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Jesus C. Dumagan

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An Alternative Framework for Sectoral Contributions to GDP Level and Growth: Application to the Philippines

Jesus C. Dumagan, Ph.D.*
5 November 2014

This paper applies relative price weights—where relative price is the ratio of a sector’s GDP deflator to the aggregate GDP deflator—to convert sectoral real GDP to homogeneous units using the economy’s GDP as “numeraire” in an alternative framework for GDP level aggregation and growth decomposition. This alternative and the “traditional” framework—without relative price weights—are compared and applied to Philippine GDP to show that the latter framework is deficient and misleading for its inability to determine the effects on GDP growth of changes and differences in sectoral relative prices that need to be taken into account.

Key Words: Real GDP; relative prices; index numbers; aggregation; additivity
JEL classification: C43, O47

I. Introduction

GDP deflators differ between sectors (e.g., industries) and also differ from the economy-wide GDP deflator and, thus, it is arguable that real GDP of industries are not necessarily measured in homogeneous units and, therefore, their simple addition, i.e., without weights, in current practice is questionable. Hence, in group analysis involving industries, real GDP of the industries need conversion to homogeneous units for consistent aggregation. Therefore, this paper applies relative price weights—where relative price is the ratio of an industry’s GDP deflator to the aggregate GDP deflator—to convert real GDP of industries to homogeneous units using the economy’s GDP as “numeraire” in an alternative framework for GDP level aggregation and growth decomposition. For comparison, this alternative and the “traditional” framework—

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* Visiting Professor, School of Economics, De La Salle University, Room 221 LS Hall, 2401 Taft Avenue, 1004 Manila, Philippines; Tel.: (632) 526 4905 or (632) 524 4611 loc. 380; E-mail: jesus.dumagan@dlsu.edu.ph or jcdcu91@yahoo.com.
without relative price weights—are applied to Philippine GDP to show that the latter framework is deficient and misleading for its inability to determine the effects of changes and differences in industry relative prices on GDP growth that theory implies exist and, thus, need to be known.

The rest of this paper is organized as follows. Section II presents GDP value index decomposition employing either direct indexes for GDP in constant prices or chained indexes for GDP in chained prices. The end result is a “generalized” (GEN, in short) framework for GDP level aggregation and growth decomposition that applies to any real GDP. In this GEN framework, relative price weights resolve the “non-additivity” of industry GDP in chained prices by converting them to homogeneous units for additivity with GDP as the numeraire. Similarly, relative price weights reformulate the “additivity” of industry GDP in constant prices also by converting them to homogeneous units. Section III re-examines the “traditional” (TRAD, in short) framework for level aggregation and growth decomposition of GDP in constant prices and compares it to this paper’s GEN framework. Section IV presents a comparative application of TRAD and GEN to Philippine GDP in constant prices.\(^1\) Section V concludes this paper.

II. “Generalized” (GEN) GDP Level Aggregation and Growth Decomposition

Readily available data on nominal GDP (i.e., in current prices) and on real GDP (i.e., either in constant prices or in chained prices), by sectors or industries over time, will suffice for the analytic procedures in this paper. The price and quantity indexes used in the analysis are implicit or computed values obtained from the above nominal and real values. Thus, data on commodity prices and quantities are not necessary.

For analytical purposes, let 0 be the base period that is more than one period away from \(t - 1\) and \(t\). To link period 0 to \(t - 1\) and \(t\), denote the price indexes by \(P_{0,t-1}\) and \(P_{0,t}\); and the quantity indexes by \(Q_{0,t-1}\) and \(Q_{0,t}\). The GDP value index—i.e., relative change of GDP in current prices from \(Y_0\) to \(Y_{t-1}\) or to \(Y_t\)–can be expressed as the product of pairs of price and quantity indexes. That is,

\[
\frac{Y_{t-1}}{Y_0} = P_{0,t-1} \times Q_{0,t-1} \quad ; \quad \frac{Y_t}{Y_0} = P_{0,t} \times Q_{0,t} .
\]

\(^1\) This GEN framework was applied to US GDP in chained prices in Dumagan (2014).
Two pairs of price and quantity indexes that satisfy (1) are employed in current practice of computing real GDP. One pair is the Paasche price and Laspeyres quantity indexes and the other is the Fisher price and Fisher quantity indexes (Fisher, 1922; Balk, 2010).

