BASIC NEEDS BUDGETS REVISITED: DOES THE U.S. CONSUMER PRICE INDEX OVERESTIMATE THE CHANGES IN THE COST OF LIVING FOR LOW-INCOME FAMILIES?

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ABSTRACT

The consumer price index (CPI) is used in the United States to measure changes in the cost of living. Since the CPI is used to index the official U.S. poverty guidelines and to establish eligibility criteria for various public assistance programs, a change in the methodology used to calculate the CPI would impact the accuracy of poverty statistics and, more importantly, poor families' access to public assistance. Since the majority of these poor families are headed by women, the CPI becomes a critical issue for feminist economics. In December 1996 the United States Senate Finance Committee's Advisory Commission to Study the Consumer Price Index issued its final report which concluded that use of the consumer price index results in widespread substantial overindexing. This paper uses the basic needs budgets (BNB) to evaluate changes in the cost of living for low- income families. The author compares the cost of the BNBs for single- parent families in 1983 and 1996 and finds that the cost of the bundle of goods and services included in the BNBs has increased faster than the CPI. The author finds similar results for two-parent families.

KEYWORDS

CPI, poverty, single-parent families, poverty measurement, Boskin Report, basic needs

INTRODUCTION

In the United States, poverty continues to be a feminist issue. The majority of poor families in the United States live in households headed by single parents and these single parents are predominantly women. Even using the flawed official U.S. government methodology to define poverty, 54 percent of all poor families in 1996 had a single female head of household and almost one-third of families in the United States headed by a single woman

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had incomes below the official poverty thresholds. As dismal as these statistics appear, because the official approach to defining and measuring poverty is deficient, these statistics underestimate the extent of poverty suffered by women in the United States.

Barbara Bergmann and I developed the basic needs budgets (BNBs) eight years ago as an alternative measure of poverty for single-parent families in the United States. Bergmann (1986: 230) had lambasted the official U.S. government's approach in her book, *The Economic Emergence of Women*:

> United States government statistics on poverty among single mothers tend to underestimate the extent of the problem. The government officials who established the officially designated poverty line – the income the government says a family requires if it is to be considered nonpoor – took no account of the situation of the employed single mother. They made no allowance for out-of-pocket child-care expenses, and assumed all meals could be prepared at home "from scratch." Many single mothers with earnings above the official poverty line should be counted as poor when the extra expenses they have due to their employment are taken into account.

Bergmann was not only responsible for identifying the need for this research and steering my work in this direction, she also profoundly influenced the methodology we eventually chose for the development of the budgets. While most analysts agree that the U.S. government's official method for setting the poverty thresholds is inadequate, few agree on any single alternative methodology. I wanted to flex my econometric muscles and set the poverty thresholds by using the government's consumer expenditure survey to estimate a set of parameters for a system of consumption equations derived from the Stone Geary utility function. Bergmann rejected my approach because she recognized that what I had noted as "anomalies" in the data set were fatal flaws which rendered my results nonsensical and inapplicable to policy questions. For example, the child care expenditure standard which "fell out" of the estimations was far below any common-sense notion of the cost of child care.

Bergmann urged me to scrap the fancy econometrics and go with a straightforward, easy-to-understand, detailed family budget not unlike the budgets which are used to measure poverty in some countries and which had been published for many years by the U.S. Bureau of Labor Statistics (BLS). We made a myriad of explicit "value judgments" but at each junction we tried to explain precisely which assumptions we had made and why. For example, in developing the housing expenditure standard we made a judgment that a decent standard of living for a single parent should include sufficient income to rent an apartment with a separate bedroom for the parent. Likewise we assumed that the single parent did not have a washing

machine and therefore included the cost of using a laundromat and disposable diapers in the clothing expenditure standard. In her 1995 article summarizing the ways in which feminist thinking has affected economics, Julie Nelson cites the basic needs budgets as an "illustration of what can be accomplished when the focus stays closer to the policy question, with less allegiance to particular models and methods" (Nelson 1995: 145). Bergmann is the person responsible for maintaining the focus of our work on the policy question.

