



The Curious Case of GDP Growth

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The Central Statistics Office (CSO), the custodian of Indian statistics, has faced a lot of questioning after the release of the new GDP series with 2011-12 as base. The RBI, Ministry of Finance, IMF, several credit rating agencies have all questioned the validity of the revisions.1 Some analysts like Ruchir Sharma of Morgan Stanley have gone as far as to assert that these revisions if not corrected will make Indian statics as suspect as Chinese GDP data in the past. This will be a real pity.

The extent of the revisions is shown in Table 1 below. With the new base year of 2012-13, GDP growth in FY 14 (2013-14) has been revised upwards to 6.6% at factor cost and a whopping 6.9% at market prices. This represents about 2% increase in GDP growth over the earlier estimate of 5%. Surely, such a large scale revision will or should significantly affect the understanding of the underlying economic phenomenon and lead to a marked policy shift. Contrary to what Surjit S Bhalla (SSB) would have us believe, not even the government is taking the revised estimates seriously enough as reflected in a lack of any change in policy direction. 2

Table 1: Comparison of GDP growth

GDP at factor cost		
	Old Series	New Series
FY 2013	4.5	4.7
FY 2014	4.9	6.6
GDP at market prices		
	Old Series	New Series
FY 2013	4.7	5.1
FY 2014	5.0	6.9

Old Series: Base 2004-05; New Series: Base 2011-12 Source: MOSPI, CMIE, CPR Research

The large upward revision of FY 2013-14 GDP growth from 5.0% to 6.9% and even more so of manufacturing sector from (-) 0.7% to 5.3% surprised most analysts. This acceleration is in sharp contrast to all other observed high frequency data such as car sales, heavy vehicle sales, credit-deposit growth, projects under implementation, coal production, cement-steel production, petroleum consumption, non-oil-non-gold imports, corporate taxes, excise duty collections etc. The year FY 2013-14 also had witnessed significant currency volatility as a result of the US Fed taper talk that prompted RBI to raise rates three times, seriously dampening both consumer and business sentiments.

According to the Chief Statistician of the Government of India, Professor T C Anant who was kind enough to spend an hour with us on February 11th, these revisions are due to two structural changes in the computation of growth of gross value added. According to him, the two structural changes in the new series represent significant improvement both in the sectoral coverage and estimation methodology and have consequently resulted in the marked upward estimates of GDP growth for FY

1 The Economic Survey, 2014-15, pointed out that this growth surge is accompanied by dramatic declines in savings and investment ratios. 'The data show that private corporate investment increased robustly in 2013-14 which seems at odds with stressed balance sheets and the phenomenon of stalled projects.....Until a longer data series is available for analysis and comparisons, and until the changes can be plausibly ascribed to the respective roles of the new base, new data, and improved methodology, the growth narrative of the last few years may elude a fuller understanding.'

2 Perhaps in his fondness of contrarian positions, Surjit S Bhalla (SSB) has made a valiant attempt to defend the revisions as kosher and reflective of ground realities. On this occasion, unfortunately, SSB's contrarian stance will only help to obfuscate the issues. It will be used by the CSO to sit back and not undertake a thorough review of its new series as it should be doing.

14 and a higher forecast of 7.4% for FY 15. Professor Anant further explained that even previously in the old series, manufacturing GDP computed on the basis of IIP (Index of Industrial Production) numbers would get revised up later when ASI (Annual Survey of Industries) data becomes available after a lag of two years. This is clearly preferable as the IIP reflects trends in volume of production (being based on physical production data), which can often diverge from the GVA estimates that are based on trends in value of production as in ASI estimates.

The first structural change in the new series has been in the coverage of the organized corporate sector (essentially covering the manufacturing and services sector) which has been made much larger by shifting from the use of RBI corporate data base confined to 2,500 units to the Ministry of Corporate Affairs (MCA) database of more than 5,00,000 entities in the manufacturing and services sectors. For the manufacturing sector, the source of data for computing gross value addition (GVA) has been shifted from the establishment (or plants and factories) as collected from the Annual Survey of Industries (ASI) to the corporate profit and loss accounts submitted to the Ministry of Corporate Affairs (MCA) under their e-governance initiative. The latter, it can be argued, better captures the growth impact of changes in productivity, embodied technology and brand equity and hence a methodological improvement

Second, in the case of Wholesale and Retail Trade (WRT) the estimation of GVA is now being done on the basis of sales tax returns rather than on the basis of the growth of wages and employment in these sectors. These estimates came from data provided by the successive NSSO rounds, which as we know are not held annually and require extrapolation over years. Sales tax data on the other hand is more regularly available and covers a much larger population. The noteworthy feature of the new methodology is the much larger universe now being covered for estimating GVA in both the manufacturing and trade sectors.<sup>3</sup>

The two changes are, of course, an improvement over the earlier methodology. The nagging question which remains unanswered is whether the new estimates reflect a once for all change that comes about by capturing a larger set of economic activity. While it may have yielded a higher growth rate in the two years (FY 13 and FY 14), this will simply not be comparable to the earlier series. The CSO would have done far better to give us a longer series of estimates going backward based on the new methodology to offset these genuine fears.

