Slate

Beware The Household Analogy!

By: Matthew Yglesias - Jan. 31, 2013

Daniel Mitchell of the Cato Institute doesn't like "Keynesian-laced" GDP reports which he thinks are misleading:

But here's the problem. GDP numbers only measure how we spend or allocate our national income. It's a very convoluted way of measuring economic health. Sort of like assessing the status of your household finances by adding together how much you spend on everything from mortgage and groceries to your cable bill and your tab at the local pub.

Wouldn't it make much more sense to directly measure income? Isn't the amount of money going into our bank accounts the key variable?

The same principle is true - or should be true - for a country.

This, dear readers, is a great illustration of the perils of the household analogy. Your household's expenditures and incomes don't necessarily sum up to zero. In fact, it's extremely unlikely that they sum up to zero. In any given year, your family is going to be either borrowing money (I took out a mortgage in late 2012, for example) or else saving money (this year I'm making payments on the mortgage).

The American economy isn't like that. The sum total of income earned by firms and households net of taxes and subsidies has to equal the total amount of money spent by firms, households, the government, and foreigners. There's no other way for it to work. If you earn $1,000 someone else has to spend $1,000. On a quarter-by-quarter basis, Commerce Department estimates of GDP and Mitchell's preferred Gross Domestic Income sometimes diverge, but that's measurement error—as any good Cato scholar should know, the government isn't perfect. On a conceptual level, GDP = GDI by definition. This isn't some kind of Keynesian conspiracy, it's just what the figures mean.