question of the people of South Vietnam, I think its a question of the people of South Vietnam feeling its worth their efforts—that they're going to make the sacrifice, that they feel that their country and their government is worth fighting for; and I think the development of the last several years have shown, have demonstrated that the people of South Vietnam feel no association and no affiliation for the government of Saigon and I don't think it's up to us here in the United States, I don't think it's up to us here in the United States, to say that we're going to destroy all of South Vietnam because we have a commitment there. The commander of the American forces at Ben Tre said we had to destroy that city in order to save it. So 38,000 people were wiped out or made refugees. We here in the United States—not just the U.S. Government, not just the commanders of and forces in South Vietnam, the U.S. Government and every human being that's in this room—we are part of that decision and I don't think that we need do that any longer and I think we should change our policy.

I don't want to be part of a government, I don't want to be part of the United States, I don't want to be part of the American people, and have them write of us as they wrote of Rome: "They made a desert and they called it peace."

I think that we should go to the negotiating table, and I think we should take the steps to go to the negotiating table.

And I've said it over the period of the last 2 years, I think that we have a chance to have negotiations, and the possibility of meaningful negotiations, but last February, a year ago, when the greatest opportunity existed for negotiations the Administration and the President of the United States felt that the military victory was right around the corner and we sent a message to Ho Chi Minh, in February 8th of 1967 virtually asking for their unconditional surrender, we are not going to obtain the unconditional surrender of the North Vietnamese and the Viet Cong anymore than they're going to obtain the unconditional surrender of the United States of America. We're going to have to negotiate, we're going to have to make compromises, we're going to have to negotiate with the National Liberation Front. But people can argue, "That's unfortunate that we have to negotiate with the National Liberation Front," but that is a fact of life. We have three choices: We can either pull out of South Vietnam unilaterally and raise the white flag, I think that's unacceptable.

Second, we can continue to escalate, we can continue to send more men there, until we have millions and millions of more men and we can continue to bomb North Vietnam, and in my judgment we will be no nearer success, we will be no nearer victory than we are now in February 1968.

And the third step that we can take is to go to the negotiating table. We can go to the negotiating table and not achieve everything that we wish. One of the things that we're going to have to accept as American people, but the other, the other alternative is so unacceptable. One of the things that we're going to have to accept as American people and that the U.S. Government must accept, is that the National Liberation Front is going to play a role in the future political process of South Vietnam.

And we're going to have to negotiate with them. That they are going to play some role in the future political process of South Vietnam, that there are going to be elections and the people of South Vietnam, are ultimately going to determine and decide their own future.

That is the course of action, that is the course of action that I would like to see. I would like to see the U.S. Government to make it clear to the government of Saigon that we are not going to tolerate the corruption and the dishonesty. I think that we should make it clear to the government of Saigon that if we're going to draft young men, 18 years of age here in the United States, if we're going to draft young men who are 19 years old here in the United States, and we're going to send them to fight and die in Khe Sanh, that we want the government of South Vietnam to draft their 18-year-olds and their 19-year-olds.

And I want to make it clear that if the government of Saigon, feels Khe Sanh or Que Son and the area in the demilitarized zone are so important, if Khe San is so important to the government of Saigon, I want to see those American marines out of there and South Vietnamese troops in there.

I want to have an explanation as to why American boys killed, 2 weeks ago, in South Vietnam, were three times as many—more than three times as many, as the soldiers of South Vietnam. I want to understand why the casualties and the deaths, over the period of the last 2 weeks, at the height of the fighting, should be so heavily American casualties, as compared to the South Vietnamese. This is their war. I think we have to make the effort to help them; I think that we have to make the effort to fight, but I don't think that we should have to carry the whole burden of that war, I think the South Vietnamese should.

And if I am elected President of the United States, with help, with your help, these are the kinds of policies that I'm going to put into operation.

We can do better here in the United States, we can do better. We can do better in our relationships to other countries around the rest of the globe. President Kennedy, when he campaigned in 1960, he talked about the loss of prestige that the United States had suffered around the rest of the globe, but look at what our condition is at the present time. The President of the United States goes to a meeting of the OAS at Montevideo—can he go into the City of Montevideo? Or can he travel through the cities of Latin America where there was such deep love and deep respect? He has to stay in a military base at Montevideo, with American ships out at sea and American helicopters overhead in order to ensure that he's protected, I don't think that that's acceptable.

I think that we should have conditions here in the United States, and support enough for our policies, so that the President of the United States can travel freely and clearly across all the cities of this country, and not just to military bases.

I think there's more that we can do internally here, I think there's more that we can do in South Vietnam. I don't think we have to accept the situation, as we have it at the moment. I think that we can do better, and I think the American people think that we can do better.

George Bernard Shaw once wrote, "Some people see things as they are and say why? I dream things that never were and say, why not?"

