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TO THE

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LETTER OF TRANSMITTAL

JULY 21, 1961.

HON. WRIGHT PATMAN,
*Chairman, Joint Economic Committee,
House of Representatives, Washington, D.C.*

DEAR SIR: Transmitted herewith is a report of the Subcommittee on Economic Statistics on "Government Price Statistics."

Hearings have been held and this report prepared in accordance with the instructions to the subcommittee contained in the program for the year as outlined in the Joint Economic Committee's "Report on the 1961 Economic Report of the President" (H. Rept. No. 328, 87th Cong., 1st sess.).

Members of the committee staff with special responsibilities on this study were James W. Knowles, who assisted in planning and organizing the hearings, and John W. Lehman, who assisted in the preparation of this report.

Sincerely yours,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Economic Statistics.

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GOVERNMENT PRICE STATISTICS

I. INTRODUCTION

The Joint Economic Committee since its organization has had a continuing interest in all tools of economic analysis. High on the list of important measures of economic activity are the prices of the goods and services we use as individuals; the prices of the commodities which move in agriculture, commerce, and industry; and the prices of the goods we exchange with the world.

From time to time the Joint Economic Committee as a whole or through its Subcommittee on Economic Statistics has examined various aspects of our price statistics. The first of these studies, "The Consumers' Price Index of the United States Bureau of Labor Statistics," was completed in 1949 and the committee's concern has continued through the studies of employment, growth, and price levels concluded last year. The recent hearings and this report of the Subcommittee on Economic Statistics, however, provide the broadest review of our major price indexes which the committee has attempted.

The basis for this review and the focus of the hearings and the subcommittee's report is a report entitled "The Price Statistics of the Federal Government," prepared for the Office of Statistical Standards of the Bureau of the Budget by a distinguished group of scholars and experts organized as the Price Statistics Review Committee of the National Bureau of Economic Research. The report was transmitted to the Office of Statistical Standards November 30, 1960. As had been done in connection with a similar report on "The National Accounts" in 1957, the Joint Economic Committee asked the Subcommittee on Economic Statistics to hold hearings on this report with a view to providing an opportunity for public comment and suggestion and for a wider understanding of the findings of this important study. The subcommittee hearings were held on January 24 and May 1-5, 1961. The hearings were carefully designed to insure opportunity for presentation of the points of view of the Price Statistics Review Committee itself; the Office of Statistical Standards, the Government agencies producing statistics; statistics users from industry, labor, agriculture; and experts from the colleges who use or are working with price indexes. The Price Statistics Review Committee's report and supplemental staff papers are printed in full in the January 24 hearing.

It will not be the purpose of this brief subcommittee report to evaluate each analysis and recommendation contained in the report of the Price Statistics Review Committee. One of the important contributions of the Review Committee's report will be to stimulate many analyses and discussions in the producing agencies, the universities, and in the statistics profession generally. We think it would be helpful to record our understanding of the points of view expressed at the hearings on the major recommendations of the Review Committee and to make such general or specific recommendations as we feel are appropriate at this time.

Before doing so, however, we wish to express our appreciation to Dr. Bowman and the staff of the Office of Statistical Standards and to the Price Statistics Review Committee for their part in this significant study. We also, as did the Review Committee, wish to express our confidence in the spirit and work of the Government agencies producing our statistics and to reiterate the statement made several times during our hearings that this Nation has the best statistics in the world. We want to keep them that way.

II. HEARING FINDINGS AND COMMENTS ON THE REVIEW COMMITTEE'S RECOMMENDATIONS

The Price Statistics Review Committee's study concentrated on the main price indexes of the Federal Government: the Consumer Price Index, the Wholesale Price Index, and the Indexes of Prices Received and Paid by Farmers. Lesser attention was paid to import and export price indexes, construction cost indexes, and asset price indexes. The Review Committee's recommendations aimed at improving the quality of the price indexes are summarized in the first chapter of the report as follows:

I. All indexes:

1. Schedules of periodical revisions of weight should be adopted.
2. Probability sampling should be used, so that the precision of the index can be measured.
3. New commodities should be introduced more promptly.
4. The price collection agencies should be given funds for research divisions. The development of methods of coping with quality changes (some of which are discussed in the report) should be a major task of such divisions.

