Etceteras . . .

Real Gross Domestic Private Product, 2000–2012

ROBERT HIGGS

In the 1930s and 1940s, when the modern system of national income and product accounts (NIPA) was being developed, the scope of national product was a hotly debated topic. No issue stirred more debate than the question, Should government product be included in gross product? Simon Kuznets (Nobel laureate in economic sciences, 1971), the most important American contributor to the development of the accounts, had major reservations about including all government purchases in national product. Over the years, others have elaborated on the reasons he gave and adduced others.

Why should government product be excluded? First, the government's activities may be viewed as giving rise to intermediate rather than final products, even if the government provides such valuable services as enforcement of private-property rights and settlement of disputes. Second, because most government services are not sold in markets, they have no market-determined prices to be used in calculating their total value to those who benefit from them. Third, because many government services arise from political rather than economic motives and institutions, some of them may have little or no value. Indeed, some commentators—including the present writer—have ultimately gone so far as to assert that some government services have negative value: given a choice, the people victimized by these "services" would be willing to pay to be rid of them.

When the government attained massive proportions during World War II, this debate was set aside for the duration of the war, and the accounts were put into a form that best accommodated the government's attempt to plan and control the economy for the primary purpose of winning the war. This situation of course dictated that the government's spending, which grew to constitute almost half of the official gross domestic product (GDP) during the peak years of the war, be included in GDP, and the War Production Board, the Commerce Department, and other government agencies involved in composing the NIPA recruited a large corps of clerks, accountants, economists, and others to carry out the work.

The Independent Review, v. 18, n. 1, Summer 2013, ISSN 1086–1653, Copyright © 2013, pp. 157–160.

After the war, the Commerce Department, which carried forward the national accounting to which it had contributed during the war (since 1972 within its Bureau of Economic Analysis), naturally preferred to continue the use of its favored system, which treats all government spending for final goods and services as part of GDP. Economists such as Kuznets, who did not favor this treatment, attempted for a while to continue their work along their own different lines, but none of these economists could compete with the enormous, well-funded statistical organization the government possessed, and almost all of them eventually gave up and accepted the official NIPA (O'Brien 1994, 242; Higgs 2006, 64–68).

Thus did government spending become lodged in the definition and measurement of GDP in a way that ensuing generations of economists, journalists, policymakers, and others considered appropriate and took for granted. Nonetheless, the issues that had been disputed at length in the 1930s and 1940s did not disappear. They were simply disregarded as if they had been resolved, even though they had not been resolved intellectually but simply swept under the Commerce Department's expansive (and expensive) rug. In particular, the inclusion of government spending in GDP remained extremely problematic.

Generations of elementary economics students since World War II have come away from Economics 101 having learned, if anything, that GDP is defined as

$$GDP = C + I + G + (X - M).$$

That is, GDP for a given period, usually a year, is the sum of spending for final goods and services by domestic private consumers (C), domestic private investors (I), and domestic governments (G) at all levels, plus foreign purchases of U.S. exports (X) minus Americans' purchases of U.S. imports (M).

This sort of accounting supplies the basic framework for the Keynesian models that swept the economics profession in the 1940s and 1950s, from which a key policy conclusion was derived: that the government can vary its spending to offset shortfalls or excesses of private spending and thereby stabilize the economy's growth while maintaining "full employment." From the beginning, the most emphasized part of this conclusion was that increases in government spending can offset declines in private spending and thereby prevent or moderate macroeconomic contractions.

Much of the increase in government spending in recent decades has taken the form of increased transfer payments—payments for which the government receives no current good or service in return—such as Social Security pensions, disability benefits, and payments via Medicare or Medicaid to subsidize program beneficiaries' health care services. In 2000, such payments amounted to 56 percent of total federal expenditures; in 2012, they were 61 percent (U.S. Office of Management and Budget 2012, 332–33). Transfer payments do not enter the computation of national income and product; only purchases of final goods and services do. Keynesian economists argue, however, that government can use increases in transfer payments to cushion business slumps in the same way that it can use increases in its purchases of final goods and services because increases in transfer payments augment personal income and stimulate greater consumption spending, hence greater investment spending, and therefore, from both sources, an increase in GDP.

The foregoing issues have taken on special cogency during the past five years as the federal government has greatly increased its total spending. Real total federal outlays increased by 25 percent, from $2,564 billion to (an estimate of) $3,213 billion (in chained 2005 dollars) between fiscal years 2007 and 2012 (U.S. Office of Management and Budget 2012, 27). Although much of this increase has taken the form of increases in transfer payments, the part that is included in GDP has also risen substantially—at the federal level, it increased by 13 percent (in real dollars) between 2007 and 2012. Some of this increase was offset by a decrease in state and local government purchases of final goods and services, which fell by 4 percent during this period (data from U.S. Commerce Department n.d.).

