TOPIC 2: BIAS OF A CONSUMER PRICE INDEX, SHALL WE TRY ESTIMATE IT?
Chair: Jack Triplett (United States)

The issue:

Many types of errors affect the compilation of CPI's. Some, such as, sampling errors in the price and family expenditure surveys, response errors, transmission and processing errors are common to all statistical surveys. Others are more specific to the price index making, for example: adjustments for quality changes (including introduction of new goods and services) and problems of product and outlet substitution. Although, price index makers are well aware of these sources of error, it is only recently that some statistical agencies have started to investigate them and release quantified information about specific errors. The question that now arises is how feasible, (and desirable) is it to assess a total CPI bias?

Discussion:

Jack Triplett launched the discussion by reviewing the literature on the measurement of the CPI, reminding us that the problem was not entirely new as the Stigler Report, commissioned by the Office of Management of Budget in 1961, assessed in problems of price measurement in the U.S. In fact, the CPI in France and in the U.K. has been attacked in the past for underestimating rather than overestimating inflation.

He argued that the recent interest and concern on bias in the CPI has risen again for two main reasons: i) The Federal Reserve Bank has set its inflation target to zero, and therefore it wonders what value of the CPI implies a zero inflation, ii) Because the CPI is used extensively to adjust for taxation and escalate social benefits, the budgetary implication of small biases in the CPI could amount to a large overpayments (if the CPI is upwardly biased).

He then summarized that in the United States at least, the common view is that the bias in the CPI is upward. This view is based on the fact that the CPI is seen as a Cost-of-Living (COL) index, which implies that the problems created by product and outlet substitution and insufficient adjustment for quality change (including introduction of new products and services) lead to a over measurement of price change.

Although many countries have accepted the empirical estimation of the American bias and have used it in their own context, some participants did not accept the COL as the appropriate framework to judge the CPI. For some of them, the CPI should only reflect pure price change and therefore, the failure of a fixed weight index to capture product substitution cannot be seen as a source of bias. In fact, it was pointed out that the COL is not the framework put forward for the new harmonized indices that are being developed by the European Union to make rates of inflation in the European Union countries comparable. In the same vein, there were discussions about the need to clarify the definition of inflation and for the development of a broad, economy wide measure of inflation.

Some of the participants strongly argued that the CPI is more than a mere statistic, it is an institution which is viewed as reliable and almost infallible and any serious questioning of its credibility or reliability could have serious political and social repercussions. It is therefore important that improvements to the instrument should be seen as marginal rather than fundamental.

It was also discussed that some of the important advantages of the CPI , its timeliness, frequency and absence of revision, makes it useful for a variety of contractual and legal purposes. Although users will often recognise that the CPI was not designed for such uses, it is often the best measure available. In these cases the measure of bias is irrelevant for users who only need hard numbers.

Most participants, if not all, recognized that the questions of bias need to be addressed in future researches and meetings, but it is also important to ensure that the changes are done carefully to avoid any weakening of the CPI.