635

93d Congress } JOINT COMMITTEE PRINT
1st Session }

INFLATION AND THE CONSUMER IN 1973

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON CONSUMER ECONOMICS

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

JANUARY 14, 1974

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
28-006 WASHINGTON : 1974

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $ .35 cents
Stock Number 5270-02203

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
WILLIAM PROXMIRE, Wisconsin, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	JOHN SPARKMAN, Alabama
HENRY S. REUSS, Wisconsin	J. W. FULBRIGHT, Arkansas
MARTHA W. GRIFFITHS, Michigan	ABRAHAM RIBICOFF, Connecticut
WILLIAM S. MOORHEAD, Pennsylvania	HUBERT H. HUMPHREY, Minnesota
HUGH L. CAREY, New York	LLOYD M. BENTSEN, JR., Texas
WILLIAM B. WIDNALL, New Jersey	JACOB K. JAVITS, New York
BARBER B. CONABLE, JR., New York	CHARLES H. PERCY, Illinois
CLARENCE J. BROWN, Ohio	JAMES B. PEARSON, Kansas
BEN B. BLACKBURN, Georgia	RICHARD S. SCHWEIKER, Pennsylvania

JOHN R. STARK, *Executive Director*
LOUGHLIN F. MCHUGH, *Senior Economist*

ECONOMISTS

WILLIAM A. COX
JERRY J. JASINOWSKI
LUCY A. FALCONE
JOHN R. KARLIK
SARAH JACKSON
RICHARD F. KAUFMAN
L. DOUGLAS LEE
COURTENAY M. SLATER

MINORITY

LESLIE J. BANDER
GEORGE D. KRUMBHAAR, Jr. (Counsel)
WALTER B. LAESSIG (Counsel)

SUBCOMMITTEE ON CONSUMER ECONOMICS

HUBERT H. HUMPHREY, Minnesota, *Chairman*

SENATE	HOUSE OF REPRESENTATIVES
WILLIAM PROXMIRE, Wisconsin	WILLIAM S. MOORHEAD, Pennsylvania
ABRAHAM RIBICOFF, Connecticut	MARTHA W. GRIFFITHS, Michigan
JACOB K. JAVITS, New York	HENRY S. REUSS, Wisconsin
CHARLES H. PERCY, Illinois	HUGH L. CAREY, New York
	WILLIAM B. WIDNALL, New Jersey
	CLARENCE J. BROWN, Ohio

LETTERS OF TRANSMITTAL

JANUARY 14, 1973.

To Members of the Joint Economic Committee:

Transmitted herewith for the use of the Members of the Joint Economic Committee and other Members of Congress is a study entitled "Inflation and the Consumer in 1973." The study has been prepared by the members of the staff of the Joint Economic Committee and the Congressional Research Service of the Library of Congress.

The study is an examination of the impact of the 1973 inflation on the cost of living and purchasing power of consumers and what implications may be forthcoming for the economy. Nothing in the study should be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its individual members.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

JANUARY 11, 1973.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the Unites States.

DEAR MR. CHAIRMAN: Transmitted herewith is a staff study entitled "Inflation and the Consumer in 1973." The study was undertaken in order that members of the Joint Economic Committee, other Members of Congress, and the general public, might better understand the severity of inflation in 1973 and the economic squeeze it has put on consumers. Only by fully understanding what rising prices are doing to consumers and the economy can we develop proper anti-inflationary policies. This study is intended as a modest step toward that objective.

It provides an analytical review of the impact of inflation and does not make recommendations for correcting the problem. It is hoped that the study will serve as the basis for hearings and the development of policy recommendations. Nothing in the study should be interpreted as representing the views of the Joint Economic Committee or any of its members.

The study was prepared by Jerry J. Jasinowski and Lucy Falcone, with the administrative assistance of Beverly Park, of the Joint Economic Committee staff. Additional assistance was received from other members of the Joint Economic Committee staff and Julius Allen and Henry Canaday of the Congressional Research Service of the Library of Congress. I would like to express my own appreciation to the Committee staff and to the Congressional Research Service personnel who prepared the study.

HUBERT H. HUMPHREY,
Chairman, Subcommittee on Consumer Economics.

CONTENTS

I. INTRODUCTION AND FINDINGS

Every American has been touched by the inflation in this Nation's economy during 1973. For most consumers it has brought a lowering of living standards and, all too often, real suffering. It is no exaggeration to say that inflation was the number one economic problem consumers had to face in 1973. And yet there continues to be widespread public misunderstanding over the severity of the current inflation, what specific price increases have occurred, how they have affected the consumer's cost of living and purchasing power, how much inflation has hurt certain special groups such as the poor, and so on.

In part the public has been confused because of the way we measure inflation with aggregate indices and relatively esoteric statistical measures. It is extremely difficult for the typical consumer, for example, to put any meaning on a 0.5 percent monthly increase in the aggregate Consumer Price Index (CPI). Consumers also find it hard to keep up with and understand how quarterly or annual changes in the Consumer Price Index or the Wholesale Price Index (WPI) influence their family budgets and standards of living. Understandably, consumers think of inflation primarily in terms of the specific commodity price increases they experience in their daily or weekly shopping.

In addition, the Administration has too often misled the American consumer about inflation, first with optimistic pronouncements on the course of inflation in 1973, and then with defensive denials that the extremely rapid rise in prices during 1973 was hurting consumers. Not only was inflation not hurting consumers, but consumers themselves failed to realize how well off they were, Administration spokesmen said. Some of these statements bear review as a prelude to our analysis of the impact of inflation on consumers during 1973.

In his February 22, 1973, State of the Union Message, the President said:

> The state of our Union depends fundamentally on the state of our economy. I am pleased to report that our economic prospects are very bright. For the first time in nearly 20 years, we can look forward to a period of genuine prosperity in a time of peace. We can, in fact, achieve the most bountiful prosperity that this Nation has ever known * * * we have a good chance to reduce the overall inflation rate to 2½ percent by the end of 1973.

On August 23, 1973, Dr. Herbert Stein briefed the press on the state of the economy and well being of consumers, saying:

> * * * there is apparently the feeling in the country on the part of the people that they are worse off than they were, say a year ago, whereas our statistics would seem to indicate that on the whole they are better off.

The purpose of this study is to examine these and other Administration statements about inflation, as well as other questions about the impact of inflation on consumers during 1973. The results are modest because the research and data in this field are rather limited. Nevertheless, our preliminary findings are:

- **The rate of inflation during 1973 was extremely severe, with the Consumer Price Index increasing 8.8 percent, the highest rate of increase since 1947. The Wholesale Price Index increased 18.2 percent, the largest increase since 1946.**
- **Consumers are correct in their perception that the 1973 inflation was quite widespread among essential consumer commodities and services, with historically larger than average price increases occurring for food, housing, clothing, transportation, and fuel.**
- **The 1973 inflation dramatically increased the cost of living. A family with a budget of $12,614, for example, had to pay an extra $1,168 just to maintain their 1972 living standards in 1973. The same family had to spend $502 more for food, $165 more for housing, $30 more for transportation, and $57 more for clothing and personal care to maintain 1972 living standards.**
- **Social Security and income tax payments also increased dramatically between 1972 and 1973. A family with a budget of $12,614, for example, had to pay $281 more in taxes during 1973, or what amounts to a 15 percent increase. Social Security taxes alone increased 31 percent.**
- **Consumer purchasing power has not kept pace with inflation and the cost of living during 1973, with all measures of real purchasing power falling throughout 1973, or during some recent quarters. The income of a family or household after allowing for the erosion of inflation, for example, declined approximately 1 percent during 1973.**
- **Lower income consumers have been hurt the most by the 1973 inflation because a high proportion of their purchases are necessarily concentrated in such items as food, housing, and fuel, where price increases have been particularly severe. As a result, the impact of higher prices on lower income consumers was about one-fourth larger than on other consumers in 1973.**
- **There is no indication at this time that the rate of inflation will moderate in 1974 and consequently the real purchasing power of consumers is likely to continue to decline. In view of the recent slowdown in economic activity, and the energy crisis, unemployment will certainly increase during 1974. This situation of higher prices and fewer jobs will further erode consumer income and confidence, which in turn will add substantially to recessionary prospects in 1974.**

