

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

To compare economic statistics across countries, the data must first be converted into a common currency. Unlike conventional exchange rates, purchasing power parity (PPP) rates of exchange allow this conversion to take account of price differences between countries. By eliminating differences in national price levels, the method aids 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. The World Bank has compiled PPPs directly for 118 of the world's approximately 220 distinct national political entities. For countries for which it does not directly compile PPPs, it produces estimates 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 eco-

nommic 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 to link countries globally and regionally have raised a number of issues relating to data reporting. In the past they have also 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, but use the method extensively in analyses.

The importance of PPPs in economic analysis underlines the need to improve PPP data. That effort 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.