

# Gdp failure to measure standard of living economics essay



**ASSIGN  
BUSTER**

Nowadays, the more economic and technology develop, the more measures of living standard are used. The gross domestic product (GDP) is one the primary indicators used to gauge the health of a country's economy. By using real GDP (Gross Domestic Product) as the main indicator of well - being, it is recognised that the indicator is not a perfect measure as many important factors are neglected (Economics help, 2007). Some people said that real GDP is increasingly criticized for its failure to adequate measure the standard of living. In my view, the criticism is seemed right. GDP per capita is a commonly used measure of the standard of living but not necessarily an accurate one. Therefore, this essay will argue that real GDP is failure to measure the living standard or not. This essay is divided into three main sections. Section one, which will analyse some supportive arguments and some evidence to support the key argument. However, the second section will aim to examine the opposite view. It will show the role of GDP as a measure of economic development. Moreover, it is a rough guide to living standard. Finally in the conclusion, the syntheses will be concluded based upon the arguments and evidence in the main body.

## **Gross Domestic Product**

GDP is the most commonly used indicator of national income. It attempts to measure the sum of the incomes received by the various wealth-creating sectors of the economy, from manufacturing and retail to agriculture and service industries. Besides, it is used for some purposes, for instance, economic welfare comparisons, international comparisons of GDP and business cycle assessment and forecasting, etc (Michael Parkin, 2008). There are many ways to define GDP such as Michael Burda and Charles Wyplosz

(Macroeconomics a European Text, 4th) indicated: GDP is the sum of all net final sales within a geographic location during a period of time (usually a year).

According to Makiw, GDP is divided into 4 components (Principles of economics, 7th, 2001, page 499):  $GDP (Y) = C + I + G + NX$

C: consumption (spending by households on goods and services, with the exception of purchases of new housing)

I: investment (spending on capital equipment, inventories, and structures, including household purchases of new housing)

G: government purchases (spending on goods and services by local, state, and federal governments)

NX: net exports (spending on domestically produced goods by foreigners (exports) minus spending on foreign goods by domestic residents (imports))

Nominal GDP is GDP evaluated at current market prices

Real GDP is GDP evaluated at the market prices of some base year

Nominal GDP = P current year x Q current year

Real GDP = P base year x Q current year

In which, P: price of goods and services

Q: total final goods and services

GDP per capita is an approximation of the value of goods produced per person in the country. Thus, ' GDP per capita tells us the income and expenditure of the average person in the economy' (Principles of economics, 7th, N. Gregory Mankiw, 2001, p. 504)

## **Standard of living**

The standard of living is a measure of economic welfare. It generally refers to the availability of scarce goods and services, usually measured by per capita income or per capita consumption, calculated in constant dollars, to satisfy wants rather than needs. Improvement in standard of living can result from improvements in economic factors such as productivity or per capita real economic growth, income distribution and availability of public services, and non-economic factors, e. g., protection against unsafe working conditions, clean environment, low crime rate, etc. It incorporates material comfort, ease of living, and opportunities for personal satisfaction. When we mention to standard of living, it is important to analyze some factors such as:

**Social Health:** Medicine cares per person, hospital beds, life expectancy rate, infant mortality, teenage births, unemployment, etc.

**Environment:** water pollution, air pollution, etc.

**Infrastructure:** transportation, leisure centers, etc.

## **Limitations of GDP in measuring the standard of living**

### **Unpaid work: household production; volunteer work and community services**

GDP focus on goods and services sold in the market creates a measurement problem. In the social, there are a large number of activities do not enter the market like housework, home care, volunteer work and community service etc..., but these things are virtual for well - being. We can see the value of these tasks performed at home and in the community in which no money is exchanged: Simply joining in housework or enjoying a picnic in the park with family or friends is leisure time, added to well - being. Besides, volunteer, who are spending their time and energy to do the social jobs, are gratified in showing the love and care for human. Thus, a society in which children run recklessly in the street without guidance, elder citizens are left to die in their beds, lonely and un - care or public places are a hangout for drug dealers could not in high standard of living. Therefore, real GDP per capita increasing does not mean the living standard is growing up. Overall, the activities that are affected the living standard of community do not involve market transactions and therefore are not reflected in GDP.