II. HOW SEVERE WAS THE 1973 INFLATION?

Today's headlines about inflation can be better understood in some historical context. Comparison with other points of reference enable us to answer the question: how severe was the 1973 inflation? Table 1 is a review of inflation in the United States since 1960, as measured by the Consumer Price Index (CPI), the Wholesale Price Index (WPI), and the Gross National Product implicit price deflator.

The early 1960's was the longest period of reasonable price stability in the post-World War II era. The average annual rate of price increase measured by the GNP deflator from 1961–65 was only 1.4 percent, considerably less than the post war average of 2.7 percent. For the same period, the Consumer Price Index rose at an average rate of just 1.3 percent and the Wholesale Price Index edged up by only 0.7 percent per annum. Industrial commodity prices were practically stable at the wholesale level over this period, and food prices at retail rose at an average annual rate of only 1.5 percent.

Beginning in 1965, however, and primarily as a result of the strong upsurge in government spending due to the Vietnam War buildup, the demand for resources increased sharply and prices began to rise more rapidly than they had in the 1961–65 period. Wholesale prices rose 1.7 percent in 1966. In the first quarter of 1966, the GNP deflator climbed at an annual rate of 3.1 percent—the largest increase in 8 years. Consumer prices jumped from an average 1961–65 annual rate of 1.3 percent to an annual rate of 3.4 percent in 1966. Although this acceleration in prices slacked somewhat in early 1967, due primarily to a fall in prices for farm products and processed foods and feeds, the retardation of the rate of inflation was short-lived. During 1968 and 1969 the rate of inflation measured by the CPI continued to rise by over 1 percent annually. In 1969 consumer prices rose 6.1 percent, considerably more rapidly than at any time since 1951.

Attempts by the Nixon Administration to control this inflation focused almost entirely on reducing aggregate demand through highly restrictive monetary and fiscal policy. So severe were the policies that real Gross National Product declined in the fourth quarter of 1969, as well as in the first quarter of 1970 and, although there was some positive economic growth in the second and third quarters of 1970, GNP declined in real terms for the full year 1970. Unemployment during 1970 rose rapidly as a result—from 3.9 percent in January to 6.0 percent in December. By 1970 not only had excess demand been eliminated from the economy, but restrictions on demand had been overdone and this precipitated the first U.S. recession in ten years.

But the Administration's policy of severe fiscal and monetary restraint produced only modest reductions in the rate of inflation. Although the rate of increase in wholesale prices slowed somewhat in 1970, consumer prices continued their rapid rise. The Consumer Price

28-006—74——2

Index edged down only slightly from its high of 6.1 percent in 1969 to 5.5 percent during 1970. Prices as measured by the GNP deflator rose 5.4 percent in 1970.

By early 1971 it was clear that the Administration's crude use of monetary and fiscal policy had backfired as an anti-inflation strategy, failing to dampen inflationary expectations, and providing no selective expenditure, or price-wage policies that would encourage jobs and productivity.

Recognizing the failure of these policies, the Administration dramatically reversed itself and launched the New Economic Policy (NEP) in August 1971. The first aim of the new program was to dampen the inflationary spiral with a wage-price freeze and guidelines. In addition, fiscal policy shifted to stimulate the economy by encouraging private capital expansion and increasing Federal Government expenditures. Although unbalanced in several respects, the New Economic Policy was clearly superior to previous Administration policies, causing output to rise, unemployment to fall, and price increases to moderate. The New Economic Policy ushered in the best price performance experienced under the Administration. The Consumer Price Index increased only 3.4 percent in 1971, down from the 5.5 percent increase experienced during 1970, and this rate of increase in the CPI was maintained during 1972. Comparing it with the decade of the 1960's, the annual rate of consumer price increase from August, 1971 to December 1972, 3.2 percent, falls between the low 1.3 percent rate of CPI inflation for the 1961–65 period and the considerably higher 4.5 percent rate of inflation for the 1966–70 period. Although not an outstanding record, an annual rate of price increase of 3.2 percent cannot be called a failure in the inflationary environment of the late 1960's and early 1970's.

The Administration's record on prices, unfortunately, does not end in 1972. In what has been the most dramatic increase in inflation since World War II, wholesale and retail prices climbed to record highs in 1973. From a 6.5 percent annual increase in 1972, wholesale price increases jumped threefold to 18.2 percent in 1973. Farm product prices rose from an annual rate of 18.7 percent in 1972 to an annual rate of 36.1 percent during 1973. In other words, the Administration's anti-inflation program yielded wholesale price increases over three times their rate during 1972, and about 12 times their historical average increase during the 1960's.

As could be expected, consumer prices followed wholesale price increases, although they have not yet fully reflected those increases. In 1973 consumer prices increased about 8.8 percent, or 5 percentage points more than a year ago. Price increases for food accounted for about 51 percent of the overall Consumer Price Index rise in 1973, surging at a 20 percent annual rate. This 1973 rate represents a five-fold jump in food price increases over the average annual rate of increase for the period 1965–70—the most spectacular increase in food prices since the 1920's. In addition, non-food commodity and services prices have risen substantially above their 1972 rates of increase.

In his Economic Report to the Nation for 1973 the President said: "Consumer prices increased a little more than 3 percent from 1971–72—a far cry from the runaway inflation rate of 6 percent that confronted us in 1969." While the President is justifiably proud of his 1972 price stability record, his 1973 record was far worse than the 6 percent "runaway" inflation of 1969. Consumer prices increased about 9 percent—three percentage points higher than what the President described as runaway inflation—and three times higher than the rate of inflation during the 1960's. The 1973 inflation was in fact the most severe experienced by the United States since the post-World War II year of 1947.