II. Consumer Price Index:

1. The present index should be extended to include single persons as well as families, and the index should cover rural nonfarm as well as urban workers.
2. A more comprehensive index for the entire population, not only the wage and salary earners, should be made.

III. Wholesale Price Index:

1. The structure of the overall index should be revised to reflect the prices of a condensed input-output table for the commodity producing industries.
2. The individual product prices should, where feasible, be collected from buyers (not from sellers, as at present) to get more accurate information on actual transaction prices.

IV. Indexes of Prices Received and Paid by Farmers:

1. The statutory prescriptions of the obsolete base (1910-14) and the inappropriate use of interest and taxes per acre, which are not prices, should be reconsidered.
2. The coverage of the indexes (particularly that of prices paid for living) should be increased.
3. The indexes for farms as production units should be segregated from the index for farms as consumer units.
4. The method of pricing should be shifted over to "specification pricing," and enumerative methods of collecting data should be adopted at least for commodities difficult to specify.

In their examination of the price indexes the Review Committee did not attempt to provide detailed descriptions of the procedures to implement their recommendations, feeling that as academicians they lacked the detailed knowledge of operating and cost questions to

make such decisions. They did, however, list those recommendations which they believed deserved first priority in terms solely of the contribution the proposal makes to the knowledge of price behavior, not its costs or administrative simplicity. The recommendations are classified under a few broad headings and only first- and second-run priorities are distinguished.

The following section of our subcommittee report will discuss the comments of witnesses at the hearings on the priorities as listed by the Review Committee.

FIRST PRIORITIES

The first priorities are classified under extensions, reorientations, scientific procedures, and revision policies.

Extensions of the price index program

1. *A major program for expansion of the export and import price indexes* is listed as an early priority because of the growing need for such information in connection with the problems of the balance of payments and problems of gold flow. The Review Committee points out that price indexes as such are not currently being prepared either for exports or imports. We use, instead, unit value indexes which measure changes in the average value of imports or exports per physical unit regardless of whether the change in value is due to a change in price per se or to some other circumstance such as a change in the size or quality of the item being imported or exported. Comparisons between the prices of imports and exports of the United States with other country data cannot be made without substantial and not too reliable adjustments. The Bureau of Foreign Commerce which compiles these figures is aware of the deficiencies and concurs in the Review Committee's minimum suggestions for immediate improvement by (1) the institution of systematic comparisons with domestic price movements as revealed by BLS and other sources and with appropriate foreign export or import price series, and (2) the substitution, where appropriate, of price changes as revealed by these external sources for Census unit values.

The Bureau of the Budget and one of the user witnesses also endorsed this recommendation that more emphasis be given to export and import prices. There was no disagreement with the proposal.

2. *The assumption of real responsibility by the Federal Government for a comprehensive and reliable construction cost index* was another recommendation which found no opposition or uncertainty among the witnesses. The Review Committee in appendix B of its report listed the following seven deficiencies in the present "composite" construction cost index: "(1) Most of these indexes are compiled by private firms as a byproduct of other activities viewed as far more important. They are not reviewed by a central agency for adequacy of statistical procedures nor for consistency. Information in sufficient detail to permit adequate review, the Committee is informed (although it has not itself attempted to contact the compilers directly), is not generally available. (2) The indexes are not prepared in order to provide appropriate coverage for the categories of construction they are used to deflate. Instead, these categories are deflated by whichever of the available indexes seems to fit most closely (or least distantly) each category of construction activity. In some cases no relevant index

is available. (3) The bill of materials priced and included in the indexes is usually incomplete, and in some cases grossly so. (4) Weights by which various indexes of wage rates and materials are combined are usually based on periods in the remarkably remote past, and their accuracy even for the period to which they relate is dubious. (5) It appears that the wage rates and prices used frequently do not represent actual transaction prices but rather some type of quoted or "normal" price. (6) The geographic coverage and weighting of the indexes are rarely suitable and comprehensive. (7) The timing of the cost indexes is not, in general, appropriate for deflation of the construction activity estimates, which represent an allocation over time of contracts or other valuations established at an earlier date."

