# Is per capita income a true measure of economic development

Per capita income is a measure of the amount of money earned per person in a nation or geographic region. Per capita income can be used to determine the average per-person income for an area and to evaluate the standard of living and quality of life of the population. Per capita income for a nation is calculated by dividing the country's national income by its population. Per capita income counts each man, woman, and child, even newborn babies, as a member of the population. This stands in contrast to other common measurements of an area's prosperity, such as household income, which counts all people residing under one roof as a household, and family income, which counts as a family those related by birth, marriage, or adoption who live under the same roof. The United States Census Bureau takes a survey of income per capita every ten years and revises its estimates every September. The Census takes the total income for the previous year for everyone 15 years and older and calculates the median average of the data. The census includes earned income (including wages, salaries, self-employment income), interest income, dividends as well as income from estates and trusts, and government transfers (Social Security, public assistance, welfare, survivor and disability benefits). Not included are employer-paid healthcare, money borrowed, insurance payments, gifts, food stamps, public housing, capital gains, medical care, or tax refunds.  According to 2020 Census data, the national per capita income for the year was $39,052 in 2020. We can see, from the U.S. Census Bureau, that the per capita income is lower than the median household income of $67,521 in 2020. Each metric has its advantages. Per capita income is helpful when analyzing a large number of people, such as the population of the United States, which stands at more than 330 million. Median household income is helpful when determining the level of income disparity and poverty in a certain area as the median number eliminates outlier income figures that could skew the data set. Per capita income is a measure of the amount of money earned per person in a nation or geographic region.Per capita income helps determine the average per-person income to evaluate the standard of living for a population.Per capita income as a metric has limitations that include its inability to account for inflation, income disparity, poverty, wealth, or savings. Perhaps the most common use of income per capita is to ascertain an area's wealth or lack of wealth. For example, income per capita is one metric the U.S. Bureau of Economic Analysis (BEA) uses to rank the wealthiest counties in the United States, the other being median household income. Per capita income is also useful in assessing an area's affordability. It can be used in conjunction with data on real estate prices, for instance, to help determine if average homes are out of reach for the average family. Notoriously expensive areas such as Manhattan and San Francisco maintain extremely high ratios of average home price to income per capita. Businesses can also use per capita income when considering opening a store in a town or region. If a town's population has a high per capita income, the company might have a better chance at generating revenue from selling their goods since the people would have more spending money versus a town with a low per capita income. Although per capita income is a popular metric, it does have some limitations. Since per capita income uses the overall income of a population and divides it by the total number of people, it doesn't always provide an accurate representation of the standard of living. In other words, the data can be skewed, whereby it doesn't account for income inequality. For example, let's say a town has a total population of 50 people who are earning $500,000 per year, and 1,000 people earning $25,000 per year. We calculate the per capita income as ($500,000 * 50) + (1,000 * $25,000) to arrive at $50,000,000 in total income. When we divide $50,000,000 / 1,050 (total population), the per capita income is $47,619 for the town. However, the per capita income doesn't give us a true picture of the living conditions for all of those living in the town. Imagine if federal aid or public assistance was provided to towns based on per capita income. The town, in our example, might not receive the necessary aid such as housing and food assistance if the income threshold for aid was $47,000 or less. Per capita income doesn't reflect inflation in an economy, which is the rate at which prices rise over time. For example, if the per capita income for a nation rose from $50,000 per year to $55,000 the next year, it would register as a 10% increase in annual income for the population. However, if inflation for the same period was 4%, income would only be up by 6% in real terms. Inflation erodes the purchasing power of the consumer and limits any increases in income. As a result, per capita income can overstate income for a population. The cost of living differences can be inaccurate when making international comparisons since exchange rates are not included in the calculation. Critics of per capita income suggest that adjusting for purchasing power parity (PPP) is more accurate, whereby PPP helps to nullify the exchange rate difference between countries. Also, other economies use bartering and other non-monetary activity, which is not considered in calculating per capita income. Per capita income doesn't include an individuals savings or wealth. For example, a wealthy person might have a low annual income from not working but draws from savings to maintain a high-quality standard of living. The per capita metric would reflect the wealthy person as a low-income earner. Per capita includes children in the total population, but children don't earn any income. Countries with many children would have a skewed result since they would have more people dividing up the