**Fresh Row: What is India’s GDP and how is it calculated?**

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A latest National Sample Survey Organisation (NSSO) report has raised fresh questions over India’s gross domestic product (GDP) and national income calculation methodology. According to Mint, which first wrote about it on May 8, 2019, about 38% of companies, which the NSSO surveyed from the MCA-21 database of companies used for calculating GDP, could not be traced or were wrongly classified.

Here’s a primer:

**What is GDP?**

Gross Domestic Product or GDP represents the total value of all the final goods and services that are produced within a country's borders within a particular time period, typically a year or a quarter.

**How is GDP calculated?**

It can be calculated by using three methods—the supply or production method, the income method and the demand or expenditure method and by definition the value of GDP should be identical, irrespective of the method used. This is because one person’s or entity’s income is another person’s spending on expenditure. For instance, what households spend in buying provisions at a local store is the shop owner’s income. Likewise, an employee’s salary is what his/her company spends.

How is GDP calculated using the supply or production method?

The monetary value of all products and services generated across the economy will give the country’s GDP.

**How is GDP calculated using the income method?**

Simply put, adding the earnings of all the people and the income of capital employed would give the GDP of the country.

*How is it calculated using the demand or expenditure method?*

The government spends money on welfare measures and salaries of its employees. Industry incurs expenditure on investment and wages. Consumers spend money on buying goods and services, or saving. The sum total of spending made by all entities across the economy would give the GDP of the country.

**What is real and nominal GDP?**

Nominal GDP is calculated at current prices. Real GDP is GDP adjusted for inflation.

**What is a “base year”?**

The base year of the national accounts is chosen to enable inter-year comparisons. It gives an idea about changes in purchasing power and allows calculation of inflation-adjusted growth estimates.

The new series has changed the base to 2011-12 from 2004-05. Every national accounts dataset gives GDP calculations for two years: 2011-12 and the current year.

**When was the new series launched?**

A decision to change the GDP calculation method was taken during the UPA-II years. The NDA government launched the first set of data, giving out levels of GDP and growth rates from 2011-12.

What are the main differences in the old and new methods to calculate GDP?

In the previous method, the index of industrial production (IIP) or factory output was the main measure to calculate manufacturing and trading activity. The limitation was, that this only counted volume and did not give an idea about value. For instance, in the old method, the number of motorcycles produced in the plant was counted, as opposed to the motorcycles’ value that the plant rolled out.

In the communication sector, telecom subscriber base was used in the old sector as compared to minutes of usage in the new formula.

**What’s on now?**

Previously, the first GDP estimates were based on IIP data. It was updated every two years factoring in data from the Annual Survey of Industries (ASI). ASI only gave out goods’ value produced by firms registered under the Factories Act.

Now, the corporate affairs ministry’s MCA 21 records, a wide-ranging compilation of balance sheet data of lakhs of firms, is used.

The use of MCA 21 records for national income calculations have brought to light a segment of organised activity, which was earlier, for the most part, invisible. This is the lower end of the corporate segment. These are companies which are not listed in stock exchanges, and were virtually left out of national income calculations.

**What is Gross Value Added (GVA)?**

The new method adopts a gross value added (GVA)-based approach as compared to a pre-dominantly volume-based calculation previously.

GVA, which is GDP minus taxes, serves as a more realistic proxy to measure changes in the aggregate value of goods and services produced in the economy.

Earlier, the IIP served as the primary metric to gauge manufacturing and trading activity. The problem was, it only counted the number of units produced and did not distinguish, between, say the value of a luxury car and an entry-level hatch-back. It is possible that factory output would have remained stagnant over a period of time, but its value would have multiplied.

One can keep selling the same number of cars, but keep improving the quality so the value goes up. An even better example than cars is computers. A purely output-based method would not be able to capture the innovations and the value additions in such products and industrial activity.

The GVA method also factors in value addition and economic action carried out by activities such as marketing. Such activity can be of a very high value in case of large FMCG companies.

