Revised GDP calculation method in India and its impact

March 1, 2016: Gross domestic production (GDP) represents the health of the economy and is used as an indicator by the Government and policy makers for planning and policy formulation. It represents a single number that indicates the monetary value of all finished goods and services produced within a country.

Methods to calculate GDP are based on Income approach (Factor cost) and Expenditure approach (Market price). Income approach would include total compensation to employees /wages, rent earned/gross profit/interest earned and taxes less subsidies. Whereas expenditure approach includes calculations based on total consumption, investment, government spending and net exports. These methods would arrive at two different values which are close in range. These values are referred to as nominal GDP. The GDP value derived by both the methods is adjusted for inflation by comparison with the GDP values in the base year to arrive at real GDP. Now, out of these values, real GDP value calculated by expenditure approach is considered as official value of GDP and is reported in media and also for calculation purposes by rating agencies, investors, world organizations, etc.

Change in method of calculation of GDP in India:

In 2014, India changed from factor cost to market price method as official method of calculation of GDP. Additionally, base year was changed from 2004-05 to 2011-12. Also the purview of industries included in calculation of GDP was increased.

The change in method of calculation was in line with adopting the recommendations of System of National Accounting 2008 (SNA 2008), to bring figures used for calculating GDP in line with the international standards.

The data used for calculation of GDP included updated data from the population census of 2011, National sample survey (NSS) 68^{th} round of employment, unemployment and consumer expenditure (2011-12).

Now we take a look at impact of change in the method of calculation of GDP.

Evaluating the change

- Global investors use growth prospect numbers to allocate their investment allocations between countries - GDP is a key metric here. So news that India's GDP growth has averaged 6 per cent for the last three years and not 4.6 per cent as thought earlier, may help investors view India in a more favorable light.
- IMF's world economic outlook projections are not based on factor cost. This used to create confusion in the past, with IMF's projections turning out to be very different from that of the government. Now due to change in the method, this has become easier.
- Not only IMF, but majority of countries in the world use market price method to calculate GDP. Hence, India's comparison with world economies has become much easier now.
- A higher growth rate helps government achieve a better fiscal deficit. The Government has been successful in bringing down the fiscal deficit in India to 3.9 percent. A favorable base due to higher GDP growth helps government achieve the target.

Critical reception of new method of calculation of GDP:

Despite a surge in growth rate, the GDP growth has not been seen very positively by many organizations across the world. There are doubts and skepticism regarding the GDP calculation method amidst the investor community, mostly because of an unprecedented growth rate post-2008 crisis.

Major reason for the doubts is the lack of structural growth along with the increase in numbers. For example, if we review the Oct-Dec 2014employment statistics, we can see there has been a generation of only 1.17 lakhs jobs, which has declined from 1.75 lakhs in the first quarter and 1.58 lakhs in the second quarter. However, according to economists, every major change in the data accounting method demands time to adjust to the current adjacent data points. Therefore, as soon as a change is made in method of data accounting other adjacent data need not be in line with it immediately after the change.

Deeper insights: Factors indicating high growth

- Widening of data pool: When the base year of national accounts statistics is changed, there is some change in the levels of GDP estimates. This is because of increase in the purview of companies being analyzed. The change in base year effected the number of companies to be analyzed, increased from 2500 in 2004-05 series to 5000 companies in 2011-12 series.
  The effect of the change in base year and the changes made in the new series ranges from -2% in 2011-12 to -0.1 per cent in 2013-14.
- The Nikkei India Manufacturing PMI was at 52.4 for March, 2016 which shows expansion in the manufacturing activity.
- Although the factory capacity utilization has reduced in the 3rd quarter of 2015-16 from high levels attained post- 2008, the data has remained at an above average level.

Further to the above mentioned factors, if we compare India's growth rate with developing nations like China, India is seen to have sustainable economic growth structure.China's export-oriented economy suffered a setback due to slowdown in demand and lead to events like China's stock market crisis and Yuan devaluation. India's economy also bore the brunt of slowdown in 2008, but managed to maintain a positive growth throughout. Global organizations like World Bank and IMF have predicted India's growth rate would surpass Chinese growth rate by 2016-17.

Another factor accountable for rise in GDP growth, is record lowering of crude oil prices. Crude oil accounts for major portion of country's imports and lowering of crude oil prices has led to huge lowering of fiscal deficit in turn increasing the GDP.

Though there have been multiple and diametrically opposite views on perception of change in methodology of GDP calculation, it is important to give it some time so that structural changes reflect the growth and also come in line with data sets to effectively reflect growth of the nation.