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Government Math

CPI and Inflation

Human Realizations

It is important that I preface this essay with some human realizations and history. We cannot deny, regardless of party (Republican or Democrat), that individuals and administrations lie or mislead. From an administration that lied about having sex with an intern in the oval office to an administration that told us that Iraq had weapons of mass destruction (WMDs), regardless of it severity, in all cases, lies, misleading, or half-truths are a fact of every administration to protect their own and secure the power that the office holds.

Needless to say, if administrations and presidents can break-in to offices (Watergate), be involved in illegal land dealings, lie about torture, illegally tap phones, sell weapons to the enemy (Iran-Contra), have sex in the oval office, then changing economic reporting practices is a cake walk. It can be easily sold to Congress, the Senate, and the American people if explained by someone with irrefutable credentials and the ability to address any misgivings.

I will admit that my opening salvo is rather damning and bold as to the government history and practices, however I found it important to lay the groundwork before moving forward. Let me clarify the reason, which otherwise would seem an inappropriate attack. Simply too many people (economist, analyst, and most importantly the "talking heads" on CNBC that we rely on) take governmental reporting data as gospel. No one is willing to roll up their sleeves and to do it themselves or to check the math. Granted, it would be a daunting task, however when someone does take the time to do it, they are called quacks or conspiracies. What happened to investigative journalism in this country, I know that government economic data is not exciting as say a Watergate break-in, having sex in the oval office, or secret torture bases. However, it does have a very crucial affect to every citizen in this country and is no less important. Hopefully the opening remarks will raise doubt or at the very least question the stream of numbers pouring from governmental departments as gospel.

It is an undisputed fact that every administration in our generation, from Kennedy to the present (Bush Jr.) has made changes to government reporting, operations, departments, methods, etc. They all usually have a rather detailed and justifiable reason for doing so.

But like I pointed out above, and to use a much used quote, "There is a lie, a damn lie, and then there is Statistics!"

The market works on one simple principal, two people agree on price and not on value, it's important to note it is their PERCEPTION of value that creates the trade. At the end of the day, fundamentals and math will solve for value and perception falls to the wayside. If that perception is solely predicated on government economic data, well…good luck.

Brief Review of Government Economic Data

Since the 1970s we have seen an increase of new governmental reporting departments, expansion of the Commerce Department, the Bureau of Labor and Statics, and many other machinations. Additionally, we have seen many changes to the formulas and methods being used to report economic data.

Every recent administration that has taken office has injected their own biases, people, and changes into these departments. It has become almost expected as a new administration takes office to clean house and bring in their advisors. This doesn't stop with just the executive branch—it expands to almost every governmental department and that is not to say there is something wrong with it, it is just a matter of fact. It is understood that the Administration wants to have people in place that have the same goals and agenda, people that the administration trusts or respects. However, it does mean that changes are forever in the work.

The problem with changes, usually nothing, but when it comes to reporting statistical information it becomes harder to measure year-over-year impacts to those numbers, as they continue to change the method or formulas.

Economic reporting has become one of the most important, if not the leading agendas of any recent administration. Inflation helped caused President Carter's loss in the re-election, President Bush Sr. actually blamed Greenspan (economy) for him not getting reelected, President Clinton (as stated by Carville and Stephanopoulos) indicated the number one important factor during election was jobs and inflation, and the current President (Bush Jr.) is pushing for the new C-CPI-U method of inflationary reporting—which is currently running about .5% below the current CPI numbers.

Economic data reporting to the public, as far as political spin, became important with the rapid rise in inflation that this country faced during the 60's into the 70's. A story was reported that President LBJ was given the inflation numbers by the Bureau of Labor and Statics (BLS) and didn't like them. He told them to go back and redo them until they came up with something better. LBJ knew that reporting higher inflation was an additional moral back-breaker to the American people in the height of the Vietnam War.

However, it was President Kennedy before him that made the first big changes to economic reporting data by adjusting the Employment numbers. In fact it is the employment and unemployment reporting that has been changed so many times since the 70's that any accurate year-over-year measurement has become indistinguishable. They have changed things from; counting those on unemployment benefits, stop counting those that fell off unemployment benefits, the "discourage workers", counting part-time workers into the labor numbers, counting temp workers into the labor numbers, that if we were to use the original method for the unemployment number, we are actually around 12% unemployment. That is not either good or bad it just a fact.