The expressions in (1) yield aggregate real GDP defined by,

\[ X_{t-1} = \frac{Y_{t-1}}{P_{0,t-1}} = Y_0 \times Q_{0,t-1} \; ; \; \; X_t = \frac{Y_t}{P_{0,t}} = Y_0 \times Q_{0,t} \]

Moreover, by similar procedures, industry real GDP is also computed for each \( j \) by,

\[ X_{t-1}^j = \frac{Y_{t-1}^j}{P_{0,t-1}^j} = Y_0^j \times Q_{0,t-1}^j \; ; \; \; X_t^j = \frac{Y_t^j}{P_{0,t}^j} = Y_0^j \times Q_{0,t}^j \]

It may be noted that (2) and (3) yield implicit price and quantity indexes from the real and nominal values of aggregate and industry GDP in published national accounts data.

In current practice, real GDP in (2) and (3) are in constant prices if the Paasche price and Laspeyres quantity index are direct (e.g., in the Philippines and other “developing” countries) but are in chained prices if these indexes are chained (e.g., Australia, Japan, UK, and other “developed” countries in the EU and OECD). Alternatively, chained Fisher price and Fisher quantity indexes are used to obtain GDP in chained prices but only in Canada and the US.²

The second expressions in (2) and (3) yield GDP in constant prices where,

\[ X_t = \frac{Y_t}{P_{0,t}} \; ; \; \; X_t^j = \frac{Y_t^j}{P_{0,t}^j} \]

\[ X_t = \sum X_t^j \quad \text{if } P_{0,t} \text{ and } P_{0,t}^j \text{ in (4) are direct Paasche price indexes.} \]

The result in (5) shows “additivity” of GDP in constant prices (see the Appendix) based on the “consistency-in-aggregation” property of the Paasche formula (Balk, 2010; Vartia, 1976). In contrast, (2) and (3) yield GDP in chained prices where,

² For country practices of GDP in chained prices, see Aspden (2000) for Australia; Maruyama (2005) for Japan; Brueton (1999) for the UK; Schreyer (2004) and EU (2007) for EU and OECD countries; Chevalier (2003) for Canada; and Landefeld and Parker (1997), also Moulton and Seskin (1999) for the US. Brueton (1999) noted that the EU System of National Accounts 1995 recommended Paasche price and Laspeyres quantity indexes as more practical than the theoretically superior Fisher price and Fisher quantity indexes recommended by the UN System of National Accounts 1993 and adopted by Canada and the US.
\[(6) \quad X_t \equiv \frac{Y_t}{P_{0,t}} ; \quad X_t^j \equiv \frac{Y_t^j}{P_{0,t}^j} ;\]

\[(7) \quad X_t \neq \sum_j X_t^j \text{ if } P_{0,t} \text{ and } P_{0,t}^j \text{ in (6) are chained Paasche price or Fisher price indexes.}\]

The result in (7) shows “non-additivity” of GDP in chained prices (Balk, 2010; Ehemann, Katz, and Moulton, 2002; Whelan, 2002).\(^3\)

However, this paper formulates a framework for GDP level aggregation and growth decomposition that is exactly additive for GDP either in constant prices or in chained prices, i.e., regardless of the formula for \(P_{0,t}\) and \(P_{0,t}^j\). For this purpose, note that (4) to (7) satisfy,

\[(8) \quad Y_t = \sum_j Y_t^j ; \quad s_t^j \equiv \frac{Y_t^j}{Y_t} ; \quad \sum s_t^j = 1.\]

Industry relative prices—defined as ratios of industry GDP deflators to the aggregate GDP deflator—play a crucial role in this paper’s framework. Also, this framework uses the ratios of industry real GDP to aggregate real GDP. Hence, define,\(^4\)

\[(9) \quad r_t^j \equiv \frac{P_{0,t}^j}{P_{0,t}} ; \quad w_t^j \equiv \frac{X_t^j}{X_t} ; \quad r_t^j = \frac{Y_t^j}{Y_t}/\frac{X_t^j}{X_t} = \frac{s_t^j}{w_t^j} = \frac{s_t^j}{w_t^j} = \frac{s_t^j}{w_t^j}.\]

Note that all the above relations hold also at \(t-1\). Therefore, regardless of the index formula for \(P_{0,t}\) and \(P_{0,t}^j\), it follows that by applying the relative price weights, \(r_t^j\), to industry real GDP the general result from (2) to (9) is that,\(^5\)

\[(10) \quad \frac{Y_t}{P_{0,t}} = \sum_j \frac{P_{0,t}^j Y_t^j}{P_{0,t}^j P_{0,t}} ; \quad X_t = \sum_j r_t^j X_t^j ; \quad \frac{X_t}{X_{t-1}} = \sum_j r_t^j w_{t-1}^j \frac{X_t^j}{X_{t-1}^j} ;\]

\[(11) \quad \sum_j r_t^j w_{t-1}^j \neq 1 \text{ if } r_t^j \neq r_t^j ; \quad \sum_j r_t^j w_{t-1}^j = \sum_j w_{t-1}^j = 1 \text{ only if } r_t^j = r_t^j = 1.\]

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\(^3\) Non-additivity is universal in countries that have implemented GDP in chained prices.

