The current status of the debate on the CPI

por

JACK R. TRIPLETT
Bureau of Economic Analysis and National Bureau of Economic Analysis

SUMMARY

The final report of the Boskin Commission (after its chair Michael Boskin) arrived like a huge boulder that fell into a quiet pool of water. It made enormous splash in the U.S. and the tidal waves and ripples have spread out all over the world. But eight month after the report’s December 1996 publication, the center of the pool where the boulder lended has become almost completely still.

This paper presents some of the reasons why there was no opportunity grasped following the publications of the report. The paper concludes that one opportunity missed is the creation of a more unified economic statistical system. Although Statistics USA is not going anywhere, there are still hope for the future.

1. INTRODUCTION

In this introduction, Jacob Ryten has well, summarized the responses and reactions to the Boskin report by statistical agencies in other countries. It seems appropriate to go back to the country where the current round of worldwide public discussions began and review the current status of the debate on the CPI in the U.S.

To put it succinctly, in the U.S. the CPI issue is dead. I don’t think I’m exaggerating. The report of the CPI Commission (or Boskin Commission, after its chair, Mike Boskin) arrived like a huge boulder that fell into a quiet pool of water. It made
an enormous splash in the U.S., it probably had the greatest public impact -certainly the greatest immediate impact- of any report in the history of economic measurement. The tidal waves and ripples from the report have spread out all over the world, as Jacob Ryten has explained, and have made their own impacts. Now, a scant eight months after the report’s December, 1996 publication, the center of the pool where the boulder landed has become almost completely still.

One reason I say the center is now quiet is the budget accord that has just been reached in the U.S. between the President and the Congress. The agreement contains no provision for adjustments or cuts in the CPI escalator for Social Security payments or the escalator for tax brackets. The CPI has disappeared as a budget issue.

A second measure of stillness in the center of the pond is action on improving the CPI. Some CPI changes are being made, and they certainly go in the right direction. BLS has proposed budget increments far useful improvements -increasing the size of the Consumer Expenditure Survey (the basis for CPI weights) from 5000 to 7500 consumer units, improving processing systems in order to speed up CPI weight changes, computing a superlative index number in five years, and increased data collection on quality change and new products. Though those are clearly improvements, they are relatively small, and it remains to be seen whether they will fare better in the remainder of this year’s budget process than have other proposals for data improvements in past budget cycles.

I thought I would review for this international audience the reasons why the drive to improve or change the CPI, or to change the government escalation formulas that use the CPI, seems to have stalled. Some things can be learned from the experience. I emphasize that this is my personal report from inside the beltway, as it’s said in Washington. My intention is solely to indicate what seems to have transpired and why it transpired. Among the reasons for what happened are some characteristics of the CPI Commissions’s report, which I will point out, but these remarks are not intended as a criticism of the Commission’s reports, or as a review of the substance of the report, even though some comments on the substance are necessary.

2. FIRST ROUND

In the first round of the Washington debate on the CPI, Alan Greenspan proposed some two and a half years ago that Congress could save a lot of money on Social Security by reducing the escalator that tied payments to the CPI because, he contended, the CPI overstated inflation. This was very attractive to Congress because it seemed a way, a politically acceptable way, to cut a very large portion of the budget. It provided o cover, in other words, for an action that many members of
Congress wanted to take and that they felt was necessary to take, but which was politically unpopular.

3. SECOND ROUND

In round two, the Boskin Commission was appointed. The Commission had two charges. First: What is the number by which the CPI overstates inflation?. Second: What should be done to improve the CPI?.

Now, in a very real sense those two charges worked against each other. I suspect that even some members of the Commission would now agree.

The first way they worked against each other is from the political perspective. If economists know what the right inflation number is, why fund improvements in the CPI?.

You didn’t need to spend the money. Indeed, even though members of the Commission have gone out of their way to compliment the professionalism of BLS staff and their contributions to what is known about measurement problems in the CPI, the message that many readers carried away from the Commission’s report was lack of progressiveness, or worse, of the BLS in disposing of the resources that were already at its command.

