GDP at Market Price vs GDP at Factor Cost

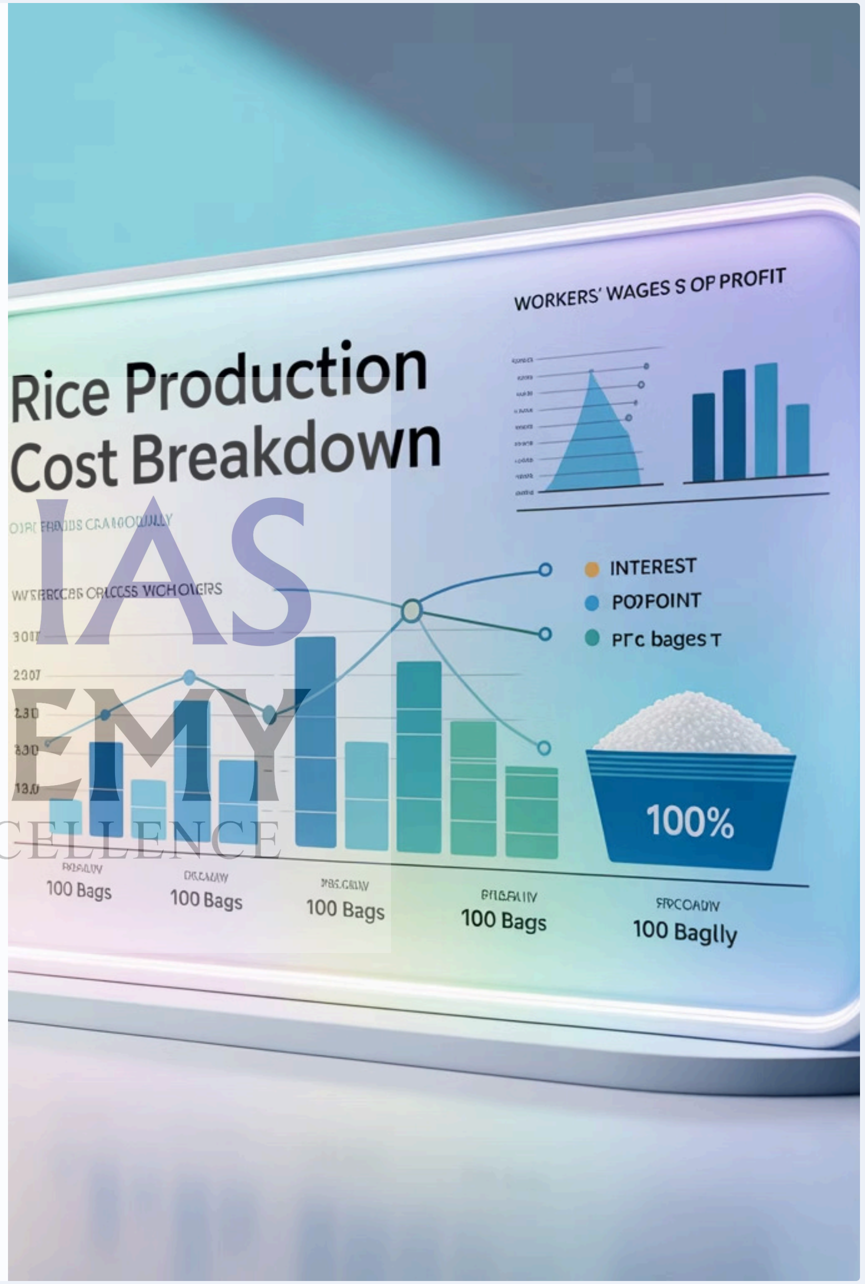
Cost of Production

It's the **total money spent** to produce goods or services — including:

Wages (to workers), **Rent** (for land/building), **Interest** (on capital/loans), **Profit** (for entrepreneur)

A company produces 100 **bags of rice** in a year.