\(^4\) This paper avoids calling \(w_t^j\) as “real shares”—that usually connote that they sum to one—because \(w_t^j\) do not necessarily sum to one in the analytical framework of this paper.

\(^5\) The application of relative price weights to industry GDP to obtain aggregate GDP in (10) was implemented by Dumagan (2013) to labor productivities of industries to obtain aggregate labor productivity following the same procedure by Tang and Wang (2004) for GDP in chained prices that Dumagan generalized to any real GDP, i.e., in chained or in constant prices.
Real GDP, $X_t$, is either in constant or in chained prices depending on the aggregate deflator, $P_{0,t}$, since the industry deflators, $P_{0,t}^j$, cancel out when (10) is simplified. Moreover, (10) and (11) show that $X_t$ equals the weighted sum of $X_t^j$ and the implicit GDP quantity index, $X_t/X_{t-1}$, equals the weighted sum of the implicit industry quantity indexes, $X_t^j/X_{t-1}$, where the sum of the weights may not equal 1 unless all prices change proportionately (i.e., constant relative prices), in which case all price indexes are equal so that $r_{t-1}^j = r_t^j = 1$. Note that $X_t^j/X_{t-1}$ may be calculated at different levels of aggregation while allowing $w_t^j$ and $r_t^j$ to adjust to maintain the value of $X_t/X_{t-1}$. Thus, $X_{t-1}$, $X_t$, and $X_t/X_{t-1}$ are consistent in aggregation.

This paper’s aggregation procedure in (10) reformulates the “additivity” of GDP in constant prices and resolves the “non-additivity” of GDP in chained prices considering that the common GDP deflator, $P_{0,t}$, converts GDP to homogeneous units that are necessarily additive. In this case, GDP of all sectors or industries are converted to homogeneous units with GDP as numeraire, measured either in constant or in chained prices depending on the formula for $P_{0,t}$. Hence, (10) and (11) comprise a “generalized” (GEN) framework for any real GDP. In this light, all procedures from this framework will be referred to as GEN, in short, for expository purposes.

II-A. GEN GDP Level Aggregation by “Purchasing Power Parity” Conversion

In the GEN aggregation equation, $X_t = \sum_j r_t^j X_t^j$, industry level contributions, $r_t^j X_t^j = Y_t^j/P_{0,t}$, are additive because they are measured in homogeneous units or in the same real

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6 This result implies that the industry deflators and the aggregate deflator need not have the same functional form because the industry deflators cancel out and only the aggregate deflator is relevant in the aggregation.

7 Strictly speaking, $r_t^j$ is a “relative price index” since it is the ratio of price indexes, the industry GDP deflator divided by the aggregate GDP deflator. In contrast, “relative price” is the ratio of commodity prices. By construction of price indexes, when all commodity prices change in the same proportion, e.g., $\delta\%$, then relative prices are the same and all price indexes for industries and for the aggregate equal $(1 + \delta/100)$ so that $r_t^j = 1$. If the proportionate change remains $\delta\%$ in other years, i.e., constant, then $r_{t-1}^j = r_t^j = 1$.

8 Dumagan (2014) provides an empirical illustration of this result for the implicit US GDP Fisher quantity indexes.
value per unit across industries. This may be clarified by an analogous example of converting real GDP of countries to “purchasing power parity” (PPP) values to make them additive.

Suppose US nominal GDP is $Y^S$ and US GDP deflator is $P^S$ so that US real GDP is $Y^S / P^S$. Also, suppose Philippine (PH) nominal GDP is $\Phi Y^P$ and PH GDP deflator is $P^P$ so that PH real GDP is $\Phi Y^P / P^P$. Without the currency denominations, $\$$ and $\Phi$, and the deflators, $P^S$ and $P^P$, then $Y^S$ and $Y^P$ are just “numbers” in which case the simple sum, $Y^S + Y^P$, makes sense because “one” of $Y^S$ is the same as “one” of $Y^P$. But the simple sum, $\$Y^S / P^S + \Phi Y^P / P^P$, is not sensible because they are not in the same units. For this sum to be sensible, one way is to express the units in US PPP values. This requires multiplying $\Phi Y^P / P^P$ by the “real exchange rate” (RER) as follows,

$$
\text{(12)} \quad \frac{\$Y^S}{P^S} + \frac{\Phi Y^P}{P^P} \left( \frac{P^P}{P^S} \right) \left( \frac{\$}{\Phi} \right) = \frac{\$Y^S}{P^S} + \frac{\Phi Y^P (\$ / \Phi)}{P^P (P^P / P^S)} = \frac{\$Y^S}{P^S} + \frac{\Phi Y^P (\$ / \Phi)}{P^S}.
$$