But there are other problems with the new estimates, which despite SSB's heroic attempts cannot be simply be pooh poohed away. According to the new series, the growth of GVA in the manufacturing sector has gone up from a negative 0.7% in FY 14 to a very healthy 5.3%. It is argued that this has happened because the new data captures the entire gamut of value added activities in any given firm and not merely the trends in physical production, which is captured by the series of Index of Industrial Production or even the Annual Survey of Industries. Firstly, it is not clear how the activities in the corporate headquarters (marketing, after sales service, financial transactions and human resource development) could be rising when the actual production, reflected in the IIP and ASI data, was declining.

Secondly, and more importantly, GVA is comprised of profits, wages and depreciation. Data from other sources tell us that none of these three variables were on a rising trend at least in the formal/organized manufacturing sector. Real wages and employment have been reported as hardly rising and in large parts stagnant with nominal wages barely keeping up with inflation. Other released by CMIE, RBI and other banks reflect decline in corporate profitability and combined with the slump in corporate private investment and poor credit off-take from banks by the manufacturing sector during

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<sup>3</sup> At the industry level, changes have affected the year-on-year growth rates in the case of mining and manufacturing due to the adoption of MCA21 database, and in the case of non-financial services due to the use of sales/service tax as an indicator for nominal growth. – MOSPI (Ministry of Statistics and Program Implementation) Press Note on new GDP series.

2012-13 and 2013-14, it rules out any rise in profitability or capital investment, the latter would affect depreciation estimates included in GVA. Growth in non-agriculture credit off take in FY 14 was a mere 14% compared to more than 20% in good years. It has further come down to even lower around 12% in March 2015, which will signify an even lower rate of growth of the manufacturing sector in FY 15, contrary to CSO's rosy forecasts.<sup>4</sup>

According to CSO, apparently companies reported flat top lines indicating stagnant sales but improved bottom lines reflecting increase in overall efficiency (value addition). Thus, higher profitability contributed to faster growth in GVA. However, this assertion of higher corporate profitability is not corroborated by any other supporting evidence. Corporate tax collection have remained muted over the last two years. The results from CMIE database that covers around 14,458 companies in non-financial sector do not reflect huge acceleration in profitability to warrant a sharp upward revision in manufacturing sector growth. Therefore, for the formal manufacturing sector it is certain that the new estimates overstate growth in GVA by an order or magnitude.

It is possible that the informal sector units, hitherto not included in growth estimates, have been captured in the new estimates. This amounts to expanding the universe and not necessarily an increase in growth rates. This is compatible with and reflective of the large increase in the share of the manufacturing sector that is now reported by the CSO. Manufacturing sector's share in total GDP, for long bemoaned to have remained stagnant, has in one stroke been increased by 4% points from 13% to 17% as a result of these revisions.<sup>5</sup> We repeat that this is an improvement in that it brings in the contribution of the informal manufacturing sector and thus better captures the state of manufacturing activity in the economy. But this does not reflect higher growth rates unless one assumes that the rate of growth of GVA in the informal sector, hitherto uncovered, is far higher than in the formal sector. In a recent article, Dr Arvind Virmani has argued that the small globally connected organised sector of India has been impacted by global demand recession as reflected in poor IIP numbers and quarterly corporate results but large unorganised sector catering to the domestic market has been growing strongly.<sup>6</sup>

However, it is implausible to argue that informal manufacturing sector growth rate in FY 14 accelerated while the formal manufacturing sector was experiencing a sharp decline. The informal sector constitutes the third or the fourth tier of the manufacturing activity and supplies to the larger enterprises. Growth in the informal sector could hardly be rising when the industries to which its units were supplying inputs was declining.

Another argument could be that the informal sector supplies finished products to local markets that are not related to the formal manufacturing sectors and can have autonomously generated high rates of growth. But local markets are crucially dependent on the state of the agriculture sector. This sector, even according to the revised CSO estimates, has not done much better in these two years. The upward revision in manufacturing sector growth by the CSO on the grounds that it is based on a

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<sup>4</sup> Advance estimates for 2014-15 has pegged manufacturing sector growth at 6.8%. However, the available corporate profitability data do not reflect this buoyancy in GVA in the manufacturing sector. According media reports, aggregate net profit of 2,941 companies in the third quarter declined by 16.9% - the worst in five quarters. Therefore, the acceleration in GVA in the manufacturing sector in 2014-15 as reflected in the advance estimates, cannot be explained by corporate profitability.

<sup>5</sup> According to MOSPI press note, *'Marked changes have also been observed in the shares of two major industries, namely, "manufacturing" and "trade". In the case of manufacturing, with the availability of the MCA21 database, coverage of the activities other than manufacturing in the companies has improved significantly.'*

<sup>6</sup> "The global financial crisis and the consequent global demand recession and excess capacity have affected ... the globally connected and competitive corporate sector of India. Thus, all indicators connected with these companies, such as IIP, corporate profits, corporate and excise tax revenue would also lag the GDP recovery."

larger data set, does not seem to be justified. Even the domestic consumption indicators like car sales, two-wheeler sales growth were declining.