TABLE 1.—CHANGES IN SELECTED PRICE INDEXES, 1960-73

[Percent change per year][1]

Period	GNP deflator: Total	GNP deflator: Private	GNP deflator: Private nonfarm business	Consumer Price Index: All items	Consumer Price Index: Food	Consumer Price Index: Nonfood commodities	Consumer Price Index: Services	Wholesale Price Index: All commodities	Wholesale Price Index: Farm products	Wholesale Price Index: Processed foods and feeds	Wholesale Price Index: Industrial commodities
1961	1.1	0.7	0.8	0.7	−0.9	0.6	1.9	−0.2	−0.9	1.1	−0.1
1962	1.1	1.0	0.8	1.2	1.5	0.7	1.7	0.0	1.5	0.5	−0.2
1963	1.4	1.1	1.1	1.6	1.9	1.2	2.3	−0.1	−4.1	0.3	0.5
1964	1.7	1.4	1.4	1.2	1.4	0.4	1.8	0.4	−0.6	0.0	0.6
1965	1.7	1.5	1.0	1.9	3.4	0.7	2.6	3.4	11.1	6.9	1.4
Average: 1961-65	1.4	1.1	1.0	1.3	1.5	0.7	2.1	0.7	1.4	1.8	0.4
1966	3.5	3.3	3.2	3.4	3.9	1.9	4.9	1.7	−1.2	2.2	2.2
1967	3.5	3.0	3.1	3.0	1.2	3.1	4.0	1.0	−2.7	−1.2	1.9
1968	4.1	3.8	3.5	4.7	4.3	3.7	6.1	2.8	4.4	3.0	2.7
1969	5.3	5.0	4.7	6.1	7.2	4.5	7.4	4.8	8.4	6.8	3.9
1970	5.4	4.8	5.3	5.5	2.2	4.8	8.2	2.2	−4.7	0.8	3.6
Average: 1966-70	4.4	4.0	4.0	4.5	3.8	3.6	6.1	2.5	0.8	2.3	2.9
1971	3.6	3.2	2.7	3.4	4.3	2.3	4.1	4.0	8.1	4.7	3.2
1972	3.3	3.2	2.4	3.4	4.7	2.5	3.6	6.5	18.7	11.6	3.6
1973	7.1	7.1	6.8	8.8	20.1	5.0	6.2	18.2	36.1	20.3	14.8
1972: I	5.7	4.9	4.5	3.3	6.5	3.1	4.4	4.6	7.1	5.6	4.1
II	1.6	1.6	0.6	2.5	0.3	2.0	3.1	4.9	12.4	2.4	4.3
III	2.8	2.7	1.8	4.4	7.7	3.7	3.0	7.2	32.6	9.7	3.4
IV	3.3	3.5	2.9	3.4	4.9	1.3	3.9	9.4	23.6	30.9	2.4
1973: I	6.1	5.7	4.1	8.6	28.6	4.0	3.6	21.1	77.3	37.1	10.2
II	7.3	7.6	5.5	7.4	14.7	5.4	4.5	23.4	61.0	31.9	14.9
III	7.0	7.3	4.3	10.3	28.8	2.6	7.4	13.2	67.3	14.8	4.5
IV	7.9	7.7	13.4	9.0	9.2	7.9	9.4	15.5	−28.1	1.3	31.3

[1] Annual percent changes for GNP data are calculated from 4th quarter to 4th quarter. Annual percent changes for WPI and CPI data are calculated from December to December. Quarterly percent changes are expressed at compound annual rates.

Source: Bureau of Labor Statistics, Department of Labor, Bureau of Economic Analysis, Department of Commerce, and Joint Economic Committee.

III. WHICH CONSUMER PRICES INCREASED?

The overall Consumer Price Index measures the month to month change in the price of a "market basket" of goods and services usually purchased by urban wage earners and clerical workers. The current market basket, introduced in 1964 and based on a 1960–61 survey of consumer expenditures, consists of prices of about 400 items that were thought to be representative of all the goods and services purchased by wage earners and clerical workers.[1] The major categories of expenditures, and the importance they have in the market basket, are identified in the first column of Table 2. Certain items, such as food and housing, are given heavy weight in the market basket to reflect their importance in total consumer expenditures. Such a breakdown of the CPI market basket gives a more detailed picture of the many goods and services urban consumers buy and the relative importance of each.

The fact that the Consumer Price Index is based on a composite of the prices of certain goods and services means that the aggregate CPI number gives at best a limited view of price movements, and at worst may mask important prices changes. The aggregate CPI numbers for a particular month, for example, the 0.3 percent increase reported in September 1973, are really a national average calculated from price changes in 54 urban areas, with the price changes in each area based on the average monthly price change for the 400 items in the market basket. But in almost every month some individual prices will increase less than the national average, or even decline, as fruits and vegetable prices declined 7.2 percent in September. On the other hand, every month some prices will rise more than the national average, as dairy product prices increased 2.9 percent in September. Only by examining the details of price changes for the major components of the Consumer Price Index market basket can we get a comprehensive picture of current price movements.

Still another reason to examine the details of recent consumer price increases is to test the Administration proposition that consumers have exaggerated the seriousness of inflation overall because of the recent rapid increase in food prices. In an August 23, 1973, press conference, for example, in response to a question about why the Administration believes housewives "exaggerate" the seriousness of the

---

[1] Obviously these 13-year-old expenditure patterns are somewhat dated and do not take account of shifts in purchasing habits, the introduction of new items, and so forth. New information on actual spending patterns will not be available until the BLS ongoing 1972–73 Survey of Consumer Expenditures is completed, perhaps by 1977. They also do not actually reflect the often very different spending patterns of individuals and families who are not wage earners and clerical workers, such as the retired, farmers, managers, and the self-employed.

current inflation, Dr. Herbert Stein of the Council of Economic Advisers offered the following observation:

> Well, if she were willing to sit down with me and examine that question, I would ask her if she remembered what her income was a year ago, if she kept a budget, and estimated the increase in the cost of all of the things she buys, including the housing in whatever form it comes, the insurance premiums, medical costs, and so on, and whether she has, in other words, a true perception of what has happened to her cost of living, as distinguished from a perception she may have from having seen the price of chicken yesterday go up from 69 to 79 cents. It may be. I don't doubt that there may be people who are worse off. There are always people who are worse off. But what I am suggesting is that analysis of individual cases would show that people are better off than they are likely to think in circumstances such as we now have.

So, putting ourselves in the position of examining what specific prices have increased, and by how much, as Dr. Stein suggests, what do we find?

TABLE 2.—ANNUAL RATES OF CHANGE FOR SELECTED COMPONENTS OF THE CONSUMER PRICE INDEX, 1960 THROUGH 1973

	Relative importance[1]	1960–70	1971	1972	1973	1973, I[2]	1973, II[2]	1973, III[2]	1973, IV[2]	Contribution to inflation in 1973[1][3]
Food	22.5	2.7	4.3	4.7	20.1	28.6	14.7	28.8	9.2	0.51
Cereals and bakery	2.2	2.3	2.0	1.8	28.2	10.4	14.9	34.7	58.2	0.07
Meats, poultry and fish	6.0	2.7	4.6	10.3	26.4	71.4	9.8	71.0	−20.8	0.18
Fruits and vegetables	3.0	2.5	12.5	2.3	14.1	20.8	31.2	−18.3	31.3	0.05
Apparel	9.0	2.6	2.2	2.7	4.1	3.9	4.9	4.2	3.5	0.04
Housing	33.9	2.8	3.4	3.5	7.1	3.7	4.6	8.3	11.9	0.27
Rent	5.1	1.8	3.8	3.5	4.9	6.1	4.0	4.6	4.9	0.03
Homeownership	16.4	4.1	2.7	4.1	7.7	2.3	5.7	10.9	12.4	0.14
Fuels, utilities	4.7	1.2	5.9	3.7	11.4	7.8	5.6	4.5	29.5	0.06
Furnishings operation	7.3	1.9	3.7	2.3	4.7	2.0	4.3	5.6	6.8	0.04
Transportation	13.1	2.3	1.5	2.4	4.5	2.7	7.1	2.6	5.6	0.07
New cars	2.1	0.3	−3.2	0.2	1.3	3.0	5.2	6.6	−8.9	0.00
Used cars	2.1	2.2	−2.1	7.3	−2.1	−4.4	33.9	−6.4	−23.2	−0.01
Public transportation	1.4	4.7	4.7	3.4	1.4	−4.6	2.8	3.6	3.9	0.00
Gas and oil	2.9	1.3	−0.1	2.6	18.6	7.4	25.5	−5.9	55.8	0.06
Medical care	6.4	4.3	4.8	3.3	5.2	2.7	3.6	3.3	11.5	0.04
Personal care	2.6	2.3	2.5	3.1	6.3	5.4	6.0	4.6	9.5	0.02
All items	100.0	2.7	3.4	3.4	8.8	8.6	7.4	10.3	9.0	1.00

1 Components will not add to total since some expenditure categories have been omitted.
2 Percent changes expressed at seasonally adjusted compound annual rates.
3 Calculated by multiplying the relative importance of each component by its annual rate of change in 1973 and dividing this total by the annual rate of change in the overall CPI.

