When it comes to comparing two countries, we usually think about the standard of living in both countries. Well, I hail from the economically prosperous land of Singapore. Hypothetically, if I were to move to another country, for example neighbouring Malaysia, I would first consider the standard of living there. We can derive the standard of living in many different aspects. Would I move to Malaysia if the standard of living there were lower than in Singapore?

Today, we will discuss what exactly the standard of living is. We will also talk about how we can determine the standard of living in each country and compare between different countries.

What is Standard of Living?

In economics, the standard of living of a country is defined as the well-being of the residents in that country. There are two aspects of the standard of living – the material and the non-material aspects. Material well-being is derived from consumers consuming goods and services. On the other hand, non-material well-being is derived from intangibles. Some of these intangibles include the freedom levels and security in the country.

The government's primary goal is to improve the standard of living of citizens living in the country. This is done by achieving a favourable balance of trade, full employment, price stability, and sustainable and inclusive growth. With all these macroeconomic goals fulfilled, the standard of living in society will increase over time.

National Income

National income refers to the total income a country earns from producing its final output within a given period. The national income of a country is equal to its national expenditure and national product. This means that all three are of the same value, but why is this so?

The value of a country's output must be equal to the amount of money that the country spends on it. This makes the national expenditure equivalent to the national product. When the national output is produced, factors of production (FOPs) are employed. They are then paid in factor income, which is the national income. As such, the national income, the national expenditure, and the national product of a country have the same value.

With that, we can calculate the national income of a country via three methods. Firstly, we can add up the factor income of all the FOPs in the country. This gives the value of the national income. Next, we can evaluate the amount of money spent on buying the output produced by that country. We can then obtain the amount of national expenditure. Lastly, we can calculate the values of all the final goods and services across economic sectors in that country. This is the national output value.

Measuring Standard of Living (National Income)

Gross Domestic Product (GDP)

Before we begin, let us first define GDP. GDP is the value of all final goods and services produced by FOPs within the geographical boundaries of a country. The value refers to the area bound by the aggregate demand curve between the price and the quantity. GDP is measured during a given period – this is usually done annually.

When we determine a country's GDP value, we count the value of all final goods and services within the geographical borders of that country. Therefore, it does not matter if a foreigner owns the FOPs.

You may have heard of the terms “real GDP” and “nominal GDP”. Real GDP refers to the GDP value at a constant price, accounting for inflation. On the other hand, nominal GDP refers to the GDP value measured using current market prices in that year.

You may also have heard of “GDP per capita”. This means the value of GDP per person living in that country. Essentially, it measures the average income of the country. We can use the following formula:

GDP per capita = GDP ÷ total population

Gross National Income (GNI)

GNI is similar to the GDP in determining the value of all final goods and services. However, residents of that country must own the FOPs producing the goods and services. The factors may be located within the country or overseas – it does not matter at all!

That said, residents who earn factor income from outside the country are considered in the country’s GNI value. For example, the South Korean company Samsung has investments worldwide. These investments will then go back to South Korea, where the South Korean owners of the company will then receive. This will be counted in South Korea’s GNI. To calculate the GNI of a country, we can apply this formula:

GNI = GDP + factor income from abroad – factor income paid abroad

The formula gives the GDP and the net factor income from abroad.

Human Development Index (HDI)

The HDI is a composite index that accounts for a country’s education, life expectancy, and income. It measures both the material and non-material well-being of residents in a country. It aims to emphasise that economic growth alone is not enough to assess a country’s development. The HDI values have a range of between zero and one. The closer the value is to one, the more developed the country is.

Earlier, I mentioned whether I would move to Malaysia if the standard of living there were lower than in Singapore. As Malaysia has a lower HDI than Singapore, I would be unlikely to do so. Malaysians, please do not be offended just yet – I will now explain the flaws in the

HDI system that will make me consider further.

Comparing Standard of Living within a country

In most cases, the real national income per capita is used to compare residents' standard of living within a country. This includes the changes in the population of that country and accounts for inflation rates. However, this method of comparison is flawed as well.

The most crucial flaw of this system is that it does not account for residents' non-material standard of living. With economic activities, there are many negative externalities produced. As such, while residents' material standard of living may have increased, the same cannot be said for the non-material aspect. For example, citizens may also spend more time at work or work harder.

Other issues include the government being unable to obtain accurate information on the country's economy. This consists of the underground economy, which includes illegal and undeclared legal activities. As such, the national income derived is lower than it actually is. On top of that, the real GDP per capita is the average income for every citizen in the country.

Therefore, increasing the real GDP per capita does not mean that every citizen now earns more. As such, the measurement does not consider the income distribution. This, however, can be supplemented by using the Gini coefficient.

Comparing Standard of Living between countries

To compare residents' standard of living in different countries, we use the national income per capita. However, this is very difficult as this measurement has many issues.

Different governments will collect data differently. As such, we are unsure whether the national income of both countries is correct. Both countries also have different levels of income inequality and spend on other economic sectors. Once again, the non-material standard of living is neglected as well.

Another problem is the use of different currencies. In most cases, the GDP per capita is calculated with a single currency – the US Dollar. However, with exchange rates that are constantly changing, the GDP may not be calculated accurately. Moreover, exchange rates do not show the relative price differences between both countries. This is solved by using the Purchasing Power Parity (PPP) rate.

Conclusion

That was a lot of information to take in! However, the most important thing here is that when we calculate residents’ standard of living in a country, we should not forget the non-material aspect. After all, money is not everything.