The Canard About Falling Incomes

Don’t believe the government’s consumer-price index, which is obsolete.

*By*

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As election season approaches, chants about the hollowed-out middle class predictably grow louder. Wages have been flat for decades, we’re told. “In 1973, the inflation-adjusted median income of men working full time was $54,030. In 2016, it was $51,640,” the New York Times breathlessly reported last year. Sounds awful. Except it’s nonsense. Cast a leery eye on anyone who uses 1973 as a base—it was a high-water mark before a deep recession. But the real red flag—what makes this argument totally bogus—is the phrase “inflation-adjusted.”

The odoriferous offender is the manufacturer of inflation data, the Bureau of Labor Statistics. After the creation of Social Security in 1935, Congress would occasionally bestow vote-winning gifts on retirees in the form of benefit increases. In 1975 Congress switched to automatic cost-of-living adjustments based on a consumer-price index, or changes for “a market basket of consumer goods and services.” That’s food, rent, electricity, T-Mobile,[Netflix](http://quotes.wsj.com/NFLX) .

Forget for a moment that some of that didn’t exist in 1975. As consumer items got more feature-rich and complex, the BLS simply couldn’t note the absolute price of, say, a microwave oven. So the bureau came up with the indulgently named hedonic quality adjustment, defined as “decomposing an item into its constituent characteristics, obtaining estimates of the value of the utility derived from each characteristic, and using those value estimates to adjust prices when the quality of a good changes.”

It’s a better measurement but still inaccurate. Here’s a thought experiment: Think about your car’s automatic emergency braking, sometimes known as precrash or collision avoidance. It has been an increasingly popular option in recent years. By 2022, it will be standard on most cars. Some silicon sensors and a few pieces of code—today it costs maybe $50 to produce. But what’s it worth?

Let’s do a little hedonic decomposing of our own. Before these sensors, you would have had to hire a person to ride shotgun and constantly watch for potential collisions and slam on the brakes for you. In 2016 the AAA Foundation for Traffic Safety [estimated](https://newsroom.aaa.com/tag/american-driving-survey/?mod=article_inline) the average driver spends almost 300 hours a year in the car, logging more than 10,000 miles. Paying someone even $10 an hour to stare into traffic means that over five years, collision avoidance is worth nearly $15,000. Double if you want someone to look out the back window, too.

Does this show up anywhere in the consumer-price index? Of course not. One of the most lifesaving features has dropped in cost by three orders of magnitude in less than a decade. To the BLS, it’s practically nonexistent.

Then there’s that hunk of glass and plastic in your pocket. Your smartphone is your newspaper deliveryman, librarian, stenographer, secretary, personal shopper, DJ, newscaster, broker, weatherman, fortuneteller—shall I go on? The mythical man of 1973 certainly couldn’t afford $100,000 or more for dozens of workers at his beckoning.

By the time the BLS puts something new in the CPI basket, it’s already cheap, so it misses the massive human-replacement price decline. The CPI is good at freezing a lifestyle and standard of living and showing how it gets more expensive over time. Great. But the CPI absolutely doesn’t take today’s technology-infused lifestyle and work backward to show how much more expensive it would have been in 1973. Yet that’s what pundits infer when they talk about a hollowed-out middle class. How would the BLS reverse-decompose artificial intelligence and Alexa? Good luck with that.

The CPI is obsolete. The feds should more accurately rename it the CDI, for Currency Debasement Index. Most hedge-fund managers I know rely on the CRB Commodity Index, which tracks everything from oil and hogs to molybdenum and orange juice, as a proxy for inflation. The Bureau of Economic Analysis and the Fed also use hedonic adjustments for inflation, meaning that official measurements of gross domestic product and productivity are also massively understated.

Worse, that undermeasured hedonic cost decline driven by technology has allowed price increases to sneak in elsewhere without triggering classic inflation fears. Have you bought tickets to a professional basketball game lately? Studied your hospital bill? Rented an apartment? Bought smelly cheese, organic balsamic vinegar or a textbook?

Don’t believe the numbers—at least not the government’s numbers. Former Fed Chairman Alan Greenspan was on to this in 1996, saying the optimal level of inflation was “zero, if inflation is properly measured.” Freezing today’s lifestyle and going backward, I estimate a “true” median income of $347 in 1973 against the $51,640 of 2016. Today’s middle class isn’t hollowed-out. It’s living high on the hog.