Source: Bureau of Labor Statistics, Department of Labor, and Joint Economic Committee.

Table 1 shows how consumer prices have increased for the categories of food, nonfood commodities, and services. It is immediately apparent that increases in food prices are the most important single cause of recent aggregate price increases, with food prices increasing 20.1 percent in 1973, about 14 times the 1.5 percent increase for the 1961–65 period, and about five times the food price increase during the 1966–70 period. So it is accurate to emphasize these extraordinary increases in food prices as an explanation of the current inflation, as the Administration has done.

But in addition to these staggering increases in food prices, the prices for nonfood and service items have also risen much faster in 1973 than they did during the decade of the 1960's. The 1973 annual rate of price increase for nonfood items sold at retail was 5.0 percent, double what it was one year ago, and a great deal more than the 2.7 percent average for the 1960's. Likewise, service prices accelerated from annual rates of 3.6 percent in the first quarter of 1973 to 9.4 percent in the fourth quarter of 1973, compared to an average annual increase of 4.1 percent in the 1960's. It is clear from this evidence that all of the broad categories of consumer items have experienced price increases in 1973 substantially above the historical price standards of the 1960's.

It is possible to examine price increases within the Consumer Price Index in even greater detail by focusing on the expenditure classes for various items. Table 2 shows price increases from the early 1960s forward for the expenditure classes of food, apparel, housing, transportation, fuel, medical care, and personal care. Let us examine what has happened to the prices for these essential consumer items during 1973.

Food.—As we have already indicated, food prices in 1973 have soared to an annual rate of 20.1 percent, eight times the average annual rate of increase during the 1960's. Increases in meat prices were the most important single cause of this food price spiral, with vegetables and fruits the second most important area of food price inflation.

Housing.—Although not as well publicized as the food price explosion, prices for housing and related items escalated rapidly during 1973. As the quarterly data in Table 2 indicate, housing prices shot up from a 3.7 percent annual rate in the first quarter of 1973 to an 11.9 percent annual rate in the fourth quarter of 1973. Compared to the 1960's, when housing prices increased at an average annual rate of 2.8 percent, price increases for housing have more than doubled to a 7.1 percent annual rate during 1973. Given that housing has a relative importance of about 34 percent in the Consumer Price Index, this means prices for housing account for about 27 percent of the 1973 inflation.

A breakdown of the price increases in the housing category also reveals how much specific household commodities and services increased. Rent increases accelerated, for example, from a 1.8 percent average annual rate in the 1960's to a 4.9 percent annual rate in 1973, more than doubling the rate of increase. The cost of owning and operating a home showed an even higher rate of price increase, escalating from 2.3 percent in the first quarter of 1973 to a 12.4 percent annual rate in the fourth quarter of 1973. In 1973 prices related to homeownership increased 7.7 percent, a considerable increase above the 4.1 percent average annual rate for the 1960's. Household furnishing prices contributed significantly to the rise in housing prices, increasing by 4.7 percent in 1973, double their historical rate. As with other housing prices, price increases for furnishings accelerated in the fourth quarter.

Transportation.—The third category of significant price increases for 1973 was transportation, accounting for about 7 percent of the inflation. Overall transportation prices increased from an average annual rate of 2.3 in the 1960's to an annual rate of 4.5 in 1973 due primarily to sharply rising fuel prices. This overall price increase was the product of price increases and decreases that took place during this period. Public transit prices, for example, dropped from an average annual increase of 4.7 percent for the 1960's to a 1.4 percent rate of increase in 1973. New car prices accelerated very sharply during the first 9 months of 1973 but dropped 9 percent in the fourth quarter as the fuel crisis dampened large car sales. Used car prices dropped dramatically in the third and fourth quarters for the same reason.

Fuel.—Fuel prices, which increased at rates substantially higher than historically, accounted for 12 percent of the inflation in 1973. As fuel prices rose sharply in the fourth quarter, increases in heating oil, coal, gasoline and motor oil accounted for 33 percent of the CPI inflation in the last 3 months of the year. Home heating fuel and utility prices rose 11.4 percent for the year with a 29.5 percent increase in the fourth quarter accounting for much of the rise. The overall 29.5 percent increase in the fourth quarter masks much sharper increases for oil and coal prices, however. Electricity and natural gas prices, which are also included in the fuel and utility component, changed very little because they are stricly regulated at either the Federal or State level. However, home heating oil and coal prices rose 177 percent in the fourth quarter of 1973.

Prices for gasoline and motor oil also rose sharply during the year. In the first half they increased about 16 percent. In the third quarter, BLS reported a drop in gas and oil prices of 5.9 percent, a drop which was largely a statistical fluke. In September the Cost of Living Council announced changes in the method for computing price ceilings for gasoline. Two weeks later, after repeated protests from gas station owners, the regulations were again revised. The regulation changes precipitated a short-lived drop in gasoline prices during which time BLS happened to be collecting its monthly statistics on retail gas prices. The fourth quarter rise in gas and oil prices of 55.8 percent is more representative of the actual movement of prices in the second half of the year.

Apparel.—Prices for clothing, shoes, and other apparel items also showed considerable acceleration during the recent inflation, jumping from an annual average of 2.6 in the 1960's to an annual rate of 4.1 percent during 1973. Although modest compared to the price escalation in other categories of goods and services, such as food and housing, the 1.5 percentage point jump in apparel prices contributes to the consumer's perception that most retail prices are escalating.

Medical Care.—Prices for medical care increased 5.2 percent in 1973, a rate somewhat higher than that experienced in the 1960's. However, quarterly changes in these costs as reported by the Bureau of Labor Statistics are very misleading in that health insurance premium price changes are reflected only in the October CPI. The Committee staff is looking into the feasibility of improving data on health insurance premium costs, which are the major source of the problem of accurately measuring this component.

The above review indicates that consumers are essentially correct in their view that "all prices are rising faster than usual." Although food was the major area of inflation during 1973, contributing 51 percent of the overall inflation measured by the CPI, housing price increases contribured to 27 percent of the inflation, transportation price increases contributed 7 percent, and apparel price increases 4 percent. Moreover, all of the above areas of consumer expenditures had price increases substantially above their historical average rates during the 1960's, and above the price increases that occurred during 1972. As 1973 price increases for housing, apparel, and transportation were almost twice as large as they were during 1972, it is not hard to conclude that the consumer was right in his perception that the 1973 inflation was broadly based.

IV. HOW HAVE HIGHER PRICES AFFECTED THE COST OF LIVING?

Although the public thinks of the Consumer Price Index as a cost of living index, it falls short of being a true cost of living index in several ways. First, it does not include the cost of income and social security taxes. Second, the Consumer Price Index assumes that the market basket mix of goods purchased remains constant. In fact, consumers shift the composition of their purchases both in response to relative price changes and in response to changing tastes and styles. Thus, the Consumer Price Index does not precisely measure the final price changes on the consumer's overall budget. We would like to know how many extra dollars consumers had to spend to maintain their living standards in 1973, how inflation influenced the allocation of their budget dollar, how much of the budget dollar went for increased tax payments, and so on.

