THE ETHICS OF STATISTICS

Does the U.S. consumer price index provide a clear indication of the cost of living? The following articles present two sides of the argument.

by Ron Robins & Robert Fisher

THE U.S. CONSUMER PRICE INDEX affects both Americans and Canadians, as consumers and especially as investors. It influences interest rates, bond yields, and returns from many other investments.

But some economists and statisticians conclude there is obfuscation of these statistics and that they're subsequently misrepresented in the media, which usually have neither the time nor expertise to examine them.

These observers note that the current U.S. CPI incorporates numerous and continuous changes and weightings of components, rendering it a mostly theoretical exercise based on highly questionable hypotheses.

According to John Williams, a private New Jersey consulting economist, "The cost of living [is] being replaced by the cost of survival. The old system told you how much you had to increase your income in order to keep buying steak. The new system promise[s] you hamburger, and then dog food, perhaps, after that." The old system, Williams says, ended with the Clinton Administration.

On his website, at www.shadowstats.com, Williams says that inflation, as reported by the U.S. CPI, "is understated by roughly 2.7% per year due to recent redefinitions of the series as well as to flawed methodologies.

Williams discusses the inclusion by government statisticians of a concept called hedonics to adjust values in the index. "Hedonics adjusts the prices of goods for the increased pleasure the consumer derives from them," he says. "That new washing machine you bought did not cost you 20% more than it would have cost you last year, because you got an offsetting 20% increase in the pleasure you derive from pushing its new electronic control buttons instead of turning that old noisy dial. When gasoline rises 10 cents per gallon because of a federally mandated gasoline additive, the increased gasoline cost does not contribute to inflation. Instead, the 10 cents is eliminated from the CPI because of the offsetting hedonic thrills the consumer gets from breathing cleaner air."

The way U.S. housing costs are included is another oddity, keeping that component – at 32% of the CPI – low. Although two-thirds of the U.S. population live in their own homes, the statisticians use theorized imputed home rents as the basis for the housing statistic. Of course, rents have been virtually stagnant for years while home purchase prices, insurance and local taxes, etc., have been going through the roof.

Williams says that U.S. government welfare and social security payments are now 70% lower than what they would have been had the old 1970s-style CPI, with its fixed basket of goods, been used.

Another statistician, Jim Willie, elaborates further on this point. In Domino Distortions, an article on his website at www.GoldenJackAss.com, he says, "In my view, the [U.S.] CPI has become little more than a measure intended to exploit the trend of falling imported finished product prices, in order to keep cost of living raises down in U.S.-government pensions of various types. The CPI is kept low by ignoring numerous rising prices, such as property taxes, town usage fees (water, sewer, sanitation), professional services (doctor, dentist, lawyer), home services (carpentry, plumbing, electrical, roofing), college tuition, restaurant meals, sports club fees, and more."

So, is the U.S. CPI constructed and presented in an ethical manner? I am not inclined to think so.

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ETHICAL & ACCURATE: A REPLY

After reading Ron Robins's arguments, I find I must respectfully disagree with his premise.

The essence of statistical analysis is in continually working to improve the model in order to reduce the error factors. This is what the U.S. Bureau of Labor Statistics is doing.

The fixed basket of goods has been known for years to be a flawed measure of consumer purchase patterns. One key reason is that it ignores the substitution effect. The substitution effect says that, if the price of one good or service rises too high, consumers will switch to a comparable product or service that fits their price range.

Another reason is that the fixed basket ignores new products or takes too long to incorporate a new product or service. In the typical product price cycle, a new product comes on the market at a high price, the price falls over time as the product is improved and becomes more readily available and more of a commodity, then tends to remain steady or even rise again as the product matures. Computers are an example. By incorporating new products slowly, the fixed basket does not