

How would an economist go about comparing the standards of living in the UK, the Russian Federation and Bangladesh? [12 marks]

Standard of living is most often thought of economically by the national income of the economy. To compare the standards of living in a country an economist compares the relative national income of each individual in a country.

To do this you use the gross domestic product, the GDP of the three countries. This figure demonstrates the value of the goods and services produced within the economy, and so the amount of goods and services available to consumers. As the value of goods and services is equal to the spending on them GDP also represents the income of consumers in the economy, and so is an indicator of the standard of living. GDP demonstrates the value of goods and services available to the consumer, and an individual living in an economy with a higher GDP is generally seen as having a better standard of living.

However to compare countries it is necessary to use the GNP, the gross national product instead of GDP, the gross domestic product. GDP measures growth within the economy, but to compare internationally the net income flow from foreign ownership of assets must be excluded. This is what GNP is. GNP is used for international comparisons as assets where the profits are sent abroad do not help contribute to our economy and so do not count towards our standard of living.

Yet this value can still be deceptive as it includes inflation. An increase in GNP can be due to either an increase in the amount of goods and services produced or in the value of the goods and services produced. An increase in the value could increase GNP and mask an underlying decrease. Therefore a 'base year' must be chosen and every years GNP valued at that years prices.

GNP before this year must be inflated to be valued at that years prices and subsequent years deflated to demonstrate the real increase in GNP not a superficial increase which could have been caused by inflation giving the appearance of GNP increasing when it actually decreased.

Another factor that must be taken in to account is the population of a country. A very high GNP can deceptively suggest a high standard of living as if the country has a very high population, this may be a very low output per individual. This must therefore be taken into account, and so the GNP must be divided between the population of the country to give GNP per capita.

However, the single largest problem with comparing the GNP per capita of different countries is the way measurements from different countries are displayed. Each country values goods and services produced within its economy using its own currency. Russia will measure it's currency in terms of the Rouble, the UK in terms of Pounds Sterling and Bangladesh in terms of the Taka.

When we usually convert currency, for example to go on holiday we use market exchange rates. These however can fluctuate a great deal on a monthly basis and the Russian Rouble is notoriously volatile. The standard of living in a country does not fluctuate like market exchange rates and often we also find that a higher standard of living can be found abroad at a lower cost. This is, for example an experience many tourists have to less economically developed countries that their pound gives them more spending power abroad.

To compare the GNP per capita of countries it is therefore necessary to convert to a common currency. By tradition this currency is the American Dollar. Yet, as we have established market exchange rates are not suitable as they fluctuate regularly and do not demonstrate the purchasing power a unit of the currency has.

The concept of PPP, 'Purchasing Power Parity' compares the cost of a basket of simple goods, required for subsistence to give a more realistic comparison of the worth of a currency.

This final figure, GNP per capita measured at PPP rates gives an average figure for the comparative wealth of individuals within an economy and is generally viewed as a good indicator of the standard of living.

Discuss the problems an economist would face in making this comparison using GNP figures alone. [13 marks]

When comparing these figures however there are numerous flaws in using the single figure of GNP per capita at PPP rates.

The monetary value only accounts for goods and services exchanged in the market economy and that the government chooses to record. For example, in Japan the activities of the mafia are recorded as they pay tax, whereas in the UK this is part of the 'hidden economy' that does not count towards GNP figures. The hidden economy is worth ~7% of UK GDP. Economically this means that the GNP figures underestimate the standard of living yet it can be argued that goods such as drugs from the hidden economy can decrease the quality of life.

When an individual provides a good or service for themselves, washing their own clothes instead of using a laundrette, doing your own plumbing or cooking are not recorded as economic activity in the UK, whereas in the USA an estimate is made of the value of these goods and services and this figure included in GNP. In the three countries being compared above this is not likely to have a proportionally large affect on the UK GNP but for countries such as Bangladesh where home produced goods and services are common due to extended families and trade within the market economy being less well organised.

These are goods and services someone else could potentially have provided for you yet do not count towards GDP. This means that GDP is underestimated, which means that GNP is underestimated and so the GNP per capita is underestimated. Particularly in Bangladesh where people are 'money poor' and 'time rich' this is an issue. In the UK we are, generally, 'time poor' and 'money rich' so GNP per capita more accurately represents the standard of living in the UK.

There are further problems with the actual value calculated as the GNP per capita. For many countries, particularly in parts of the USSR and Bangladesh there are rural communities and to record data here would be very costly. Therefore much of the data is estimated.

When collecting such large amounts of data statistical errors are likely to arise, and different countries deal with these errors in different ways. Some countries will discard the data entirely whilst others will estimate the figure.

The figures calculated for GNP are therefore not always accurate and depending on the country may be hard to compare as different countries include and exclude different economic activity in their calculations for GNP.

Even a high GDP does not necessarily imply high living standards, simply high value output. During the '80s the USSR during the cold war produced primarily military goods and whilst these created a high GNP people had to queue to obtain simple goods necessary for sustenance such as a loaf of bread. So here the GNP would have been deceptively high suggesting a much higher standard of living than the Russians experienced.