Unfortunately there is no existing government index or set of statistics that tell us how families actually spent their money as they attempted to grapple with the 1973 inflation. New information on actual spending patterns will not be available until the current Bureau of Labor Statistics 1972–73 Survey of Consumer Expenditures is completed, perhaps in 1977.

The Bureau of Labor Statistics has developed a set of three family budgets, however, that do show how much it costs a family of four persons to maintain certain hypothetical living standards. Cost of living estimates are developed by translating a general living standard—such as low-budget, intermediate-budget, or higher-budget—into a list of the commodities, services, and taxes necessary to reach those general standards. In this way the three family budgets developed by BLS become benchmark estimates of the budget costs for different standards of living.

Creation of a family budget series must be based on a specific family situation. The BLS family budgets are for a precisely defined urban family of four: A 38-year-old husband employed full time, a nonworking wife, a boy of 13, and a girl of 8. The family has been in existence for 15 years, the husband is an experienced worker, and the family has, for each budget level, average inventories of clothing, house furnishings, durables, and so forth.[1]

The most recent family budget data available is that which was released by the Bureau of Labor Statistics in June 1973 covering the time period from Autumn 1971 to Autumn 1972. The Committee staff has updated these data to Autumn 1973 by applying changes in the Consumer Price Index to the Autumn 1972 budget costs for each major class of goods and services. In addition, the staff has made new

[1] For further details about the specifications of the families for each budget level, see: "Three Budgets for an Urban Family of Four Persons, 1969, 1970." Supplement to BLS Bulletin 1570-5, Autumn 1972, "Urban Family Budgets and Comparative Indexes for Selected Urban Areas."

estimates for 1973 income and social security taxes. The results of these changes and their influence on total budget costs are illustrated in Table 3, and several aspects deserve emphasis.

First, the increase in the overall costs of maintaining living standards rose much more during 1973 than in 1972 or historically. The family with a middle budget of $12,614, for example, had to pay an extra $1,168 just to maintain their 1972 living standards in 1973. Compared to 1972, when budget costs for a comparable family rose $475, these 1973 budget cost increases more than doubled. The additional costs of maintaining the higher budget standard of the family with a budget of $18,130 were $1,572 in 1973, compared to an increase of $653 in 1972. The percentage cost increase over the year for the two budgets was at the extraordinarily high rate of 9 percent—almost one-tenth of the consumer's total budget.

Second, there is an especially dramatic shift in budget cost increases for the lower budget family when 1972 and 1973 are compared. The family with a $8,116 budget had to pay an extra $730 in 1973 to maintain 1972 living standards, compared to a budget cost increase of only $172 in the previous year. Thus, the escalation of budget costs for the lower budget family between 1972 and 1973 was almost three times greater than for a middle or high budget family.

Third, increased budget costs for food are the primary reason that total consumption costs for all three living standards rose so rapidly. Food costs for the low budget family jumped from $2,058 in 1972 to $2,445 in 1973—an increase of $387. The budget food costs for the middle and higher budget families increased even more in absolute dollar terms—due to higher eating standards—with jumps of $502 and $634 respectively. At all three budget levels, the dollar increase in food costs during 1973 were about four times greater than those dollar increases were in 1972.

Moreover, the rapid rise in food prices has increased the share of the budget dollar allocated for food costs at all three budget levels. For the lower budget family, the percent share of the budget allocated for food rose from 27.9 to 30.0—an increase of about 2 percentage points. The percent share of the budget allocated for food increased from 23.4 to 25.2 for the intermediate budget family, and from 20.4 to 22.1 for the higher budget family. The somewhat larger increase in the share of the budget devoted to food in the lower budget is of course due to the greater proportion food is of the total budget costs of low income families.

Fourth, as we would expect from our analysis of the expenditure categories of the Consumer Price Index, the budget costs for most other consumption items also increased considerably more in 1973 than they did in 1972. Comparing columns (2) and (6), we see significantly larger dollar increases for all consumption items. The only component which increased less than in 1972 was housing for the intermediate and higher budget families.[2]

[2] This decline in housing costs appears to be a result of the peculiar way housing costs are estimated in this index rather than a real-world decline in those costs. Homeownership budget costs, which account for 75 to 86 percent of the housing costs for the intermediate and higher budget classes, are derived from a detailed calculation that assumes continuing payments on a six-year old house. The effect of this procedure is noticeable in the sharp jump in budget housing costs from 1971 to 1972, six years after a substantial rise in mortgage rates from 1965 to 1966.

TABLE 3.—ANNUAL BUDGET COSTS AT 3 LEVELS OF LIVING FOR A 4-PERSON FAMILY: AUTUMNS 1972–73

Family and item	Autumn budget, 1972	Budget dollar increase, 1971–72	Percent budget dollar increase, 1971–72	Percent share of budget, 1972	Autumn budget, 1973	Budget[1] dollar increase, 1972–73	Percent budget dollar increase, 1972–73	Percent share of budget, 1973
Lower budget:								
Food	2,058	94	4.8	27.9	2,445	387	18.8	30.0
Housing	1,554	38	2.5	21.0	1,646	92	5.9	20.3
Transportation	546	10	1.9	7.4	563	17	3.1	6.9
Clothing and personal care	864	16	1.9	11.7	905	41	4.7	11.2
Medical care	629	20	3.3	8.5	660	31	5.0	8.1
Other consumption	378	10	2.7	5.1	408	30	7.9	5.0
Total consumption	6,029	188	3.2	81.6	6,627	598	9.9	81.7
Other items	365	8	2.2	4.9	394	29	7.9	4.9
Social security[2]	397	10	2.6	5.4	442	45	11.3	5.4
Personal income taxes[3]	595	−34	−5.4	8.1	653	58	9.7	8.0
Total budget	7,386	172	2.4	100.0	8,116	730	9.9	100.0
Intermediate budget:								
Food	2,673	141	5.6	23.4	3,175	502	18.8	25.2
Housing	2,810	172	6.5	24.6	2,975	165	5.9	23.6
Transportation	979	15	1.6	8.6	1,009	30	3.1	8.0
Clothing and personal care	1,217	22	1.8	10.6	1,274	57	4.7	10.1
Medical care	632	20	3.3	5.5	664	32	5.0	5.3
Other consumption	702	18	2.6	6.1	757	55	7.9	6.0
Total consumption	9,013	387	4.5	78.7	9,854	841	9.3	78.0
Other items	576	16	2.9	5.0	622	46	7.9	4.9
Social security	482	63	15.0	4.2	632	150	31.1	5.0
Personal income taxes	1,375	9	0.7	12.0	1,506	131	9.5	11.9
Total budget	11,446	475	4.3	100.0	12,614	1,168	10.3	100.0

Higher budget:								
Food	3,370	172	5.4	20.4	4,004	634	18.8	22.1
Housing	4,234	254	6.4	25.6	4,484	250	5.9	24.8
Transportation	1,270	20	1.6	7.7	1,309	39	3.1	7.2
Clothing and personal care	1,770	30	1.7	10.7	1,853	83	4.7	10.1
Medical care	659	21	3.3	4.0	692	33	5.0	3.8
Other consumption	1,159	30	2.7	7.0	1,251	92	7.9	6.9
Total consumption	12,462	527	4.4	75.3	13,593	1,131	9.1	74.9
Other items	967	30	3.2	5.8	1,043	76	7.9	5.8
Social security	482	63	15.0	2.9	632	150	31.1	3.5
Personal income taxes	2,647	33	1.3	16.0	2,862	215	8.1	15.8
Total budget	16,558	653	4.1	100.0	18,130	1,572	9.5	100.0

[1] Autumn 1973 budget dollar increases are calculated on the basis of Consumer Price Index percent changes from October 1972 to October 1973.

