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THE CURRENT ~~ATTACK ON THE~~ CONSUMER PRICE INDEX

by Teresa Ghilarducci

Recent rates of inflation have reached unprecedented levels threatening the stability of the U.S. economy. While all sectors are affected, the losers in this inflationary period are those with little control over the prices of their products or labor services. Workers, whether employed, out of work, retired, poor, or disabled cannot automatically raise their incomes along with rising prices.

Organized labor's major attempts to keep up with inflation are cost-of-living adjustment clauses (COLAs), which are negotiated in wage and benefit contracts, and legislated in social security and food stamp programs. The Consumer Price Index, which measures the changes in the prices of goods and services bought by American consumers, is used as the barometer of inflation in most COLA clauses. In 1980 approximately nine million public and private workers are covered by some kind of escalator clause. Over 31 million social security beneficiaries receive an annually adjusted COLA mandated by Congress in 1972. And 20 million food stamp beneficiaries also receive cost of living increases.

Some politicians, economists, and employers are demanding an alteration of the Consumer Price Index. Those who must provide the COLA money have two options to save on costs (short of eliminating COLAs altogether). They can pursue policies which either reduce inflation, or change the method of measuring inflation. They consider the latter option more desirable, partly because the policies necessary to stop inflation are both difficult and elusive, and partly because inflation decreases real wages--especially those not subject to COLA.

The most insidious specific proposal comes from an ongoing attack on the CPI's use in indexing social security benefits. For example, Fortune magazine and Pensions and Investments magazine call for the use of the Personal Consumption Expenditures deflator in the Department of Commerce data instead of the CPI, in computing the social security COLA. The PCE is not an index of prices of consumer goods and services. If it had been used last year the increase generated by the social security COLA would have been much smaller.

The most widely publicized attacks on the CPI are currently based on the following myths:

1. MYTH: The CPI market basket of goods and services contains items which consumers have long replaced with cheaper substitutes. Therefore, including changes in the price of steak does not represent the rate of inflation for the consumer who switches from steak to rice and beans.

FACT: This argument sidesteps the meaning and purpose of an index. The CPI measures the cost of maintaining a certain material standard of living by tracking price changes of goods needed to meet that specific standard. Inflation causes consumers on fixed incomes to live at a lower standard. The index measures how much extra income is needed to reach the original standard after inflation. This myth loses even more of its relevance because most past inflation was caused by price increases in essential goods and services such as energy (especially transportation), health care, and food. These have few readily available substitutes.

2. MYTH: The CPI assumes that a family buys a new house every month, so that rising mortgage costs exaggerate the reported overall inflation rate.

FACT: Measuring the costs of "housing services" is very complex. There are many types of housing services and many ways of financing shelter costs. Therefore BLS is continually examining various cost measuring methods, and has concluded that the present procedure of including property taxes, insurance costs, maintenance and repair costs, housing prices, and interest costs in the housing index is the best available method. (This method overestimates housing costs for long-term buyers; it underestimates housing costs for new buyers.)

3. MYTH: The CPI does not regularly take into account price increases that are due to quality improvements of market basket items; thus measured inflation is overestimated.

FACT: The BLS does incorporate estimates of quality changes when it brings the market basket up to date. However, this argument may be more compelling when used the other way around. For every product that has improved, as many or more have declined in quality; thus if anything the CPI underestimates inflation.

The motives and validity of current attacks on the CPI should be regarded with suspicion. In the face of current inflation rates, proposals to revise the index drastically, or to limit its use, or to replace it altogether are merely examples of the ancient and ludicrous practice of killing the messenger who brings the bad news, instead of confronting the message.

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