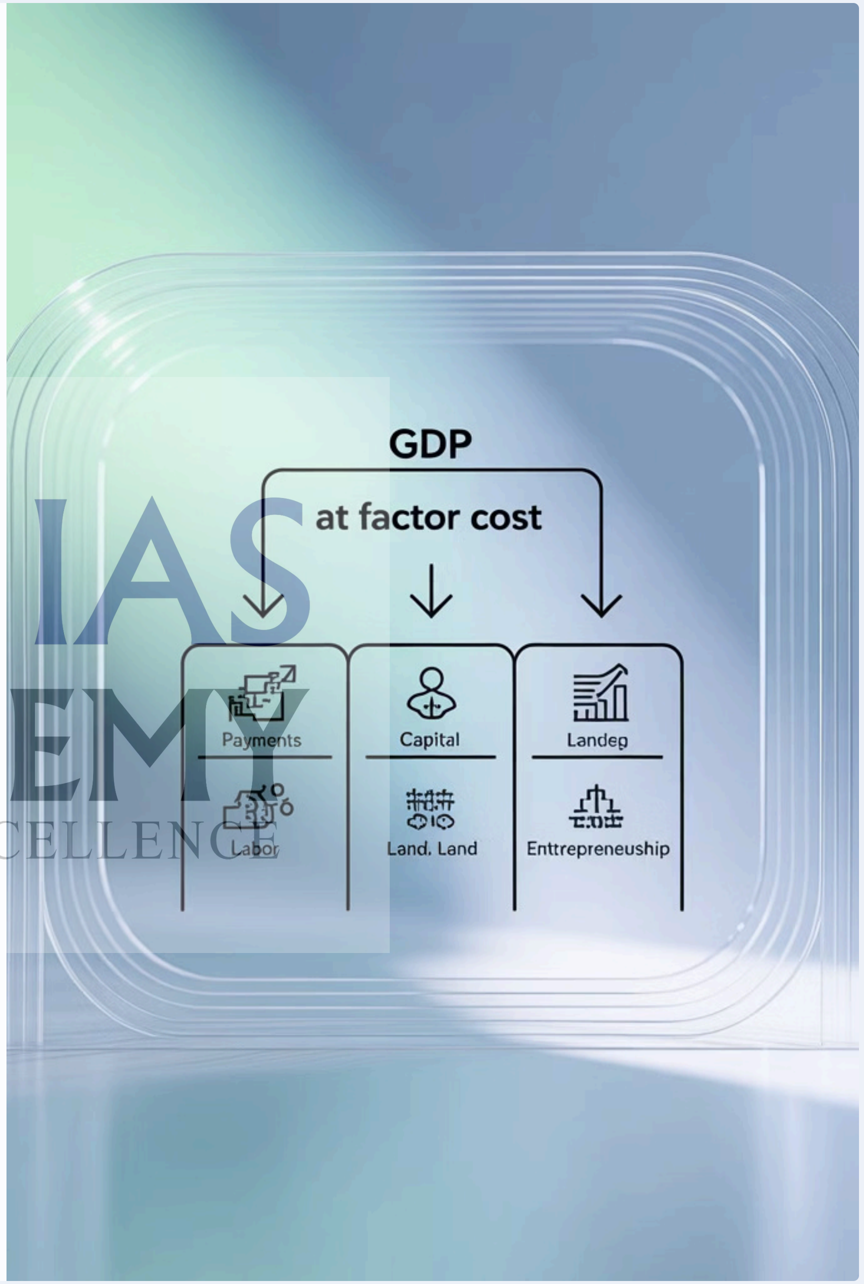
Item	Cost
Workers' Wages	₹40,000
Rent for Warehouse	₹20,000
Interest on Machines	₹10,000
Profit to Owner	₹30,000
Total Cost	**₹1,00,000**



This total ₹1,00,000 is called **GDP at Factor Cost** — because it is calculated **based on payments made to factors of production** (land, labor, capital, entrepreneurship).

Why is it important?

> It shows **how much income** is generated by the **actual producers** in the economy, **before taxes or subsidies** are added



Indirect Tax?

- It is levied **on goods and services**, paid by consumers as part of the purchase price. **The seller collects** this tax **from the buyer** and then **remits it to the government.**

- Imagine buying a shirt for ₹1,000 with 18% GST.

> You pay: ₹1,000 (shirt) + ₹180 (GST) = **₹1,180**

The shopkeeper forwards the ₹180 GST to the government. **You do not interact directly with the tax authority** for this payment.

Direct Tax?

