CONSUMER PRICE INDEX REVISIONS

By Brit Harvey

The Consumer Price Index (CPI) is the most frequently used statistic among the thousands generated by the federal government. It is the most common indicator of change in the "cost of living", and is used as an escalator in numerous contracts leases and government entitlement programs. Currently, a 1% increase in the CPI triggers $2.5 billion in government expenditures alone.1/ In the distinctly glamourless world of economic statistics, the CPI is a media darling, regularly garnering front page headlines. As with any celebrity, the CPI's very popularity has rendered it fair game for critics. This article briefly describes the CPI, it's problems, changes planned for 1983, and the likely future impacts of these changes.

The Anchorage urban area is the only locale in Alaska for which a CPI is calculated. CPI figures are released every other month. There are two types of CPI's. The CPI-U is for the urban consumers, and approximates the buying habits of 80% of the population. The CPI-W is for wage and clerical workers and approximates the buying habits of 40% of the population. These CPI's are based on different "market baskets" of goods and services which were arrived at by a survey last conducted in 1972.

Over the years the CPI has become an increasingly important economic factor, as contracts, leases and government entitlement programs such as social security and food stamps have been indexed to the CPI. The CPI is no longer simply a statistical estimate of the inflation rate, but is also a generator of inflation. Under these conditions, the quality of the CPI methodolgy is an important substantive issue, not simply a subject for arcane debate among statisticians.

The primary criticism of the CPI in recent years has focused on housing costs, and particularly on the homeownership com-

1/ Bruce Hanchett, Bureau of Labor Statistics Regional Commissioner: conversation; July 29, 1982.

ponent. In Anchorage, approximately 50% of the CPI market basket consists of housing. Nationally, housing is a smaller percentage, but still greatly exceeds any other component. The large housing component renders the overall CPI highly sensitive to changes in housing costs. During the late 1970's, the surge in the homeownership component, both the house price itself and the cost of the mortgage, was a major factor in pushing the national CPI well into double-digits.

Critics point out only 6% of the population buys a house in any single year, that buying housing is partially an investment rather than a purely consumptive activity, and that the CPI methodology for surveying house and mortgage prices has severe flaws.

In response to this criticism, much of which came from Bureau of Labor Statistics staff responsible for producing the CPI, the CPI methodolgy will change in January 1983 to a "rental equivalency" method for calculating homeownership cost. An attempt will be made to estimate what it would cost homeowners to rent their homes, and this consumptive portion of their involvement with their real estate will be included in the CPI. Had this method been used in the past, the CPI would have been substantially depressed during the 1979-1980 period when the CPI nearly hit 15% on an annualized basis. This change will be made in January 1983 for the CPI-U, and January 1985 for the CPI-W. The CPI-W is delayed to accommodate existing labor contracts which use it as an escalator. The CPI-U will also be published concurrently for the first six months of 1983 using the current methodology. The CPI-U and CPI-W, which are now very similar, may diverge when different calculation methods are used in the 1983-1985 period. Some confusion is likely. Anyone using the CPI as an escalator in any contract or lease should specifically state which CPI is involved.

What is the likely influence on the CPI of the new method for calculating homeownership costs? There is no consensus on this point. While the rental equivalence method would have slowed the CPI increase during the past several years, there is no reason to assume this will occur in the future. Should rental costs increase more rapidly than homeowner costs in 1983 and beyond, the change in methods could actually result in an acceleration in inflation as approximated by the CPI-U. In view of the fact that rental prices tend to lag behind changes in homeownership costs, and that homeownership costs recently peaked, the odds of the CPI methodology change increasing the rate of CPI increase must be considered at least 50%.