Discuss the drawbacks of GDP per head as an indicator of living standards and suggest what improvements might be made to produce a more useful measure.

The normal way of comparing the economic well-being of a nation or the individuals in the nation, is usually by using per capita income. This is the average income per head of the country. It is obtained by dividing the GDP (Gross Domestic Product) by the population. Using this method, the living standards between countries, and also living standards within a country overtime can be compared. However, there are a number of reasons why this may not be an accurate guide to measuring the living standards of a country, or the individuals living in the country.

Firstly, per capita income ignores the effects of inflation. If prices rise more rapidly in one country than in another, per capita income will be artificially inflated. In order to overcome this difficulty, money GDP can be deflated by the use of a price index, and by comparing the real per capita income, a better indication of relative living standards is deduced.

Secondly, real GDP does not include externalities. Externalities are third party costs which do affect living standards of the population, such as pollution and congestion. These pose costs on third parties and represent real opportunity costs for them, reducing their effective disposable income, and hence living standards. Pollution and congestion and other negative externalities also have negative effects on health. The time spent ill, is an opportunity cost to leisure, and furthermore, less days working reduces output.

Furthermore, if real GDP per head is high, this may not be due to high wages, but due to long working hours. Long working hours result in less leisure time and stress, which reduces living standards.

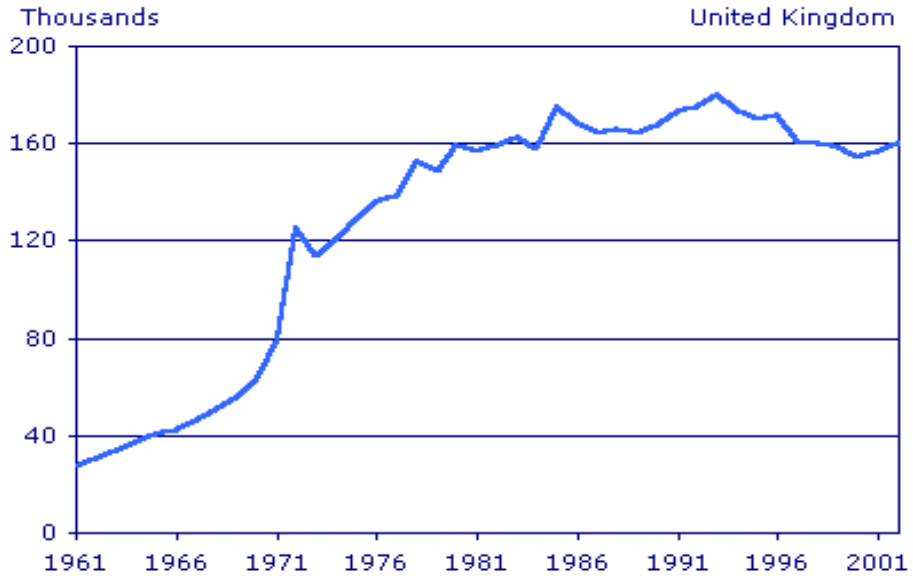
Another reason why the real GDP may not be a good measure of standard of life is that the values that are shown up do not include quality of the goods. There may be increased output, but the goods that are being produced may be worse in term of quality, and thus the quality of life may not be improving. For example the output of washing machines may have increased, but the quality of metals being used in the washing machines may have fallen, and thus quality and durability of the washing machines have fallen. Therefore, the satisfaction obtained by the individual from the washing machine has in fact fallen.

High incomes could be being caused by faster economic growth, but this may have been caused by using non renewable resources, such as oil and coal, in which case the increased living standard may be only temporary. Therefore, it means increased living standards for now, but in the future, the living standards may fall.

Another reason this increased output may not represent an increase in living standards, is that resources may be being transferred from consumer goods into capital goods, as shown in the Production Possibility Frontier (PPF) overleaf. Thus, although output has

increased, the quality of consumer goods on which current living standards depend, has actually fallen. We can see how this would show on the PPF below:

There are certain things that are difficult to quantify, and which are not reflected in Real GDP statistics. The real GDP does not take into account social problems in the community, and even though the statistics may be showing an increase in income, the social problems may be reducing the quality of life of the people. For example, we can see divorce rates have increase significantly over the past 4 decades. Also there may be increased stress, alcoholism and suicide rates, and all these have negative effects on living standards.



Rate of Divorce in UK

We are assuming in using the real GDP statistics that most of the population is around the same income per head. However the distribution of income differs very considerably both between different countries, and within a particular country. This, therefore, could result in the real GDP portraying an image of living standards that does not represent the whole of that country.

There have been efforts to improve the method to measure living standards. For example the Americans had tried to use the MEW system (Measure of Economic Welfare) many years ago to attempt to measure living standards more accurately, by including working hours and leisure time, and also pollution.

Another measure is by the UN, who devised the Human Development Index, which measures the income per head, the life expectancy value, and an education attainment value. These are then grouped together and given a general mark out of 1, the closer to one, the greater the living standards. Although this does not include values for pollution, qualities of consumer durables or divorce rates, it is at least an improvement of raw GDP statistics.

Alternative methods involve measuring the ownership of consumer durables, social welfare statistics and home ownership statistics.

The number of households owning a consumer durable, such as a computer or a television, could be measured in different countries, and the number of households owning the consumer durable could be used to compare living standards between countries.

Other social welfare statistics which could be useful to measure the quality of life could be the number of patients per doctor, hospital waiting list figures, infant mortality rates and a value for an average food intake per person. Also literacy rates, average educational attainment levels, crime rates, and divorce rates, as already mentioned, could be used to help derive a figure to measure living standards.

In conclusion, any measure of living standards depends on the perception of human beings, and so the values obtained may not necessarily represent the opinion of the individual. Therefore, in order to obtain a value that accounts for as many aspects of living standards as possible, the more statistics included in the final figure obtained, the better.