Administrations (Democrats and Republicans) will continue to change reporting methods and formulas. Of course any reasonable person would not expect to believe it was to get any method of clarity or better resolution. For I am sure if they had changed a method that would report lower job numbers and higher inflation, they would never venture down that road. The most interesting fact, which cannot be denied, is that every change to the employment methodology has only increased employment reporting and decreased the jobless numbers. As pointed out before, the Clinton administration made it clear the Job numbers and Inflation were the top priorities for re-election, "The Improved Economy under the Clinton Administration". Not saying it wasn't improving, but the difference between what was reported and how much it was actually improved went unnoticed.

At the end of the day, 12% of the nation's work force is unemployed (once we strip away all the changes that added or subtracted from the methodology to its original forum). I doesn't matter what label you wish to place on them, Temp Worker, Part-time Worker, Discouraged Worker, etc. Labels don't equal math, they are only used to stereo-type groups to either add them to the job numbers or remove them from unemployment numbers. It's an art form that the government has gotten very good at.

We never question these numbers because they come from the government, they must be accurate, they must be right, and why would the government have reason to TRY and make the numbers look good? I don't need to point out the obvious.

However, in good times (during the Dot.Com boom and housing boom, which have both come back to bite us) no one cared if they were accurate or not. They stated that the economy is great and it "FELT" great—no one took heed to the mounting debt or "real" inflationary pressures. The government said everything was rosy and there was no inflation—so we all agreed. Even analyst and economist agreed, but they only had the government numbers to work with, since they didn't do the math themselves. As they say, "Garbage in, Garbage out!"

Of course if the economic data was wrong or incorrect the government could always just revise those numbers, something that has become so frequent the government has even set dates to report those revised numbers (as a trader once told me "A get out of jail free card, in case they F### up!"). It's not like it happens just once in a while, it's every month they revise them. Now we all understand the margin of error and the need to revise, but we have seen swings in these revisions by 100—500%, which is a little ridiculous by anyone's standards. But the government gets a free pass, no questions, no criticisms, it just a revision. However, if this kind of practice was done at a Bank, Wall Street Firm, or Public company they would face charges of "book cooking" and manipulation. A public company could not continually release earnings numbers better than expected, only to revise them lower, because the accounting department decided to use their own "Creative" accounting system. Ask Arthur Anderson how that worked out for them?

Consumer Price Indicator (CPI)

The key measurement to inflation?

Before we move forward as to what the CPI is and how it is measured, let's remember the fundamental purpose of the CPI is to measure the change of a fixed basket of goods over time, in order to view price fluctuation to determine inflation. It is NOT used to measure the change in the standard of living because people have a choice on what to purchase. It is important that we clarify that because many of the recent changes to the measurement have been argued based on the cost of living and freedom of choice. It is a sound argument if we forget the purpose of the CPI by substituting the measurement of inflation with the measurement for standard of living.

For instance you price a steak, a loaf of bread, a gallon of milk, etc. The following year you price the same products, look at the price change, and you are able to determine the rate of inflation. How much have items increased in price. That is the purpose of the CPI, the rate of change on a fixed basket of goods (with a modicum of replacements when a product is no longer serving its core use, such a computer for a typewriter). However, replacing a core use in a fix basket is miles away from substitution.

My argument is that changes to the CPI no longer measures inflation, but instead measures the choices we make as to the shift in the cost of living. These changes and their interpretation have misguided our understanding of what we really are measuring. It is certainly not inflation in the true measure of the rate of price fluctuations. However, the Fed, government agencies, and economist continue to refer to the CPI as the key measurement of inflation. Are they wrong? Yes, but only in so far as calling it a measurement of inflation, instead of what it has become, a measurement of substitutions based on consumers choice of lowering their standard of living or remain at utility efficiency (utility of living). I will clarify the differences in the Standard of Living and Utility of Living later on.

The CPI is reported on a monthly and annual (year-over-year) measurement. It's the government's chief economic measurement in reporting inflation. What is even more important, which most people do not realize, is that it is used to determine Social Security benefits (monthly payments to Social Security recipients). Please keep this in mind as we review the purpose and changes made to the CPI.