A Direct Tax is a tax you pay straight to the government, and it's based on your income or wealth.

If you earn **₹10 lakh** a year, and your income tax is **₹1 lakh**, you pay that **₹1 lakh directly to the government**.

Subsidy

A subsidy is **financial aid** provided by the government to **reduce the cost of goods or services**, making them **more affordable** for consumers or producers.

Milk Subsidy

Government gives **money to dairy companies**, reducing milk prices for consumers. You pay ₹30 instead of ₹40, making daily essentials cheaper.

Fertilizer Subsidy

The government pays part of the cost to fertilizer companies. Farmers buy at lower prices, which helps keep **farming affordable and food prices stable.**

EV Subsidy

High upfront costs often hinder Electric Vehicle (EV) adoption.The Indian government's **FAME scheme** provides subsidies (e.g., ₹15,000 per kWh for two-wheelers), directly lowering prices for buyers.

Purpose	Example
To help poor people afford basics	LPG subsidy, food grains, education
To support farmers or producers	Fertilizer subsidy, electricity
To promote certain sectors	EVs, solar energy, exports

Cost of Production

Imagine a company produces bags of rice with a total cost of production (including wages, profit, etc.) of **₹1,00,000**.

This represents the GDP at Factor Cost.

Indirect Tax

The government charges a 10% Goods and Services Tax (GST) on this production, which amounts to **₹10,000**.

This tax is added to the market price.

Subsidies

To keep rice prices affordable for consumers, the government provides a subsidy of **₹5,000** to the producers.

This subsidy reduces the market price.

GDP at MP = ₹1,00,000 + ₹10,000 – ₹5,000 = ₹1,05,000

So the market sees the rice as worth **₹1,05,000** — **that's GDP at Market Price**.

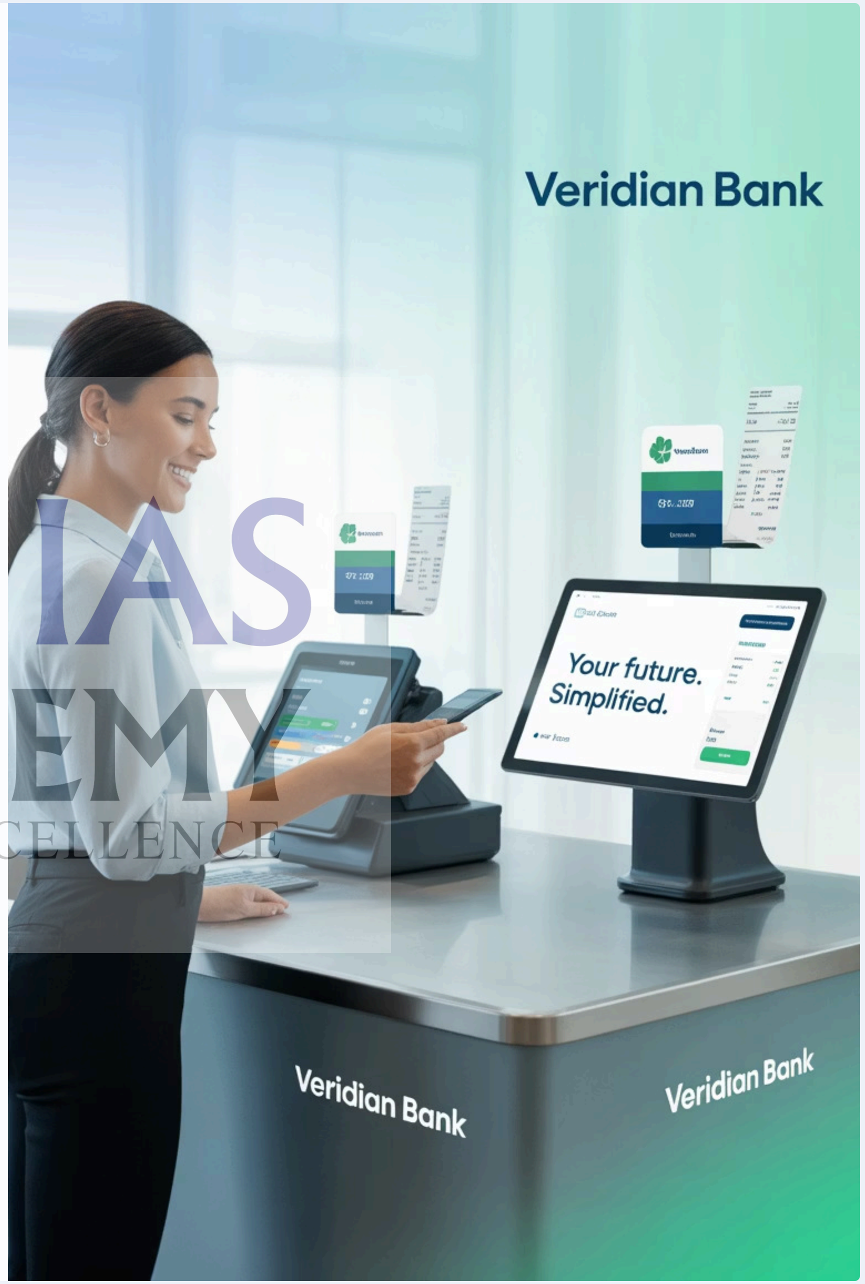
> **GDP at Market Price = GDP at Factor Cost + Indirect Taxes – Subsidies**

