
ARE WE MISMEASURING OUR ECONOMY?

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On last week's "Behind the Markets" podcast, we spoke with Leonard Nakamura, an economist at the [Federal Reserve \(Fed\)](#) Bank of Philadelphia and a former professor at the Wharton School. This was a privilege, and we had a special conversation commemorating the launch of a new partnership between Wharton Business Radio and the Philadelphia Fed for a new Philadelphia Fed podcast, featuring segments from live conversations aired on Wharton Business Radio. The Philadelphia Fed anticipates this podcast starting at a quarterly frequency, but those organizing it hope to increase the amount of content over time.

Inflation and Growth Mismeasurement

Nakamura's research focuses on mismeasurements in the official [gross domestic product \(GDP\)](#) statistics. Nakamura started off the conversation talking about estimates—and he fully cautioned that these estimates have a very wide standard error and uncertainty associated with them. He said that we may be mismeasuring real economic growth by as much as 2%. This mismeasurement alone essentially would be a doubling of the reported GDP statistics. He also can see how we may be "overcounting" inflation by as much as 2% a year—or we may have more declining prices ([deflation](#)) than we realize. Both are very large numbers relative to the reported statistics. Here are some of the calculation examples:

- We have gone from a "widget-driven" economy to a "digit-driven" economy. Digital information has been growing at roughly 60% per year, but this amount of "digital growth" is only 1% of [personal consumption expenditures](#). Yet in GDP accounts, we've had nearly zero real growth in telecommunication output, showing that there are real problems measuring the growth in this output. The reason: the way the statisticians meter measure telecommunications output is the *number of minutes* spent on phone calls—yet all the other digital transfer information has exploded higher.
- Health care: Our doctors are better trained and have more knowledge, yet their contribution to GDP is essentially measured by the time spent with a patient. Therefore, a hospital stay that used to take seven days but now only takes one day shows up as declining GDP, even though same outcome was achieved with a dramatic increase in productivity. There was some conversation about the proper classification of this as either being in the consumption component of GDP or the investment component, and in a general sense, health care was more an investment rather than consumption—and education is in a similar situation.
- Nakamura was also careful to emphasize that he does not believe this is the fault of our agencies doing the calculations. He thinks the U.S. has the best statistical agencies in the world, and some of the global slowdown in productivity that we see in the U.S. is a global phenomenon, suggesting some of the mismeasurements happening are percolating globally.

For those who follow economic growth statistics and want to understand the important and real issues inherent in measuring the size and growth of economy, this was a great conversation with the Philly Fed and Professor Siegel.

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DEFINITIONS

Federal Reserve: The Federal Reserve System is the central banking system of the United States.

Inflation: Characterized by rising price levels.

Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Deflation: The opposite of inflation, characterized by falling price levels.

Personal Consumption Expenditure (PCE) Price Index: measure of price changes in consumer goods and services in the U.S. economy.