income versus countries with fewer children. The welfare of the people isn't necessarily captured with per capita income. For example, the quality of work conditions, the number of hours worked, education level, and health benefits are not included in per capita income calculations. As a result, the overall welfare of the community may not be accurately reflected. It's important to consider that per capita income is only one metric and should be used in conjunction with other income measurements, such as the median income, income by regions, and the percentage of residents living in poverty. “Development can be seen as a process of expanding the real freedoms that people enjoy.” Amartya Sen Economic growth assesses the expansion of a country’s economy. Today, it is most popularly measured by policymaker and academics alike by increasing gross domestic product, or GDP. This indicator estimates the value added in a country which is the total value of all goods and services produced in a country minus the value of the goods and services needed to produce them. It is common to divide this indicator by a country’s population to better gauge how productive and developed an economy is – the GDP per capita. A brief history of growth and GDP The idea of economic growth stems from classical economics where growth in national income represents the growth in the wealth of a nation – the classical hallmark of success. The concept of economic growth gained popularity during the industrial revolution, when market economies flourished. In the 1930s, Nobel laureate, Simon Kuznets wrote extensively about national statistics and propagated the use of GDP as the measure of the national income of the US. However, Kuznets took this measure with a pinch of salt and wrote, “The national income total is thus an amalgam of relatively accurate and only approximate estimates rather than a unique, highly precise measurement” (Kuznets, 1934). Against the backdrop of a bloody world war, governments were on the look for analytical tools to raise taxes to finance the newly minted war machine. It was at the 1944 Bretton Woods conference that GDP became the standard tool for measuring a country’s economy. Right from the classicals to the neo-classicals, the idea of development was intertwined with economic growth, i.e. accumulation of wealth and production of goods and services. Finally, it was at the end of World War II in 1945 that the notion of developing nations came to the fore of public policy. US President Harry Truman, at his inaugural address in 1949, defined a larger part of the world as “underdeveloped areas” and stated that development should be based on “democratic fair-dealing” (Truman announces Point Four program). Today, the predominance of GDP as a measure of economic growth is partly because it is easier to quantify the production of goods and services than a multi-dimensional index can measure other welfare achievements. Precisely because of this, GDP is not, on its own, an adequate gauge of a country’s development. Development is a multi-dimensional concept, which includes not only an economic dimension, but also involves social, environmental, and emotional dimensions. Towards inclusive and sustainable growth One of the limitations of GDP is that it only addresses average income, failing to reflect how most people actually live or who benefits from economic growth. Thomas Piketty (2014) presents a two-fold theory on how the wealth of a society becomes more concentrated and why this is counterproductive to development: The first law posits that inequality rises when the rate of return of capital (profits, dividends, interests and rents) is larger than the rate of economic growth. The second law posits that sustained increases in the capital-to-output ratio concentrates income in the hands of the owners of capital to the detriment of workers (return of capital surpasses the return of labour, i.e. wages). Piketty analyses an extensive trove of data sets, although limited to developed countries only. He claims that these laws explain the market failures inherent to capitalism. These failures should be corrected through government intervention in the form of: increasing the public provision of goods and services, a robust social safety net, and progressive taxation of income and wealth. If left unchecked, growing inequalities can not only slow down growth, but also generate instability and disorder in society, posing a threat to the very foundation of liberal democracy. The consequence of the rich accumulating ever more capital and wealth, is that economic and, consequently, political power become increasingly concentrated in the hands of a wealthy few. This skews policy making processes towards overly representing the interests of these wealthy elites. Therefore, a growing GDP cannot be assumed to necessarily lead to sustainable development. On the other hand, there is good criticism of Piketty’s so called ‘fundamental laws of capitalism’ on the grounds of savings and depreciation rates miscalculations (Mankiw, 2015; Milanovic, 2016). Alternate measures The Human Development Index One expanded indicator, which attempts to measure the multi-dimensional aspect of development, is the Human Development Index (HDI), conceived by the United Nations Development Programme (UNDP). Mahbud ul Haq and Amartya Sen developed the index, which is better suited to track the progress, not only of rich, but also of poor nations. The first report on HDI was conducted in 1990. It incorporates the traditional approach to measuring economic growth, as well as education and health, which are crucial variables in determining how developed a society is. This is calculated through a geometric mean of GDP per capita, life expectancy at birth, and the average between mean years of schooling and expected years of schooling. The Human Capital Index On 11th October 2018, The World Bank launched the Human Capital Index (HCI). This newly created index ranks 157 countries’ performances