This is an area of statistics in which the Subcommittee on Economic Statistics has long sought improvement because of the great significance of the construction industry as a factor in economic stability and growth. A beginning has been made and the Bureau of the Budget reports that funds have been included in the 1962 budget, now before the Congress, for the Bureau of the Census to initiate a program in this area. The Federal Statistics Users' Conference, representing 150 companies or organizations in industry, labor, and agriculture, has found this to be a first priority among needs identified by their members. The Department of Commerce needs such indexes in connection with its estimates of gross private domestic investment which is the second largest category in gross national product.

Reorientation of the major price indexes

1. *The Consumer Price Index and the Index of Prices Paid by Farmers for Family Living.* Indexes should be revised as rapidly as possible in the direction of more precise measures of the changing cost of a given level of living. In particular, the introduction of new products should be accelerated and the measurement of quality change given high research priority.

The first sentence of this three-part recommendation introduced an extended discussion in the hearings as to (1) the differences in concept between an index which tries to measure the changes in the cost of a fixed market basket of goods and services and an index which tries to measure changes in the cost of a given level of living or welfare, (2) the relationship of the present Consumer Price Index to these two types of indexes, and (3) the desirability and feasibility of following the Review Committee's recommendation to move toward the welfare or constant-utility approach for both the Consumer Price Index and the Index of Prices Paid by Farmers for Family Living.

Statistics users from industry, labor, and agriculture appearing or represented at the hearings were generally opposed to trying to go very far in the direction of an index which puts major emphasis on attempting to measure how much a given level of satisfaction, or welfare, costs in one period of time as against another. They based their opposition somewhat on the concept of such an index but mostly on the impossibility of finding proper measures for such satisfactions. The academic witnesses who appeared the last day of the hearings were more hopeful that something could be done in working toward a welfare index and that it would be worthwhile to devote research effort in that direction.

The last part of the recommendation, acceleration of the introduction of new items and the need for giving high research priority to devising measures of quality change, was more widely accepted. It was felt that the research into how quality changes can be measured is essential to a better understanding of changes in the present Consumer Price Index. It was pointed out that there is a widespread feeling that because of improvements in quality which are not taken into account by present methods of compiling the Consumer Price Index, the index may have overstated by some undefined amount the rise in prices which has occurred in the last decade. But it also was made clear that there is no reliable quantitative evidence to support this claim, nor, in fact, is there empirical evidence to measure the extent of downward bias which also might be occurring in the case of deterioration of quality of some goods and services. There was quite general agreement that everything possible should be done to determine whether or not useful, objective measures of quality change could be developed.

There was not a similar degree of unanimity on the need for changing the present methods of introducing new products into the index, but there was a willingness to see some research time devoted to this purpose.

2. The Wholesale Price Index should be shifted to the format of an input-output system to achieve greater comprehensiveness of price coverage and a more rational system of weights.

There was general endorsement of this proposal to make this oldest of the price indexes a better research tool by giving it a more clearly defined and meaningful universe and a more useful arrangement of the index components. The endorsements of the proposal, however, were accompanied by warnings that this would be an expensive process. It was also pointed out that the need for simultaneously maintaining the old indexes would continue for a long time.

Scientific procedures of the price collecting agencies

1. Full descriptions of the procedures employed in constructing each index should be published after every major index revision.

The compiling statistical agencies agreed on the general desirability of this recommendation from the standpoint of encouraging a maximum of understanding and as a stimulus to research outside of government in new or improved methods, but pointed out the difficulty of allotting adequate time to this work in competition with day-to-day operating demands. Some users, while agreeing with the desirability of such publications, warned against this publication at the expense of operating functions and research. It was made clear that an investment in such descriptions would be a key requirement to stimulating research outside of the Government agencies and thereby expanding the research which could be done at no cost to the Government.

There also was some feeling, particularly in connection with agricultural price indexes, that if a choice had to be made it would be preferable to publish more raw data from which researchers could develop additional series for their own needs.

2. Separate research units, working in close collaboration with the operating divisions, but free of operating responsibilities, should be created within each agency.

