



ECONOMIC BRIEF NO. 24

Government Needs A Price Index

This series of economic briefs explores fundamental concepts in economics and community and economic development.

When most of us think about measuring inflation, we immediately check on the most familiar measure, the Consumer Price Index (CPI).

The CPI measures changes in the cost of a "market basket" of goods bought by typical households, such as ground beef, jeans, electricity, gasoline, and housing. However, the CPI is not the only price index, and sometimes it's not the price index

price of all the items in the Gross Domestic Product. These indexes are useful for separating out changes in real quantities produced from changes that just represent higher prices.

Local governments need their own index, because they spend their money on their own peculiar mix of goods and services. American City and County magazine provides a partial government

index. It is made up of a mix of items from the producer price index and the consumer price index that are important in local government budgets like cement, follows labor costs as well as monitoring changes in consumer prices. In 1995, compensation costs for state and local government workers (including wages, salaries and benefits) rose 2.8 percent, somewhat less than the average of 3.2 percent for all civilian workers. If we put the partial government index together with the government compensation costs, the price index for local government rose about 2.6 percent last year, just a little faster than the CPI, even though wages and benefits rose more slowly.

What is the value of this blended index that is geared toward the mix of products and services that cities and counties actually buy and that considers worker compensation? Like workers, local governments sometimes need to ask for a raise from their employers, the taxpayers. Sometimes they are called upon to justify any increases in spending.

Correcting for inflation with the appropriate index gives a better idea of whether an increase in spending by your local government is really providing more in the way of goods and services or whether your local government is just trying to stay abreast of rising costs of materials, equipment, and services they buy.

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needed for the purpose at hand.

When economists measure the real (inflation-adjusted) rate of growth of income and output, they don't adjust these figures using the CPI. That's because a lot of items, like backhoes, fire trucks, road resurfacing, and industrial robots don't figure into consumer budgets. Other price indexes are tailored to government, to industry (the producer price index) and for exports and imports. A composite index measures what is happening to the average

diesel fuel, computers, floor coverings, plywood, paper, office machines, and furniture. From early 1995 to early 1996, this index rose 2.3 percent, a little less than the CPI of 2.5 percent but a little more than the construction cost index of 1.9 percent or the producer price index of 2.2 percent.

However, labor costs, which account for more than half of all local government spending are a missing part of this index. For this part of the index, economists turn to the Monthly Labor Review, which