The Economist

Calculating European GDP

Changing the scales

How revisions will soon bulk up GDP

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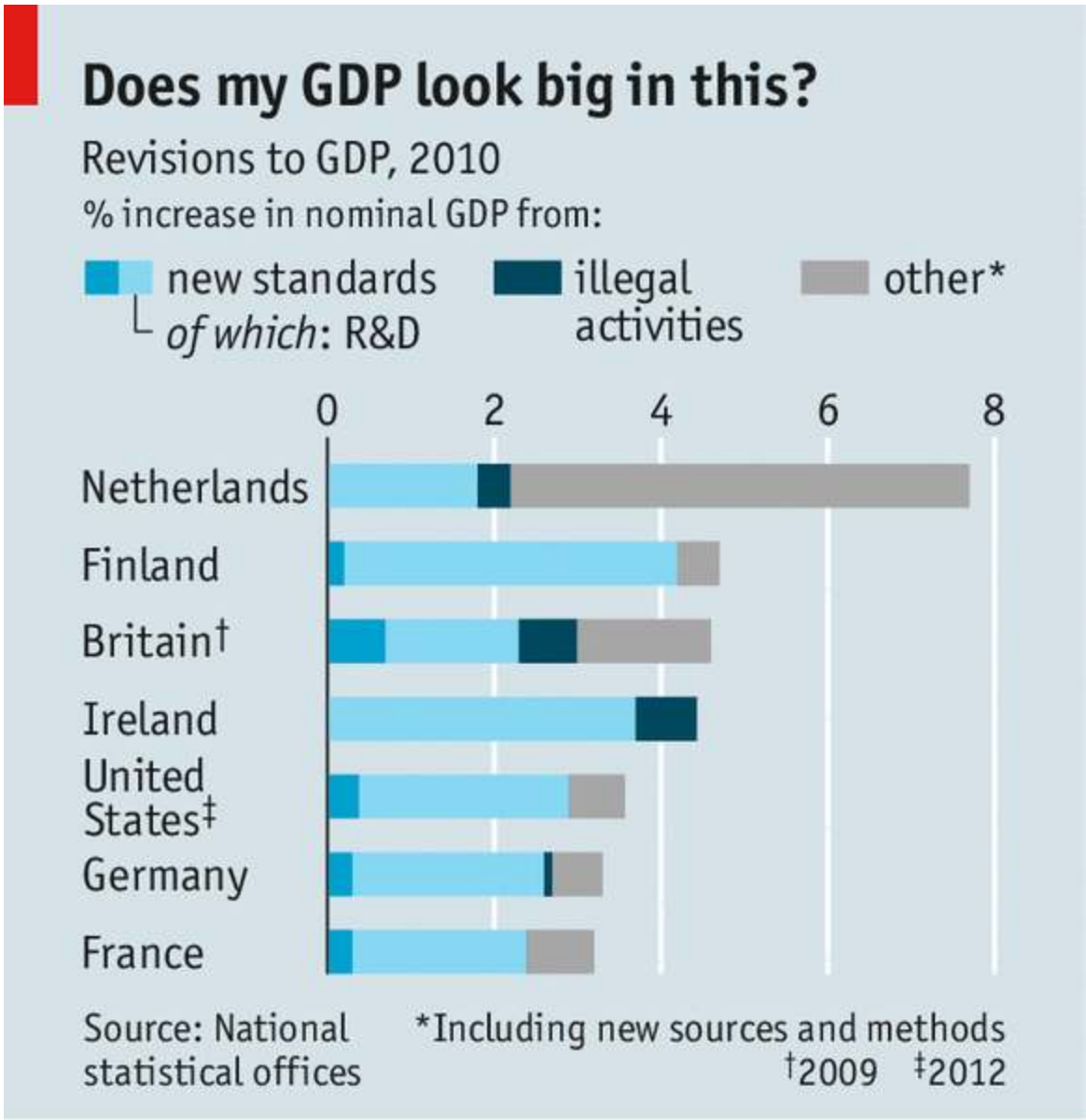
RECENT figures showing that the euro zone's recovery stalled in the second quarter were dismal. But an overhaul of European national accounts is due in



September. This will not rewrite the narrative of a feeble and faltering recovery but it will reveal that Europe's economies are bigger than previously reckoned. The revisions will not be on the epic scale of the one in Nigeria earlier this year, which almost doubled its estimated output. But they will raise

GDP in Europe's biggest economy, Germany, by 3.3%, in line with the boost to American GDP from a similar exercise a year ago (see chart).

European countries are adopting new global standards for what counts as output. These replace rules dating back to 1995, when the internet age had barely begun. By far the biggest change in how output is measured will come from reclassifying research and development (R&D). By treating it as an investment, rather than as if it is being consumed in the course of production, it will add to GDP.

In research-intensive Finland, one of a handful of European states that have unveiled accounts conforming to the new guidelines, reclassifying R&D has lifted the level of GDP in 2010 by 4%. Other countries will get a smaller boost; for example R&D is reckoned to have raised GDP in France by 2.1% and in Germany by 2.3%. In southern Europe, where R&D is especially low, the new international standards may in total raise GDP by only 1-2%.

The European revisions will also recognise in the national accounts that prostitution, drug-peddling and cigarette and alcohol smuggling are economic activities, even if illegal ones. But the effect will be modest, saving national blushes. In Germany, where prostitution has been made legal and is already included in GDP, the lawbreakers will add only 0.1%. The impact is higher in Britain and Ireland, where it raises GDP by 0.7%.

Yet another source of extra GDP will come from incorporating new data and improved methods of compilation, which together would have boosted the estimates even under the old guidelines. In France this adds a handy 0.8%, out of an overall upward shift of 3.2%. The impact is especially large—making up most of the total rise of 7.6%—in the Netherlands, which had fallen behind in updating its accounts.

The Dutch revamp has softened the setback to the economy in the first quarter of 2014. A fall in GDP of 1.4%, as unusually mild weather depressed consumption and output of natural gas, became a decline of only 0.4% because the revisions have reduced the weight of this industry in GDP. But in general the new figures will not materially alter the euro zone's mediocre performance because GDP will also be revised upwards for previous quarters and years.

The recalculations still matter, because GDP is a benchmark in European governance. In various guises it determines national contributions to the EU budget and handouts to poorer regions. It also forms the denominator for budgetary measures such as debt and deficits. Already the higher levels of GDP are tending to flatter public-debt burdens, reducing the French debt-to-GDP ratio by 1.6 percentage points, for instance. The process is not automatic. Ireland is now reporting a higher debt-to-GDP ratio for 2011 owing to an increase in debt under the new rules that outweighed the rise in GDP. But every little helps.

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