Q12. Write down some of the limitations of using GDP as an index of welfare of a country.

Ans: Limitations of using GDP as an indicator are as follows:

(i) Non-monetary exchanges: GDP measures the goods and services produced in an economy during a particular period of time. However, it does not take into account those transactions that do not come under monetary terms. In less developed countries there are non-monetary exchanges, particularly in rural areas. Hence, these transactions remain outside the domain of GDP. The household sector and volunteer sectors get ignored in GDP.

(ii) Inflation: GDP does not take into account the level of prices in a country. Because of inflation, the cost of living increases leading to a decrease in the standard of living. The loss of welfare due to this decrease is not taken into consideration by GDP as an index of welfare.

(iii) Externalities: Increase in the national income is associated with increased levels of pollution, accidents, disasters, shortage and depletion of natural resources, etc. These factors affect human health and lead to ecological degradation. GDP fails to consider the costs or valuations of such factors.

(iv) Income pattern: GDP disregards the income distribution pattern. The increase in aggregate national income may be a result of the increase in income of a few individuals. Thus, this may lead to false interpretation of social welfare.

(v) Welfare: GDP ignores the welfare component as the goods and services produced may or may not add to the welfare to a society. For example, the production of goods, like guns, narcotic drugs, high-end luxurious goods increase the monetary value of production, but they do not add to the welfare of the majority of population.

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