Over Estimation of GDP - Arvind Subramanian Remarks

Why in news?

Former Chief Economic Adviser (CEA) Arvind Subramanian recently claimed in a research paper that India's GDP growth from 2011-12 to 2016-17 was likely to have been overestimated.

What is the former CEA's claim?

- Official estimates place average annual growth at about 7% for the 2011-12 to 2016-17 period.
- But actual growth may have been about 4.5%, with a 95% confidence interval of 3.5% to 5.5%.
- The methodological changes have led to GDP growth being overstated by about 2.5 percentage points per year between 2011-12 and 2016-17.

What were the parameters used?

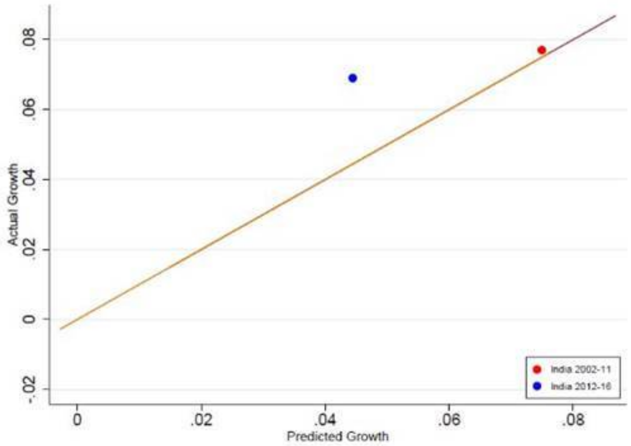
- Firstly, 17 key indicators that are typically correlated with GDP growth were complied for the period 2001-02 to 2017-18.

- These include –
    i. electricity consumption
    ii. two-wheeler sales, commercial vehicle sales, tractor sales
    iii. airline passenger traffic, foreign tourist arrivals, railway freight traffic
    iv. index of industrial production (IIP), IIP (manufacturing), IIP (consumer goods), petroleum, cement, steel
    v. overall real credit, real credit to industry
    vi. exports and imports of goods and services
- Secondly, India is compared with other countries.
- For a sample of 71 high and middle income countries, relationship between a set of indicators and GDP growth for the pre and post-2011 periods was estimated.
- [The indicators chosen (credit, exports, imports and electricity) are simple, reliable, and typically not produced by the agency that estimates GDP.]

What are the key arguments?

Correlation between annual growth of indicators and GDP, 2001-2011 and

2012-2017



The horizontal axis shows growth predicted for different countries based on the cross-country relationship between the indicators and GDP growth; the vertical axis shows actual growth.

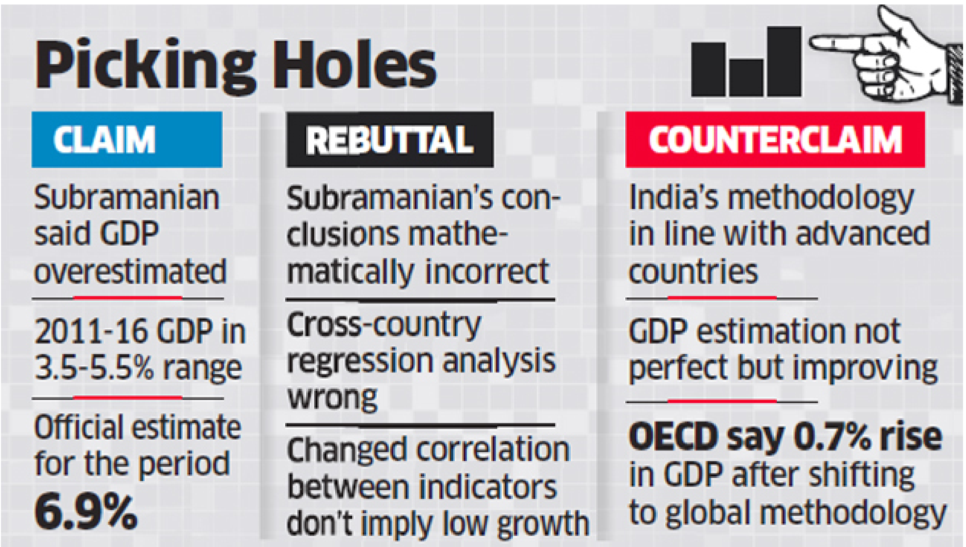
The line shows the growth predicted by the indicators (horizontal axis) and what is officially reported (vertical axis).

- **Mismatch** - In the first period (2001-2011), the India data point (red) is right on the line.

- This indicates that it is a normal country i.e. India's reported GDP growth is consistent with the cross-country relationship.
- However, in the second period (2012-2017) the India data point (blue) is well above the line.
- This implies that its GDP growth is much greater than what would be predicted by the cross-country relationship.
- It is high by over 2.5 percentage points per year.
- **Cause** - Reproducing the detailed methodology underlying the GDP estimates is hard for outside researchers.
- So it is difficult to trace the source of the problem.
- But, possibly, one sector where the mis-measurement seems particularly severe is the formal manufacturing.
- Before 2011, formal manufacturing value added from the national income accounts moved closely with IIP (Mfg.) and with manufacturing exports.
- But afterward, the correlations turn strongly and bizarrely negative.

What was the government response?

- The government has issued a clarification refuting the claim.
- Also, the Economic Advisory Council to the Prime Minister (EAC-PM) is planning to issue a point by point rebuttal.



What are the implications of overestimation?

- Growth estimates are significant not just for reputational reasons but critically for internal policy-making as well.
- The new evidence implies that both monetary and fiscal policies over the last years were overly tight from a cyclical perspective.
- E.g. interest rates may have been too high, by as much as 150 basis points
- Also, inaccurate statistics on the economy's health weaken the drive for reform.
- E.g. if it was known that India's GDP growth was actually 4.5%, the urgency to act on the banking system or on agricultural challenges may have been greater
- The popular narrative has been one of "jobless growth", hinting at a disconnect between fundamental dynamism and key outcomes.
- But in reality, weak job growth and acute financial sector stress may have been a consequence of the modest GDP growth.

What lies ahead?

- Policy discourse recently has focused on employment, agriculture and redistribution more broadly.
- But most importantly, restoring growth must be the key policy objective.
- Going forward, there must be reform urgency drawn from the new knowledge that growth has been only moderate in recent years.
- Importantly, GDP estimation in its entirety must be revisited by an independent task force.
- It should comprise of both national and international experts, statisticians, macro-economists and policy users.
- Moreover, with the current large amounts of transactions-level GST data, the revisit may, for the first time in India, help make expenditure-based

estimates of GDP.

Source: Indian Express

Quick Fact

Economic Advisory Council to the PM

- Economic Advisory Council to the Prime Minister (EAC-PM) is an independent body.
- It is constituted to give advice on economic and related issues to the Government of India, specifically to the Prime Minister.
- Its functions include –
    1. analyzing any issue, economic or otherwise, referred to it by the Prime Minister and advising him thereon
    2. addressing issues of macroeconomic importance and presenting views thereon to the Prime Minister; either suo-moto or on a reference
    3. submitting periodic reports to the PM on macroeconomic developments and issues with implications for economic policy
- The council would attend to any other tasks as may be desired by the Prime Minister from time to time.