GDP at Market Price

It is the GDP **valued at the prices consumers actually pay** in the market — including **indirect taxes** and **excluding subsidies**.

> **GDP at Market Price = GDP at Factor Cost + Indirect Taxes – Subsidies**

> So, GDP at MP reflects **what the economy produces** - **valued at what buyers actually pay** — including tax effects.



Components of GDP at Market Price

Factor Cost

Cost of production paid to factors (wages, rent, etc.)

Indirect Taxes

GST, excise, etc. (increase market price)

Subsidies

Reduce market price (e.g., on food, LPG)

Calculating GDP at Market Price

Let's say the GDP at **Factor Cost** = ₹261.2 lakh crore

Start with Factor Cost

₹261.2 lakh crore

Add Indirect Taxes

+ ₹14.8 lakh crore

Subtract Subsidies

- ₹4 lakh crore

Then, GDP at Market Price = ₹261.2 + ₹14.8 – ₹5 = ₹272 lakh crore

Why GDP at Market Price Matters

Feature	Importance
Valued at actual transaction prices	**Used in national accounts (Economic Survey, Budget)**
Includes tax impact	More reflective of **the price level consumers face**
Important for **calculating fiscal indicators**	e.g., Fiscal Deficit as % of GDP

Calculating GDP at Factor Cost

Let's use the figures from our previous example to calculate GDP at Factor Cost:

Start with GDP at Market Price

₹272 lakh crore

Subtract Indirect Taxes

- ₹14.8 lakh crore

Add Subsidies

+ ₹4 lakh crore

Thus, GDP at Factor Cost = ₹272 – ₹14.8 + ₹4 = **₹261.2 lakh crore**.

What is GDP at Factor Cost?

GDP at Factor Cost (GDP at FC) is measured based on the income received by the factors of production (labour, land, capital, entrepreneurship), **excluding the impact of indirect taxes and subsidies**.

> **GDP at Factor Cost = GDP at Market Price – Indirect Taxes + Subsidies**

Why GDP at Factor Cost Matters

Feature	Importance
Shows **true income of producers**	Excludes distortions of taxes/subsidies
Useful for understanding **production structure**	Sectoral comparison (agriculture, services)
Formerly used in national accounting	Now replaced by GDP at MP in official stats

Comparing Perspectives

Producer's Perspective (Factor Cost)

Focuses on what producers actually earn from their economic activities before government intervention through taxes and subsidies.

Consumer's Perspective (Market Price)

Reflects what consumers actually pay in the marketplace, including all taxes and after accounting for subsidies.

Historical Context

1

Pre-2015

India primarily used GDP at Factor Cost as the main indicator in official statistics and economic analysis.