## **Changes in the quality of life**

### **Environment:**

According to Perkins, GDP is a measure of goods and services produced by an economy (Economics of development, 2006) but it is not deducted the cost of ' bad' society produces like pollution, natural resources. If a soap or tobacco pollutes the air and water resource, the value of soap/tobacco product is included in GDP while the costs of pollution are not deducted. The

environment is directly affected by the economic activity such an industry or agricultural sector like exhausted fume, deforestation, polluted air and water, etc. If we have a high real GDP, the environment damages, we could not hope to have a good standard of living.

Table 1: Air pollution in China Sources: World Bank Statistics

## **City**

### **City population**

### **Particulate matter**

### **Sulfur dioxide**

### **Nitrogen dioxide**

### **thousands 2005**

### **micrograms per cubic meter 2004**

### **micrograms per cubic meter 1995-2001**

### **micrograms per cubic meter 1995-2001**

Beijing

10, 717. 00

89. 00

90. 00

122. 00

Changchun

3, 046. 00

74. 00

21. 00

64. 00

Chengdu

4, 065. 00

86. 00

77. 00

74. 00

Chongqing

6, 363. 00

123. 00

340. 00

70. 00

Kunming

2, 837. 00

70. 00

19. 00

33. 00

Nanchang

2, 188. 00

78. 00

69. 00

29. 00

Shanghai

14, 503. 00

73. 00

53. 00

73. 00

In recent years, China is one of the countries have higher economic growth and China's GDP figure is standing in the top five – largest countries. For instances, China achieved real GDP growth around 10 percentage from 2004 until 2008.

Table 2: China's main indicators Source: World Bank Statistics



The more economy is going up, the more pollution is increasing. We can see in Table1; Beijing, Shanghai and Kunming are the big cities in China and have highly – developed industrial rate. Almost China’s cities (referred in Table 1) do not reach WHO air quality. Hence, Production in the industry sector is added to GDP contributing the higher GDP, whereas, pollution from industry sector is ignored and is not deduced.

Although the expenditure to improve the environment is added to GDP, it does not mean that the standard of living is increasing. Generally, GDP does not mention to environment which is one of the important indicators to measure the standard of living.

### **Health: life expectancy and infant mortality...**

Life expectancy and infant mortality also are to evaluate the standard of living. Similar to environment, these factors are not clearly showed up in real GDP. A higher real GDP enables us to spend more money to medical research, health care; and contribute to lengthen our life expectancy.

Besides the good point in a higher real GDP that we have just seen, the human has to face new healthy and life expectancy problems every year. People died in AIDS, drug abuse and cancer ...increase. Although the operation of spending money to medical research and other equipment is made a higher real GDP, we can see that real GDP growth overstates the improvements in welfare.

### **Leisure time and happiness**

Thus, leisure time and happiness are the factors that add to standard of living but it is difficult to show these things though GDP. Our time spent

working is valued as part of GDP, while, our leisure time is not. The more time we spent on working, the higher GDP we got. To the contrary, we have less time to enjoy the life, it means leisure time decreases.

## **Economic equality and social justice**

According to Parkin (Economics, 3th, p. 21. 21), a country might have a large real GDP per person, but with a high degree of inequality. GDP could show the income of society in general but could not show the gap amongst citizens: some people might be wealthy, whereas others live in poverty and unemployed. If income distribution is very uneven, then despite high per capita availability of commodities, large numbers of persons may have a very low standard of living and other very high standard – valid comparisons can be made only among reasonably homogeneous groups. Vietnam is considered one of the countries has the highest GDP growth in recent years. However, the gap living standard between urban and rural area is quite large and this trend is increasing.

GDP (2008): \$84. 98 billion, real growth rate (2008): 6. 23%, per capita income (2008): \$1, 024

GDP (2006): \$61 billion, Real growth rate (2006): 8. 3%, per capita income (2006): \$726.

(Source: US Department of State)

So, even GDP is increasing we could not accurate residents have better off well – being or worse off well – being.

