

Economics focus | Grossly distorted picture

If you look at GDP per head, the world is a different—and, by and large, a better—place

WHICH economy has enjoyed the best economic performance over the past five years: America's or Japan's? Most people will pick America. The popular perception is that America's vibrant economy was sprinting ahead (albeit fuelled by credit and housing bubbles that have now painfully burst), whereas Japan crawled along at a snail's pace. And it is true that America's average annual real GDP growth of 2.9% was much faster than Japan's 2.1%. However, the single best gauge of economic performance is not growth in GDP, but GDP per person, which is a rough guide to average living standards. It tells a completely different story.

GDP growth figures flatter America's relative performance, because its population is rising much faster, by 1% a year, thanks to immigration and a higher birth rate. In contrast, the number of Japanese citizens has been shrinking since 2005. Once you take account of this, Japan's GDP per head increased at an annual rate of 2.1% in the five years to 2007, slightly faster than America's 1.9% and much better than Germany's 1.4%. In other words, contrary to the popular pessimism about Japan's economy, it has actually enjoyed the biggest gain in average income among the big three rich economies. Among all the G7 economies it ranks second only to Britain (see left-hand chart).

Using growth in GDP per head rather than crude GDP growth reveals a strikingly different picture of other countries' economic health. For example, Australian politicians often boast that their economy has had one of the fastest growth rates among the major developed nations—an average of 3.3% over the past five years. But Australia has also had one of the biggest increases in population; its GDP per head has grown no faster than Japan's over this period. Likewise, Spain has been one of the euro area's star performers in terms of GDP growth, but over the past three years output per person has grown more slowly than in Germany, which like Japan, has a shrinking population.

Some emerging economies also look less impressive when growth is compared on a per-person basis. One of the supposedly booming BRIC countries, Brazil, has seen its GDP per head increase by only 2.3% per year since 2003, barely any faster than Japan's. Russia, by contrast, enjoyed annual average growth in GDP per head of 7.4% because the population is falling faster than in any other large country (by 0.5% a year). Indians love to boast that their economy's growth rate has almost caught up with China's, but its population is also expanding much faster.

Over the past five years, the 10.2% average increase in China's income per head dwarfed India's 6.8% gain.

Focusing on GDP per person also affects comparisons of economic health over time. During the past five years, world GDP has grown by an average of 4.5% a year, its fastest for more than three decades, though not as fast as during the golden age of the 1960s when annual growth exceeded 5%. But the world's population is now growing at half of its pace in the 1960s, and so world income per head has increased by more over the past five years than during any other period on record (see right-hand chart). Mankind has never had it so good.

Redefining recession

Once you accept that growth in GDP per head is the best way to measure economic performance, the standard definition of a recession—a decline in real GDP over some period (eg, two consecutive quarters or year on year)—also seems flawed. For example, zero GDP growth in Japan, where the population is declining, would still leave the average citizen better off. But in America, the average person would be worse off. A better definition of recession, surely, is a fall in average income per person. On this basis, America has been in recession since the fourth quarter of last year when its GDP rose by an annualised 0.6%, implying that real income per head fell by 0.4%.

Many Americans will shrug this off, especially those politicians who believe that the prime goal of policy is to retain their economic and military dominance over the world. They see the size of a country's GDP as the best measure of its economic clout, in which case the absolute rate of GDP growth matters more than growth in income per head. Europeans seem less bothered about global dominance—although they are sure to gloat about the fact that the weakening dollar means that the euro area could overtake America as the world's biggest economy this year.

There are several other reasons Americans can quibble over the use of GDP per head, especially with reference to Japan. Firstly, its shrinking population is also an ageing one in which the labour force will decline as a share of the population. Unless this is offset by more rapid productivity growth, this could make it harder to maintain the same growth in output per person in future and so harder to pay pension bills. Secondly, slower GDP growth makes it more difficult to reduce the ratio of existing public-sector debt to GDP, which stands at a hefty 180% in Japan. Last, but not least, investors care about GDP growth. Corporate profits depend upon the absolute rate of growth of an economy. And companies wanting to invest abroad will favour markets that are expanding more rapidly.

If GDP per head is nevertheless a superior measure of people's prosperity, why do governments not publish such figures each quarter along with their standard GDP figures? Population statistics tend to be less up-to-date than GDP figures and are generally not available on a quarterly basis. But that is a lame excuse: it should be much easier to count bodies than to put a value on diverse sorts of economic output. Not only do people have a right to know whether average living standards are rising or falling, but publishing such numbers could also benefit some countries. If Japan's government had drawn attention to the sprightlier growth in income per head in recent years, in contrast to endless reports about its "underperforming" economy, consumers may have felt cheerier and spent more—in other words, its GDP growth would have been stronger. ■

Looking through a different lens



Sources: IMF; Angus Maddison; Economist Intelligence Unit; National statistics