In (12), $(\$ / P^S) / (\Phi / P^P)$ is the RER that adjusts the nominal exchange rate, $\$/\Phi$, for differences in purchasing power, i.e., difference between $P^S$ and $P^P$. Thus, RER converts PH real GDP to the same units as US real GDP. The end result is that one unit of $\$Y^S / P^S$ and one unit of $\Phi Y^P (\$ / \Phi) / P^S$ are the same in real US$, with exchange value of $(1 / P^S) / (1 / P^S) = 1$, which demonstrates PPP.\footnote{To express (12) in “consumer” PPP, the GDP deflators, $P^S$ and $P^P$, need to be replaced by the corresponding US and PH consumer price indexes.}

Following the above example, it can be seen that $r^i_t X^i_t = Y^i_t / P_{0,t}$ is a PPP value. In this case, since all $j$ are in the same country, the nominal exchange rate is 1/1 and the common deflator, $P_{0,t}$, means that the exchange value between each unit of $Y^i_t$ is $(1 / P_{0,t}) / (1 / P_{0,t}) = 1$. Thus, all $r^i_t X^i_t$ are PPP values and, therefore, exactly additive from the fact that $X_t = \sum_j r^i_t X^i_t$ implies $Y_t = \sum_j Y^j_t$, which is exactly additive.

**II-B. GEN GDP Growth Decomposition**

By definition, GDP growth $g_t$ and industry GDP growth $g^i_t$ are,

$$
\text{(13)} \quad g_t \equiv \frac{X_t}{X_{t-1}} - 1 \quad ; \quad g^i_t \equiv \frac{X^i_t}{X^i_{t-1}} - 1.
$$
Combining (10), (11), and (13), it can be verified that,\(^ {10}\)

\[
\text{(14)} \quad g_t = \sum_j \left[ s_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j \right].
\]

In (14), the growth contribution of each industry is broken out into three components,

\[
\text{(15)} \quad \text{PGE (pure growth effect)} = s_{t-1}^j g_t^j;
\]

\[
\text{(16)} \quad \text{GPIE (growth-price interaction effect)} = (r_t^j - r_{t-1}^j) w_{t-1}^j g_t^j;
\]

\[
\text{(17)} \quad \text{RPE (relative price effect)} = (r_t^j - r_{t-1}^j) w_{t-1}^j.
\]

PGE may be interpreted as an industry’s growth contribution due to with-in industry efficiency changes, holding relative prices constant so that GPIE and RPE are zero. On the other hand, when there are no efficiency changes so that PGE is zero, an industry’s growth contribution could come from non-zero GPIE and RPE when relative prices change and induce resource reallocation between industries.

**III. “Traditional” (TRAD) GDP Level Aggregation and Growth Decomposition**

The TRAD framework for GDP in constant prices may now be re-examined.

**III-A. TRAD GDP Level Aggregation**

In TRAD aggregation, GDP in constant prices is the *simple* sum of the GDP in constant prices of industries given earlier in (5) where,

\[
\text{(18)} \quad X_t = \sum_j X_t^j.
\]

However, this paper’s GEN aggregation in (10) questions the additivity of \(X_t^j = Y_t^j / P_{0,t}^j\) in (18) because \(X_t^j\) is not necessarily in homogeneous units of measure because of differences between the industry deflators, \(P_{0,t}^j\).\(^ {11}\) However, this question is put aside for the moment to illustrate TRAD growth decomposition.

---

\(^ {10}\) To obtain (14), note that (9) implies \(s_{t-1}^j = r_{t-1}^j w_{t-1}^j\). Therefore, \(\sum_j s_{t-1}^j = \sum_j r_{t-1}^j w_{t-1}^j = 1\) so that either sum may be used in place of 1 if needed. Also, \(\sum_j s_{t-1}^j g_t^j\) may be added and \(\sum_j r_{t-1}^j w_{t-1}^j g_t^j\) may be subtracted simultaneously in the right-hand side of (14).