**What is the latest controversy surrounding the GDP data?**

A report showed that a latest survey of the National Sample Survey Organisation (NSSO) titled 'Technical Report on Service Sector Enterprises in India' found around 38% of companies included in the MCA-21 database either untraceable or wrongly classified. This has raised questions whether India has been overestimating its GDP levels and growth.

How has the government responded to this?

The statistics ministry has said an official committee will examine the NSS technical report on services sector enterprises. The ministry said that the issue of coverage, quality and timeliness of the MCA database vis-a-vis the Annual Survey of Industries (ASI) had been discussed in detail in the various meetings of the Advisory Committee on National Accounts Statistics and adopted only thereafter.

The Central Statistics Office (CSO) is currently in the process of undertaking the new base revision to 2017-18. The statistics ministry had commissioned the NSSO technical report for this purpose.

**What could be the possible reasons for these companies becoming untraceable?**

One likely reason could be that many of these untraceable companies could actually be `shell’ or paper companies. One in every three registered company in India is defunct, the government has found out, and as of February 28, 2019 the ministry of corporate affairs (MCA) has struck off 6.2 lakh companies from the official records as part of the plan to crack down on shell or paper companies.

Out of the 6.7 lakh companies that were shuttered down, 10,640 companies were liquidated or dissolved; 6.2 lakh companies were declared defunct (and hence struck-off from official records); 22,532 companies were amalgamated or merged with other companies; 10,086 companies were converted to Limited Liability Partnership (LLP) and 4,794 were converted to LLP and dissolved.

The 6.22 lakh `defunct’ and struck-off companies accounted for 33% of the 18.6 lakh registered companies as of February 28, 2019.

**When is a company’s name struck off official records?**

Under the section 248 of the Companies Act, 2013, a company’s name can be removed from the Registrar of Companies (RoC) if it fails to commence business within one year of its incorporation or is not carrying out operations for three years.

The ongoing move to shutter down such companies is part of a drive to remove entities that do not contribute to an economic activity and are rather a burden on the system. The corporate affairs ministry is also examining companies’ data to see if they are involved in tax evasion or money laundering.

The ministry of corporate affairs data also showed that nearly two-thirds or 11.9 lakh companies are active. Active companies carry out normal business and trading activities, generating income and meeting the basic requirements such as filing financial statements. Inactive or shuttered companies, therefore, may be one of the reasons why these could be showing up as `untraceable’ in the NSSO’s technical report on MCA 21 data.

**What has the government said about the likely impact of these untraceable companies on GDP calculations?**

The statistics ministry said that “there is no impact on the existing GDP/GVA estimates for the corporate sector as due care is taken to appropriately adjust the corporate filings at the aggregate level based on the paid up capital”. The ministry said that every revision in the estimates of GDP/GVA is based on the data available at the time of the respective release.

**What are experts saying on the issue?**

There are views on both sides of the fence. While some experts have said that the `untraceable’ companies may have led to an overestimation of India’s GDP levels and growth, others have pointed out that the value addition is captured at the level of spending through the expenditure method while calculating GDP and national income. For instance, a company may have set up a shell subsidiary to evade taxes and the later shuttered it down following a government clampdown, but the its value addition and expenses made will get captured at various stages of spending.

**What are the other criticisms about GDP estimates using the new method?**

One of the biggest criticisms is about the back series that was launched in November 2018. The back series data serves as a link between the old and new formulae. The back series is aimed at calculating/updating national accounts using the new formula to help allow inter-year comparisons and enable better economic forecasting.

Owing to the limitations of the availability of data, in some areas either splicing method or ratios observed in the estimates in the base year 2011-12 have been used for the previous years. The big question is: How can you extrapolate MCA 21 data for previous years when the data itself started getting collated only in 2008 and has undergone several rounds of changes in the later years.

**Why the criticism?**

It was previously estimated that India clocked double-digit growth of 10.3% in 2010-11. This has now been revised to 8.5%, according to the new estimates.

Likewise, real or inflation-adjusted GDP growth rates of 9.3%, 9.3% and 9.8% in 2005-06, 2006-07, 2007-08 respectively were revised downwards to 9.9%, 8.1% and 7.7%.