The last two administrations (Clinton and Bush) have made the biggest changes to inflation reporting, than any other previous administration. You can clearly see this is not a Right Wing conspiracy or Democratic Socialist Agenda—it's both parties making changes. And those changes (regardless of reason) have mathematically reduced the reported results.

Substitution Method (The Boskin Plan)

In the 90's it was argued by Boskin (brief bio: Dr. Michael Boskin, chairman of the Council of Economic Advisors 89-93, was the chairman of the Commission on the Consumer Price Index, whose report transformed the way the government measured inflation, GDP and productivity.) that CPI was over stating inflation and a method he had been working on would give a more accurate measure of inflation. His argument was, "We should allow for substitution here because people can buy hamburger instead of steak, when steak goes up." My argument with this change, while it correctly points out peoples freedom of choice and to adjust for higher prices, is that it clearly does not measure inflation, it measures the affect of the cost of living, by lowering the standard of living.

By Boskin's own argument, "….people can buy hamburger instead of steak, when steak goes up.", he clearly makes my point. Isn't he saying that there IS inflation because steak is going up, and therefore inflation is affecting the consumer? The consumer purchasing hamburger doesn't change the fact that steak has increased in price. By making substitutions what are we actually measuring? It most certainly is NOT inflation.

His method alone indicates not that we are over stating inflation, but rather inflation is affecting people's standard of living and instead of facing that fact—lets measure the impact of the cost of living, by lowering the standard of living.

It is important at this point to clearly define Standard of Living and Utility of Living. Boskin and his supporters frequently will use Utility of Living and Standard of Living synonymously. However, there are NOT synonyms. Utility of living is the cost of meeting the essentials regardless of standard. Like replacing hamburger with steak. The argument is that both offer protein so the utility essential is met. However, I think you would clearly agree that the Standard of Living has dropped, even though Utility of living has met its burden. Eating at McDonald's vs. eating at Ruth Chris's Steak House both meet the Utility of Living, but you would have to agree that the Standards between to two are vast. I know this is an extreme, but it makes the point, using Boskin's own Hamburger vs. Steak analogy. This is a very important fact, because Boskin would argue that the essentials of living (or Utility) are not affected by the substitution method, so by that twisted logic the Standard of living remains the same.

What happens the next time Boskin argues for substitution, "We should allow for substitution here because people can buy SPAM instead of hamburger, when hamburger goes up?" I am taking this to the extreme again, but to make a point if we continue along this vain we will all be eating Dog food to keep the CPI low.

Boskin's Plan became a very hot topic in Washington in the late 90s because the CPI was used to adjust Social Security payments to compensate for the increase cost of living. By using the Boskin Substitution method the CPI would be lower and therefore hold down the Governments payouts to Social Security. It was a tough fight for politician's because on one hand the new CPI method showed lower inflation, meaning the administration could report a booming economy—a feather in any administration cap, additionally it relieved the burden of Social Security that has been teetering on bankruptcy. Many politicians backed away from the argument quickly, as they would be making the case for higher inflation and a worse economy. Remember, this was during the Dot. Com boom so no politician wanted to be the one to say the economy is facing higher inflation. Ironically it was a perfect time to introduce such a change to the CPI, from measuring inflation to measuring the cost of living, the economy was in one of its greatest booms in history—the internet revolution, I am sure no one then really cared about changes being made—because life was good!

Politicians' are always in a hard spot between garnering votes and stating reality. You can't blame them, the nature of the politician is to remain popular with his constituency to stay in office and/or gain office. Reporting anything that would hamper the vote or make the party look bad is not a fight worth fighting. Additionally a side benefit is that Social Security payments could be reduced and pushed out the bankruptcy problem to the next administration. No denying that the Substitution method helped band aid the Social Security debt temporarily, regardless if it was the intention or not.

In the end, if the price of steak goes up, inflation goes up—even if consumers choose to buy hamburger. There is no getting around that math, unless you substitute!

For those not familiar with the substitution methodology or those who believed that it was ONLY intended to make core changes like "typewriters to computers", well I have news for you. Here is the actual BLS text on the substitution methodology. I think once you read it, you will see how these substitutions create more ambiguity in the calculation.