\(^ {11}\) Let \(j = (1,2)\) so that \(X_t^1 = Y_t^1 / P_{0,t}^1\) and \(X_t^2 = Y_t^2 / P_{0,t}^2\) where a unit of \(Y_t^1\) and a unit of \(Y_t^2\) are the same because they are in current prices. However, a unit of \(X_t^1\) is worth \(1/P_{0,t}^1\) and a
III-B. TRAD GDP Growth Decomposition

TRAD GDP level aggregation in (18) and the definitions of GDP growth, \( g_t \), and industry GDP growth, \( g_t^j \), in (13) together yield the TRAD GDP growth decomposition,

\[
 g_t = \sum_j w_{t-1}^j g_t^j ; \quad w_{t-1}^j \equiv \frac{X_{t-1}^j}{X_{t-1}} ; \quad \sum_j w_{t-1}^j = 1 .
\]

It follows from the definitions in (9) that (19) may be rewritten as,

\[
 g_t = \sum_j w_{t-1}^j g_t^j = \sum_j \left( \frac{s_{t-1}^j}{r_{t-1}^j} \right) g_t^j .
\]

If GDP is in constant prices, it can be shown that the TRAD growth decomposition in (20) and the GEN growth decomposition in (14) will yield the same GDP growth. That is,

\[
 g_t = \sum_j \left( \frac{s_{t-1}^j}{r_{t-1}^j} \right) g_t^j = \sum_j \left[ s_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j \right] .
\]

However, it can also be shown that the TRAD and GEN growth contributions of the same industry are not equal unless all prices change proportionately, i.e.,

\[
 \left( \frac{s_{t-1}^j}{r_{t-1}^j} \right) g_t^j \not= s_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j g_t^j + (r_t^j - r_{t-1}^j) w_{t-1}^j .
\]

By construction of price indexes, all price indexes are equal if all prices change in the same proportion so that \( r_{t-1}^j = r_t^j = 1 \) (see footnote 7) and (22) yields TRAD and GEN contributions of the same industry equal to \( s_{t-1}^j g_t^j \). Therefore, if prices do not change in the same proportion, TRAD and GEN will yield unequal growth contributions for the same industry although the sum of industry growth contributions will still equal GDP growth, \( g_t \), in (21).

By taking into account changes in relative prices, the GEN growth contribution of an industry is given by the sum of the three components in the right-hand side of (22). In contrast, TRAD ignores changes in relative prices so that the growth contribution of an industry is given only by the single component in the left-hand side. Thus, it appears that TRAD is deficient for its inability to determine the “reallocation effects” on GDP growth of changes and differences in relative prices that are measured by the GPIE and RPE components of GEN. Moreover, TRAD unit of \( X_t^2 \) is worth \( 1/P_{0,t}^2 \). Since \( P_{t}^1 \neq P_{t}^2 \), the exchange value between \( X_t^1 \) and \( X_t^2 \) is \( (1/P_{0,t}^1)/(1/P_{0,t}^2) \) \neq 1, implying \( X_t^1 \) and \( X_t^2 \) are not PPP values and, hence, may not be added.
takes into account the level of relative price in an industry’s growth contribution but in a perverse way. To see this, note that the TRAD growth contribution may be rewritten as,

\[ w_{t-1}^j g_t^j = \left( \frac{s_{t-1}^j}{r_{t-1}^j} \right) g_t^j = s_{t-1}^j \left( \frac{P_{0,t-1}^j}{P_{0,t-1}^j} \right) g_t^j. \]

It appears from (23) that TRAD tends to increase or overestimate the growth contribution of an industry with a low relative price, i.e., \( r_{t-1}^j \equiv \frac{P_{0,t-1}^j}{P_{0,t-1}^j} < 1 \). Conversely, TRAD tends to decrease or underestimate the growth contribution of an industry with a high relative price, i.e., \( r_{t-1}^j \equiv \frac{P_{0,t-1}^j}{P_{0,t-1}^j} > 1 \). These results appear contrary to the basic production principle that resources tend to be reallocated to industries with rising relative prices and, thus, promote their growth and raise their contributions to the economy’s growth.

**IV. Comparative Application of GEN and TRAD to the Philippines**

A comparative application of the GEN and TRAD frameworks to Philippine GDP will be instructive. For this purpose, consider Philippine GDP in Table 1.

<table>
<thead>
<tr>
<th>Table 1. Philippine GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Philippines</td>
</tr>
<tr>
<td>Agriculture and forestry</td>
</tr>
<tr>
<td>Fishing</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
</tr>
<tr>
<td>Manufacturing</td>
</tr>
<tr>
<td>Construction</td>
</tr>
<tr>
<td>Electricity Gas and Water Supply</td>
</tr>
<tr>
<td>Transport Communication and Storage</td>
</tr>
<tr>
<td>Trade and Repair of Vehicles, Personal, and Household Goods</td>
</tr>
<tr>
<td>Financial Intermediation</td>
</tr>
<tr>
<td>Real Estate Renting and Business Activity</td>
</tr>
<tr>
<td>Public Administration, Defense, and Social Security</td>
</tr>
<tr>
<td>Other Services</td>
</tr>
</tbody>
</table>

Source: Economic and Social Database (08-28-2014), Philippine Institute for Development Studies, compiled from the National Accounts, Gross Domestic Product by Industrial Origin (Revised/Rebased), National Statistical Coordination Board.