on a set of four health and education indicators according to an estimate of the economic productivity lost due to poor social outcomes. The main benefit is that it focuses on outcomes, rather on inputs, analogously to the Social Progress Index (SPI) and unlike GDP. For example, educational quality as measured by actual adjusted learning is weighted more appropriately against years of schooling. The main criticism to the HCI is that it might end up overvaluing the material benefits of education and health, thus commoditising people, instead of their societal contributions and their inherent aspect of being basic human rights. Notwithstanding, it is expected that mainly developing countries will make use of the HCI in order to quantify the results of social sector investments, thus increasing spending on human development (health, education, social security, etc.), which the World Bank argues have been forgotten at the expense of infrastructure and institutional development. The Social Progress Index There is arguably a better way of measuring societal development: the SPI. The SPI was developed by the non-profit, Social Progress Imperative. It is one of the outcomes of the Commission on the Measurement of Economic Performance and Social Progress – or simply, Stiglitz-Sen-Fitoussi, after its leaders. The main objective of the Commission was to investigate how the wealth and social development of countries could be measured beyond the uni-dimensional GDP measure. It is still a relatively new indicator, with data only for four years, however it covers a wide span of more than 130 countries. The SPI is a refinement of the HDI because it expands the number of composite indicators from only four to fifty-four in a wide array of areas, including basic human needs, foundations of well-being, and opportunities to progress. Therefore, this index is capable of synthesising the most relevant aspects that determine development. For example, access to water and sanitation, educational and health outcomes, public criminality, housing, access to information, and communication. Naturally, the main drawback of the SPI is its comparatively large complexity and lack of practicality when used to inform policy making. Facets of the SPI 1. Economic growth as freedom The view underlying the SPI pays tribute to Sen’s (2000) conceptualisation of economic growth as not an end in itself, but rather, an effective means of expanding personal and societal freedoms – the impact it has on people’s lives. For example: political liberties in the form of freedom of expression and free elections, government transparency and accountability, personal security/safety, and access to economic opportunities such as participation in trade and production. Therefore, development consists of the elimination of deprivations of liberty that limit the choices and opportunities of persons to exercise their agency in their own lives. 2. A multi-dimensional development perspective The great added value of the SPI is that it combines various indicators of subjective components that are often eschewed from the economic debate. These include: political rights, freedom of expression, assembly and religion, the level of corruption, tolerance for, and discrimination and violence against, minorities and immigrants. No single aspect of the index demotes a country. Instead, a combination of variables provides expanded insight into the level of development of a country. It is not surprising that developed countries top the table, however, some of the richest countries in terms of GDP are still lagging behind in certain developmental variables. Some disappointing scores come from the US, France, Italy, Russia, Brazil and China. 3. Economic growth versus development There are three main explanations why countries underperform in relation to the size of their economies: They have a sizeable contingent of poor people, Wealth and income inequality is high and/or growing, and Environmental degradation has not been properly addressed. Although the third is captured by the SPI, the two former explanations are not. Poverty and inequality are increasingly being debated in academic literature, not only due to their negative impacts on human development, but because they drag GDP growth. Policy choices, like tax reforms that mostly benefit the rich and non-wage earners (Sammartino, 2017; Burman et al., 2006), are aggravated by recent stylised facts such as a growing gap between real wage growth and labour productivity growth (Mishel, 2012) and stock market bull runs whose proceeds are largely accrued by the rich (Matthew, 2008). Economic growth: for whom? Is the average worker’s life getting any better? Economic growth, measured popularly via GDP, is a complementary indicator to development, but not an adequate indicator when considered on its own. The challenge of modern capitalism is to balance its role as an efficient and effective mode of production with its tendency to concentrate income, wealth and, thus, power. In fact, social progress will lead to economic progress and that is where the SPI is a welcome improvement to development metrics. The measurement of GDP could also be made more robust if it captured, not only physical capital, but also natural and human capital. When dissociated from social progress, economic growth in its pure accounting format (GDP expansion) will inevitably result in less inclusivity and a generalised sense of social discontent, pernicious in democratic societies. Therefore, the current measure of economic growth as GDP has many limitations when used to assess development. Given the multi-dimensional nature of development, the SPI can be seen as a more adequate indicator. In what regards the IGC’s work, in the end of the day, the creation of new indexes and methodologies to measure human and economic development are very welcome, since it will provide us with a wider toolkit to analyse our main subject: economic growth.

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