Limitations of GDP as a measure of economic output

1. GDP does not adjust for depreciation (but NDP does).
2. GDP is in current dollar terms, not adjusted for price changes (but real GDP makes that adjustment).
3. GDP is not adjusted for population changes (but GDP per capita is adjusted accordingly).
4. Many productive activities are not exchanged in market transactions. Such nonmarket activities must be either estimated and included in GDP or excluded from GDP.
   A. The services of owner-occupied houses are estimated (rental value) and included in GDP. However, other durable goods which yield a stream of services beyond the one-year accounting period are not included in GDP.
   B. Do-it-yourself activities and unpaid services in the home are not estimated or included in GDP.
   C. Farmers' personal food consumption is estimated and included in GDP, but consumption from personal gardens is not otherwise included. This makes a bigger difference in the calculations of GDP for developing countries.
   D. Government output is a significant part of GDP and is estimated and included at the cost to the government.
5. Illegal activities are not counted in GDP, though they are part of our nation's production.
6. Maintenance of durables is productive, but is not estimated in GDP when performed at home or when covered by warranty.
7. Some productive transactions are not reported (tax avoidance), and that income/output is not included in GDP.

Limitations of GDP as a measure of social welfare

1. Composition of output affects welfare, but is not accounted for in GDP. All market goods are included in GDP and are weighted the same (cigarettes, penicillin, alcohol), although they may have quite different effects on welfare.
2. The distribution of income/output is ignored in calculations of GDP, although it affects perceptions of welfare.
3. Similarly, changes in taxes and transfer payments affect welfare but are not considered in GDP.
4. Quality changes are ignored in GDP (unless they are reflected in price changes), although they affect welfare.
5. Leisure time is important to welfare, but may actually have an inverse relationship to GDP.
6. GDP includes spending on military and police protection, which are sometimes called "regrettable necessities" in running our economy. However, it includes no measurement of the circumstances which cause us to need such services. For example, if we double our police force and GDP increases, but crime rates triple... are we better off?
7. Externalities and social costs such as pollution and alcoholism affect welfare but are not included in GDP. For example, if we sell more liquor and GDP rises but so do traffic fatalities... what has happened to welfare?