

Comparing Standards of Living in the Global Economy

Background

People living in the developed countries of the world enjoy a higher standard and living and quality of life than people living in the developing or transition countries. The term *standard of living* is a measurement of people's economic well being as determined by income, the purchasing power of that income, and government transfer payments and other services provided to individuals to supplement that income.

The term quality of life is far broader than standard of living. *Quality of life* refers to the overall economic, social, political, and cultural conditions under which people live. Major determinants of one's quality of life include people's access to the necessities of life, such as food, clean water, clothing and shelter. It also includes people's access to essential services that will help them achieve to their potential, such as education, a health care system, communications and transportation systems, and so on. In recent years, quality of life issues have also included specific mention of people's civil and human rights—including equality for women in education, the workplace, and the family.

Let's take a look at the two most often used measurements of the standard of living in different economies: the per capita GNP (on an exchange rate basis) and per capita GNP (on a purchasing power parity basis).

Developed Countries: Comparing GNPs on an Exchange Rate Basis

Traditionally, the most commonly used measure use to compare economic well being across national borders was to compare the per capita GNPs of different countries. Recall, however, that countries have their own currencies. How can cross-border comparisons be made if Russia uses the ruble, India the rupee, and China the yuan to calculate GNP (and per capita GNP)? The traditional answer to this question is that statisticians would simply convert foreign currencies into U.S. dollar equivalents using the current exchange rate for these currencies. For instance, in the summer of 2001 the exchange rate for the Indian rupee was .0215—or about 2 cents in U.S. currency. Therefore, all calculations to convert India's GNP and per capita GNP into U.S. dollars would be based on about 50 rupees per \$1US.

Using the per capita GNP based on current exchange rates, the standard of living is easy to calculate. Figure 1, for example, shows the per capita GNPs of a number of developed, developing, and transition economies in the left-hand column. Using this measurement, we could conclude that the standard of living in Germany (per capita GNP of \$25,350) was nearly 70 times that of Bangladesh (per capita GNP of \$370). But is this comparison accurate? Are there other factors that should be considered in this comparison?

Comparing Per Capita GNPs: The Purchasing Power Parity Approach

Over the past several years, many leading international organizations—including the International Monetary Fund, or IMF—have begun to use a different measurement to compare the standard of living of people in different countries. This approach utilizes a concept called purchasing power parity (PPP). *Purchasing power parity* makes certain adjustments in the exchange rates to more accurately reflect the actual purchasing power of currencies within domestic economies.

Figure 1
Comparing Per Capita GNPs:
Exchange Rates vs. PPP

Countries	Per Capita GNP (Exchange Rate Approach)	Per Capita GNP (PPP Approach)
<i>Developed Countries</i>		
Germany	\$25,350	\$22,404
USA	\$30,600	\$30,600
<i>Developing Countries</i>		
Bangladesh	\$370	\$1,475
China	\$780	\$3,291
<i>Transition Countries</i>		
Bulgaria	\$1,380	\$4,914
Czech Rep.	\$5,060	\$12,289

Source: *World Development Report 2000/2001*, The World Bank

Notice from Figure 1 that the per capita GNP for the poorer developing countries and transition countries tends to rise significantly when calculated on a PPP basis. Why is this so? The main reason is that within their own economies, prices for many goods and services tend to be far lower than a comparable “market basket” of similar goods and services in the developed countries. Thus, people in the developing and transition economies are able to purchase a greater quantity of goods and services with smaller amounts of money.

Economists say that the *cost of living* (lower prices for most consumer goods, housing, fuel, and so on) is lower in developing nations, hence the purchasing power of the currency is higher. In simpler terms, the incomes of people in the poorer regions of the world stretches further than the incomes of people in the richer regions of the world.

This is not to say that the standard of living in Bangladesh is similar to that of Germany. On the contrary. Even using the per capita GNP based on PPP, the standard of living for people in Germany (\$22,404) is still about 15 times that of the people of Bangladesh (\$1,475), as shown in the right-hand column of Figure 1.

Also notice that the per capita GNP of the United States remains constant, regardless of which approach is used in the calculations. This is because we need a common standard on which to base all comparisons of GNP or per capita GNP. Note that Germany’s per capita GNP on a PPP basis declined when converted to US dollars. This denotes a higher cost of living in Germany than in the United States. Thus, Germans tend to pay more for many commonly consumed items.