> "The CPI is constructed as an aggregation of basic indexes computed for approximately 200 item categories, such as "ice cream and related products," in each of 38 geographic areas. Within each of these index components, or strata, prices for specific items in a sample of outlets (stores) are combined to produce a basic index. Consequently, the use of the formula will address only the issue of consumer substitution within strata.
>
> Substitution can take several forms corresponding to the types of item- and outlet-specific prices used to construct the basic indexes:
>
> - Substitution among brands of products, for example, between brands of ice cream;
> - Substitution among product sizes, for example, between pint and quart packages of ice cream;
> - Substitution among outlets, for example, between brands of ice cream sold at two different stores;
> - Substitution across time, for example, between purchasing ice cream during the first or second week of the month;
> - Substitution among types of items within the category, for example, between ice cream and frozen yogurt;
> - Substitution among specific items in different index categories, for example, between ice cream and cupcakes.
>
> Thus, in response to an increase in the price charged by a store for a certain brand of ice cream, a consumer could respond by redistributing purchases along any of several dimensions represented by other priced items in the category: to another brand of ice cream whose price had not risen, to a larger package of ice cream with a smaller price per ounce, to ice cream at a different store where ice cream is on sale, or to a brand of frozen yogurt. The consumer also could respond by postponing the ice cream purchase until a later date. (Prices for CPI items are collected throughout the month and then averaged.)
>
> Finally, the consumer could substitute from the ice cream brand to a specific alternative dessert item, such as cupcakes or apples, that is in another CPI category. This latter form of substitution, although across CPI categories, would still have the effect of reducing the quantity consumed of the higher-priced ice cream brand relative to the quantities of other items within the ice cream stratum."
>
> —*Report by the BLS*

As you can see they can Substitute brands, product size, items within a category, items in different categories, even substitute prices over different times. I wish I could make those kinds of substitutions in the stock market. The BLS has carte blanc on the changes they can make to such an extent that any reporting is subject to such a wide variety of variables that to make any month-over-month measurement (forget year-over-year) seem virtually indistinguishable with regard to statistical accuracy.

I showed the BLS text to a friend of mine (who specializes in mathematics and statistics). I hid the fact that it was from the BLS and suggested this as a methodology for calculating inflation and asked what he thought. He said "The government would never allow it; this is not math or measurable math by any stretch of the imagination. It reeks of falsification, manipulation, and just plain error." When I told him this WAS the BLS document on Substitution he stated, "Go figure, government employees are the lowest common denominator. Hopefully economist can see through the non-sense!"—I hope so, too.

Hedonics

The CPI additionally gets an adjustment to the cost of the products based on the "Ease of Use". This idea is that technology has benefited our lives, so the cost that the consumer pays for the product would be reduce by its "ease of use" when calculating the CPI. This is known as Hedonics and reduces the cost of the goods in substituted basket.

Example: My new voice activated phone did not cost me 10% more than it would have cost me last year, because I received a 10% ease of use because I didn't have to push the buttons.

How you actually measure Hedonics and determine the reduction in the calculation even leaves some economists scratching their heads. Not only is it subjective, the mathematical impact further reduces the CPI data. I understand that our life styles through the increase of technology have benefited, but to tell people that we are going to reduce the cost of the product when calculating CPI because she/he received a 10% lifestyle benefit is silly. Why, because the consumer did not receive a 10% discount when they bought it.

Hedonics is just another governmental method of reducing the component cost that doesn't take Main Street into consideration.

Unlike the Substitution method, which lowered the standard of living because it is assumed that consumers will avoid products increasing in price, Hedonics discounts the price of the products because they offer an increase of the standard of living. The irony should not escape you.

In both cases they do not take the actual impact of the consumer on Main Street.

What happens when the consumer still wants a steak, regardless of the price increase (therefore not substituting hamburger for steak). He drops $25 on some Chops, instead of $5 on Hamburger. Then he goes out and buys a new IPhone for $399, but the Hedonic adjustment lowers the phone cost by 50% (to $199) because of the "ease of use" when calculating inflation.

The CPI would have you believe that he bought (or should of) cheaper hamburger for $5 and got the IPhone for $199 because of "ease of use", but ask him and he would tell you his wallet is still $425 lighter than before.