From Table 1, GEN computes industry relative prices and applies them as weights of industry GDP in constant prices to convert the latter to PPP values that are also in constant prices since the deflator, \( P_{0,t} \), is a direct Paasche price index. The results are shown in Table 2.
where relative prices change from year to year and differ between industries. Hence, TRAD and GEN growth contributions of the same industry are unequal as shown later in Table 4.

Table 2. GEN Conversion of Philippine GDP in Constant Prices to PPP

<table>
<thead>
<tr>
<th>TRAD</th>
<th>GEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP in Constant Prices (million constant 2000 pesos)</td>
<td>Relative Prices (weights)</td>
</tr>
<tr>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Philippines</td>
<td>6,312,173</td>
</tr>
<tr>
<td>Agriculture and forestry</td>
<td>568,935</td>
</tr>
<tr>
<td>Fishing</td>
<td>130,032</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>72,046</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1,395,711</td>
</tr>
<tr>
<td>Construction</td>
<td>348,262</td>
</tr>
<tr>
<td>Electricity Gas and Water Supply</td>
<td>215,423</td>
</tr>
<tr>
<td>Transport Communication and Storage</td>
<td>482,094</td>
</tr>
<tr>
<td>Trade and Repair of Vehicles, Personal, and Household Goods</td>
<td>1,055,672</td>
</tr>
<tr>
<td>Financial Intermediation</td>
<td>426,787</td>
</tr>
<tr>
<td>Real Estate Renting and Business Activity</td>
<td>678,899</td>
</tr>
<tr>
<td>Other Services</td>
<td>663,442</td>
</tr>
</tbody>
</table>

Source: Author’s calculations by applying this paper’s GEN procedures for PPP in (10) to GDP in Table 1. Industry relative price, the ratio of an industry GDP deflator to the aggregate GDP deflator, is the value per unit of industry real GDP measured in units of aggregate real GDP, the numeraire. Hence, PPP values are “homogeneous” units of measure and, therefore, additive across industries in each column (5) and (6).

Unless GDP is converted to PPP, TRAD “shares of GDP in constant prices”–given by $X_t^j / X_t$–are unwarranted. The “correct” shares are obtained from $(Y_t^j / P_0, t) / (Y_t / P_0, t)$, which equal industry shares of GDP in current prices, $Y_t^j / Y_t$. These shares are shown in Table 3.

Table 3. Shares of Philippine GDP

<table>
<thead>
<tr>
<th>GDP in Current Prices (percent shares)</th>
<th>TRAD GDP in Constant Prices (percent shares)</th>
<th>GEN GDP in PPP Values (percent shares)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Philippines</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td>AGRICULTURE, HUNTING, FORESTRY, AND FISHING SECTOR</td>
<td>11.83</td>
<td>11.23</td>
</tr>
<tr>
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<tr>
<td>Public Administration, Defense, and Social Security</td>
<td>9.64</td>
<td>9.75</td>
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Source: Author’s calculations from Table 1 and Table 2.
As noted earlier, TRAD yields perverse results by tending to overestimate (underestimate) the growth contribution of an industry with a low (high) relative price. This can be seen in Table 4 by comparing TRAD and the PGE component of GEN. Recall from (22) that the TRAD growth contribution of an industry is \((s_{t-1}^j/r_{t-1}^j)g_t^j\) while for the same industry the PGE component of the GEN growth contribution is \(s_t^jg_t^j\). Hence, TRAD raises the growth contribution of an industry above PGE \((t = 2013, \text{Table 4})\) when relative price is low or \(r_{t-1}^j < 1\) \((t - 1 = 2012, \text{Table 2})\). Conversely, TRAD lowers the growth contribution of an industry below PGE \((t = 2013, \text{Table 4})\) when relative price is high or \(r_{t-1}^j > 1\) \((t - 1 = 2012, \text{Table 2})\). Unfortunately, these perverse results are embedded in current practice given that the TRAD growth contribution formula is so far the only “known” formula when GDP is in constant prices and, thus, is presently the “official” formula.\(^{12}\)

Table 4 shows that TRAD and GEN decompositions yield sums of industry growth contributions equal to the economy’s GDP growth of 7.18 percent in 2013. However, TRAD ignores changes in industry relative prices so that the growth contribution of an industry is given only by the single row component in the first column. In contrast, by taking into account changes in relative prices, the GEN growth contribution of an industry is the row sum of PGE, GPIE, and RPE. Consequently, when these contributions are added to get the major sector contributions, TRAD and GEN will yield different results as summarized below.

