Source : www.thehindu.com Date : 2019-11-13

THE PROBLEM WITH RE-BASING GDP ESTIMATES

Relevant for: Indian Economy | Topic: Issues relating to Planning & Economic Reforms

In the next few months, the Central Statistics Office (CSO) proposes to replace the gross domestic product (GDP) series of 2011-12 base year with a new set of National Accounts using 2017-18 as the base-year. According to the chief statistician, this will be done as soon as the new consumer expenditure survey and the Annual Survey of Industries (ASI) results become available. Normally, rebasing is a routine administrative decision of any national statistics office.

But these are not normal times in India for users and producers of the national accounts. For the past four years there has been a raging controversy over the current GDP figures on account of questionable methodologies and databases used. According to official data, the annual economic growth rate has sharply decelerated to about 5% in the latest quarter, from over 8% a few years ago. The reality may, however, be far worse. Independent studies using multiple statistical methods to validate the official GDP estimates by the former Chief Economic Adviser, Arvind Subramanian, and Sebastian Morris of the Indian Institute of Management, Ahmedabad, have suggested that the annual GDP growth rates during the last few years may have been overestimated by 0.36 to 2.5 percentage points.

Why is there such distrust in the official GDP figures? To understand the origins of the dispute, one has to go back to early 2015 when the CSO released a new series of GDP with 2011-12 as base-year, replacing the earlier series with the base-year 2004-05. Periodic rebasing of GDP series every seven to 10 years is carried out to account for the changing economic structure and relative prices. Such re-basing usually led to a marginal rise in the absolute GDP size on account of better capturing of domestic production using improved methods and new databases. However, the underlying growth rates seldom change, meaning that the rebasing does not alter the underlying pace of economic expansion.

The 2011-12 base year revision was different, however. The absolute GDP size in the new base year 2011-12 contracted by 2.3% (compared to the old series), and the annual GDP growth rate went up sharply from 4.8% in the old series to 6.2% in 2013-14. Similarly, the manufacturing sector growth rate for 2013-14, swung from (-) 0.7% in the old series to (+) 5.3% in the 2011-12 series. Such large variations in growth rates for the same year may be justified if the material conditions of production warranted. But the higher growth estimates recorded by the new series did not square with related economic indicators such as bank credit growth, industrial capacity utilisation or fixed investment growth. Thus began the questioning of the new GDP series.

The suspicion of official output estimates became particularly intense after the demonetisation of high valued currency notes in November 2016. By most analyses, the economic shock severely hurt output and employment. For example, the Ministry of Finance’s Report on Income Tax Reforms for Building New India (September 2018; convenor: Arbind Modi), provided data on fixed investment in the private corporate sector based on actual corporate tax returns. It shows that the fixed investment to GDP ratio in the private corporate sector fell sharply from 7.5% in 2015-16 to 2.8% in 2016-17 (suspected to be on account of demonetisation). However, surprisingly, the ratio in the national accounts went up from 11.7% in 2015-16 to 12% in 2016-17.

Similarly, chief economist of the International Monetary Fund, Gita Gopinath’s academic research paper (co-authored) published by the highly regarded National Bureau of Economic Research in the U.S. in May 2019 showed an adverse effect of demonetisation on growth rate. Yet, the official GDP for the year 2016-17 grew at 8.2%, the highest in a decade.

The source of the problem, according to many economists, is the underlying methodologies for calculating GDP (in the 2011-12 series) which they claim are deeply flawed, as well as the new dataset used in estimating the private corporate sector's contribution. Some of the recent, prominent criticisms are as follows.

In a first, the CSO estimated value addition in the private corporate sector using the statutory filing of financial results with the Ministry of Corporate Affairs. The private corporate sector accounts for about a third of GDP, and spans all production sectors, and roughly about half of the private corporate sector output originates in manufacturing. The database of the Ministry of Corporate Affairs has been criticised by many as unreliable; hence it is possible that the private corporate sector output has been overestimated. For example, the Ministry's database on "active" companies — that is companies claiming to have submitted audited financial results regularly for three years — seems to contain many companies that are actually inactive (not producing output on a regular basis). Last year when the National Sample Survey Office (the government's premier, independent, data-gathering agency), used the Ministry of Corporate Affairs list of active companies to canvass a sample of companies in the services sector, it found that up to 42% of the sample companies were not traceable, had failed to provide the information for the survey, or had failed to provide audited accounts.

For estimating GDP of the private corporate sector, questionable methods are also used for blowing-up unverified "sample" estimates for the unknown and varying universe of "working" or active companies.

State domestic product (SDP) estimation uses many of the same databases and methodologies used in all-India GDP estimation. The methodological changes made in the 2011-12 base-year revision have adversely impacted the quality of SDP estimates on two counts. First, the Ministry of Corporate Affairs data does not have factory identifiers (that is, location of production units, but only has the location of the company head office); it has distorted distribution of the SDP estimates across States. Second, for estimating value-added in the informal or unorganised sector, State-specific labour productivity estimates are unavailable in the 2011-12 series. Hence the method used distorts output estimation.

The CSO has denied the claim that the underlying methodology is flawed and that there are serious problems with the new database being used. The official response throughout the debate has been that the 2011-12 GDP series follows global best practices (meaning, following the latest United Nations System of National Accounts guidelines) and applies better methods using much larger datasets; hence the official estimates are blemish-less. This ignores the fact that India has always followed UN guidelines, and that larger data sets are not necessarily better.

The proposed change over to a new base-year of 2017-18, is, in principle, a welcome decision. However, considering the methodological disputes and data related questions relating to the current national accounts series, as illustrated above, what would the rebasing potentially accomplish? Doubts will persist so long as the underlying methodological apparatus remains the same; feeding it with up-to-date data is unlikely to improve its quality.

In view of the problems with the current series, a chorus of academic and public voices has proposed setting up an independent commission of national and international experts to review the GDP methodology. The ideal time to do this would be now so that solutions could be found and incorporated into the new GDP series. Conversely, if a new rebased series is introduced without any changes it will only entrench the existing methodological problems, and ensuring that the debate will continue for the next half decade. And as the debate continues, so will the loss of credibility.

R. Nagaraj and Rajeswari Sengupta are with the Indira Gandhi Institute of Development Research, Mumbai

END