[2] Social security payment increases are projected historical growth due to income changes plus the increase in individual tax rate from 5.25 to 5.85 (January 1973), and the increase in the maximum base on which the tax is computed from $9,000 to $10,800.

[3] Personal income tax changes are estimated on the basis of the historical average for 1972 projected to 1973. It is assumed that income changes for 1973 are equal to budget changes, with income tax levels initially held to 1972 levels, then adjusted higher so that income taxes continue to be the same proportion of the budget as they were in 1972. The resulting 1973 change in income tax payments has a variability of a few dollars as a result of the procedure.

Fifth, in addition to increased costs for consumption items, it appears that tax payments also added substantially more to the budget costs of consumers in 1973 than they did in 1972. Because of the higher social security tax rates enacted in 1973 the staff estimates an 11 percent rise in social security payments for the low budget family over 1972, and a 31 percent rise in payments for the intermediate and higher budget families. The family with a middle budget of $12,614, for example, had to pay $632 for social security in 1973, $150 more than in 1972. The increased cost of social security payments was so large in 1973 that it increased its share of the average consumer's budget from 4.2 to 5.0 percent.

Personal income tax payments can also be expected to rise 8–9 percent over 1972 for all three budgets as a result of increasing money income levels, which were not offset by new reductions in Federal income taxes paid, such as those associated with the 1971 Revenue Act. This means that compared with almost no increase in 1972 for the intermediate budget family, income tax payments increased $131 in 1973, to a level of $1,506. The shift is even more dramatic for the low income family, where a $34 tax reduction in 1972 was replaced with a $58 increase in tax payments in 1973.

As one can see, the budget costs of consumers rose dramatically during 1973, primarily as a result of inflation, but to some extent because of increased tax payments. The major increase in costs was for food, although other consumption items and taxes are seen to be substantially higher than 1972 levels. The additional budget costs for low income families showed the greatest escalation over 1972, with a spectacular threefold rise. Although these estimates may be high because they do not adjust for consumer shifts in expenditure patterns in response to higher prices, or do not adjust for the benefit increases associated with tax increases, they are nevertheless the best approximations available. We also have not discussed to what extent income increases may have offset these cost increases, a subject to which we now turn.

V. WHAT HAS HAPPENED TO CONSUMER PURCHASING POWER?

To look at the effect of higher prices on the cost of living and consumer budget expenditures is to examine only one side of the ledger. Consumers usually experience higher incomes during an inflation, which will increase the size of their budgets in monetary terms, and this may offset price increases. Thus, in addition to looking at the cost of living, it is necessary to examine consumers' real purchasing power, i.e., their income gains adjusted for the price increases that have occurred. The question then becomes, did the real purchasing power of consumers increase during 1973, and did it keep pace with historical increases?[1]

Throughout the year Administration spokesmen insisted that real purchasing power showed an extraordinary rise and did so aggressively and without qualification. They said several times during 1973 that the American consumer was better off in terms of his real purchasing power, and that consumers were in fact confused if they thought otherwise.

On August 1, 1973, for example, Dr. Herbert Stein told the Joint Economic Committee:

> Probably the key thing to say is that the real per capita incomes of the American people, after allowing for inflation, rose substantially from the fourth quarter of 1972 to the second quarter of 1973 and were much higher than ever before. This is the fundamental measure of the performance of the economic system. We are interested in the inflation problem almost entirely in relation to the behavior of real incomes. Thus, people are interested in whether the inflation is changing the distribution of income in a way that they regard as adverse. We are interested in whether the inflation threatens to bring the growth of real incomes to an end.

Dr. Gary Seevers made the same basic case to the Joint Economic Committee about 2 months later, although the argument had become somewhat embellished.

> In other words, the level of living of the *average* American family was not only significantly higher than a year earlier, despite widespread feelings to the contrary, but the improvement was substantially better than the average annual improvement in the past 10 years.

---

[1] Purchasing power is defined to include the purchase of savings if so desired by the consumer, but does not take into account the accretion in income brought about by any appreciation in consumer assets. Purchasing power can therefore be though of as the current flow of economic resources into the household, apart from the stock of economic resources in the household and, in this sense, purchasing power is less than a complete measure of economic well-being.

Such statements do not give an accurate picture of what happened to the real purchasing power of the American consumer in 1973. These statements, which are just examples of many others made by the Administration, are based on a selective use of statistics, where the time period, statistical series, or unit of measure is varied so as to mask the true impact of inflation on consumer purchasing power in 1973.

Because there are several ways one can measure changes in consumer purchasing power or income, Table 4 lists nine of the major income and earnings measures available. Income improvements are examined in the discussion below in a variety of ways: On an hourly basis, in terms of gross weekly pay, weekly pay on an after-tax basis, and in terms of per capita and household units. All the statistical series are examined over a relatively long period of time in order to provide some historical perspective on the question of changes in purchasing power during 1973. With the table before us, it is clear that by any reasonable measure, the real purchasing power of consumers seriously declined during 1973, or increased less than historically.

TABLE 4.—ANNUAL RATES OF CHANGE FOR SELECTED MEASURES OF INCOME AND EARNINGS[1]

	1965–69	1970	1971	1972	1973	1973:I	1973:II	1973:III	1973:IV
Disposable income, current prices	8.4	7.8	7.5	9.0	10.9	11.5	8.8	10.2	12.6
Disposable income, 1958 prices	4.0	3.1	4.4	6.1	3.2	6.1	0.6	3.1	2.9
Per capita disposable income, 1958 prices	2.8	2.0	3.3	5.3	2.4	5.3	−0.1	2.4	2.1
Disposable income deflated by CPI[2]	3.2	2.9	4.0	6.4	1.5	5.2	−0.4	−1.2	2.4
Per household disposable income deflated by CPI[2]	1.9	−0.1	1.5	2.1	−1.2	2.4	−3.6	−2.9	−0.9
Real adjusted hourly earnings, private nonfarm	1.5	0.9	2.4	3.6	−1.6	−1.0	−1.6	−1.0	−2.6
Real compensation per man-hour, total private	2.9	0.9	3.2	3.5	1.4	5.2	−2.3	−1.7	−1.7
Real gross weekly earnings, private nonfarm	0.7	−1.8	3.5	3.4	−1.7	−1.6	0.0	−1.2	−3.8
Real spendable weekly earnings[3]	−0.4	−1.3	3.5	4.3	−3.1	−5.0	−1.0	−2.0	−4.4

[1] Percent changes for annual data are based on 4 quarter changes, from 4th quarter to 4th quarter; percent changes for quarterly data are based on quarterly averages expressed at compound annual rates.
[2] Data provided by the Survey Research Center, University of Michigan.
[3] Earnings expressed in 1967 dollars for a worker with 3 dependents.

Source: Bureau of Labor Statistics, Department of Labor; Survey Research Center, University of Michigan, and Joint Economic Committee.