THE BASIC NEEDS BUDGETS

The basic needs budgets (BNBs) were initially developed as an alternative approach for calculating poverty rates. In my initial research I developed BNBs and recalculated poverty rates for single-parent families for 1983 (Trudi Renwick 1991). Bergmann and I published an article in the *Journal of Human Resources* which recalculated poverty rates for 1989 (Renwick and Bergmann 1993). In a subsequent paper I extended the concept of the BNB to include two-parent families and estimated the cost of the consumption baskets for 1992 (Renwick 1993). I recently updated my original research on single-parent families to calculate poverty rates for 1995 (Renwick 1998). As Bergmann hypothesized in *The Economic Emergence of Women*, the U.S. government's poverty statistics understate the extent of poverty among single-parent families. For example, in 1995 the poverty rate for single-parent families whose head of household was employed full-time outside the home nearly doubles when the BNB approach is substituted for the official U.S. government methodology.

In this paper I use the BNBs to examine a different issue – whether or not changes in the overall consumer price index, the tool most commonly used in the United States to measure inflation at the retail level, accurately reflect changes in the cost of living for low-income families. There are two reasons why the change in the cost of the BNBs may differ from the changes in the cost of the overall CPI basket. First, BNBs are constructed assuming that families rely on "inferior" goods to survive with limited incomes. For example, the food cost estimates assume that families economize by eating beans rather than meat and when they do eat meat that it is hamburger rather than prime rib. If the prices of the "inferior" goods have risen more rapidly than the prices of "average" goods, the cost of the BNB goods and services will increase more rapidly than the CPI. Second, the cost of the BNB basket may change at a different rate than the cost of the CPI basket because of the differences in the relative weights (percentage of the budget) assigned to each consumption category. If the items which are heavily weighted in the BNBs (food, housing, and health care) have been rising more rapidly than the overall CPI, the cost of the BNBs will rise faster than the overall CPI.

FINAL REPORT OF THE ADVISORY COMMISSION TO STUDY THE CONSUMER PRICE INDEX

In late 1996, an advisory commission to the United States Senate Finance Committee issued its final report on the consumer price index. The report, entitled "Toward a More Accurate Measure of the Cost of Living," concluded (1996: iv) that the use of the consumer price index (CPI) to index social security benefits and federal income tax brackets results in "widespread substantial overindexing." The Advisory Commission estimated that the bias in the CPI was about 1 percent per year which, if left uncorrected, could contribute up to $134.9 billion to the deficit in the year 2006. The Commission's findings and recommendations received widespread attention in the press.

While the report focused on the impact of the CPI "bias" on social security benefits and tax brackets, the CPI also impacts the official U.S. government's poverty statistics. Since the official poverty thresholds are updated each year using the CPI, a change in the CPI impacts the poverty statistics. If the CPI does not accurately reflect the changes in the cost of living for low-income families, poverty statistics are distorted. Since the official poverty thresholds are used to set eligibility criteria for federal programs (e.g. food stamps) a change in the method used to calculate the CPI could also result in changes in program benefits for millions of low-income families. Since most poor families are headed by women, feminists in the United States need to be concerned with the CPI debate.

The special commission's report summarily dismisses the notion that the biases in the CPI may differ substantially across demographic subgroups:

> Some have suggested that different groups in the population are likely to have faster or slower growth in their cost of living than recorded by changes in the CPI. *We find no compelling evidence of this to date...*
> (Advisory Commission: 71; emphasis added)

Many economists who have studied poverty measurement would disagree. For example, Patricia Ruggles (1990: 41) noted that the consumption weights used to construct the CPI are supposed to be representative of urban consumers as a whole and:

> to the extent that the poor have different patterns of consumption from this population – for example, spending more on food and housing, and less on consumer durables such as refrigerators or home computers – that fact is not reflected in the price index. Therefore, if the prices for food and housing rise at a different rate than for other goods, the index may misrepresent the actual spending power of those with very low incomes.