2

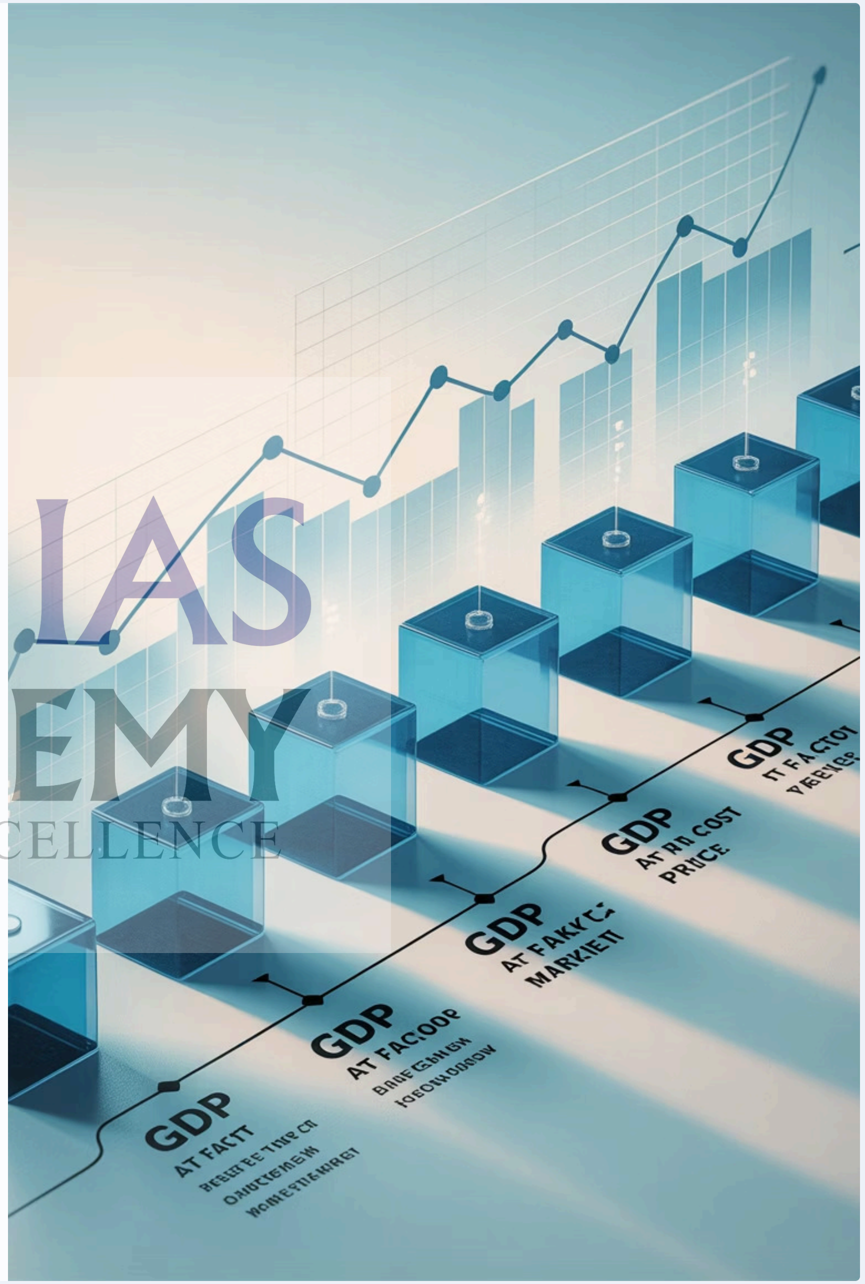
2015

India shifted to using GDP at Market Price as the standard measure, aligning with international practices.

3

Post-2015

GDP at Market Price became the primary indicator in the Economic Survey, Budget documents, and other official reports.