The percentage point growth contributions in Table 4 reveal that for the *Agriculture, Hunting, Forestry, and Fishing Sector*, TRAD yields 0.121 while GEN yields 0.201. These results show that TRAD understates this sector’s growth contribution by underestimating GEN’s PGE and excluding the positive GPIE and RPE components. A major factor for this understatement is that in this sector, *agriculture and forestry* contributed 0.106 percentage points according to TRAD which is much lower than the 0.184 percentage points contribution according to GEN due to a PGE larger than 0.106 and positive PGIE and RPE (i.e., rising relative prices) in agriculture.

For the *Industry Sector*, TRAD yields 2.978 while GEN yields 2.127. In this case, TRAD overstates this sector’s growth contribution by overestimating GEN’s PGE and excluding the

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\(^{12}\) For example, the official *Philippine Development Plan 2011-2016* used the TRAD formula in Figures 2.1, 2.2, 2.3, and 2.4, pp. 36-41.
negative GPIE and RPE components. A significant source for this overstatement is that in this sector, *manufacturing* contributed 2.269 percentage points according to TRAD which is much higher than the 1.317 percentage points contribution according to GEN due to a PGE smaller than 2.269 and negative PGIE and RPE (i.e., falling relative prices) in manufacturing. Moreover, it is interesting to note a *sign* reversal in the contribution of *mining and quarrying* from *positive* according to TRAD to *negative* according to GEN because of negative PGIE and RPE in mining and quarrying. Furthermore, there a *size* reversal in the contribution of *construction* from a *smaller* positive according to TRAD to a *larger* positive according to GEN because of positive PGIE and RPE in construction.

Finally, for the *Service Sector*, TRAD yields 4.082 while GEN yields 4.853. It appears that TRAD understates this sector’s growth contribution by underestimating GEN’s PGE and excluding the positive GPIE and RPE components. The major factor for this understatement is that TRAD underestimated the GEN contributions of all industries by missing their positive PGIE and RPE components, except for *transport, communication and storage*. In the case of the

<table>
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<th>Table 4. TRAD and GEN Industry Contributions to Philippine GDP Growth</th>
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<tr>
<td><strong>TRAD</strong></td>
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<td>GDP growth (percent)</td>
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<td>2013</td>
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<tr>
<td>Agriculture and forestry</td>
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<td><strong>INDUSTRY SECTOR</strong></td>
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<td>Electricity Gas and Water Supply</td>
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<td><strong>SERVICE SECTOR</strong></td>
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<tr>
<td>Public Administration, Defense, and Social Security</td>
</tr>
<tr>
<td>Other Services</td>
</tr>
</tbody>
</table>

Source: Author's calculations from GDP in Table 1 of GEN growth components given by pure growth effect (PGE), growth-price interaction effect (GPIE), and relative price effect (RPE) in (15) to (17) and of TRAD growth contributions in (20).
latter industry, TRAD showed a growth contribution of 0.428 percentage points while GEN showed only 0.291 because of negative GPIE and RPE.

V. Summary and Conclusion

Considering that GDP deflators differ between industries and also differ from the economy-wide GDP deflator, this paper argues that real GDP of industries are not necessarily measured in *homogeneous* units and, therefore, questions TRAD GDP level aggregation by simple addition, i.e., without weights, of industry real GDP. As an alternative, this paper’s GEN GDP level aggregation applies relative prices as weights of real GDP of industries to convert them into PPP values that are in homogeneous units—with the economy’s GDP as numeraire—for additivity. For comparison, GEN and TRAD are applied to Philippine GDP in constant prices to show that the TRAD framework is deficient and misleading for overlooking the significant role of relative prices recognized by the GEN framework.

Given that relative prices change year to year and differ between industries, TRAD and GEN growth contributions of the same industry will be unequal. By ignoring *changes* in relative prices, TRAD is deficient for its inability to determine the “reallocation effects” on GDP growth of relative price changes that are measured by GEN industry growth contributions. A further deficiency is that TRAD takes into account the *level* of relative price in an industry’s growth contribution in a *perverse* way by raising the growth contribution of an industry with a low relative price or, conversely, lowering the growth contribution of an industry with a high relative price. These results are contrary to the basic production principle that resources tend to be reallocated to industries with rising relative prices and, thus, promote their growth and raise their contributions to the economy’s overall growth.