A high GNP now could be due to large investment in capital goods, which will lead to larger growth later. Japan invested heavily in the 1950s and experienced large growth in the 1960s, and yet whilst this may have improved the GNP per capita during this period students were under more pressure to pass exams and workers had to put in extra hours.

Furthermore if a high GNP were caused by extensive production of consumer goods then whilst the country may experience a very high standard of living now this is not sustainable and over the long run the standard of living will fall. This is not represented in GNP per capita which only states the current standard of living.

Yet supposing the GNP did represent the actual national income, and that it consisted of a suitable balance of capital and consumer goods the GNP per capita only suggests an average income per person. In the UK in 1986 40% of the national income went to the top 20% of the population. In Bangladesh in 1992 the situation is similar, yet in the Russian Federation in 1996 50% of the national income went to the top 20%. (Anderton: p162) This suggests that there are many people in poverty.

This leads to another issue, when comparing data between countries not only do countries differ in their methods of collection but also the time at which they collect. Comparing just the three countries above uses data ranging from a decade apart. This will seriously distort the comparison as large changes are likely to have happened since the data was collected now over 15 years ago.

A lower GNP could be caused by government investment, which is generally viewed as less efficient than investment by private individuals. This led to the privatisation of many industries during the 1980s in the UK. However in the UK we still have the NHS, postal service and the Education system. These are services that improve our standard of living yet are more inefficient than privatised services and so cause an underestimation in our standard of living by lowering the GNP.

Perhaps then, the income of an individual does not necessarily reflect their standard of living. There are four key other factors that affect our standards of living.

Firstly safety from natural hazards such as floods and earthquakes but also from wars and fear of attack. In the UK after the terrorist attacks in the USA and bombings in Ireland the standard of living may have dropped for many people.

Political freedoms that we take for granted in the UK were not the case during communist rule in the USSR. The freedoms to visit family and voice an opinion without fear.

The environment in which people work and for how long they have to work in that environment. In the UK 100 or 150 years ago during the industrial revolution typically hours would have been longer and the working area much more dangerous, so it can be argued that the standard of living has increased as we have to work fewer hours in much safer conditions.

Finally the social environment of a country, the accompanying cultural traditions and freedom to practise them. In the UK this involves going to museums and socialising.

To many people these factors may be much more important to the standard of living than changes in income. However, these can be very hard to measure.

GNP would rise as divorce rates rise as more goods and services are required to sort out legal matters, yet the standard of living for the family would have decreased. Also if a good or service is produced in an environmentally unfriendly manner then more people must be employed to tidy up the damage caused. This would cause a rise in GNP as more goods and services would be available, but people will probably have experienced a decrease in the standard of living due to the pollution.

Living in a cramped urban environment like 95% of the Japanese do would not be seen as a high standard of living, yet can make the workers more productive as they do not need to commute as far to work and can participate in secondary and tertiary sectors of production more easily.

In the UK there are many families where two parents work, whilst this increases GNP it may have a detrimental affect on family relations with children. In Bangladesh the opposite is true with many families having only the man educated and working for the family. Whilst the woman does not work she is at home for the children and can produce goods at home. Here again a higher GNP per capita in the UK may be deceptive, as instead of needing to buy ready prepared meals for the family, for example, in Bangladesh the woman at home can prepare them.

So, what alternatives are there to GNP per capita for measuring the standard of living? Health, happiness and leisure are as important to most people as income yet GNP per capita focuses solely on income.

The Human Development index uses three factors to work out a comparative human development. Firstly, the GNP per capita to represent standard of living as previously mentioned.

Healthy living is measured by life expectancy of a baby at birth. In 1997 in the UK this was 77, yet in countries like Sierra Leone in 1997 this was as low as 37 (Economics Today: January 1996).

Knowledge measured by the adult literacy rate, in the UK in 1997 this was 99% yet again in 1997 in Sierra Leone only 33% (Economics Today: January 1996).

One of the problems with using the Human Development Index (HDI) is that each year the criteria has changed slightly and so comparisons cannot be made between countries, and different organisations work out slightly different values so to make any realistic comparison the data must be from the same source for the same time period.

A further suitable substitute to measure standard of living is the World Bank's measure of economic wealth. This involves looking at the four categories of wealth, and unlike GNP takes into account the unsustainable nature of exploiting limited natural resources. The resources of a country fit into one of the following categories.

The 'natural resources' of a country, the land, coal, oil, gas and timber. The 'Produced assets' referring to any man made machinery goods, buses planes and TV's. The 'Human resources' determined by their education and health and 'Social capital,' the value of relationships and happiness.

No measure of 'Social capital' has yet been devised and so current values of economic wealth based on the World Bank's guidelines are measured using the first three categories.

Whilst other methods exist GNP per capita is still the most widely accepted economic indicator of the standard of living. This is because the data is readily available, governments collect it for their own purposes and the cost of collecting more specific data has to be weighted up to how useful this data would actually be. Furthermore in many areas GNP per capita over estimates, and in others under estimates, so to a degree these factors can cancel.

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