In a similar vein, many argue that the consumption patterns of the elderly are significantly different than the rest of the population. The 1987 amendments to the Older American Act of 1965 directed the Bureau of Labor Statistics to develop an experimental index for consumers 62 years of age and older. From 1987 to 1993 the experimental index rose slightly more than the overall consumer price indices but since this experimental index was derived from data on older households from the Consumer Expenditure Survey, the sample size was generally considered too small for reliable estimates (N. Amble and Ken Stuart 1994: 11–16).

On the other hand, the Census Bureau has expressed concern that the CPI may have historically overstated the changes in the cost of rental housing because prior to 1983 the CPI measured housing prices using a procedure that included changes in the asset value of owned homes. In recent publications the Census Bureau has published alternative historical series using thresholds updated using an experimental index, the CPI-U-X1 which applies the post-1983 rental equivalence approach to the 1967–83 period. The resulting poverty thresholds are lower. The poverty rates for individuals are reduced by approximately 1.5 percentage points per year. For example, the official poverty rate for individuals in 1994 was 14.5 percent but when the CPI-U-X1 thresholds were used, the poverty rate for individuals fell to 13.2 percent (U.S. Bureau of the Census 1996: Tables B-8 and B-9).

The Advisory Commission report describes four categories or types of potential bias in using changes in the CPI as a measure of change in the cost of living – substitution bias, outlet substitution bias, quality change bias, and new product bias. A primary hypothesis of this paper is that each of these biases is less relevant for low-income families than for the population at large. For example, substitution bias occurs because a fixed market basket fails to reflect the fact that consumers substitute relatively less expensive goods for more expensive goods when relative prices change. However, if families are initially limited to only the least expensive goods, there is much less room for substitution and therefore less likelihood of substitution bias. Outlet substitution bias occurs when shifts to lower price outlets are not properly reflected in price surveys. In this area as well, it is less likely that low-income families with limited mobility are able to take advantage of lower price outlets. In fact for many years advocates have argued that BLS price surveys fail to take into account the higher-than-average food prices paid by low-income customers, particularly in the inner cities. As for new product bias and quality change bias, while the "representative" American family may be achieving higher levels of utility thanks to their improved home computer or new microwave oven, this is probably not true for lower income groups. Families living at subsistence have much less opportunity to incorporate new or improved items into their family budgets.

UPDATING THE BNB EXPENDITURE STANDARDS FOR OVER TIME

The BNBs define "basic need" as a standard greater than that required for mere physical survival but well below average consumption patterns. Expenditure standards are estimated for seven major budget categories: (1) food, (2) housing, (3) health, (4) transportation, (5) clothing, (6) personal care, and (7) child care. Where possible, official definitions of expenditure standards were used to estimate the dollar amounts for the major budget categories. For example, the food component is based on the U.S. Department of Agriculture Low Cost Food Plan. The child care standard is based on the Internal Revenue Service's maximum allowed expenditures for claiming the child and dependent care tax credit, updated for inflation. Other expenditure standards are derived from the now defunct Bureau of Labor Statistics family budget series. When the BNBs are used to measure poverty, they are adjusted for geographic differences in the cost of living, the employment status of the parent(s), ages of the children, receipt of private and public noncash benefits and taxes.

In order to assess whether or not the CPI accurately reflects changes in the cost of the goods and services included in the BNBs, this paper presents estimates of the cost of the basic needs budgets for single-parent and two- parent families for 1996. Where possible, the updates rely on data from new surveys and therefore reflect prices actually paid by low-income consumers. For example, the housing standard is taken from 1993 American Housing Survey data while the health care standard relies on published data from the 1987 National Medical Expenditure survey. Where new data are not available, the expenditure standards have been updated using the most specific consumer price index available. Using the most specific CPI available, for example, using the index for rental housing rather than shelter, should provide the closest estimate of the changes in the cost of living for low-income families. Even if the consumer price indices were used to update all items, the change in the cost of the BNB goods and services would differ from the change in the cost of the CPI basket because each "basket" uses different relative weights for specific items.