Additionally, some countries have the same amount of real GDP but standard of living is quite different. It would be wrong to assume that higher per capita GDP means higher income for all, or even most families. According to Perkins (Economic of development, 2006), there are several reasons in this case: The Government promotes economic growth not just to improve the welfare of their citizens but also to augment the power and glory of the state and its rulers like expanding their militaries, developing weapons of mass destruction. When the gains from growth are channeled to such expensive projects, they often provide little benefit to the country's citizens. Or other reason, resources may be heavily invested in further growth, with significant consumption gains deferred to a later date.

### **Underground economic activity**

Underground economy is a part of the economy that purposely hidden from the view of the government (Parkin M., Economics, 8th, 2008, p. 494 – 495). It includes the production that uses illegal labour, jobs done for cash to avoid paying income taxes, etc. It is depended on the economic that these activities are large or small. Sometimes, these activities are large so we could not know exactly income per population or the leisure time they have.

### **Inflation and Population**

Inflation and population also affect on the GDP to measure the standard of living, especially when comparing GDP between other period in one country or other countries. For instance, if we see GDP of two countries and said that this country is better than other is wrong because it depends on population.

Like Indian and Norway: Indian has higher GDP than Norway, but when we compare GDP per capita is different because Indian population is bigger than <https://assignbuster.com/gdp-failure-to-measure-standard-of-living-economics-essay/>

Norway. Although GDP is not perfect to measure the standard of living, it has some good affects that we will mention in the next paragraphs.

## **The balance between consumption and investment**

We need to analyse the balance between consumption and investment. If an economy devotes too many resources to satisfying the short run needs & wants of consumers, there may be insufficient resources for investment needed for long term economic development.

Faster economic growth might improve living standards today but lead to an over-exploitation of scarce finite economic resources thereby limiting future growth prospects.

## **Purchasing power – differences in the cost of living between countries**

Data on relative standards of living is normally adjusted to reflect estimates of purchasing power parity to take account of differences in the cost of living – so that each unit of currency has (approximately) the same purchasing power. One Euro of income in each country may not have the same real purchasing power because of differences in the average cost of living. For example, relative prices of a basket of goods and services for consumers in Britain are estimated in 2003 to be 18% higher than the EU15 average. The Scandinavian countries have significantly higher prices whereas Mediterranean countries have relative price levels less than four fifths of the EU average. As the following passage makes clear, movements in the exchange rate also have an effect on the relative cost of living in different locations around the world.

## **GDP measure the standard of living**

GDP measure both the economy's total income and the economy's total expenditure on goods and services. Moreover, GDP per capita show the average amount of income that each individual of the population potentially has access to. The more money each individual is able to access, the higher the potential standard of living they have. And ' because most people would prefer to receive higher income and enjoy higher expenditure, GDP per capita seems a natural measure the standard of living' (N. Gregory Mankiw, Principles of economics, 7th , page 504).

There are difficult to measure the standard of living as it consists of huge factors like healthcare, educations, life expectancy, etc... We only can approximate. GDP fairly estimates the standard of living in the economy to help the Governments fulfil their policy and compare to other economies. So, GDP is a rough guide to living standards. We could not ignore that a large GDP does in fact help us to lead a good life. GDP does not measure the leisure time, the health of citizens but with a higher GDP, Government can afford better conditions for all of these things.

Table 5: Source: World Development Indicators

## **Liberia**

## **Japan**

## **Japan**

**2006**

**2005**

**2006**

Population, total (millions)

3. 6

127. 77

127. 77

Population growth (annual %)

3. 9

0. 06

0. 00

Life expectancy at birth, total (years)

49. 3

82. 00

Mortality rate, infant (per 1. 000 live births)

157

2. 80

Literacy rate, youth female(% of female ages 15-24)

69. 5

Prevalence of HIV, total (% of population ages 15-49)

1. 4

GDP per capita (current US \$)

333. 239

30, 310. 34

32, 040. 05

Liberia is one of the poorest countries with low GDP per year. Even the Government wants to improve the health – care, they could not do their purpose properly because of limited their resources like budget. And, Japan is one of the highest GDP countries with GDP per capita 2006 about \$ 32, 040. 05 and higher than Liberia around 10 times. We can see the different between two countries that have a huge gap in GDP: in 2006, Average life expectancy at birth in Liberia was 49. 3 ages, whereas, this index in Japan was 82. Infant mortality rate in Liberia was 157 deaths per thousand live births, comparing to this rate in Japan was 2. 8 deaths per thousand live births.

