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JMC

ECONOMIC POLICY BOARD  
EXECUTIVE COMMITTEE MEETING

November 18, 1976  
8:30 a.m.  
Roosevelt Room

AGENDA

- |                                                         |           |
|---------------------------------------------------------|-----------|
| 1. Multiple Consumer Price Indexes and Indexed Programs | OMB       |
| 2. Potential OPEC Price Increase                        | FEA       |
| 3. Economic Outlook                                     | Troika II |





EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

NOV 16 1976

MEMORANDUM TO: THE EXECUTIVE COMMITTEE OF THE ECONOMIC  
POLICY BOARD

From: James F. Lynn

Subject: Multiple Consumer Price Indexes and Indexed  
Programs

Summary

Statement of Issue

The CPI is being updated and revised for the first time since 1963. Beginning in April 1977, two revised indexes will be published. Which index should be used for measuring automatic cost-of-living increases for Federal programs linked to the CPI?

Analysis

The current CPI, which was designed to measure the purchasing power of the dollar for urban wage earners and clerical workers, covers about 35 percent to 40 percent of the population. As of April, a revised index for urban wage earners and clerical workers will be published.<sup>1/</sup> The other new index, to be published beginning in April, will cover all urban households and will include about 80 percent of the population, double the coverage of the current index.

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<sup>1/</sup> The existing index will continue to be published for 6 months to provide continuity for bargaining agreements that have been made on the basis of this index.

Both the revised consumer price index for urban wage earners and clerical workers and the new index for all urban households will be calculated and published for at least the next 3 years. After extensive review during this period, a decision will be made as to whether only the all-urban index or both the indexes are needed. Two years ago the labor unions argued strongly that a separate index for wage earners and clerical workers should be retained.

Either of the two new indexes could be used as the basis for determining the automatic cost-of-living increases for Federal programs linked to the CPI. We do not know whether one of the indexes will consistently rise faster than the other, and if one index were to rise faster we do not know which one it would be. Consequently, we do not know how the budget would be affected by choosing one index rather than the other.

OMB's General Counsel is of the opinion that shifting to the index for all urban households will require legislation.

If we decide to propose using the all-urban CPI, it is important that the Administration make its recommendation before BLS publishes the new indexes next April and also that the Congress enact the necessary legislation before that date. If we do not recommend the all-urban index until later and meanwhile the other index has risen faster, it would appear that we were making our choice mainly to save money. Also -- and most importantly -- if our recommendation or the legislation is delayed, there is a danger that because of political pressure we would be "gamed" into using whichever index initially increases more. (It should be noted that even if one index rises more rapidly than the other initially, there is no guarantee that it will continue to do so in the future.)

A discussion of the options follows and a more extensive paper is attached as Tab A.

## Options

- Option 1 -- Propose legislation in the 1978 budget to shift to the all-urban CPI.

### Pro

- We cannot be certain which of the indexes would be a better measure of the price changes that affect specific beneficiary groups, but the all-urban index has the advantage in this respect of covering most of the beneficiaries of Federal programs linked to the CPI. The current index excludes most such beneficiaries.
- It would help to focus attention on the index that is better for measuring inflation.
- It would make it easier to discontinue the index for wage earners and clerical workers later. This would save money and reduce confusion.

### Con

- It will require legislation to change from the index for urban wage earners and clerical workers, and the Congress may not be willing to shift to an index with which they have no experience.

- Option 2 -- Announce that the index for urban wage earners and clerical workers is the applicable index under current law and that the Administration will consider proposing legislation on the new index after gaining experience with it.

### Pro

- It would not require legislation at this time.
- It might be politically less controversial.

Con

- Would result in using the less desirable index from a conceptual point of view.
  - Would result in the likelihood that a shift to the broader index would result only if it produced larger automatic cost-of-living increases.
  - Would show an Administration lack of confidence in the work of BLS in developing the new index, especially since BLS initially planned to produce only the all-urban index.
  - If we delay and if the new index rises more rapidly than the old one, the absolute level of the two indices will obviously differ at the end of three years. There will then be strong pressures for a one-time, catch-up adjustment. (February 1977 is the only date on which the absolute levels of the two indices are certain to be equal.)
- Option 3 -- Propose a weighted average of the two indices with the weights gradually shifting over the three-year period so that the new index receives a 100 percent weight in the fourth year.

Pro

- Allows the Congress to "diversify their risks" between the two indices and may thereby make the change more acceptable.

Con

- The new index was proposed because it is superior conceptually. A proposal to average the old and the new indices may imply that we are not confident in our new concept.
- Implies averaging the weights obtained from our new broader sample with the weights obtained from a sub-group within that sample. This has little logical appeal.
- A weighted average with shifting weights is a complex concept which may not be well understood by the public and the Congress.

## Issue: Multiple Consumer Price Index

Statement of Issue

The consumer price index (CPI) is being updated and revised for the first time since 1963. Beginning in April 1977, two revised indexes will be published. Which index should be used for measuring automatic cost-of-living increases for Federal programs linked to the CPI?