Food

As noted earlier, the BNB food expenditure standard is taken from the U.S. Department of Agriculture (USDA) monthly estimates of the cost of the Low Cost Food Plan. USDA has not updated the food lists it uses to construct its cost estimates since 1984 but each month publishes a new cost estimate based on changes in the prices published by the Bureau of Labor Statistics.

Table 1 Cost of the USDA Low Cost Food Plan: 1983–96

	Cost of the USDA Low Cost Food Plan for a single parent with two children
Monthly cost: 1996	$384
Monthly cost: 1983	$193
Change in the cost of the Low Cost Food Plan: 1983–96	99%
Change in the overall CPI	54%

Note: All currency figures are in current U.S. dollars.

Table 1 compares the changes in the cost of the USDA Low Cost Food Plan with the changes in the CPI. The cost of the USDA Low Cost Food Plan increased by approximately 62 percent between 1983 and 1996 while the CPI for all items increased by 54 percent.

Housing

The BNBs use data from the American Housing Survey (AHS) to estimate the cost of decent housing. The AHS is conducted every two years by the Census Bureau. The expenditure standard used for shelter costs is the monthly rental cost (rent and utilities for a two-bedroom apartment) which defines the twenty-fifth percentile of the rental distribution for two-bedroom apartments in each of three locational categories – central city, suburban, and rural, plus an allowance for household operations. An index based on the median rental cost of two-bedroom apartments in each of the four Census Bureau regions is then used to estimate costs by region. The 1996 estimate is based on the data from the 1993 AHS updated using the changes in the CPI rental cost index. As can be seen in Table 2, the cost of a two-bedroom apartment has grown faster than the CPI in central city and suburban areas but considerably slower than the CPI in rural areas.

Health care

The original BNBs used data from the 1977 National Health Care Expenditure Survey to estimate the cost of health insurance and out-of-pocket expenditures, health care costs not covered by health insurance which were updated to 1983 and 1989 using the consumer price index for medical care services. Data from the 1987 National Medical Expenditure Survey was used to set the standard for 1996 out-of-pocket expenditures. I obtained estimates of the average cost of a group health insurance policy premium for 1995 from the Health Insurance Association of America.

Table 2 Monthly cost of rental housing: 1983–96

	Central city	*Suburban*	*Rural*
Monthly rental cost of a two-bedroom apartment: 1996	$414	$498	$277
Monthly rental cost of a two-bedroom apartment: 1983	$252	$298	$199
Change in the rental cost of a two-bedroom apartment: 1983–96	64%	67%	39%
Change in overall CPI	54%	54%	54%

Note: BNB housing expenditure standard includes an additional allowance for household operations.

Table 3 summarizes the estimated cost of health insurance and out-of-pocket health care expenses for a single parent with two young children. The out-of-pocket expenditures represent the mean per capita expenditures for health care not covered by health insurance policies. Since the average expenditures for health care not covered by health insurance policies are much lower for families with public insurance, lower standards are established for those with public health insurance. Health care costs have risen much faster than the overall CPI. To the extent that these expenditures represent an important share of total expenditures for low-income families, use of the overall CPI will fail to measure the true increase in the cost of living for this group.

Child care

For the child care expenditure standard, the BNBs use the Internal Revenue Service's maximum allowed expenditures for purposes of claiming the child and dependent care tax credit. At least in 1982, when the allowance was increased from $2,000 to $2,400, this figure represented some kind of official consensus on a reasonable expenditure on child care. I use the overall CPI to "index" the maximum per child allowance for inflation through 1990. For subsequent years I use the CPI sub-index for child care and nursery schools which brings the child care expenditure standard up to $3,978 for 1996. (See Table 4.)

