# World Bank International Comparison Program

<http://go.worldbank.org/YVRZDKSAT0>

Understanding the factors that affect levels of economic and social development in countries, and monitoring poverty reduction at the global level requires measures that convert indicators such as GDP and other economic statistics measured in national currencies, into a common accounting unit, typically the United States Dollar. Because market exchange rates are based on short-term factors and are subject to substantial distortions from speculative movements and government interventions, comparisons based on exchange rates, even when averaged over a period of time such as a year, yield unreliable and misleading results.

The problems associated with comparing indicators of social and economic development across countries have been known for some time, as have the shortcomings associated with the use of exchange rate conversion factors. Indeed it was the recognition of these problems by the international community in the sixties that first gave rise to the ICP, with a view to generating PPP data. By establishing purchasing power equivalence, where one dollar purchases the same quantity of goods and services in all countries, PPP conversions allow cross-country comparisons of economic aggregates on the basis of physical levels of output, free of price and exchange rate distortions.

<http://www.imf.org/external/pubs/ft/fandd/2007/03/basics.htm>

One of the two main methods of conversion uses market exchange rates—the rate prevailing in the foreign exchange market (using either the rate at the end of the period or an average over the period). The other uses the purchasing power parity (PPP) exchange rate—the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country.

To understand PPP, let's take a commonly used example, the price of a hamburger. If a hamburger is selling in London for £2 and in New York for $4, this would imply a PPP exchange rate of 1 pound to 2 U.S. dollars. This PPP exchange rate may well be different from that prevailing in financial markets (so that the actual dollar cost of a hamburger in London may be either more or less than the $4 it sells for in New York). This type of cross-country comparison is the basis for the well-known "Big Mac" index, which is published by the*Economist* magazine and calculates PPP exchange rates based on the McDonald's sandwich that sells in nearly identical form in many countries around the world.