

Improving public policy making for economic growth and poverty reduction

Rebasing GDP: Rationale and the Economic Implications

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A country's Gross Domestic Product (GDP) changes in size, structure and composition over time. GDP is the total value of all goods and services produced within the country's borders over a period of one year, valued either at current prices or constant base year prices. Prices of goods and services change over time, such that the same banana that cost Ksh 5 three years ago may seem more valuable today at Ksh 10, yet it is the very same banana. To avoid this misconception of value change, simply due to price changes without a concomitant change in volume of GDP, a base year is chosen when prices are stable and GDP of subsequent years is then measured at the base year prices. This gives only real changes in volume or quantity of goods and services. Removing effects of inflation or price changes by using base year prices is referred to as deflation.

With many economic and price changes, an old base year ceases to be relevant, creating the need to choose a more recent year for a GDP valuation base, which gives a more realistic picture of the economy. This change of a base year is rebasing, which gives a clearer picture of the economy commensurate with the changes taking place, including sectoral changes. New sectors such as the communication industry have gained importance in their contribution to GDP, while old sector such as agriculture may improve or decline in prominence relative to the other sectors. Rebasing is therefore done to obtain real GDP value at more recent and hence more comparable prices, and also reconstitute and take cognizance of new goods and services being produced in the economy.

Rebasing and subsequent growth and sectoral changes in the economy may be analogously compared to the body of a woman from birth to old age, which is easy to relate to. Even though the body changes in size and social status, its composition changes only minimally since it remains the same one body. Stages of significant change are birth, onset of adolescence/puberty, start of motherhood and menopause. At birth, body weight is small and organs are also small but most of the body components are in place. Most of the changes in a young girl easily relate to status at birth, and this forms the 1st base.

At puberty, the 2nd phase, a young lady's body shape changes with the widening of hips and development of breasts. Analogously, these are like expansion and emergence of new sectors in the economy. On average, this girl will look the same up to her early 20s. Status at puberty is easily related to the changes in the young lady, making puberty a 2nd base. Generally, a girl becomes a mother in her mid 20s. This brings other changes in the body, including widening of the waistline and weight increase. As more babies come up until menopause, the changes to the woman's body will easily compare to when she got her first baby, and this becomes a 3rd base. After menopause, other changes occur in the woman's body and her status will subsequently compare easily to this status, making it a 4th base. These are stages of rebasing in the woman's body growth. Unless one donates a kidney or loses a body part such as teeth, appendix, or a limb, or wrinkles and gray hair emerge, the body remains one whole but differently structured unit.

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Analogously, changes in an economy are reflected in real GDP changes. A stable base year is chosen for GDP valuation and other years' GDP computed at this base year prices, which makes it possible to assess the real changes in volume. Over time and with changes in the structure of the economy, another year closer and more comparable to the present in prices and goods and services produced within the economy is chosen and a rebase done. It would not make comparable sense to continue comparing Kenya today with Kenya at independence. The current rebasing is not the first for Kenya, which now has rebased 6 times in 1957, 1967, 1976, 1985, 2005 and 2014.

Given the dynamism of the economy, new ways of doing things emerge with new innovations. Some sectors expand while others shrink, and new products and services as well as new sectors emerge. Rebasing becomes important to accommodate these changes. Major sectors such as agriculture, forestry and fishing remain significant contributors to GDP, but their proportionate contribution may decline with emergence of new and fast growing sectors. Although the agriculture sector has grown significantly over the years, other sectors including real estate have grown by a large margin, contributing relatively more to GDP than before. The sectors showing the largest shift in importance after the recent rebasing include real estate and manufacturing, while electricity supply, finance and insurance, as well as information and communication technology (ICT) also show substantial growth. Wholesale and retail trade, accommodation and food, education and public administration shrunk in GDP contribution.

GDP growth is dynamic, and note should be taken that it is not proportionate between countries. Comparison between countries is similar to comparing different women. GDP of poor economies and those in conflict grow much slower, just like ill or malnourished persons, while others

grow large and at times fast (like the lovely ladies in the Slim Possible Program). Kenya's GDP grew by 20.5% in eight years between 2001 and 2009. The Democratic Republic of Congo (DRC) rebased after five years to reflect a whopping 66.4% GDP growth. Ghana rebased after 13 years and reflected a 62.8% growth, while Uganda and South Africa rebased after 5 years and reflected a 10.5% and a 13.7% growth, respectively. However, rebasing can also reflect a negative growth. Ethiopia rebased after 12 years and reflected a negative 1% growth, while Botswana reflected a negative 10% growth.

In as much as Kenya has shifted in its comparative position relative to other countries given the seemingly higher GDP after rebasing, the country can easily reverse back if the other countries also rebased their GDP computation. Having a common base year for comparator countries is very important, and hence Kenya alongside the East African countries plans to rebase again by 2017 using 2015 as the base year.

Kenya's GDP growth after rebasing may not translate to reduced unemployment, given that the key growth sectors of manufacturing and ICT are capital-intensive. However, the real estate growth may have come with increased employment in the construction industry for unskilled and semi-skilled workers, and informal sector jobs aligned with real estates. Although there may be some improvement in welfare with total and average (per capita) GDP growth, it may not be by the same magnitude of GDP growth after rebasing. This is more of a monetary valuation change, which is also influenced by changes in exchange rates that influence the local currency value and value of imports and exports that influence local price changes. Monetary and fiscal policies that the various arms of government design are guided by sectoral performance of the economy, and this rebasing helps the government to see the real, actual and current picture of each sector.

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KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

KIPPRA acknowledges generous support from the Government of Kenya, the African Capacity Building Foundation (ACBF), and the Think Tank Initiative of IDRC, who have continued to support the Institute's activities over the years.

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