The problem with substitution and hedonics is that it does not take Main Street into consideration. It assumes that the consumer is constantly adjusting their cost of living (arguably calculating a lower standard of living, regardless of utility efficiency). It further assumes they are also getting actually discounts when purchasing goods that are increasing that standard of living, which you and I know they are clearly not.

The CORE!

It's the Core that's all that matters!

First, what is the Core? We hear it all the time on CNBC, Bernanke uses it as "THE" measurement of inflation. So why is it so important?

The Core is actually just the CPI measurement without food and energy (like gasoline). It's just looking at the basket of goods like cloths, computers, etc. It is a good calculation when you want to see how products (no affected by higher energy costs or food) change in price.

The problem with the Core is that it redirects focus from the "Big Picture" of inflation. It would seem that if the government could ignore the impact of food and energy prices on the rate of inflation, it would go away. If someone of influence, respect, and stature (like the Fed chairman) states that we should only pay attention to the "Core", of course it will become the new "buzz" word of the "talking heads". The Administration has learned one thing (if anything) and that is if you repeat something enough, it must be true. Great marketing, hammer on it and eventually the lemmings, I mean "talking heads" will repeat it. This is a simple example of the industry (consumers and investors) taking what Bernanke says as Gospel and ignoring the "Big Picture". A magician calls this misdirection and it is the key to any great magic trick.

The issue is exacerbated when Bernanke, the Fed, CNBC, and the long list of analyst and "talking heads" refer to it as the "true" measure of inflation. We rely on these people for accurate information, but as the methods and formulas continue to change, weeding through all the paper work and adjustments becomes a daunting task. It is much easier if we just "nod" our heads and believe. The Core will always look better than the CPI "Headline" inflation, from the simple fact they removed food and energy—not to mention the substitution and hedonic adjustments.

Eventually reality takes hold and the consumer on Main Street does not have the luxury of ignoring the cost of gas and food, which eventually trickles over to spending (buying power). To ignore it is to be blind to the true economic picture we face as a nation. Eventually even the Fed cannot ignore the impact of food and energy, even though they love to quote the "Core" as if it is all that matters.

Here is an example from Nov. 1st, 2007

> Snip of text from the Fed meeting:
>
> "Readings on core inflation have improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation."
> —Bernanke
>
> Do you see what I see? When someone can't end a sentence with a PERIOD and has to introduce a "BUT" then what usually follows is not good.
>
> Note as per usual they have to mention the "CORE" in the beginning (cause they like talking about it and it makes inflation look low), BUT as I always say you can't ignore math and the fundamentals (and in this case MAIN STREET)—increasing energy and commodity prices may put renewed upward pressure on inflation. That's exactly what happens when you continue to ignore the "big picture"; it eventually catches up to you.

In the end, it's Main Street that will feel inflation. Main Street is the true test of everything from credit spending, housing values, and inflation. The government and economist can tout all the numbers they want, but when the consumer goes to the pump and pays $4.00 a gallon for gas, milk becomes more expensive then gas, food retail prices are rallying, the electric and gas bills are moving higher, his pocket book is feeling it no matter how we label it, not count it, or ignore it.

Is the Government Wrong?

You would be surprised in my answer, actually no. The methods and formula changes can all be justified and computed (with a revision here or there). The problem is not the math or a method, the problem is even more simple.

What is the CPI and what does it actually represent? The government would have you believe that it measures inflation, since that is what it has done since its creation. However, the changes to methodology and formulas have changed what is measuring and therefore what it really represents, and that is the Cost of Living, as impacted by inflation through the use of substitution.

The problem—the Government has failed to clearly tell us that they are no longer measuring inflation, but instead comparing impacts to the substituted Cost of Living. That is a significant difference.

It's a semantics problem that the International Labor Organization (ILO) has clearly addressed when this question was posed to them about measuring inflation:

Which of the two types of index (i.e. a fixed basket index CPI and cost of living index COLI) is preferable as a means of measuring inflation?

