

The why's and wherefore's of purchasing power parities

This year's Report systematically uses purchasing power parity (PPP) rates of exchange for comparing economic measures across countries. It uses World Bank PPPs to provide the latest overall GDP measures covering a wide range of countries, and data based on the Penn World Tables for more detailed estimates and to facilitate consistent comparisons over long periods.

To compare economic statistics across countries, the data must first be converted into a common currency. Unlike conventional exchange rates, PPP rates of exchange allow this conversion to take account of price differences between countries. By eliminating differences in national price levels, the method facilitates comparisons of real values for income, poverty, inequality and expenditure patterns.

While the conceptual case for using PPP rates of exchange is clear, practical issues remain. World Bank PPPs have been compiled directly for 118 of the world's approximately 220 distinct national political entities. For countries for which PPPs are not directly compiled, estimates are made using econometric regression. This approach assumes that the economic

characteristics and relationships commonly observed in surveyed countries also apply to the non-surveyed countries. While this assumption may not necessarily hold, fundamental economic relationships are thought to have general relevance and can be associated with independently observed variables in the non-surveyed countries.

The intricacies of the survey procedure and the need for countries to be globally and regionally linked have raised a number of issues relating to data reporting and in the past have led to significant delays in generating PPP results. As a result of these concerns, some governments and international institutions still refrain from using PPPs in regular operational policy decisions, though they use the method extensively in their analyses.

The importance of PPPs in economic analysis underlines the need for improvements in PPP data. This requires both institutional and financial support. In collaboration with Eurostat and the Organisation for Economic Co-operation and Development, the World Bank has set up an initiative to further improve the quality and availability of PPPs.