Gross Domestic Product

History of GDP

The concept of GDP was first developed by Simon Kuznets for a US Congress report in 1934. In this report, Kuznets warned against its use as a measure of welfare (see below under limitations and criticisms). After the Bretton Woods conference in 1944, GDP became the main tool for measuring a country's economy. At that time Gross National Product (GNP) was the preferred estimate, which differed from GDP in that it measured production by a country's citizens at home and abroad rather than its 'resident institutional units'.

The switch to GDP was in the **1980s**. The history of the concept of GDP should be distinguished from the history of changes in ways of estimating it. The value added by firms is relatively easy to calculate from their accounts, but the value added by the public sector, by financial industries, and by intangible asset creation is more complex.

Angus Maddison calculated historical GDP figures going back to 1830 and before.

GREEN GDP

The green gross domestic product (green GDP) is an index of economic growth with the environmental consequences of that growth factored in.

In 2004, Wen Jiabao, the Chinese premier, announced that the green GDP index would replace the Chinese GDP index itself as a performance measure for government and party officials at the highest levels.

The first green GDP accounting report, for 2004, was published in September 2006. It showed that the financial loss caused by pollution was 511.8 billion yuan ($66.3 billion), or 3.05 per cent of the nation's economy.

The Breakdown in 9/11/2001

In 2001, post the technology downfall and 9/11 attacks, US economy crashed. Despite the economy recovery, between 2002 and 2006, personal incomes fell sharply.

The gross domestic product (GDP) in the United States expanded 3.2 percent in the fourth quarter of 2010 over the previous quarter.

From 1947 to 2010, the average quarterly GDP growth was 3.30 percent hitting a record high of 17.20 per cent in March 1950 and a low of -10.40 percent in March 1958.

What is GDP and why is it so important?

The gross domestic product (GDP) is one the primary indicators used to gauge the health of a country's economy. It represents the total dollar value of all goods and services produced over a specific time period - you can think of it as the size of the economy. Usually, GDP is expressed as a comparison to the previous quarter or year. For example, if the year-to-year GDP is up 3%, this is thought to mean that the economy has grown by 3% over the last year.

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Measuring GDP is complicated (which is why we leave it to the economists), but at its most basic, the calculation can be done in one of **two ways**: either by adding up what everyone **earned in a year** (**income approach**), or by adding up what **everyone spent** (**expenditure method**). Logically, both measures should arrive at roughly the same total.

The income approach, which is sometimes referred to as GDP (I), is calculated by adding up total compensation to employees, gross profits for incorporated and non-incorporated firms, and taxes less any subsidies.

The expenditure method is the more common approach and is calculated by adding total consumption, investment, government spending and net exports.

As one can imagine, economic production and growth, what GDP represents, has a large impact on nearly everyone within that economy.

For example, when the economy is healthy, you will typically see **low unemployment** and **wage increases** as **businesses demand labor** to **meet** the **growing economy**. A significant change in **GDP**, whether up or down, usually has a **significant effect** on the **stock market**.

It's not hard to understand why: a bad economy usually means **lower profits for companies**, which in turn means **lower stock prices**. Investors really worry about **negative GDP growth**, which is one of the factors economists use to determine whether an economy is in a recession.

Why does inflation increase with GDP growth?

Reported gross domestic product is adjusted for inflation. The growth of unadjusted GDP means that an economy has experienced one of five scenarios:

1. Produced more at the same prices.
2. Produced the same amount at higher prices.
3. Produced more at higher prices.
4. Produced much more at lower prices.
5. Produced less at much higher prices.

Each of the other three scenarios has been witnessed and either immediately or eventually causes higher prices or inflation.

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Scenario 1 implies that production is being increased to meet increased demand. Increased production leads to a lower unemployment rate, further increasing demand. Increased wages lead to higher demand as consumers spend more freely. This leads to higher GDP combined with inflation.

