**Question 2**

**Comment on the difficulties of making comparisons of living standards between countries and over time. (Problems of time and space comparison)**

**Introduction**

Due to the differences in the demographics and structures of different countries, there are bound to be discrepancies when comparing the standard of living. Similarly, if various factors of change were not taking into account when comparing the standard of living over time, inaccuracy would inevitably occur. As such, it would be pertinent to note that issues such as population changes, income distribution, undeclared economic activities, composition of national income, quality of life and the differences in the cost of living between countries are all various factors that affect comparison.

**Main Body**

Population changes need to be taken into consideration in calculating national income. This is because although real income tells us about the total output of an economy, it does not tell us what is happening to the standard of living of a representative person of a country. As such, per capita real income or real income per head has to be used to measure material welfare correctly. Real national income per head is determined by dividing the total national income by the country’s population. Hence, if there is a growth in national income that is greater than the growth in population levels, then we can conclude that the standard of living of the country has improved.

Income distribution is vital because even though national income per head has increase, we still cannot say that everyone in the country is better off without knowing how the real income is distributed. To have a more accurate measurement of welfare, we need to supplement real national income per head figures with data on how an increase in real national income is distributed among the members of the population. This said, the distribution of income of two countries might differ widely even if they have similar levels of per capital income. In this case, there will be differences in the actual standard of living for the population for both countries – even though the average standard of living measured by per capita income was equal.

Undeclared economic activities can seriously undermine calculation as the national income figures does not reflect the true change in the quantity of goods and services that consumers can enjoy. Examples of undeclared economic activities includes the evasion of paying tax and illegal activities like gambling, etc. hence, if the underground economy is growing relative to the legal economy, national income figures would understate the material standard of living of the population. If the size of the hidden economy is relatively constant, the rate of economic growth may be calculated reasonably. However, even a stable sized hidden economy makes it difficult to make international comparisons of economic growth rates. This is because the size of the hidden economy differs greatly and may be also influenced by other things such as the rate of taxes.

The composition of national income must also be taken into consideration when calculating the changes in standard of living. This is because a rise in national income does not determine a rise in standard of living. For example, during a war, output may rise due to the production of more weapons but the standard of living cannot be said to have increase. Also, developing countries such as Sri Lanka and India have a large subsistence agricultural based sector that constitutes a large proportion of the countries’ GNP. They grow their own crops for domestic usage but such figures are not captured. Thus, the existence of a relatively large non-monetary sector in such economies may grossly underestimate the country’s NNP compared to developed countries where transactions are based in monetary terms.

Quality of life needs to be accounted for because a rise in standards of living may come with certain negative externalities. For example, if national income were to increase simultaneously with the average number of working hours, then the quality of life has not improved. Other externalities such as rise in pollution, crime, etc, also constitute part of it. Also, national income figures may fail to consider the number of leisure hours enjoyed by the population. For example, though Japan has a very high national income, they work very long hours and seldom take holidays so their actual standards of living may be overstated as compared to other countries. The life expectancy rates, education levels, etc will also be different for different countries, thus, when there is a substantial difference between countries, then national income would not provide an accurate basis of comparing standard of living between countries.

**Conclusion**

Lastly, there is also the problem of fluctuation of the exchange rate. To compare standards of living between countries, it is necessary to convert real national income per head into a common currency. If a country’s exchange rate strengthens against the common currency, the real per capita income will be over-valued and thus distort the measurement of standard of living. Though this problem can be resolved by the use of Purchasing power parity, which is the exchange rate based on price levels of the two countries.