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Abstract: Focuses on economists which are considered out of step with reality regarding relevant issues. Media skepticism toward their professional opinion that the Consumer Price Index was overstated; Reasons why CPI overstates inflation; Question on the relevance of the CPI panel's conclusions; Intense policy debate over fixing the index.

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THE BATTLE OVER CORRECTING THE CONSUMER PRICE INDEX

A recent Washington Post article opened my eyes to how some journalists view us economists. The story was about a poll the Post had conducted among, first, a group of economists and, then, a group of ordinary citizens. The survey featured questions on economic issues of the day, like "are inflated salaries for corporate executives a problem for the economy?" and "does free trade cost U.S. jobs?"

Despite their reputation as "dismal scientists," the economists were much more upbeat about national affairs than average citizens. How did the article interpret this? It suggested that economists are out of step with reality. I found this conclusion strange. If a big chunk of the population thinks AIDS is readily transmitted by handshakes, are physicians out of touch for believing otherwise?

Media skepticism toward the professional opinions of economists was certainly in full evidence recently when the Congressional advisory panel on the accuracy of the Consumer Price Index, or CPI, issued its report after a year of investigation. The panel's highly distinguished economists concluded that our government-calculated CPI overstates the true change in our cost of living by a lot. This is not news to economists; it has been a staple of economic textbooks for three decades.

There are several reasons the CPI overstates inflation. One is that the index calculates the change in a consumer's cost of buying a fixed bundle of goods, rather than the change in the cost of buying whatever bundle makes the consumer equally well-off. When the price of one thing goes up, consumers often switch to something else comparable (buying apples when oranges get expensive, e.g.). Today's CPI cannot capture that.

Overstatement also occurs because the CPI doesn't do a good job of capturing the increased quality of many goods over time. The panel illustrated this with the example of personal computers. The speed and computational ability of a computer currently priced at $1,500 is many times greater than a computer that sold for $1,500 in 1986. Hence, the real price of computing has fallen dramatically. The CPI, however, would tell us that there has been no change in the cost of computers.

Some commentators have questioned the relevance of the CPI panel's conclusions. In a commentary on National Public Radio, Kevin Phillips cited a poll showing that Americans "believe" prices went up 5 percent last year (the official CPI showed a change of 2.9 percent). Phillips reasoned that ordinary Americans are buying "parking and cups of coffee," and the increased quality of computers is irrelevant to their lives.

Even if that were true, the fact is, the same kind of quality increases occurred in lots of other products purchased by ordinary Americans. Does Phillips really believe the improvements in automobile quality of the past 20 years in terms of safety, durability, fuel efficiency and so forth have no relevance to families? Perhaps he should be given a new 1975 AMC Gremlin to drive for a while.

Quality improvements in consumer electronics--to cite another example--have been nothing short of phenomenal. New products have replaced less reliable or pleasing technology (e.g., CD players for turntables). Televisions have sharper pictures and last longer. I recently compared the "low price" stereo receivers analyzed by Consumers Reports last year and 21 years ago. The more recent receivers cost much less in constant dollars, yet had far better features, such as digital tuning, programmable station buttons, that were not available on even the most costly receivers in 1975. One highly objective measure of a receiver is its power per channel. The 1975 Consumer Reports "Best Buy" low-price receiver delivered 17 watts of power at 8 ohms resistance, while one of the 1996 "Best Buy" in the same category was much cheaper and delivered 110 watts. That is a six-fold improvement.

If economists have long recognized that today's CPI overstates changes in the cost of living, why now the intense policy debate over fixing the index? Changing the way the CPI is calculated would slow the growth of entitlement payments like Social Security that are tied to the index. Some clearly view this change as desirable while others view it as undesirable. However, the economic logic of the panel's conclusion is unassailable. If certain commentators consider it desirable that entitlement payments should continue to increase faster than the true rate of inflation, they should state that explicitly, and not blur the distinction between a policy goal, and its means of implementation. They should not pursue their agenda by disingenuously undercutting good research findings which show that our current inflation measure gets reality wrong.

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