Second, in Washington, the CPI debate was almost entirely a debate over the number -the Commission’s 1.1 percentage point bias estimate got the headlines. The CPI measurement issues were much too complicated for most members of Congress to understand, too complicated for the press and certainly for most of the public. That wasn’t true of everybody, I do not want to be misunderstood. I heard a presentation by a very influential Congressman who said, as nearly as I recall: “We’ll just give the BLS money to calculate geometric means for the lower level estimator and a superlative index number for the higher level aggregation”. There is sophistication in Congress on these issues, and in the press. But by-and-large it was not the CPI measurement issues that got the public attention, it was the number, the 1.1. That was the news story: Is that 1.1 number “correct”? If you understood Washington, you wouldn’t have expected anything else, which is a second reason why the two charges to the Commission worked against each other.

4. THIRD ROUND

So, round three was a protracted and acromomous public debate over the number. The CPI Commission’s report has a lot of good things in it. But the public
discussion of the report concerned the number almost exclusively, and it was cer-
tainly true that the 1.1 number was vulnerable, vulnerable in the sense that it was
too easy for people to criticize it.

In Washington, and probably in all politics (and for good reasons), when people
find a small error in a number, or in the logic or calculation method for the number, it
diminishes the credibility of other parts of a report. And I think that’s essentially what
happened. In an academic discourse if you have some small number error it is
excused because it is the big picture that counts. But in a public debate it’s often the
small points about a number that matter. Statistical agencies understand that very
well: Making an error in your number is much more publicly damaging than making
an error in your procedure.

Part of the 1.1 bias estimate was noncontroversial - the roughly 0.5 percentage
point of substitution and other technical biases. It was the 0.6 point estimate of
quality change bias that attracted public criticism. We read in the press, for example,
of real estate agents who understood (to put the matter into economists’ language)
that no hedonic function for housing ever goes through the origin, so when the
Commission in its quality change chapter, calculated the average price per square
foot of rental housing, he overadjusted for the value of quality change. This did not
come from economists in the form of technical criticisms, but from real estate agents
picking up on the small points. Reporters also found things to criticize and, as one
said to me, “If this was a sound report I shouldn’t be able to find things wrong with
it”. People did their own back of the envelope calculations that suggested that some
of the back of the envelope calculations the report contained were a little bit too
quickly done. I did a couple, Brent Moulton did some for a paper published in the
Brookings Papers on Economic Activity series, and I’ve seen others. I don’t think
calculations had big impacts but they had some.

Though it did not enter the public discussion, I think others saw more funda-
mental problems with the report’s chapter on quality change bias. It seems to me
that the chapter treated research that showed downward CPI bias very differently
from research that showed upward bias. So, perceptions of problems with the
report’s quality change chapter subtracted as well from professional backing for the
1.1 number.

I do not want to be misunderstood. I respect the effort that went into the report,
and the professional concern for improving economic statistics that take motivated
members of the Commission. But I am giving my assessment of what happened.
This is a blow-by-blow account of what happens to a political issue inside Washing-
ton. The report had a fundamental flaw in having numbers in it that people could too
readily pick apart, because the discussion of the details of the numbers diverted
attention away from the recommendations at the end of the report, some of which, were very profound recommendations that have long term potential.

Then there was round something like 3 1/2, which were the polls. The polls were clearly a strategic blunder. Mike Boskin initially took a poll (I take it there was some external push on this) that was rather selective and that got into the newspapers. So this was a bit of a problem. But more to the point, it conferred validity on other polls. The Wall Street Journal took a confidential poll of 320 academic economists. Nearly three quarters of them (71 per cent) said the CPI bias was a less than 1.1 percentage points. The Blue Chip Economic Indicators people polled their forecasting panel, 86% of whom said 1.1 was too high. The polls clearly increased doubts in the minds of many people about the 1.1 number. Has Boskin not taken the first poll, he could at least have said Polls don’t matter, it’s the expertise that matters, and the Commission has the expertise. But once he took his poll, that made it legitimate for others to poll. And also, to reiterate the point I made before, the Commission’s recommendations were more than ever lost in the press reports about the 1.1, whether the various polls were or were not biased, and so forth.