Of all of the proposals made by the Review Committee, this received the heartiest endorsement throughout the hearing. The difficulties of implementing such a recommendation were recognized by all, but the need for such units was felt to be crucial if the indexes are to take advantage of new techniques and keep abreast of the needs of all types of users. The point was also made that it was essential for colleges and private research groups to continue to expand their investigations and experiments in all areas of price index development and maintenance.

3. *Probability sampling systems should be adopted as rapidly as possible at all stages of index number construction.*

The reaction throughout the hearing to this proposal was one of recognizing the desirability of the use of probability sampling wherever practicable. No one, however, felt that probability sampling could be employed in all sampling areas without much more research. There was much interest in seeing this research go forward, in the Government agencies as well as in the universities and private research organizations.

Revision policies

1. *A periodic schedule of revisions of the weights should be adopted in connection with each major index. Comprehensive weight revisions should be made at least once every 10 years.*

This is another recommendation for which there was almost unanimous support. The only question raised was about the time interval. Everyone agreed with the idea of a revision of weights at least every 10 years but there was some interest in as short an interval as 5 years where research could demonstrate that unusually rapid and significant changes had been occurring. The basic principle of a periodic review on a definite schedule was thought crucial by all.

SECOND PRIORITIES

The second priorities are classified by the major indexes.

Consumer Price Index

1. *Extend the coverage of wage and lower salary earners' families to single persons and to the rural nonfarm families.*

The Bureau of Labor Statistics has already reached a decision to extend the index to cover single-person families. Several witnesses approved the idea of including rural nonfarm families but warned of special problems of definition and location which will need to be clarified before the proposal can be implemented. The Bureau of Labor Statistics will be reviewing some of these in considering extension of the index to nonfarm families.

2. *Produce an index number of consumer prices for the entire nonfarm population.*

There was general interest in investigating the possibility of expanding the scope of the Consumer Price Index beyond those in the wage and salary group. The interest, however, was in a "family of indexes" to cover different groups in the population rather than one comprehensive Consumer Price Index covering the entire population. Statistics users in industry and labor were particularly anxious that their endorsement of a "family of indexes" would not mean eliminating the index applying to wage and salary workers.

Wholesale Price Index

1. *Move as rapidly as possible toward the collection from buyers of more realistic prices of finished and semifinished goods.*

The enthusiasm of the Review Committee for this recommendation was not shared generally by the witnesses. The general objection cited was the increased cost of collecting information from buyers in relation to the increase in accuracy and sensitivity which made this method seem expensive for the amount of improvement to be gained over existing methods. There was an interest expressed in having pilot studies made in this area, possibly with a view to obtaining supplemental price information from buyers.

Indexes of Prices Paid and Received by Farmers

1. *Adoption of stricter specifications of commodities whose costs vary substantially at one time or change appreciably over time.*

The comments received on this recommendation agreed that stricter specifications of commodities should be adopted. The Statistical Reporting Service of the Department of Agriculture was in partial agreement but warned against specifications that might result in underestimation of price changes that are very real to the farmer.

2. *Extension of pricing in certain neglected areas such as medical care and purchase of services in production, in collaboration with the Bureau of Labor Statistics where this is appropriate.*

All of the comments on this recommendation favored it.

III. SUBCOMMITTEE COMMENTS AND RECOMMENDATIONS

The report of the Price Statistics Review Committee and the hearings which this subcommittee has held on that report present a formidable array of suggestions for improving the Nation's price statistics. There is hardly a page in either the report or the hearings which does not have on it an explicit or implicit recommendation for some kind of action. But to consider the report and hearings as a carefully constructed blueprint for a coordinated series of steps leading to a perfect set of government price indexes to meet the needs of all users on all occasions would obviously be going far beyond reality.

The contribution which has been made is in providing a way to focus the attention of statistical agencies, users of statistics, and the Congress on the possibilities and places for improving price statistics. In some cases this has been in terms of specific proposals for improvement, in others it has been to point the direction of research and experimentation needed to make as sure as possible that the indexes are relevant to their uses, measure what they are supposed to measure, and utilize the best available techniques of measurement.

With this in mind, then, the subcommittee has some comments and recommendations which we feel can appropriately be made at this time. Other comments and recommendations must await the results of the research and further study which may be called by some of our present recommendations or which will be stimulated in the colleges and government agencies by the report and hearings.