So I come here to Kansas to ask for your help. In the difficult 5 months ahead, before the convention in Chicago, I ask for your help and for your assistance. If you believe that the United States can do better. If you believe that we should change our course of action. If you believe that the United States stands for something here internally as well as elsewhere around the globe, I ask for your help and your assistance and your hand over the period of the next 5 months.

And when we win in November—and when we win in November—and we begin a new period of time for the United States of America, I want the next generation of Americans to look back upon this period and say as they said of Plato: "Joy was in those days, but to live." Thank you very much.

The New York Times—March 9, 2008

INCOME AND HAPPINESS: AN IMPERFECT LINK

By Robert H. Frank

Does money buy happiness? This week, Senator Byron Dorgan, Democrat of North Dakota, will join a long line of people who have taken serious stabs at trying to answer that thorny question. He will hold a hearing exploring whether traditional economic measures like per-capita income accurately capture people's sense of well-being.

This has long been a contested issue. Although everyone concedes that income is an imperfect welfare measure, conservative economists have tended to emphasize its virtues while liberals have been more likely to stress its shortcomings.

The debate is not just of philosophical interest; it also has important policy implications. Recent research findings offer support for specific arguments on both sides. Mounting evidence suggests, however, that per-capita income is a less reliable measure of well-being when *income inequality* has been rising rapidly, as it has in recent decades.

First, a few words about how economists measure income: The most commonly used metric is gross domestic product, the annual market value of all final goods and services produced within a country. Per-capita GDP is simply GDP divided by total population. Measured in 2000 dollars, it was $32,833 in 1998 and $37,832 in 2006. The real value of goods and services bought by Americans in 2006 was thus about 15 percent higher than it was in 1998. In purely economic terms, does that mean we were roughly 15 percent better off in 2006?

Not necessarily. To measure changes in the standard of living over time, it is necessary to adjust for inflation. But as conservatives stress, traditional inflation adjustments may overstate actual inflation because they fail to account adequately for quality improvements.

For example, although the current Honda Civic, a compact car, is about the same size as the company's midsize Accord from 1998, it is in almost every respect far superior and sells for only slightly more than the earlier Accord. Because inflation adjustments for auto prices are based on changes for corresponding models, the result is to overstate increases in ownership costs—thereby causing per-capita GDP to understate the corresponding increases in our standard of living.

Quality changes are not always positive, by the way. If you had a question about your health insurance in 1998, you could talk to a real person; today, you may find yourself in an endless phone loop. On balance, however, most consumers would probably prefer today's overall menu of goods and services in the economy to that of a decade ago.

Inflation adjustments may introduce further bias if people rearrange their spending patterns when prices rise unevenly. When beef prices rise twice as fast as chicken prices, people typically eat less beef and more chicken. Traditional inflation measures fail to take such adjustments fully into account—again, causing per-capita GDP growth to understate increases in the standard of living.

Liberals, for their part, have long objected that many expenditures included in GDP reflect reductions, not increases, in our standard of living. When crime rates increase, people spend more on burglar alarms, purchases that clearly do not signal improved living standards. A similar objection applies when tasks once performed at home are now more often bought in the marketplace—as when time-pressed parents substitute meals at fast-food restaurants for home-cooked meals.

The bias that results from the inclusion of such expenditures in GDP works in the opposite direction from the bias caused by inaccurate inflation adjustment. For all anyone knows, the two distortions may roughly offset each other.

But there is a much bigger problem, one that challenges the very foundation of the presumed link between per-capita GDP and economic welfare. That's the assumption, traditional in economic models, that absolute income levels are the primary determinant of individual well-being.

This assumption is contradicted by consistent survey findings that when everyone's income grows at about the same rate, average levels of happiness remain the same. Yet at any given moment, the pattern is that wealthy people are happier, on average, than poor people. Together, these findings suggest that relative income is a much better predictor of well-being than absolute income.

In the three decades after World War II, the relationship between well-being and income distribution was not a big issue, because incomes were growing at about the same rate for all income groups. Since the mid-1970s, however, income growth has been confined almost entirely to top earners. Changes in per-capita GDP, which track only changes in average income, are completely silent about the effects of this shift.

When measuring the economic welfare of the typical family, the natural focus is on median, or 50th percentile, family earnings. Per-capita GDP has grown by more than 85 percent since 1973, while median family earnings have grown by less than one-fifth that amount. Changing patterns of income growth have thus caused per-capita GDP growth to vastly overstate the increase in the typical family's standard of living during the past three decades.

Some economists have advanced an even stronger claim—that there is no link, at least in developed countries, between absolute spending and well-being. Recent work suggests that this is especially true for spending categories in which the link between well-being and relative consumption is strongest. For instance, when the rich spend more on larger mansions or more elaborate coming-of-age parties for their children, the apparent effect is merely to redefine what counts as adequate.

