

B.A. Part III (Economics Honours)
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Index Numbers

Meaning of Index Numbers:

The value of money does not remain constant over time. It rises or falls and is inversely related to the changes in the price level. A rise in the price level means a fall in the value of money and a fall in the price level means a rise in the value of money. Thus, changes in the value of money are reflected by the changes in the general level of prices over a period of time. Changes in the general level of prices can be measured by a statistical device known as 'index number.'

An index number is a statistical device for measuring changes in the magnitude of a group of related variables.

Index number is a technique of measuring changes in a variable or group of variables with respect to time, geographical location or other characteristics.

There can be various types of index numbers, but, in the present context, we are concerned with price index numbers, which measures changes in the general price level (or in the value of money) over a period of time.

Price index number indicates the average of changes in the prices of representative commodities at one time in comparison with that at some other time taken as the base period. According to L.V. Lester, "An index number of prices is a figure showing the height of average prices at one time relative to their height at some other time which is taken as the base period."

Features of Index Numbers:

The following are the main features of index numbers:

- (i) Index numbers are a special type of average. Whereas mean, median and mode measure the absolute changes and are used to compare only those series which are expressed in the same units, the technique of index numbers is used to measure the relative changes in the level of a phenomenon where the measurement of absolute change is not possible and the series are expressed in different types of items.
- (ii) Index numbers are meant to study the changes in the effects of such factors which cannot be measured directly. For example, the general price level is an imaginary concept and is not capable of direct measurement. But, through the technique of index numbers, it is possible to have an idea of relative changes in the general level of prices by measuring relative changes in the price level of different commodities.
- (iii) The technique of index numbers measures changes in one variable or group of related variables. For example, one variable can be the price of wheat, and group of variables can be the price of sugar, the price of milk and the price of rice.
- (iv) The technique of index numbers is used to compare the levels of a phenomenon on a certain date with its level on some previous date (e.g., the price level in 1980 as compared to that in 1960 taken as the base year) or the levels of a phenomenon at different places on the same date (e.g., the price level in India in 1980 in comparison with that in other countries in 1980).