Table 3 Annual cost of health care for single-parent families: 1983–96

	Group health insurance premium	*Out-of-pocket expenses – private insurance*	*Out-of-pocket expenses – public insurance*
Annual cost: 1996	$5,400	$1,068	$673
Annual cost: 1983	$1,322	$585	$246
Change in annual cost	308%	83%	174%
Change in overall CPI	54%	54%	54%

Table 4 Monthly cost of decent child care: 1983–96

	Cost of full-time child care for one pre-school child
Monthly cost of child care: 1996	$332
Monthly cost of child care: 1983	$206
Change in the cost of child care: 1983–96	61%
Change in overall CPI: 1983–96	54%

Other budget categories

The BNBs also use explicit expenditure standards for transportation, clothing, and personal care. The 1983 BNB standards were based on the BLS family budget standards which were updated using the applicable consumer price indices. The same methodology has been used to update the 1983 estimates to 1996. Since the BNBs include an allowance for diapers I updated the allowance for diapers by investigating the cost of generic disposable diapers at a local upstate New York pharmacy. It is interesting to note that although the BLS maintains a separate index for items such as pork chops, it does not maintain an index for disposable diapers. Table 5 summarizes the changes in each of these expenditure standards for a single-parent family with two preschool children.

CHANGES IN THE COST OF BNB GOODS AND SERVICES FOR SINGLE-PARENT FAMILIES: 1983–96

When used to measure poverty status, the BNB expenditure standards are adjusted for the receipt of noncash benefits, the employment status of the parent, the ages of the children, and the region and location of residence.

Table 5 Cost of transportation, clothing, diapers and personal care for single-parent families: 1983–96

	Monthly cost of transportation	*Monthly cost of clothing*	*Monthly cost of disposable diapers*	*Monthly cost of personal care items*
1996	$114	$81	$40	$31
1983	$57	$55	$24	$28
Change in the monthly cost: 1983–96	99%	47%	66%	13%
Changes in overall CPI	54%	54%	54%	54%

Note: Transportation standard does not include work-related travel.

In order to illustrate how the BNB budget standards are converted to poverty thresholds for individual households, I have defined three "prototype" families. For simplicity, all three prototype single-parent families are assumed to live in the central city and use public transportation. The first prototype family has two preschool children and the parent is not employed outside the home. The budget assumes that the family is covered by Medicaid and receives food stamps. The second prototype family estimates the cost of goods and services for a family with two small children in which the parent is employed full-time outside the home and must pay for child care. The second budget assumes that the employer pays two-thirds of the cost of the private group health insurance policy. The third prototype family has two older children and a parent who works full-time outside the home. The third family is also assumed to receive an employer contribution to the group health insurance premium equal to two-thirds the cost of the premium. Appendix Table A provides the detailed BNB budget for each prototype family. Table 6 summarizes the changes in the cost of goods and services for each family between 1983 and 1996.

For all three prototype families, the cost of purchasing goods and services included in the BNBs has grown much faster than the increase in the CPI. There is clear evidence that the CPI understates the increases in the cost of living for single-parent families. While the expert commission report suggested that the CPI overstated the change in the cost of living by approximately 1 percentage point per year, Table 6 shows that the CPI *understated* the cost of the BNB goods and services by approximately 1 percent. If the CPI were revised in the ways recommended by the Advisory Commission report, the revised CPI would underestimate these changes by 2 percentage points per year.

Table 6 BNB budgets for prototype single-parent families: 1983–96

	Single parent not employed outside the home	*Single parent employed outside the home with child care expenses*	*Single parent employed outside the home with older children*
Monthly cost of goods and services: 1996	$784	$2,008	$1,358
Monthly cost of goods and services: 1983	$473	$1,136	$781
Change in the cost of the BNB	66%	77%	74%
Change in the CPI	54%	54%	54%

CHANGES IN THE COST OF THE BASIC NEEDS BUDGETS FOR TWO-PARENT FAMILIES: 1992–96

In 1992 I developed BNBs for two-parent families. Appendix Table B provides a detailed accounting of the cost estimates for each budget category for two prototype two-parent families. The first family is a "traditional" family with only one parent employed outside the home. The budget assumes that the employer pays two-thirds of the health insurance premium. The second prototype family is a two-earner family in which the employers cover the entire cost of the health insurance premium. Neither family receives food stamps nor any other public benefit. Table 7 summarizes the changes in the cost of goods and services for these two families. For two-parent families the cost of the goods and services included in the BNBs increased more than the CPI for the four years between 1992 and 1996.