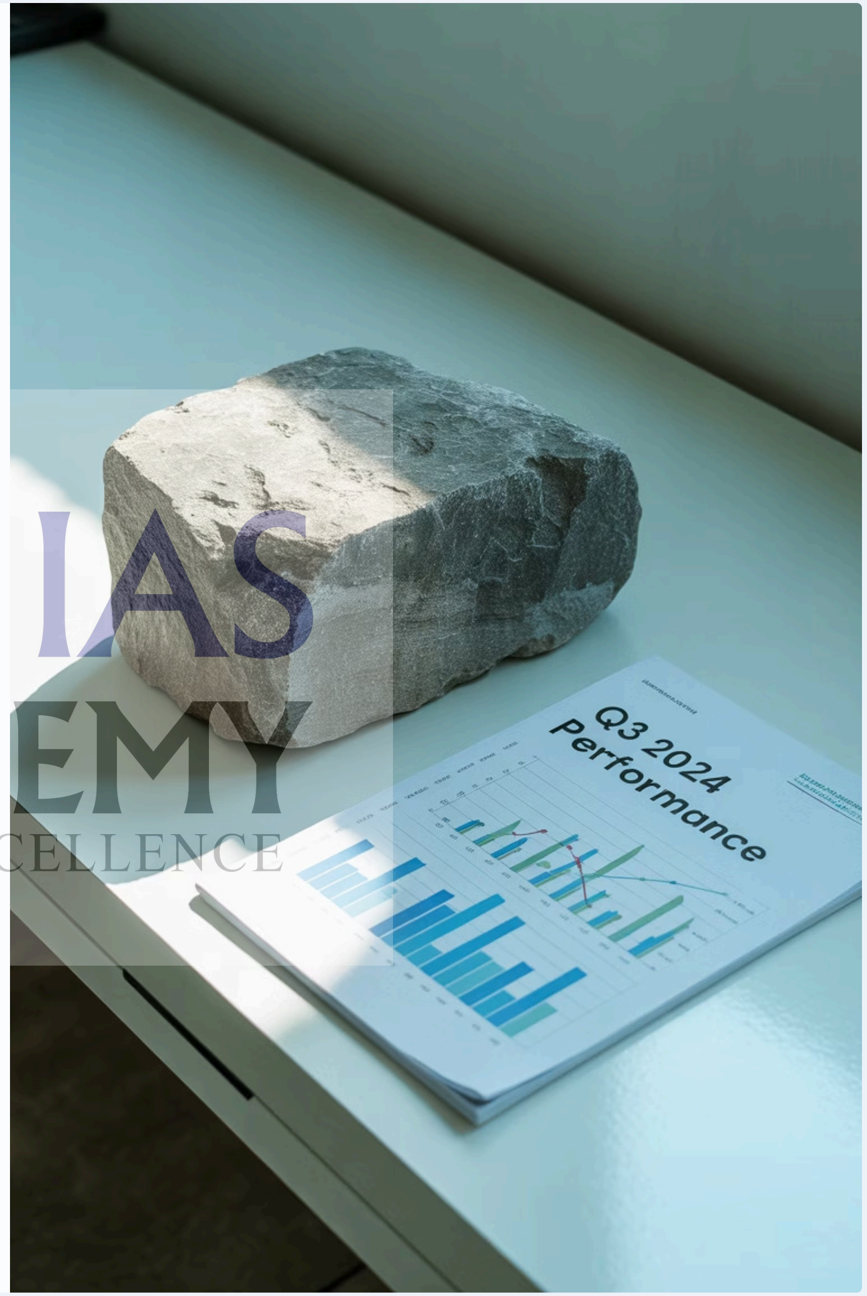
What Remained Constant

National Income's Definition

Even after the overhaul, "National Income" still officially refers to Net National Product (NNP) at Factor Cost.

Prominence of GDP at MP

It is just that GDP at Market Prices is now more prominently reported and discussed in official statistics.



Policy Applications

Economic Analysis

GDP at Factor Cost helps economists understand the true production structure without tax distortions.

Fiscal Planning

GDP at Market Price is used for calculating key ratios like fiscal deficit as a percentage of GDP.

International Comparisons

GDP at Market Price allows for standardized comparisons with other countries following the same methodology.

GDP at FC vs GDP at MP: Detailed Comparison

Aspect	GDP at Factor Cost	GDP at Market Price
Reflects	Producer's perspective	Consumer's perspective
Policy Use	Economic production analysis	Macroeconomic indicators (budget)
Official use	**Old method (pre-2015)**	Now standard (post-2015)

Definitions and Formulas

Aspect	GDP at Factor Cost	GDP at Market Price
Definition	Value at **cost of production** (excluding taxes, including subsidies)	Value of goods/services at **market prices**
Formula	GDP at FC = GDP at MP − Indirect Taxes + Subsidies	GDP at MP = GDP at FC + Indirect Taxes − Subsidies

Sectoral Analysis

When analyzing different sectors of the economy:

Agriculture

Subsidies often lead to GDP at Factor Cost being notably higher than GDP at Market Price for this sector.