Hence, it could be said that higher GDP is one of the indicators to improve health-care and then improve the living standard of countries. Therefore, Higher GDP is still a main purpose of poor countries.

Moreover, GDP does not measure the quality of education, but with a larger GDP nations can afford better education systems. America is one of the countries stayed the highest standard of living with a high GDP. As we mentioned before, Japan has a high real GDP, so how Japan's education is suitable for this indicator.

Table 6: Source: OECD Statistics

Expenditure on educations was 4.92 percentages of GDP 2005 (around \$ 190,540 millions) that was larger than GDP of Liberia 2006 many times (according to table 6).

Addition to higher GDP, it means citizens have higher income, they will have more choices to choose the luxury place for holiday and their leisure will be enjoyed with higher condition. All the material necessities of life are become easier for citizens.

Table 8: Source: OECD Statistics

That is the reason why Mankiw said that 'GDP does not directly measure those things that make life worthwhile, but it does measure our ability to obtain the inputs into a worthwhile life' (Principles of economics, 2001, page 505).



Overall, as we discussed about both sides of GDP, it is clear that in some cases GDP is a good measurement of standard of living but not all. To measure the standard of living we will comment some indicators besides real GDP:

## **Alternative measures:**

### **The Genuine Progress Indicator (GPI)**

GPI as an alternative to the gross domestic product (GDP), ' The GPI enables policymakers at the national, state, regional, or local level to measure how well their citizens are doing both economically and socially'.

The GPI starts with the same date that the GDP is based on, but GPI cover some points that GDP diminished like household and volunteer works, costs of crime and pollution. Measure that makes up GPI includes:

Income Distribution

Housework, Volunteering, and Higher Education

Crime

Resource Depletion

Pollution

Long-Term Environmental Damage

Changes in Leisure Time

Defensive Expenditures

Lifespan of Consumer Durables & Public Infrastructure

Dependence on Foreign Assets

## **The Human Development Index (HDI)**

The Human Development Index is a summary measure of human development. It includes three basic aspects of human development: health, knowledge, and a decent standard of living:

A long and healthy life

Access to knowledge

A decent standard of living

$HDI = 1/3 (\text{life expectancy index}) + 1/3 (\text{education index}) + 1/3 (\text{GDP index})$

The HDI has had a significant impact on drawing the attention of governments, corporations and international organizations to aspects of development that focus on the expansion of choices and freedoms, not just income.

## **Happy Planet Index**

The South Pacific island nation of Vanuatu is the happiest place on the planet according to the Happy Planet Index, has been constructed by the New Economics Foundation and Friends of the Earth using three factors: life expectancy, human wellbeing and damage done via a country's "environmental footprint". The UK's heavy ecological footprint, the 18th biggest worldwide, is to blame for the country's low rating in the index. Life

satisfaction varies greatly from country to country: questioned on how satisfied they were with their lives, on a scale of one to 10.

Source: Adapted from the Guardian, 12th July 2006 and BBC news online

## **Conclusion**

In conclusion, this essay has sought to find out the answer for the criticism of 'real GDP is failure to adequate measure the standard of living'. Whether GDP is failure or not, we do know that everything has negative and positive sides. GDP does not include the value of unpaid work, nor does it capture the quality of the environment or public healthcare. However, GDP estimates the economic growth and guides the standard of living. Thus, a higher GDP statistic is showed our ability to produce more and ultimately to consume more in the future. N. Gregory Mankiw view is that GDP is a good measure of economic well – being for most but not all purposes... GDP is just showed some views of standard of living, it is a reason why real GDP is increasing criticized for its alleged failure to adequate measure the standard of living.