How Big is Big? A Look at the Size of Developed Economies

Who are the largest economies in the world? While the question seems straight forward enough, the same logic that we used a moment ago concerning the PPP may influence our response. Consider Figure 2, which shows the top five economies of the world, ranked by GNP. Both the exchange rate and the PPP approaches are used to convert foreign currencies into U.S. dollars.

Figure 2
Measuring the World's Largest Economies: 1999

Exchange Rate Approach

Rank	Country	GNP (Exchange Rate Approach)
1	United States	\$8,351
2	Japan	\$4,079
3	Germany	\$2,079
4	France	\$1,427
5	UK	\$1,338

Purchasing Power Parity Approach

Rank	Country	GNP (PPP Approach)
1	United States	\$8,351
2	China	\$4,114
3	Japan	\$3,043
4	India	\$2,144
5	Germany	\$1,838

Source: *World Development Report 2000/2001*, The World Bank

Note that when the PPP approach is used, China replaced Japan as the

world's second largest economy. Also note that India jumped ahead of all of the highly industrialized countries except Japan and the United States.

Comparing Quality of Life

As you read earlier, the quality of life attempts to assess the overall conditions under which people in a country live. In the developed countries, the quality of life is relatively high. This is mainly due to the fact that wealthier countries can better afford to provide for the general well being of citizens.

In the developed world, most income and wealth come directly from private sector business activity. On one side of the market, firms produce goods and services for profit. On the other side of the market, households earn income by working, or by using their wealth to purchase income-producing assets such as bonds (interest), stocks (dividends and capital gains), or rental properties (rents). People also save money, which generates additional income in the form of interest.

The government—at the local, state, and national levels—is also well equipped to improve the quality of life for people in the developed countries. The government influences the quality of life in two important ways. First, government provides essential public goods and services to the people, including infrastructure (roads, bridges, seaports, airports, water and sewage systems, etc.), institutions (police and fire protection, courts and prisons, public schools and universities, libraries, etc.), and national security (defense). The government also provides a variety of transfer payments to those in need, including the poor, the sick, and the elderly.

Comparing Quality of Life Using Selected Indicators

It is not possible to measure with any precision the quality of life for peoples living in different world regions, who have different histories and cultures, and different values and world views. Yet, by examining some basic indicators, as shown below, we can piece together a general profile of a country and make some general commentary on the overall quality of life for the 6 billion people inhabiting the planet today. The quality of life comparisons will be made according to income status: high-income countries, middle-income countries, and low-income countries.

Health Indicators: 1998

Life Expectancy

High-income: 77.8
Middle-income: 68.8
Low-income: 63.4
(Least Developed: 44.2)

Under 5 Mortality (per 1,000 live births)

High-income: 6
Middle-income: 42
Low-income: 108
(Least Developed: 161)

Fertility Rate (births per woman)

High-income: 1.7
Middle-income: 2.5
Low-income: 3.0
(Least Developed: 4.9)

People Not Expected to Live to Age 60

High-income: 10.6%
Middle-income: 23.3%
Low-income: 29.7%
(Least Developed: 50.1%)

Availability of Essential Services

Adult Literacy Rate

High-income: 98.6%
Middle-income: 87.8%
Low-income: 68.9%
(Least Developed: 50%)

Students in Secondary Education

High-income: 95.6%
Middle-income: 70.9%
Low-income: 57.4%
(Least Developed: 31.2%)

Doctors (per 100,000 people)

High-income: 252
Middle-income: 172
Low-income: 70
(Least Developed: 30)

Availability of Essential Goods

Daily Calorie Intake (food)

High-income: 3,412
Middle-income: 2,889
Low-income: 2,596
(Least Developed: 2,099)

Per Capita Energy Consumption (kwh)

High-income: 9,531 kwh
Middle-income: 2,464 kwh
Low-income: 563 kwh
(Least Developed: 82 kwh)

Access to Clean Water (% Without)

High-income: na
Middle-income: 20%
Low-income: 30%
(Least Developed: 36%)

Televisions (per 1,000 people)

High-income: 674
Middle-income: 258
Low-income: 145
(Least Developed: 29)