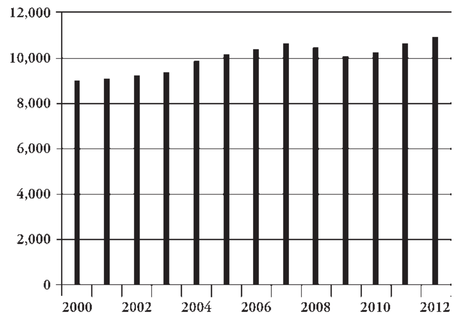
As the basic Keynesian model implies, the recent increases in government spending appear to have prevented an even greater decline in real GDP during the recession that began in the winter of 2007–2008. However that may be, because so much of this spending may have had little or no value—or even negative value—in itself, the question remains as to whether, despite what the official GDP figures show, the population's true economic well-being might have suffered a greater contraction than mainstream economists, journalists, policymakers, and others for the most part believe.

To resolve this question, I have computed what I call real "gross domestic private product" (GDPP), which is simply the standard real GDP minus the government purchases part of it. Figure 1 shows the movement of this variable from 2000 to 2012, the most recently completed year.

If real GDPP had grown at its long-run average rate of about 3 percent per year during the period from 2000 to 2012, it would have increased by about 43 percent. In reality, however, real GDPP increased during this period by only 22 percent or by about 1.7 percent per year on average. So during this period of more than a decade, private product grew at only slightly more than half of its historical average rate. Between 2002 and 2007, while the housing bubble was giving rise to seemingly buoyant growth even beyond the housing sector, the good times appeared to have returned, but the inevitable bust from 2007 to 2009 and the slow recovery since 2009 pulled the intermediate-run growth rate for 2000–2012 back to an anemic level. The recovery of the period 2009–12 brought real GDPP up to a level only 3 percent above its 2007 level, signifying five years in which almost no net gain had been made and much suffering had occurred between the beginning and the end of the period.

Perhaps the most positive statement we can make about the private economy's performance during this thirteen-year period is that it has been somewhat better than complete stagnation. Many of the measures taken to deal with the recent contraction—the federal government's huge run-up in its spending and debt; the Fed's great expansion of bank reserves, its allocation of credit directly to failing companies and struggling sectors, and its accommodation of the federal government's gigantic deficits; and the

Figure 1
Real Gross Domestic Private Product, 2000–2012
(Billions of Chained 2005 Dollars)



Source: Data compiled from U.S. Commerce Department n.d., table 1.1.6.

federal government's enactment of extremely unsettling regulatory statutes, especially Obamacare and the Dodd-Frank Act—have served to discourage the private investment needed to hasten the recovery and lay the foundation for more rapid economic growth in the long run. To find a similar perfect storm of counterproductive government fiscal, monetary, and regulatory policies, we must go back to the 1930s, when the measures taken under Herbert Hoover and Franklin D. Roosevelt turned what probably would have been an ordinary, short-lived recession into the Great Depression (Higgs 1987, 159–95; 2006, 3–29). If the government and the Fed persist in the kind of destructive policies they have undertaken since 2007, the potential for another great depression will remain. Even without such a catastrophe, the U.S. economy presents at best the prospect of weak performance for many years to come.

References

Higgs, Robert. 1987. *Crisis and Leviathan: Critical Episodes in the Growth of American Government*. New York: Oxford University Press.

————. 2006. *Depression, War, and Cold War: Studies in Political Economy.* New York: Oxford University Press for The Independent Institute.

O'Brien, Ellen. 1994. How the "G" Got into the GNP. In *Perspectives on the History of Economic Thought,* vol. 10: *Method, Competition, Conflict, and Measurement in the Twentieth Century,* edited by Karen I. Vaughn, 241–55. Aldershot, U.K.: Edward Elgar.

U.S. Commerce Department, Bureau of Economic Analysis. n.d. "Real Gross Domestic Product, Chained Dollars," table 1.1.6. In *National Income and Product Accounts.* Washington, D.C.: U.S. Commerce Department. Available at http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1#reqid=9&step=3&isuri=1&903=6. Accessed February 7, 2013; updated periodically.

U.S. Office of Management and Budget. 2012. *Budget of the U.S. Government, Fiscal Year 2013, Historical Tables.* Washington, D.C.: U.S. Government Printing Office.