



ICP AND USES OF

Purchasing Power Parities (PPPs)

*PPPs are more appropriate
currency converters than
exchange rates to compare
the GDP across countries.*



The International Comparison Program (ICP) is a global statistical initiative involving national, regional and international agencies. This unique exercise produces internationally comparable price levels, expenditure values, and Purchasing Power Parity (PPP) estimates informing users such as national policy makers, economists, international organizations and academicians about the relative well-being of citizens of countries. The ICP global office in the World Bank coordinates the collection of price data, compilation of detailed expenditure estimates and calculation of PPPs for 107 countries in Africa, Asia and the Pacific, Latin America, the Commonwealth of Independent States and Western Asia. The Organization for Economic Cooperation and Development (OECD) and the Statistical Office of the European Union (Eurostat) coordinate activities for their member countries.

Results combined with the Eurostat-OECD PPP Program will bring the total number of participating countries to about 150, making it the largest international data collection exercise in the world today. The goal of the program and related activities is to provide a reliable and relevant information base, with the ultimate objective of informing policies that affect economic and social development as well as supporting poverty measurement and monitoring efforts. The ICP also provides a data resource that is extremely valuable to businesses involved in production, sales or purchases abroad, or in financial transactions or in setting compensation levels in different countries.

*“The International Comparison Program is the largest **international data collection exercise** in the world today.”*

ROLE OF PURCHASING POWER PARITIES AT THE NATIONAL AND INTERNATIONAL LEVEL

The Purchasing Power Parity (PPP) between two countries is the rate at which the currency of one country needs to be converted into that of a second country to ensure that a given amount of the first country's currency will purchase the same volume of goods and services in the second country as it does in the first.

Gross Domestic Product (GDP) is the measure most often used by economists to represent the total economic size of countries. The GDP and its components on a per capita basis represent the distribution of a country's goods and services as they contribute to its economic well being. By comparing a country's GDP over time it is possible to measure changes in economic growth, overall productivity and, when placed on per capita basis, economic welfare or well-being. But before such comparisons can be made, it is necessary to express the GDPs—which are in national currencies and valued at national price levels—in a common currency at a uniform price level.

The International Comparison Program was established to provide an alternative to direct conversion based on exchange rates to compare per capita GDP levels between countries. Purchasing Power Parities (PPPs) generated by the program provide comparisons that are based on prices of hundreds of items divided into 155 categories of the GDP, thus avoiding the deficiencies of fluctuating currency exchange rates.



USES OF PURCHASING POWER PARITIES

Comparisons of per capita expenditures are generally considered to be a good approximation of relative economic development. Countries compare their per capita expenditures on food, education, and health, for example, with other countries from their region. Health and education expenditures as a percentage of government expenditures or total GDP give a comparable measure of the domestic resources devoted to these uses. These measures based on PPPs are important because the relative prices of these services differ greatly between countries. It is useful for national policy purposes to have ratios in both national and international prices.

Examples:

- A key measure of the potential for economic growth is the ratio of investment to the GDP. Where economic growth is related to the amount of investment, it is appropriate to make these comparisons between countries using PPP based measures.
- Living standards in different countries can be evaluated by comparing PPP based per capita expenditures of household consumption or components of household consumption.
- Price levels of basic consumption items or total consumption are used to assess the incidence of poverty and to monitor progress of policies targeted to poverty alleviation. The current practice to produce global poverty estimates makes use of US\$1/day and US\$2/day poverty lines. The comparison between countries is made using PPPs for the private consumption aggregate of the GDP. The ICP framework can be used to investigate the incidence and distribution of poverty in various regions of the same country.

*“Measures based on PPPs are important because the **relative prices** of these services **differ greatly** between countries.”*

The results of the ICP also address a very common concern for tourists, compensation administrators, and traders, namely how expensive is my country compared to a neighbor or a country to be visited. This concern can only be addressed by knowing the prices of goods and services to be bought or sold in each country as generated by the ICP along with the price of currency, the exchange rate.

- Price levels for components of the GDP can be compared across countries, especially for trading partners. Policy makers can use this information to determine if its prices are in line with its trading partners to prevent imbalances in international trade.
- Price levels between different components of a country's GDP may not be consistent and can only be determined using PPPs. The distribution of various expenditure components of the GDP provides a picture of the comparative structure that is different from the one derived using exchange rates. This is because PPPs differ from sector to sector.
- The comparison of the relationship between PPPs and exchange rates for similar countries will allow a country to consider the effect of its exchange rate policies. The extent of the deviations of PPPs from the official exchange rates shows the extent to which a currency over or understates the general price levels.
- The allocation of the bulk of the European Commission's Structural Funds (used largely to gradually reduce economic disparities between and within EU member states) is made on the basis of PPP-converted GDP per capita (*for more information please see the March 2002 issue of Statistics Brief at www.oecd.org/statistics*). However, PPPs are not used by other international organizations for calculating member countries' contributions or for assessing their eligibility for aid grants or access to loans on favorable terms.

THE INTERNATIONAL COMPARISON PROGRAM, 2003–2006 ROUND

Governance

The ICP Executive Board, consisting of 16 eminent statisticians, economists and decision-makers from around the world, is responsible for the overall guidance of the ICP.

The Global Office coordinates the program throughout all regions and countries except for those covered by the OECD and Eurostat. It leads the effort to provide a structured approach to defining the specifications of items to be priced, the development of software and the overall coordination of the Global Ring Comparison Program to connect regional PPPs.

Regional Offices in Africa, Asia and the Pacific, Western Asia, the Commonwealth of Independent States and Latin America are working closely with National Coordinators to ensure comparable data. Each regional office has formed its own Advisory Board.

A Technical Advisory Group advises on the methodology and technical issues of the ICP and its data. National statistical offices and international agencies all play important roles in this structure.

The ICP and the Eurostat-OECD PPP Program¹ are run independent of each other. The two programs collaborate on methodological improvements for the international comparison of prices. The global PPPs will be prepared by the ICP Global Office by combining the ICP regional PPPs with the Eurostat-OECD PPPs via the Global Ring Comparison Program.

¹ For more information about the Eurostat-OECD PPP Program please visit <http://www.oecd.org> and <http://europa.eu.int>

ICP KEY DATES AND MILESTONES

NOV 02 Global Office set up by the World Bank

FEB 03 Inaugural meeting of the Executive Board

SEPT 03–JULY 04 Regional and National Coordinators prepare common lists of items to be priced

JAN–OCT 04 Software for data collection finalized

OCT 04–SEPT 05 Price collection surveys conducted

LATE 2006 Preliminary Purchasing Power Parities published

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