5. FOURTH ROUND

At this point, Congress was in the position of taking action on the Commission’s report. I have been told of a private meeting in Congress where some members were admonished: An expert panel has stated that the CPI bias is 1.1, Congress should pass legislation to put his adjustment into Social Security payments. One back-bench member finally raised his hand and said: Wait a minute, I don’t understand this. We were going to get the BLS to care of it, so we didn’t have to vote.

And that, of course, is exactly the point. If Congress had to vote whether to cut the 1.1 from Social Security payments, or add it to the tax rates, then they would have to take a stand on reducing benefits or raising taxes, and if they had been in a position to do that in the first place, there would have been no need for a CPI Commission to generate an automatic cut. The attention given to the 1.1 number has all along interfered with the objective of improving the CPI, but at this point it began to interfere as well with the objective of cutting the deficit through a CPI adjustment. At a meeting at Brookings, a Congressman said: The spotlight is very bright on Congress right now, the brighter is the spotlight, the harder it is for Congress to act. The great public attention on the 1.1 number inhibited direct Congressional action on the escalation formulas.

In fact, to conclude round four, Congress and the President did not act. After all this enormous water splash surged up and fell out all over the world, the budget
escalation formulas were not changed. It is true that the budget incorporates reduced projections for the CPI rate for increase to the year 2002, but after all the projection may change for a whole host of reasons other than improvements in the CPI (more confidence that the Federal Reserve has broken the back of inflation and will continue to hold the line, for example). At the very end of the budget process, I understand that there was an agreement to take a small amount off the escalation formula (perhaps 0.15 points this being the estimate of CPI commodity substitution bias), but in the end there was no change in the formula, largely because a new estimate of the budget deficit showed that deficit reduction had largely been attained, without a change in the escalator. So there is no action on the issue that originally made CPI measurement issues so newsworthy -the possibility of reducing the Federal budget deficit by cutting 1.1 points off the CPI inflation escalator.

6. FIFTH ROUND

Round five should have been the long-range moves to improve the Consumer Price Index. Round five is the round that unfortunately didn’t happen. As I have already noted, there have been a number of small moves forward. The changes that the BLS has now proposed are clearly in the right direction. But no one can argue that the changes that have been proposed to the CPI are anywhere nearly consistent with this big splash that went up in December. There were three reasons why round five did not come off.

One reason was that Congress and the Administration wanted initiatives that would reduce the CPI. At one point, there was political discussion about giving BLS resources to improve the CPI. But implicitly, improving the CPI suggested some sort of guarantee that the improvements were going to reduce the rate of increase. However, if you look back at recent improvements in the CPI, some of them reduced the rate of increase but some of them added to the rate of increase. It is very hard to say that the next two or three improvements that come up are necessarily going to reduce the index. If you can’t say that, then Congress has lost interest in funding improvements in the CPI.

Second, though I think my BLS friends would disagree with this, there was no real BLS agenda on the table. The BLS Commissioner asked for an outside commission on the CPI, so the Boskin Commission was not unexpected from the BLS perspective. Yet, there was no comprehensive agenda for improving the CPI that could be hauled out in the middle of the big splash. Jacob Ryten made the remark that in Statistics Canada, you would regard this as an opportunity, not a threat. Heads of statistical agencies and heads of price statistics programs in other countries have made the same point to me in conversations. There is an opportunity to
improve economic measurement. Well, there is no question there is a threat. The threat arises because public discussion of measurement issues, discussions of the kind that have been in the newspapers in the US, can be very damaging to a statistical agency’s professional reputation. There is little doubt that the discussion in the US has damaged the BLS reputation in some quarters. But there is also an opportunity. And perhaps I shouldn’t say this so bluntly. I think there was no opportunity grasped, or maybe even grasped for, except in a marginal way.