Real Adjusted Hourly Earnings.—Looking first at purchasing power in terms of hourly earnings, the real adjusted hourly earnings index provides the best measure of how well wage rates have kept pace with the recent inflation. This series measures what has happened to the hourly wage for production and nonsupervisory workers in the private nonfarm economy, adjusted for changes in overtime, interindustry shifts in employment, and price increases. As one can see in Table 4, this index fell 1.6 percent during 1973, compared to a 3.6 percent increase in 1972. Thus, in terms of what production-related workers earn, it is evident that hourly wages did not keep up with inflation during 1973.

Real Compensation per Man-Hour.—Real compensation per manhour in the total private economy is a broader measure of labor payments per hour than the real adjusted hourly earnings index and provides still another measure of purchasing power. In addition to standard wage payments, it includes overtime earnings, fringe benefits, and gains in earnings brought about by workers moving to higher paying industries. The real compensation per man-hour statistics also have a somewhat broader coverage, including supervisory workers, self-employed persons, private household workers, and farm employees. This broader measure of purchasing power has the advantage of incorporating nonwage returns into an hourly measure of labor payments, but overstates the hourly wage rate to labor by including such items as overtime payments.

Due principally to its inclusion of fringe benefits and compensation to salaried workers and farmers, real compensation per man-hour held up better than real adjusted hourly earnings between 1972 and 1973. Nevertheless, from an annual increase of 3.5 percent in 1972, real compensation per man-hour increased only 1.4 percent in 1973, with actual declines of 2.3, 1.7, and 1.7 percent in the last three quarters of 1973. Even counting fringe benefits and overtime, the typical worker is currently not able to keep up with inflation.

Real Gross Average Weekly Earnings.—It is also possible to look at what has happened to purchasing power in terms of weekly earnings, which is done with the real gross average weekly earnings series shown in Table 4. This series differs from the adjusted hourly series in that it takes into account the number of hours worked per week, which in turn depends upon such things as shifts in employment patterns, a change in the amount of overtime hours, increases in the number of part-time workers, and changes in scheduled hours of work. Roughly speaking, this series is a measure of the pretax weekly earnings of production-related workers corrected for inflation.

In recent years, the weekly pay series has tended to increase less than adjusted hourly earnings on a real basis primarily because of a secular decline in the workweek and cyclical swings in the workweek due to the business cycle. But as we can see from Table 4, during the four quarters of 1973 average weekly earnings declined at roughly the same rate as adjusted hourly earnings, and substantially more than real compensation per man-hour. Real weekly earnings declined 1.7 percent in 1973, compared to an increase of 3.4 percent during 1972. As with the hourly earnings series, the declines become more pronounced in the fourth quarter.

Real Spendable Weekly Earnings.—Gross weekly earnings statistics do not tell us what income workers take home after taxes, however, which is what we need to know to determine what has happened to consumer purchasing power over private goods and services. The real spendable earnings series is such a take-home pay measure, and it is arrived at by adjusting gross weekly earnings for inflation, social security and income taxes, usually as they apply to a four-person family. The real spendable earnings series has some of the same deficiencies as the gross weekly series—it is influenced by such items as changes in part-time employment and hours worked per week—and significant tax changes can mask real earning improvements.[2] Never-

---

[2] For a thorough discussion of the limitations of the real spendable earnings series, see George Perry, "Real Spendable Weekly Earnings" in *Brookings Series on Economic Activity*, vol. 3, 1972.

theless, it is the only regularly available measure of the monthly after-tax pay a typical consumer actually receives.

By its very nature spendable weekly earnings are dramatically affected by tax changes, and recent tax increases have tended to hold this series below the other earnings series discussed above. Looking at 1973, this has meant a greater decline in purchasing power than that measured by other series, with real spendable weekly earnings declining 3.1 percent in 1973, and 4.4 percent in the fourth quarter alone. About half of this decline was due to price increases and half due to an increase in social security and Federal personal income taxes.[3]

Real Disposable Per Capita Income.—Real spendable weekly earnings provide a view of what has happened to after-tax purchasing power that is in several ways narrower than the real disposable per capita income measure of purchasing power. Developed from the National Income Accounts, disposable income statistics include all income receiving persons—wage earners, managerial personnel, the self-employed, and farmers—as well as nonprofit institutions and private trust and welfare funds. It includes all income received by these persons, such as wages, salaries, fringe benefits, dividends, rental income, personal interest income, and transfer payments. Finally, the disposable income statistics tend to incorporate a broader measure of taxes than the spendable earnings series, including important State and local tax levys. Overall, the real disposable per capita income series is one of the most comprehensive measures of the buying power of all persons in the economy. Due to its inclusion of all types of income, however, it is not as good a measure of the buying power of the average wage earner as the hourly and weekly earnings series.[4]

Because of its broader coverage, real per capita disposable income has historically tended to increase at a higher rate than the other measures of hourly and weekly earnings and rarely declines. As a result of the inflation of 1972, however, as we can see in Table 4, the rate of growth of real per capita disposable income fell from 5.3 percent in 1972 to a 2.4 percent rate of increase for 1973. In addition, real per capita disposable income actually declined during the second quarter of 1973, something that has occurred only five times in the last 20 years. Thus, even this broad measure of purchasing power has seriously deteriorated in the current inflation.

Real Household Income.—Even the small improvement in real per capita disposable income during 1973 looks much less satisfactory when viewed from the perspective of the rapid growth of households and increases in the Consumer Price Index. The disposable income statistics measure real income per person and correct for inflation using a price index called the implicit consumption deflator. Real household income statistics measure real income per family, or individual consuming unit, and usually correct for inflation using the Consumer Price Index. No issue arose about the merits of these alternative measures of real income in the past because increases in

[3] Effective Jan. 1, 1973, the Social Security tax rate was increased from 5.2 percent to 5.85 percent and the maximum base on which this tax is computed was raised to $10,800 from $9,000.

[4] For additional details on the merits and demerits of the disposable income series, see Paul M. Schwab, "Two Measures of Purchasing Power Contrasted," Monthly Labor Review, April 1971, pp. 3–13.

population have roughly paralleled the increase in households, and increases in the implicit consumption deflator have been about the same as those in the consumer price index. Of course conceptually they differ in that the disposable income series measures the real income gains for every individual in the Nation, while the household income series measures real income gains as they accrue to individual consumer units approximating families.[5]

Starting in the late 1960's, however, and due primarily to the higher rates of labor force growth and household formation of the post-World War II baby boom, real per household income only rose 2.0 percent while per capita disposable income rose 2.8 percent. As we can see from Table 4, real per household income declined 1.2 percent in 1973, falling by 3.6 percent in the second quarter, 2.9 percent in the third quarter and 0.9 percent in the fourth quarter. The decline for the last 9 months of 1973 is comparable to the declines in real income found in the hourly and weekly earnings statistics, and further reinforces the finding that real purchasing power declined over 1 percent during 1973.

As is plain from the above discussion, there is no measure of real income or purchasing power that is perfect. Different series of statistics measure somewhat different things. But the broad conclusion from a comprehensive review of all the measures is that there is no basis for arguing that the real income of consumers kept pace with inflation during 1973. All the measures of real purchasing power reviewed declined during 1973, except for real per capita income. Real compensation per man-hour showed an increase of 1.4 percent in 1973, with declines in the last nine months of 1973. The best measure of real family or household income declined 1.2 percent during 1973. This statistic is one of the better measures of what has happened to the purchasing power of American families and, in conjunction with the declines found among other measures of purchasing power, explains why consumers do not believe they were better off economically in 1973. It is because their real purchasing power in fact declined over 1 percent.