In the above light, the TRAD framework is illogical in theory and, therefore, misleading in practice. However, this paper’s GEN framework provides a theoretically consistent and practicable alternative to TRAD for level aggregation and growth decomposition of GDP in countries, like the Philippines, where GDP is measured in constant prices.
Appendix

Additivity of GDP in Constant Prices

Let there be $j=1,2,\cdots,M$ industries and let each $j$ produce $k=1,2,\cdots,N$ commodities over a period $t=1,2,\cdots,T$. Each commodity has a price $p^{kj}_t$ and quantity $q^{kj}_t$. Moreover, denote the fixed base period by $b$. Hence, GDP in current prices in $b$ and in any $t$ are,

\[ Y^j_b = \sum_k q^{kj}_b p^{kj}_b \quad ; \quad Y^j_t = \sum_j Y^j_t = \sum_k q^{kj}_t p^{kj}_t \quad ; \quad Y_t = \sum_j Y^j_t. \]

Let the GDP Paasche price indexes linking $b$ to $t$ be $P^{P}_{b,t}$ for the overall economy and $P^{P}_{b,t}$ for an industry. Using the prices and quantities in (1), these indexes are, by definition,

\[ P^{P}_{b,t} = \left( \frac{\sum_k q^{kj}_t p^{kj}_t}{\sum_k q^{kj}_t p^{kj}_b} \right) \quad ; \quad P^{P}_{b,t} = \left( \frac{\sum_j \sum_k q^{kj}_t p^{kj}_t}{\sum_j \sum_k q^{kj}_t p^{kj}_b} \right); \]

\[ P^{P}_{b,t} = \sum_j s^{jP}_{b,t} p^{P}_{b,t} \quad ; \quad s^{jP}_{b,t} = \left( \frac{\sum_k q^{kj}_t p^{kj}_t}{\sum_j \sum_k q^{kj}_t p^{kj}_b} \right); \quad \sum_j s^{jP}_{b,t} = \left( \frac{\sum_j \sum_k q^{kj}_t p^{kj}_b}{\sum_j \sum_k q^{kj}_t p^{kj}_t} \right) = 1. \]

Let $X_t$ and $X^j_t$ represent real GDP of the economy and an industry in $t$ measured in period $b$ prices. Since $b$ is a fixed base, $P^{P}_{b,t}$ and $P^{IP}_{b,t}$ are direct Paasche price indexes. In this case, $X_t$ and $X^j_t$ are the economy’s and an industry’s GDP in constant prices. These are computed by,

\[ X_t \equiv \left( \frac{Y_t}{P^{P}_{b,t}} \right) = \sum_j \left( \frac{\sum_k q^{kj}_t p^{kj}_t}{\sum_k q^{kj}_t p^{kj}_b} \right) = \sum_j \sum_k q^{kj}_t p^{kj}_t; \]

\[ X^j_t \equiv \left( \frac{Y^j_t}{P^{IP}_{b,t}} \right) = \sum_k \left( \frac{\sum_j q^{kj}_t p^{kj}_t}{\sum_j q^{kj}_t p^{kj}_b} \right) = \sum_k q^{kj}_t p^{kj}_t; \]

\[ X_t = \left( \frac{Y_t}{P^{P}_{b,t}} \right) = \sum_j X^j_t = \sum_j \left( \frac{Y^j_t}{P^{IP}_{b,t}} \right) = \sum_j \sum_k q^{kj}_t p^{kj}_b. \]

The result in (6) is the “additivity” of real GDP in constant prices. That is, the economy’s real GDP equals the simple sum of the real GDP of all sectors or industries. However, as argued in the text, (6) is objectionable because $\sum_j \frac{Y^j_t}{P^{IP}_{b,t}}$ involves summation of non-homogeneous units because, while $Y^j_t$ is homogeneous, $P^{IP}_{b,t}$ is different between industries. Thus, this paper proposes as an alternative the weighted sum given by,

\[ X_t \equiv \left( \frac{Y_t}{P^{P}_{b,t}} \right) = \sum_j \left( \frac{Y^j_t}{P^{IP}_{b,t}} \right) = \sum_j \left( \frac{P^{IP}_{b,t}}{P^{P}_{b,t}} \right) \frac{Y^j_t}{P^{IP}_{b,t}} = \sum_j \left( \frac{Y^j_t}{P^{IP}_{b,t}} \right) \frac{P^{IP}_{b,t}}{P^{P}_{b,t}} = \sum_j \left( \frac{Y^j_t}{P^{IP}_{b,t}} \right) \frac{P^{IP}_{b,t}}{P^{P}_{b,t}}. \]

Clearly, (7) is a sum of homogeneous “PPP” values of industries as explained in the text.
References