I will give one example. The US Consumer Expenditure Survey, has a sample size of 5,000 households or expenditure units. In the past, averaging three years of consumer expenditure surveys has been necessary for CPI weights. The BLS proposes to increase the survey to 7,500 households to get from two years’ data the same level of accuracy as before -not improved accuracy, but the same level. And so far as I can see, there is no program for addressing the substantial problems that exist in that survey now. Sample attrition is one, reporting accuracy is another. These are problems that affect all the other uses for the survey, uses that ought also to weigh in on the case for improving the expenditure survey. But even considering CPI uses, the detailed weights for the CPI (the expenditure totals for the CPI’s 200-odd individual expenditure classes) are not accurate now, they are relying on the law of offsetting errors to assure that the weighting error of the overall CPI is small. It is hard to see how one can have a program for improving the CPI without addressing the database on which its weights are based. The enhancement that has been proposed will only increase the sample size from 5,000 to 7,500, which looks almost minuscule compared with the scheduled 35,000 sample size of de Canadian household expenditure survey. It is such a small step.

The third reason this round five didn’t happen -to repeat what I have said before—was all the flack and debate over the Commission’s 1.1 number. The recommendations at the end were lost sight of, for some of the public and the press discredited, implicitly, by the controversy over the 1.1.

The CPI Commission’s report certainly made a lot of news. When a statistical initiative hits the big time, one would like to find that when you’re done with it you’ve got something positive out of it. It seems to me that we are back in a pool that is only a little bit more active than it was before. There haven’t been many big gains out of several months’ turmoil.

7. STATISTICS USA

Someone asked about Statistics USA. As most people know, the US statistical system is fragmented into -nobody knows how many pieces actually, economic statistics are split about six ways and not even Paasche and Laspeyres know what
is where. The proposal for unifying the statistical system, or for unifying the
economic statistics agencies, had probably not a lot of political things going for it in the
first place. When you change the structure of the statistical system, you have also
got to change the structure of the way the budget is handled in Congress. For
example, the committee that handles the BLS budget is not the committee that
handles the Census Bureau budget. So, if you change the structure of the organiza-
tion, you’ve also got to change the jurisdictions among those committees. There
isn’t anything politically to be gained by any member of Congress going out and
agitating for this, and there are possibly some losses.

Some members of Congress are interested in the issue, nevertheless. I talked
with one several months ago. He wanted to hold hearings, to find expert witnesses,
in that way to build the case for putting the statistical system together. I have be-
lieved for a long time (since my work on the Bonnen Report on the US statistical
system in the late 1970’s) that the statistical system would be much better off if it
were unified. But finding examples that could be used in hearings, examples of
innovations that could be made, where the improvement would occur, that’s harder.
If you give an example, someone will disagree and there goes your consensus.

I’ll give one example to show what I mean. The US collects what used to be
called SIC codes from different places. The BLS does it with one survey, the Cen-
sus Bureau does it as part of the economic censures. There is duplication of effort
just to find out which establishment is in which SIC. I tried, when I was chair of the
Economic Classification Policy Committee in the US, to stop that waste. It was
roughly five million dollars a year, plus a lot of extra reporting burden, plus when you
where done, there were large numbers of workers in manufacturing, for example,
who were misclassified by one or the other survey. How could you possibly justify
five million dollars, extra reporting burden, and bad data?. Well, people came in and
argued No, no, no, we want to keep doing what we’ve always been doing. And, of
course, the arguments they gave -it wasn’t that they were invalid, it’s just that if you
had a central statistical agency with a head like Ivan Fellegi of Statistics Canada, he
would say: Look there’s a broader issue here that needs to be addressed, and
although I understand these little problems, let’s work this out. In the US decentral-
ized system, it just got stalled, and nothing happened. But you can’t use something
like that in hearings, because you bring in this example and somebody’s going to
say No, that’s not so, there are all these problems we told you about. And then
you’ve got a big argument about what is so or isn’t so.
8. CONCLUSION

I can think of many cases in the US system where unifying economic statistics would create a net gain. But I can think of few cases where everyone in the system says the change is a gain and no one objects (those get done, even in a decentralized system). As soon as you’re in that situation, you’ve got a controversial hearing and there are no politics in it.

So, I don’t think that Statistics USA is going anywhere. So far as I know now, that’s also dead, but I continue to have hopes for the future. A centralized statistical agency could, if it attracted a strong professional as the head of it, greatly improve the performance of the US system.