Coming to the WRT sector, it seems that actual rate of growth of employment, especially in the formal sector, has been even lower than reported in successive NSSO rounds. Employment grew by less than 1% compared to NSSO based estimates of above 2.5%. A nominal growth of 17% in GVA in WRT sector, implying a real rate of growth of 10% (discounting inflation of an average of 6%) could come about only with a huge increase in labour productivity. There is no evidence of such a hike in labour productivity from any manufacturing sector, either formal or informal.

Once again the larger data base, made possible by switching to sales tax returns (supplied by state governments as sales tax is collected by them) has yielded a higher estimate of the GVA in the WRT sector. But this is a scale effect and does not reflect a higher growth rate. The surprising element is that despite the inclusion of the hitherto excluded units and trade activity, the share of this sector is estimated to have declined by as much as 7% in the new series.<sup>7</sup>

It is therefore not surprising that in a recent article in the Economic & Political Weekly, R Nagaraj one of the members of the sub-committee that drafted the initial report on the corporate sector in 2014, had questioned the authenticity of the data. According to him, there is a huge difference between the estimates submitted by the sub-committee of private corporate sector (PCS) in September 2014 (Version I) and the final report submitted in February 2015 (Version II). Between the two versions of the sub-committee report, gross value added in manufacturing went up by whooping 108% and PCS savings shot up by an unbelievable 257% as seen in the table 2 below. *'The wide swings in the estimates obtained between the two versions using the same methodology with a roughly similar sample size, lead one to have doubts about the numbers. This is particularly so as the final estimates were not whetted or scrutinised by any independent expert body'*, stated Nagaraj.

**Table 2: Estimates of Non-financial PCS for 2012–13**

Corporate Sector Estimates for the Fiscal 2012-13	MCA-21		Difference Between Two Versions of Sub-committee Reports (%)	NAS 2014	Difference with NAS 2014 (%)	
	Sub Committee Version I (2014)	Sub Committee Version II (2015)			Sub Committee Version I (2014)	Sub Committee Version II (2015)
Gross Value Added in Mining and quarrying	53,618	50,968	-13.1	13,573	331.9	275.5
Gross Value Added in Manufacturing	5,27,465	10,98,741	108.3	8,20,160	-35.7	34
Gross Value Added in Elec. gas and water	27,261	60,099	120.5	23,059	18.2	160.6
Gross Value Added in Total Non-financial Sector	14,73,532	22,33,985	51.6	20,12,737	-26.8	11
Savings in Non-financial Private Corporate Sector	2,09,467	7,48,047	257	6,89,273	-69.6	8.5
Investments in Non-financial Private Corporate Sector	7,15,891	9,58,722	33.9	8,46,382	-15.4	13.3

Note: NAS 2014 - National Accounts Statistics data published based on the RBI sample data; Version I- Report of the Sub-committee on Private Corporate Sector including PPPs dated 16 September 2014, Version II - Final Report of the Sub-Committee dated February 2015

Source: Nagaraj, EPW

The CSO official countered this allegation and explained that the large difference between the two versions is due to scaling up the MCA-21 database on 5.2 lakh companies to represent all active companies, including those which didn't file data in 2012-13, to ensure comprehensive coverage and make annual data comparable. An active company is one that has filed its balance sheet at least once in the previous three years - there are 14 lakh companies out of which nine lakh are active. In version II, the CSO estimated data for all those active companies, by blowing up the data based on the 5.2

<sup>7</sup> Estimates of "trade and repair services" has become lower - (i) Trade carried out by manufacturing companies, which has now become part of "manufacturing", was earlier covered in "trade" because of establishment approach; (ii) In 2004-05, no recent survey of unorganised trade enterprises was available for incorporation and hence the estimates were based on the survey conducted in 1999-2000. This has now been updated with the survey on "Unincorporated Enterprises" conducted by NSS in 2010-11. - MOSPI (Ministry of Statistics and Program Implementation) Press Note on new GDP series.

lakh companies. Similar blowing up of data was used in the earlier series using the RBI's sample of 2,500 companies.

As far as we understand, a company may not file returns with MCA in a particular year due to litigation, carelessness or business not doing well. So, can the PCS estimates spike up by 100 or 200% because of including these companies that did not file returns that year because of litigation or no profitability? This raises immense doubt that the final estimates might be considerably overestimated.

While the CSO has done well to make GDP data internationally comparable and expand its coverage to include previously excluded economic activity, it would do well to present a more comprehensive analysis and data estimates to back up its upward revisions in manufacturing and trading activity in the economy. SSB unfortunately trivialises the issue by making it out to be merely one of being either pessimistic or optimistic about the prospects of the Indian economy. The issue is far more important. The government, which has come into office one year ago and under whose watch these revisions have been announced, must ensure that the credibility of its statistics is above all doubt and provides a real and honest basis for policy making. For this, it must require the CSO to not only review the methodology but make it far more transparent by further detailing it in the public domain.

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