GENERAL COMMENTS AND RECOMMENDATIONS

No country has better price statistics than the United States but improvements are still needed.

In its introductory chapter and throughout the report the Price Statistics Review Committee made clear that they were deliberately passing over the areas of our price statistics which are strong and worthy of the highest commendation. They did so in order to concentrate on what they believed to be the critical areas for improvement.

No witness felt that he would want to change the price statistics program of the United States for any other country's, and this subcommittee agrees. The emphasis we wish to place here is on the continued improvement of that program. There is still much to be done, for example, in the measuring of economic growth. Our measures of real economic growth are related to our measures of price changes, since we deflate the current dollar value of output by prices. If our measures of price changes are biased in the direction of being too high, the deflation is too great, and we will show somewhat less economic growth than actually took place—if the measures are biased downward, somewhat more growth would be shown than in fact took place.

The continued institutionalization of our indexes as an integral part of collective bargaining or other kinds of contracts, and the way in which indexes are built into public policy such as the agricultural

price support programs, make imperative our continued alertness to ways of improvement of our price statistics.

The basis for continuing improvement of our price statistics lies in a modest but continuing provision for research in the agencies.

This was a major recommendation of the Price Statistics Review Committee and listed among their first priorities for improvements of the price indexes. Without adequate research into alternative effects it is not possible to know the extent to which a particular philosophy, procedure, technique, or method of interpretation results in an index which is more accurate or less accurate, more appropriate or less appropriate, as a measure for the uses to which it is being put.

The questions of the need for measuring or improving existing measures of quality change and for introducing new products more promptly into the indexes received a great deal of attention in the hearings and the report. The panel of academicians, for example, felt that failure to account adequately for these two factors may have left the Consumer Price Index with an upward bias during the last 10 years. They pointed out that, if there was such an upward bias in the index, it could have resulted in encouraging the use of credit policies designed to restrict an inflation which may really not have existed to the extent shown by the Consumer Price Index. Yet, other witnesses emphasize that we do not have quantitative evidence such bias existed or that there were not offsetting factors in the opposite direction.

The whole question of whether the use of probability sampling can bring improvements in accuracy or understanding needs more investigation and testing before its usefulness can be definitely determined one way or the other. This may be the place where improvements can be made in reducing the areas of subjective judgment and measuring the sampling precision of the indexes. We simply do not know enough yet about the alternatives to make such decisions with reference to specific index situations.

While the colleges and private research groups should be encouraged to do as much in this field as possible, the day-to-day living with the problem which is required for this kind of research can be carried out only in the producing agencies. It should not be necessary to provide large units to obtain the kind of continuing research which is needed but it is essential that these units be detached from operating responsibilities.

Description of the procedures used in constructing each index should be published after every major index revision.

The subcommittee recognizes here the desirability of making available the maximum feasible amount of information in order that the user can have a clearer understanding of the technical aspects of index construction and to provide the basis for some of the research which we have suggested might go on outside the statistics producing agencies. This should not be interpreted, however, as indicating that such a description would be a substitute for the shorter explanations of the use and limitations of the indexes which are so useful to the average reader. It is recognized that to prepare the kinds of descriptions called for will take special allocation of staff and funds. This would seem a good investment from the standpoint of making the indexes more useful and generating outside research.

Comprehensive weight revisions should be made on a regular schedule at least once every 10 years for each major index.

In a very stable society the kinds and proportions of the goods and services people consume, or industries use, or are imported and exported, change so little that the weight bases of the various price indexes need to be revised only infrequently to reflect adequately the actual conditions which prevail. In a dynamic society and economy such as ours, which places a premium on improvement and innovation, unless changes in weights are made with some conscious regularity it is possible that the indexes may be measuring a pattern of living that doesn't exist.

We note with approval that the Division of Statistical Standards of the Bureau of the Budget has indicated its willingness to take responsibility for recommending such reviews at regular intervals.

COMMENTS AND RECOMMENDATIONS FOR INDIVIDUAL INDEXES

Expand and improve the export and import price indexes.