CHANGE IN THE COST OF THE BNB ABSENT HEALTH CARE COSTS

Health care expenditures represent a significant percentage of all BNBs presented in this paper and have grown much faster than the overall CPI. In order to test the sensitivity of these conclusions for health care cost estimates, Table 8 summarizes the changes in the cost of BNB for all five prototype families absent health care expenditures. The results of this analysis are notable. Even without considering skyrocketing health care costs, the only low-income family for whom the cost of goods and services grew at the same rate as the CPI was the "traditional" family. The CPI underestimated the changes in the cost of living for all the single-parent families and for the two-parent family that had to pay for child care costs.

CONCLUSION

The CPI does not understate the changes in the cost of living for families in the United States with lower than average standards of living. While many

Table 7 Basic needs budgets for two-parent families

	Single-earner family	*Two-earner family*
Monthly cost of goods and services: 1996	$1,608	$1,967
Monthly cost of goods and services: 1983	$1,369	$1,721
Change in the cost of the BNB: 1983–96	17%	14%
Change in CPI	12%	12%

Table 8 Basic needs budgets absent health care expenditures

	Single parent not employed	*Single parent employed pays for child care*	*Single-parent family employed with older children*	*Single-earner two-parent family*	*Two-earner two-parent family*
Monthly cost of goods and services: 1996	$728	$1,769	$1,096	$1,316	$1,825
Monthly cost of goods and services: 1992				$1,177	$1,601
Monthly cost of goods and services: 1983	$452	$1,051	$686		
Change in BNB	61%	68%	60%	12%	14%
Change in CPI	54%	54%	54%	12%	12%

nonessential consumer goods may have experienced significant price decreases, the cost of the basic necessities described in the basic needs budgets has grown faster than the CPI. While driven by the increases in health care costs, even absent these goods and services, the cost of the BNB bundle has increased faster than the CPI. If a revised CPI is used to update the official poverty thresholds, the poverty statistics will be further distorted. Poverty will appear to have diminished without any decrease in the percentage of families who do not have sufficient income to purchase the goods and services which represent a decent standard of living in the United States today.

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Appendix Table A Monthly basic needs budgets for single-parent families: 1983 and 1996

	Family #1		*Family #2*		*Family #3*	
Family composition	Two young children		Two young children		Two older children	
Employment status	Not employed outside the home		Employed full-time outside the home		Employed full-time outside the home	
Health insurance	Medicaid		Employer assumed to pay two-thirds of insurance premium		Employer assumed to pay two-thirds of insurance premium	
Public noncash benefits	Food stamps		None		None	
	1983	*1996*	*1983*	*1996*	*1983*	*1996*
Food	39	77	193	384	264	414
Housing	282	456	282	456	282	456
Transportation	24	43	57	114	57	114
Health	21	56	85	239	95	262
Clothing	55	81	55	81	55	81
Personal care	28	31	28	31	28	31
Child care	0	0	412	663	0	0
Diapers	24	40	24	40	0	0
Total	$473	$784	$1,136	$2,008	$781	$1,358
Change in BNB	65.9%		76.8%		73.9%	
Change in CPI	54.1%		54.1%		54.1%	

Appendix Table B Basic needs budgets for two-parent families: 1992 and 1996

Assumptions	*Family #1*		*Family #2*	
Family composition	Two parents, one preschool child and one school age child		Two parents, one preschool child and one school age child	
Employment status	One parent employed outside the home		Both parents employed outside the home	
Health insurance	Employer pays two-thirds of group health insurance premium		Employers pay full cost of group health insurance premium	
Cost of BNB	*1992*	*1996*	*1992*	*1996*
Food	420	478	420	478
Housing	496	549	496	549
Transportation	95	114	145	174
Health	192	292	120	142
Clothing	105	104	105	104
Personal care	29	31	29	31
Child care	0	0	374	449
Diapers	32	40	32	40
Total	$1,369	$1,608	$1,721	$1,967
Change in BNB	17.5%		14.3%	
Change in CPI	11.5%		11.5%	