Scenario 2 implies that there is no increased demand from consumers, but that prices are higher. Through the early 2000s many producers were faced with increased costs due to the rapidly rising price of oil. Both GDP and inflation increase in this scenario. These increases are due to decreased supply of key commodities and consumer expectations, rather than increased demand.

Scenario 3 implies that there is both increased demand and shortage of supply. Businesses must hire more employees, further increasing demand by increasing wages. Increased demand in the face of decreased supply quickly forces prices up. In this scenario, GDP and inflation both increase at a rate that is unsustainable and is difficult for policymakers to influence or control.

Scenario 4 is unheard of in modern democratic economies for any sustained period and would be an example of a deflationary growth environment.

Scenario 5 is very similar to what the United States experienced in the 1970s and is often referred to as stagflation. GDP rises slowly, below the desired level, yet inflation persists and unemployment remains high due to low production.

Fact

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Three of these five scenarios include inflation. Scenario 1 eventually leads to inflation, and scenario 4 is unsustainable. From this, it's clear that inflation and GDP growth go hand-in-hand.

Recent Changes in Indian GDP Calculation

How India Calculates GDP?

Suddenly the Indian economy is looking much better than it did two weeks ago, thanks to a little sleight of hand. The Government's statistics wing made two changes to the GDP calculation last week which have had the happy effect of lifting growth to 6.9 per cent for 2013-14 instead of 4.7 per cent as estimated earlier.

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What is it?

There have been two changes to the GDP calculations. One was a change in the base year for the calculation which is done routinely every five years or so. The other was to adopt a new method to measure output. But why make any changes?

Starting now, Indian GDP will be measured by using gross value added (GVA) at market price, rather than factor cost. If you are not an economist, the previous sentence may have sounded like it's in Swahili. Simply put, GDP is the total value of goods and services produced within the country during a year. You take all final finished goods and services produced domestically in volume terms and multiply this by their market prices to arrive at the value of output. Intermediate goods need to be excluded to avoid double-counting.

In India GDP did not include what that the Government received. Now, what it earns by way of indirect taxes such as sales tax and excise duty after deducting subsidy is also added into the GDP.

Recent GDP Forecast

IMF ups India growth forecast to **7.2%** for current fiscal.

The India Economic Survey, an annual report prepared by the finance ministry, said growth would be between **8.1 and 8.5** percent in the 2015-16 financial year, reaching levels last seen five years earlier.

Why is it important?

You can question the timing, but the change in method of calculation has brought Indian GDP calculations more in line with global practise. For example, IMF's world economic outlook projections, which all of us used even recently to make India-China comparisons, are not based on factor costs. This used to create confusion in the past, with IMF's projections turning out to be very different from the Government's. As for the base year change, it is the only way to ensure that the products and services included in the GDP calculation do remain contemporary and reflect the present state of the economy.

For instance, the latest change in base year from 2004-05 to 2011-12 has included the recycling industry which didn't figure in the earlier GDP computations.

Similarly trading activities by manufacturing firms are now included in that sector's share. This change along with better data compilation (online data filed with the Ministry of Corporate Affairs) has led to manufacturing increasing its share in GDP.

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Why should you care?

Global investors use growth prospect numbers to allocate their investment allocations between countries - GDP is a key metric here. So news that India's GDP growth has averaged 6 per cent for the last three years and not 4.6 per cent as thought earlier, may help investors view India in a more favorable light.

Let's not forget that important indicators such as the fiscal deficit are measured as a ratio of GDP too. Economists say that the latest revisions will help the Government meet this year's fiscal deficit target. A more comfortable deficit number could help the Government stop tightening its belt and consider budget sops.

With indirect taxes added and subsidies deducted under the new GDP calculations, there is more incentive for the Government to raise indirect taxes and reduce subsidies. This may have an impact on sectors such as agriculture which receive a lot of subsidy. It's not always the economy, bad. It's sometimes the calculation.

Source:

The Hindubusinessline, Economic Times, Ministry of Finance, International Monetary Fund, Wikipedia

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