

Improved PPP Extrapolation Approaches

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The International Comparison Program (ICP) is a worldwide statistical initiative designed to estimate Purchasing Power Parities (PPPs) that can be used as currency converters to compare the performance of economies around the world. PPP exchange rates are the currency ratios that compare the cost of identical baskets of goods and services globally. The ICP collects detailed information on price levels in economies worldwide. Volumes estimated using PPPs enable levels of economic activity in different countries to be compared thereby providing in-depth views of the distribution of resources worldwide. Market exchange rates are often used to make such comparisons but they generally produce distorted results because they are influenced mainly by factors such as international trade in goods and services, interest rates and financial flows between countries. On the other hand, PPPs take into account the actual price levels prevailing in a country by directly comparing them with the prices for similar products in other countries. The ICP conducts surveys every five/six years to collect price and expenditure data for all goods and services that make up the Gross Domestic Product (GDP) in order to calculate the PPPs. The PPPs are utilized to adjust the GDP of different countries, initially expressed in each country's national currency, to a common currency so that their volumes of final goods and services purchased can be directly compared. There is a considerable demand for PPPs evidenced by their large and diverse applications by development organizations, governments, corporations, and myriad others. The demand for global statistics has increased and along with it the need for open and timely data. A setback to the current ICP process is the publication lag between benchmark ICPs, which are held every five/six years. As a result, PPPs are extrapolated from the latest ICP benchmark, for example through the Penn World Tables and the World Development Indicators. These publications extrapolate PPPs at high levels (GDP or its main aggregates). The World Bank is exploring new approaches to improve the extrapolation method currently used in the World Development Indicators. This paper describes the proposed improved PPP extrapolation approaches and highlights the issues associated with extrapolating PPPs from a benchmark year to later years and in interpolating between benchmarks.

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