Analysis

The current CPI, which was designed to measure the purchasing power of the dollar for urban wage earners and clerical workers, covers about 35% to 40% of the population. As of April, a revised index for urban wage earners and clerical workers will be published.<sup>1/</sup> This index will be an updated and improved version of the current index. It will incorporate revisions to consumer expenditure patterns -- the current index is based on a consumer expenditure survey taken in 1960-61, whereas the revised index will be based on a survey taken in 1972-73 -- as well as technical improvements in sampling.

The other new index to be published beginning in April will cover all urban households and will include about 80% of the population, double the coverage of the current index. An expansion of coverage has been under consideration for many years and has been strongly recommended by many. Fifteen years ago, for example, a committee appointed by the National Bureau of Economic Research, under contract with the Bureau of the Budget, concluded:

A more comprehensive index for the entire population, not only the wage and salary earners, should be made . . .

From the viewpoint of general public policy and scientific study, our basic need is for a more comprehensive Consumer Price Index covering the entire population. This is the index that is appropriate to the measurement of the changes in welfare of the Nation and to the measurement of inflation (and hence the guidance of monetary and fiscal policy.)<sup>2/</sup>

Both the revised consumer price index for urban wage earners and clerical workers and the new index for all urban households will be calculated and published for at least the next 3 years. During this period the relative movements of these two indexes will be studied. After extensive review of the performance of the two indexes -- including discussions with the Congress, professional economic and statistical groups, and the BLS Research Advisory Councils -- a decision will be made as to whether only the all-urban index or both the indexes are needed. Two years ago the labor unions argued strongly that a separate index for wage earners and clerical workers should be retained.

1/ The existing index will continue to be published for 6 months to provide continuity for bargaining agreements that have been made on the basis of this index.

2/ See National Bureau of Economic Research, The Price Statistics of the Federal Government: Review, Appraisal, and Recommendations, also published in Government Price Statistics, Part 1, Hearings before the Subcommittee on Economic Statistics of the Joint Economic Committee (87th Cong., 1st sess., 1961), pp. 21, 56.

Either of the two new indexes could be used as the basis for determining the automatic cost-of-living increases for Federal programs linked to the CPI. We do not know whether one of the indexes will consistently rise faster than the other, and if one index were to rise faster we do not know which one it would be. Consequently, we do not know how the budget would be affected by choosing one index rather than the other.

We believe that the new CPI for all urban households would be the better basis for determining automatic cost-of-living increases. We cannot be certain which of the indexes would be a better measure of the price changes that affect specific beneficiary groups. However, the all-urban index has the advantage in this respect of covering most of the beneficiaries of Federal programs linked to the CPI (e.g., social security, SSI, Federal employees retirement); the index for urban wage earners and clerical workers, on the other hand, excludes most beneficiaries. Choosing the index for all urban households has two further advantages. It would help to focus attention on the index that is better for measuring inflation, and it would make it more likely that money might be saved and confusion reduced by later discontinuing the index for wage earners and clerical workers.

OMB's General Counsel is of the opinion that shifting to the index for all urban households will require legislation.

If we were to use the new index, and such action were challenged in court, I believe the decision would most probably turn upon the court's answer to the question: is the Government using that measurement which Congress intended be used when it enacted the Federal program statute? Most likely, a court would examine the history of the CPI . . . and, in my view, conclude that Congress was referring to the published measure of the changes in cost-of-living . . . as reflected by purchasing patterns of urban wage and salary workers. [Emphasis added.] Most likely, the court would recognize the distinction between those changes which provide a more accurate way of making this measurement, and those which change the basic concept of the CPI itself.<sup>3/</sup>

If it is decided to move to the new index, the question of when to make that move needs to be addressed. Historical data for both indexes will be based on the index for urban wage earners and clerical workers simply because historical data are not available for more comprehensive coverage. An immediate shift to the all-urban CPI, therefore, would mean that the initial cost-of-living increases would be calculated on data that are not fully comparable (e.g., the September 1977 increase in civil service and military retired pay, which will be based on the CPI increase from December 1976 to June 1977).

We do not believe that this comparability problem is serious. Therefore, if legislation is proposed to shift to the more comprehensive CPI, we recommend that the shift become effective with the March 1977 index, which BLS will publish in April 1977. Any alternative to this proposal would be confusing and

<sup>3/</sup> Internal OMB memorandum from Steven D. Needle (GC) to David G. Mathiasen (BRD), dated March 5, 1976.



would delay the application of the new index because of the diversity of cost-of-living adjustments in Federal programs. For example, the July 1978 social security benefit increase will be based on the increase in the CPI from the first quarter of CY 1977 to the first quarter of CY 1978. Thus, for social security, fully comparable data for the all-urban CPI will not be available until the July 1979 increase is calculated.

If we decide to propose using the all-urban CPI, it is important that the Administration make its recommendation before BLS publishes the new indexes next April and also that the Congress enact the necessary legislation before that date. If we do not recommend the all-urban index until later and meanwhile the other index has risen faster, it would appear that we were making our choice on the basis of saving money. Also -- and most importantly -- if our recommendation or the legislation is delayed, there is a danger that because of political pressure we would be "gamed" into using whichever index initially increases more. [It should be noted that even if one index rises more rapidly than the other initially, there is no guarantee that it will continue to do so in the future.]

### Options

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