---

[5] For further discussion of the merits of the two measures, see F. Thomas Juster, testimony before the Joint Economic Committee, Sept. 26, 1973.

VI. HOW MUCH HAS INFLATION HURT THE POOR?

Apart from the issue of the impact of inflation on consumers generally, there is the question of its incidence on particular subgroups such as the poor and elderly. The Consumer Price Index makes no distinction among subgroups, assuming that all consumers, rich and poor, consume the same market basket of goods and services. This is obviously not the case, for the rich by choice spend a higher proportion of their income on luxuries, while the poor have no choice but to spend a higher proportion of their income on such necessities as food and shelter. In order to assess the impact of inflation on such dissimilar groups of consumers it is necessary to develop price indices based on the different market baskets that are consumed.

Such market baskets were developed in R. G. Hollister and J. L. Palmer's analysis of "The Impact of Inflation on the Poor." [1] They created market baskets for both rich and poor families from the 1960–61 Survey of Consumer Expenditures, which in turn were used to fashion both a Poor-Person's Price Index (PPI), and a Rich-Person's Price Index (RPI), that approximate that the true price indexes for these different groups. These market baskets are split into eight major categories, with the importance of each category to the rich and poor consumers identified in Table 5 below.[2]

In periods when price changes are about the same for all kinds of products, the different market baskets of the rich and poor will suffer the same incidence of inflation. In fact, Hollister and Palmer's study found no post-World War II evidence to confirm the notion that price rises hurt the poor more than the rich. Moreover, because inflation usually means tight labor markets, the poor may gain relatively more than other groups on the income side of their budget. The authors concluded that the "tax of inflation" may adversely affect the poor less than the "tax of unemployment" that comes about as a result of government deflationary policies.

But what has been the recent impact of price rises on the poor, a period in which food and housing prices have risen much more than other prices? Thad W. Mirer, assistant professor of economics, State University of New York at Albany, has examined this question by updating the Hollister and Palmer work, and he finds that inflation

[1] In "Redistribution to the Rich and the Poor," K. E. Boulding and M. Pfaff, eds. (Belmont: Wadsworth, 1973). Originally published in 1969 by the University of Wisconsin Institute for Research on Poverty.

[2] Hollister and Palmer designed the PPI market basket to represent the expenditure patterns of the "longer term poor." This is defined as those whose incomes and expenditures were below the officially defined income poverty line in 1960. The RPI basket represents those with 1960 incomes greater than $10,000. The Bureau of Labor Statistics' CPI represents a group of lower middle-income families, some of whom may have been included in the original calculations of the PPI weights. Any definition of groups and coverage is arbitrary, and the designations of poor, middle income, and rich are used loosely here.

TABLE 5.—WEIGHTS OF MAJOR CATEGORY EXPENDITURES

Item	Poor persons index	Rich persons index
Food	0.349	0.219
Housing	0.356	0.278
Apparel	0.078	0.118
Transportation	0.051	0.160
Medical care	0.058	0.062
Personal care	0.033	0.027
Recreation	0.034	0.077
Other	0.041	0.059

TABLE 6.—COMPARATIVE PRICE INDEXES

[August 1971=100]

Month/year	PPI	CPI	RPI
1971:			
August	100.00	100.00	100.00
September	100.00	100.08	100.09
October	100.13	100.25	100.31
November	100.32	100.41	100.44
December	100.82	100.82	100.78
1972:			
January	100.93	100.90	100.85
February	101.63	101.39	101.31
March	101.86	101.56	101.53
April	102.04	101.80	101.76
May	102.23	102.13	102.06
June	102.61	102.38	102.36
July	103.08	102.78	102.69
August	103.32	102.95	102.87
September	103.67	103.36	103.34
October	103.91	103.69	103.62
November	104.24	103.93	103.92
December	104.55	104.26	104.13
1973:			
January	105.25	104.59	104.45
February	106.24	105.32	105.18
March	107.45	106.31	106.10
April	108.36	107.04	106.93
May	109.05	107.70	107.57
June	109.88	108.44	108.28
July	110.27	108.68	108.54
August	113.04	110.65	110.34
September	113.31	110.97	110.68
October	114.07	111.88	111.49
November	115.05	112.69	112.34
December	115.86	113.43	113.03

Source: Computed from major category price indexes of the Consumer Price Index, reported in the "Monthly Labor Review" and recent Bureau of Labor Statistics new releases.

since August 1971 has been somewhat more detrimental to the purchasing power of the dollars spent by poor persons than those spent by others." [3]

Over the course of the 28 months since August 1971, according to Professor Mirer, prices have risen about 15.9 percent for the poor, 13.4 percent for the lower middle-class, and 13 percent for the rich (Table 6). The differences in the indexes for the poor and the other groups are disturbing for such a short time period. The most important factors causing this unusual situation are the sharp rises in food and housing prices, which together comprise a 40 percent larger share in the budgets of the poor than they do in those of the rich.

The differential impact of inflation on the poor during 1973 is especially dramatic. As one can see from Table 6, prices for the poor

[3] Thad Mirer, unpublished manuscript, November 1973.

rose 10.8 percent during 1973, compared to a 8.5 percent price rise for rich and an 8.8 percent rise of middle-income persons during the same period, an "extra" 2.0 percentage point rise for the poor. This means that in 1973 low income persons suffered about one-fourth more inflation than did middle and upper income consumers. At least on the price side, it appears that the inflation of 1973 has hurt the poor even more than other consumers.

The major findings of this study are summarized at the beginning and do not need to be repeated here. It is obvious that together they sketch a gloomy picture of consumer losses totally at odds with the Administration's litany that the consumer never had it so good. The consumer is not better off this year than last, inflation has seriously harmed most consumers, and this has greatly undermined consumer confidence in the economy.

These conclusions lead to a larger question: Why do the Administration's interpretations of the impact of inflation on consumers differ so much from what consumers themselves believe to be the case, and from the findings of this study? It may be that some of the differences are due to different points of view and the lack of complete data to measure the impact of inflation. It appears that the greater part of the problem, however, is the Administration's tendency to not present the full facts to Congress and the public in the hope of achieving certain shortrun political benefits. Unfortunately, the long-run economic costs of pretending things are better than they are may be extremely high. The Russian wheat deal and the energy shortage are but two recent areas where the public and Congress were given limited facts and told not to worry—until the food and energy problems became crises.

This study shows that the Administration seriously underestimated the severity of inflation in 1973 and its adverse impact on the economic position of consumers. Moreover, there is no indication at this time that the rate of inflation will moderate in 1974 and consequently the real purchasing power of consumers is likely to continue to decline. In view of the recent slowdown in economic activity, and the energy crisis, unemployment will certainly increase during 1974. This situation of higher prices and fewer jobs will further erode consumer income and confidence, which in turn will substantially increase the prospects for a recession in 1974.

Although it is beyond the scope of this study to detail the changes in policy that must be made to prevent such a gloomy outcome, there is a fundamental reform in Administration economic policymaking that should be made at this time—an increase in candor about the nature and dimensions of major economic problems such as inflation. To a considerable extent, the Nation's current economic malaise is the result of the tendency to pretend problems are not serious until a crisis occurs. We are not yet at a crisis state in consumer well-being and confidence, but we are very far indeed from the Administration's pronouncements that consumers never had it so good. Now is the time for Congress and the Administration to face up to the adverse impact inflation is having on consumers, and to alter economic policies to correct the situation.

O