According to the new series, GDP growth rate dropped to 3.1% in 2009-10, compared to the previous estimates of 3.9%, mirroring a deeper impact of the global financial crisis of 2008 on the Indian economy than previously thought.

**Why the sharp drop in GDP growth rates?**

According to the government, several factors that affected primary, secondary and tertiary sectors of the economy were over-reported in the previous estimates.

Growth rates in the primary sector fell from 5% in 2005-06 to 2% in 2011-12 against 4.6% in 2005-06 to 4.4% in 2011-12 in the previous estimates.

Secondary sector growth rates fell from 10.2% in 2005-06 to 6.6% in 2011-12 in the new series compared to 10.7% and the 8.5% respectively.

Tertiary sector growth rates fell from 9.1% in 2005-06 to 5.9% in 2011-12 according to the back series against 10.9% and 6.9% respectively earlier.

**Why is there such a big difference**?

The difference can also be partly attributed to change in the GDP “deflator” method. GDP deflators are price indices used to calculate inflation-adjusted levels of GDP. In the new estimates, different GDP deflators have been used for different sectors of the economy.

**How does GDP data factor in India’s bustling informal and black economy that operates outside regulatory boundaries?**

According to officials the GDP series captures it well because of the data from surveys of the household economy covering both assets (through the debt and investment survey), expenditure and establishment activity. Black money is not value addition. It is how much of this should have been assessed to tax and was therefore not paying tax. That is a much more difficult question to answer.

**What about the rural economy?**

The earlier formula mainly used farm produce as a proxy for calculating agricultural income. The new method has widened the scope for calculating value addition in the agricultural sector. Official statisticians say that livestock data is more widely captured in the new method. For instance, values are now also attached to byproducts of meat including “heads and legs”, “fat” “skin”, “edible offal and glands” of cattle, buffalo, sheep, goat and pig.

**How is labour income estimated in GDP calculations?**

In the earlier GDP calculation, all labour was treated as equal. The new series has used a concept called “effective labour input”. It assigns different weights are assigned on whether one was an owner, a hired professional or a helper.

**What about estimates of value of trading-related services?**

The new series uses NSSO’s 2011-12 establishment survey, compared to the 1999 survey data used in the earlier series. The latest survey showed that value addition in trade was significantly lower than what was being projected in the old series, which used extrapolated data from a survey conducted in 1999.

**How is income generated by the financial sector estimated?**

Official statisticians say the new series has significantly widened the scope of capturing economic activity and value addition in the financial sector. The earlier series was limited to a few mutual funds (primarily UTI) and estimates for the Non-Government Non-Banking Finance Companies as compiled by RBI.

In the new series, the coverage of financial sector has been expanded by including stock brokers, stock exchanges, asset management companies, mutual funds and pension funds, as well as the regulatory bodies, SEBI, PFRDA and IRDA.

**What about income estimates of local bodies and autonomous institutions?**

Economic activity of local bodies and autonomous institutions were earlier estimated on the basis of information received for seven autonomous institutions and local bodies of only four States – Delhi, Himachal Pradesh, Meghalaya and Uttar Pradesh. The new series has far wider universe that captures 60% of the grants/transfers provided to these institutions.

**When is the GDP data released and how often is it revised?**

The CSO releases the quarterly GDP estimates with a two-month lag every year. It also releases annual advance estimates in first week of January and later in the last week of February. National accounts estimates go through multiple revisions through three years based on updated data across sectors.

The first provisional annual estimates are released on the last working day of May. So, for 2018-19, the provisional GDP estimates will be released on May 31, 2019.

It will be later revised with fresh data and the first revised estimates for 2018-19 will be released on the last working day of January 2020. It will again be revised with more updated data and the second revised estimates will be released on the last working day of January 2021.

Till the release of provisional estimates in any year, the estimates are based on indicators such as IIP, wholesale price indices, core sector data on steel, cement, electricity, revenue expenditure, GST data, trade data on imports and exports, consumer prices, among others.

The estimates based on indicators are reworked when the corresponding data source becomes available. By the time of the Third Revised Estimate, the coverage and completeness in the data sources are almost final and no further revision takes place.

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