Manufacturing

Due to significant indirect taxes, GDP at Market Price typically exceeds GDP at Factor Cost.

Services

Tax and subsidy effects vary widely across different service industries.

Key Takeaways

1

Different Perspectives

GDP at Market Price shows the consumer's view, while GDP at Factor Cost shows the producer's view.

2

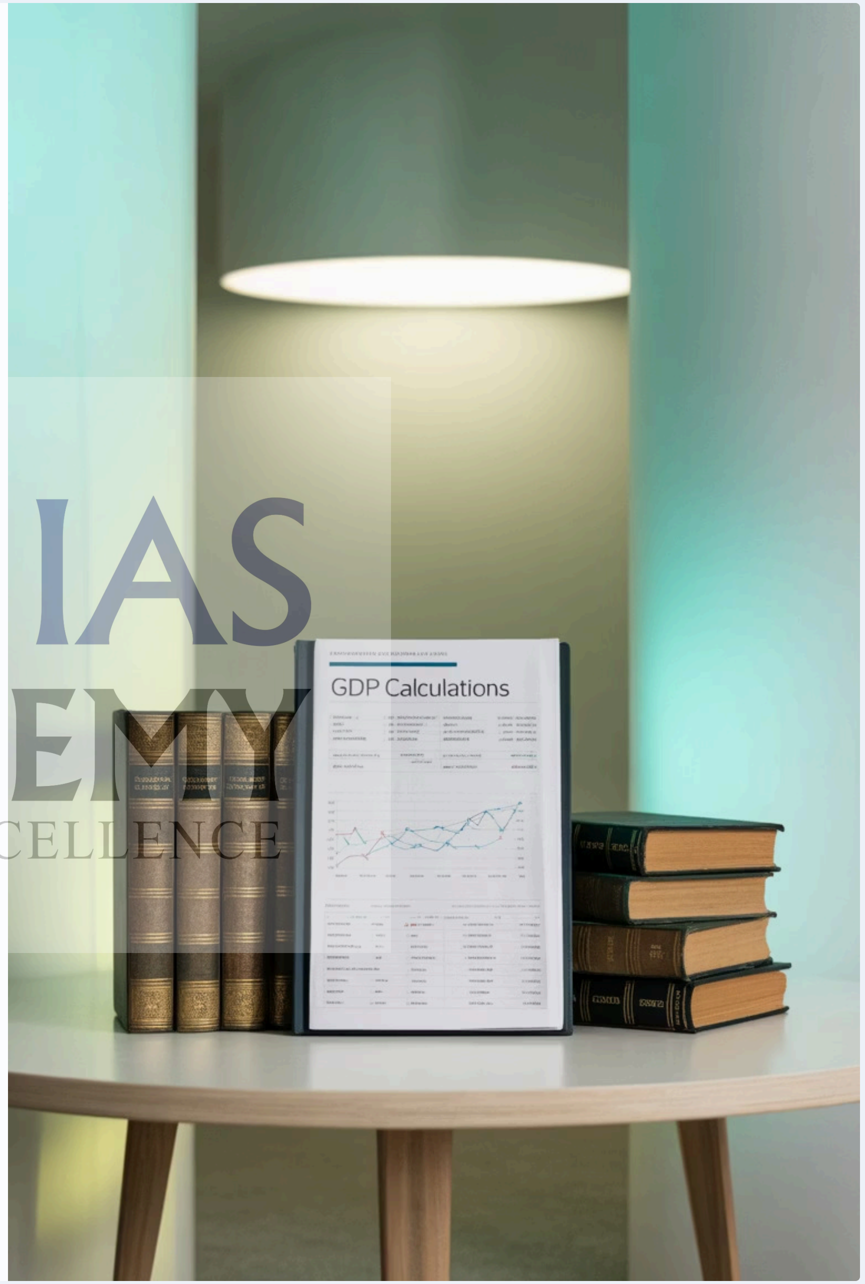
Simple Conversion

The two measures are related by a simple formula involving indirect taxes and subsidies.

3

Current Standard

GDP at Market Price is now the international standard and India's official measure since 2015.



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