Evidence also suggests that higher spending at the top instigates expenditure cascades that pressure middle-income families to spend in mutually offsetting ways. Thus, when all spend more on interview suits, the same jobs go to the same applicants as before.

Yet in many other categories, greater levels of absolute income clearly promote well-being, even in the richest societies. The economist Benjamin Friedman has found that higher rates of GDP growth are associated with increased levels of social tolerance and public support for the economically disadvantaged. Richer countries also typically have cleaner environments and healthier populations than their poorer counterparts.

That per-capita GDP is an imperfect index of economic welfare is not news. The lesson of recent work is that its weaknesses are more serious than we previously realized.

And it is an especially uninformative metric when income inequality has been rising sharply, as it has been in recent decades. A society that aspires to improve needs a better measure of what counts as progress.

Robert H. Frank is an economist at the Johnson School of Management at Cornell University.

Los Angeles Times—March 10, 2008

OUR THREE-DECADE RECESSION

THE AMERICAN QUALITY OF LIFE HAS BEEN GOING DOWNHILL SINCE 1975.

By Robert Costanza

The news media and the government are fixated on the fact that the U.S. economy may be headed into a recession—defined as two or more successive quarters of declining gross domestic product. The situation is actually much worse. By some measures of economic performance, the United States has been in a recession since 1975—a recession in quality of life, or well-being.

How can this be? One first needs to understand what GDP measures to see why it is not an appropriate gauge of our national well-being.

GDP measures the total market value of all goods and services produced in a country in a given period. But it includes only those goods and services traded for money. It also adds everything together, without discerning desirable, well-being-enhancing economic activity from undesirable, well-being-reducing activity. An oil spill, for example, increases GDP because someone has to clean it up, but it obviously detracts from well-being. More crime, more sickness, more war, more pollution, more fires, storms and pestilence are all potentially positives for the GDP because they can spur an increase in economic activity.

GDP also ignores activity that may enhance well-being but is outside the market. The unpaid work of parents caring for their children at home doesn't show up in GDP, but if they decide to work outside the home and pay for child care, GDP suddenly increases. And even though $1 in income means a lot more to the poor than to the rich, GDP takes no account of income distribution.

In short, GDP was never intended to be a measure of citizens' welfare—and it functions poorly as such. Yet it is used as a surrogate appraisal of national well-being in far too many circumstances.

The shortcomings of GDP are well known, and several researchers have proposed alternatives that address them, including William Nordhaus' and James Tobin's Measure of Economic Welfare, developed in 1972; Herman Daly's and John Cobb's Index of Sustainable Economic Welfare, developed in 1989; and the Redefining Progress think tank's more recent variation, the Genuine Progress Indicator. Although these alternatives—which, like GDP, are measured in monetary terms—are not perfect and need more research and refinement, they are much better approximations to a measure of true national well-being.

The formula for calculating GPI, for instance, starts with personal consumption expenditures, a major component of GDP, but makes several crucial adjustments. First, it accounts for income distribution. It then adds positive contributions that GDP ignores, such as the value of household and volunteer work. Finally, it subtracts things that are well-being-reducing, such as the loss of leisure time and the costs of crime, commuting and pollution.

While the U.S. GDP has steadily increased since 1950 (with the occasional recession), GPI peaked about 1975 and has been relatively flat or declining ever since. That's consistent with life-satisfaction surveys, which also show flat or dropping scores over the last several decades.

This is a very different picture of the economy from the one we normally read about, and it requires different policy responses. We are now in a period of what Daly—a former World Bank economist now at the University of Maryland—has called "uneconomic growth," in which further growth in economic activity (that is, GDP) is actually reducing national well-being.

How can we get out of this 33-year downturn in quality of life? Several policies have been suggested that might be thought of as a national quality-of-life stimulus package.

To start, the U.S. needs to make national well-being—not increased GDP—its primary policy goal, funding efforts to better measure and report it. There's already been some movement in this direction around the world. Bhutan, for example, recently made "gross national happiness" its explicit policy goal. Canada is developing an Index of Well-being, and the Australian Treasury considers increasing "real well-being," rather than mere GDP, its primary goal.

Once Americans' well-being becomes the basis for measuring our success, other reforms should follow. We should tax bads (carbon emissions, depletion of natural resources) rather than goods (labor, savings, investment). We should recognize the negative effects of growing income disparities and take steps to address them.

International trade also will have to be reformed so that environmental protection, labor rights and democratic self-determination are not subjugated to the blind pursuit of increased GDP.

But the most important step may be the first one: Recognizing that the U.S. is mired in a 33-year-old quality-of-life recession and that our continued national focus on growing GDP is blinding us to the way out.

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