The need for improved export and import price indexes arises from the growing concern with and need for understanding the factors that influence our foreign trade as a key element in our balance of payments position. Much of this discussion hinges on changes which are occurring in the relative prices of goods that enter international trade. We do not have true price indexes for either imports or exports. As is explained in the summary of comments from the hearings, our present indexes are unit value indexes and as such have great limitations for measuring price changes. The modest steps in the procedure outlined in the Review Committee's report for adapting these indexes to present needs are clearly in the right direction and every effort should be made to expedite them.

A program for an adequate comprehensive construction price index should be begun at once with a view to its early adoption and implementation.

Both statistics users and academicians feel that this is an area which has too long been neglected, and the Subcommittee on Economic Statistics has so pointed out in earlier reports. New public and private construction makes up almost one-eighth of the total value of the gross national product, with all that implies as a factor in economic stability and growth. In the words of the Review Committee:

The behavior of construction prices is of extraordinary interest to the Federal Government itself because it is a large buyer of construction, heavily supports by grants-in-aid the purchase of construction by State and local governments, and has a primary interest in private construction through various direct loan and loan insurance and guarantee programs.

The present Department of Commerce "composite" construction cost index, compiled by the Bureau of the Census, is the nearest approximation we have to a construction price index. The Commerce Department index depends entirely on combining data from secondary sources and no original data have ever been collected for it. As a result of having to combine indexes which have been worked out for a variety of purposes and by a variety of methods it is not

possible to say with any degree of confidence, for example, where or in what direction the biases in such an index lie.

Extend the Consumer Price Index coverage of wage and lower salary earners families to single persons and investigate the possibility of also extending the coverage to rural nonfarm families.

The Bureau of Labor Statistics has underway a plan for broadening their wage and lower salary earners index to cover single persons or, more precisely, single-person families. The need here is to round out the population group covered to meet the definition of the Consumer Price Index which is to measure the "change in prices of goods and services purchased by families of urban wage and clerical workers." The inclusion of rural nonfarm families, while desirable to meet a similar objective, poses special weighting problems, but it would seem worthwhile to try to develop a means for handling these problems—with a view toward the eventual development also of a family of indexes which might be combined into a comprehensive index to cover the entire population.

For the Indexes of Prices Paid and Received by Farmers, review carefully the specifications of commodities whose qualities vary substantially at one time or change appreciably over time, and extend pricing to such areas as medical care and purchases of services of production.

The Statistical Reporting Service now collects by mail much of the data for prices paid by farmers, identifying in general terms the item for which the price is to be listed. They rely on the reporter, generally a dealer who sells to farmers, to report the price of the item within the general specification which the farmer usually buys. The need is to identify items in such a way that a more nearly comparable basket of goods is priced from month to month. The Statistical Reporting Service has narrowed their classification of some items but further work is required. Where it is not possible to obtain data adequately on specified items by mail, it was suggested by the Review Committee that use might be made of direct enumeration or partial reliance on similarly specified items which are priced by the Bureau of Labor Statistics, where practicable.

The need for expanding the coverage of the indexes for medical services in the family living sector, and for certain production items, has been recognized by the Statistical Reporting Service. The greatest areas of need in the production sector are custom services such as milling, veterinary services, repair and maintenance of automobiles and tractors, and farm construction. Plans have been developed for making some of these improvements whenever funds are available.

"Market basket" or "Welfare" index?

It is not clear to the subcommittee that the extended discussion in the hearings and the report of two kinds of indexes, one designed to price a level of *constant living* and the other designed to price a *constant level* of living, were sufficiently conclusive to enable us to formulate any recommendation in this area. A number of the comments and recommendations we have set forth are directed toward what seems to be the practical working conclusion at this time: namely, that the concept of a pure constant utility or welfare index is so elusive as to make it difficult even to discuss in the abstract, and that at the same time a rigidly fixed market basket of goods would be unrelated to the fast-moving world we live in. In practice, we

try to measure the change in prices of a package of goods and services which consumers indicate by their performance in the marketplace gives them equivalent satisfactions. Nonetheless, the concept of trying to approximate as closely as possible the cost of a constant level of living for the group of people whose purchases are represented by the index is worth additional work.

This whole area of exploration is one in which our recommendation for continuing research has particular significance.