> There are two diametrically opposed views. One view is that a clear distinction needs to be made between a fixed basket index and a COLI and that a fixed basket is preferred as a means for measuring inflation. A second view is that a COLI does provide precisely that information which is required of an inflation measure. The arguments for the first view are as follows: The fixed basket approach adheres to the principle of a straightforward comparison of prices, therefore only indicating a change in prices, whereas a cost-of-living index provides information about how, given price changes and the substitution processes, expenditure would have to change to maintain the original standard of living or level of utility. A fixed basket is therefore a pure price index, while a cost-of-living index is an index which may show change even when all prices stay at the same level. As such, the latter cannot be considered as an appropriate measure of inflation. The argument for the second view is as follows: the COLI is a price index whose weights change to reflect changes in consumer preferences. It is intended to measure the change in the cost of maintaining a given standard of living and takes into account substitutions in response to changes in relative prices. However, it can "also be interpreted as measuring the change in the value of a fixed basket of goods and services where the fixed basket is a particular blend of the baskets in the two periods compared" (Hill, 1997). A COLI is preferred because in practice fixed basket indices may be biased estimates of inflation (especially in the indices with weights that are updated infrequently) and therefore are measuring changes in the value of a basket of goods and services that is no longer representative.

It is interesting that the ILO simply relates the different opposing views and their differences. Furthermore it is clear that you can't replace on with the other, as you are measuring two different things, Price Changes vs. the affect of those prices changes of the Cost of Living.

I spoke with the ILO about the CPI vs. COLI subject. They stated you can NOT replace one with the other, they measure two different things. One measures inflation based on price changes, the other measures the cost of living based on utility efficiency. When asked about the U.S. CPI method, the ILO stated it what a form of Consumer Cost of Living that is now being used as the current method of measuring inflation. I asked which is better; they said depends on what you want to measure. However, you can't say one is the other, because they are not.

It's interesting to note that measuring the Consumer Cost of Living (COLI method) is impacted by inflation affects from the fixed basket of goods, as consumer substitutions must change to avoid price increases.

The U.S. still uses the CPI to calculate Social Security payments and report on inflation, but they are clearly using the COLI substitution method and reporting the consumers change (purchasing decisions) based on a substitution and hedonic method—not inflation based on the original method of a fixed basket of goods. The change from a fixed basket to a substituted and hedonic method is a big change, even though some would have you believe that it is better or more accurate. The problem stems that one is not better than the other, they are simply different and one has to clearly make a decision on what they want to measure. However, for the government stating that the current method is measuring the "true" rate of inflation and that it IS better than a fixed basket (including core replacements)—is not true, it is misleading.

Conclusion

The government has clearly made extensive changes to the CPI calculation, enough so that it no longer measures inflation, but instead measures the adjust cost of living through substitutions. Furthermore, the government fails in its due diligence, by having respected and trusted government departments and individuals report that the CPI is measuring inflation, instead of clearly delineating the huge change and what they ARE measuring. Additionally, they continue to focus on the "Core" as the key measurement of inflation, which clearly is not what is felt on Main Street.

These failures and misdirection (or misleading) have contributed to the cause of the current economic problems, from the current credit crisis and weakening dollar to massive corporate and government debt.

Banks, Financial Firms, Investors, even the government make key decisions based on this trusted data. If that data, which I am not saying is manipulated, only changed in method and formula, is now measuring something different, then the decisions being made are on false assumptions.

While, I don't feel it is the sole responsibility of the government as to the solvency of the financial crisis, as all participants have to take blame (from the government, lending institutions, and even the borrower). However, all these individuals and firms rely on governmental data to make those decisions.

I don't believe that this is a conspiracy, just government inefficiency and administrations putting their own agenda first. They may even believe that the new methods and formulas are better. No doubt they do report more optimistic numbers than traditional methods. Additionally, it has reduced the government's payouts to Social Security benefits.

Eventually Main Street feels the differences, regardless of what is reported. To such an extent that the economic system begins to bend, teetering on breaking. The elasticity of the economic data is uncertain, but as with all measures of elasticity, it eventually breaks.

We are currently seeing the biggest financial crisis the world has ever seen, billions of losses are being reported on a daily basis, billions if not trillions more are at risk. The dollar is falling at accelerated rates hitting new lows daily; commodities and oil are reaching all time highs. The nation is in major debt, from the government and financial firms to the consumer and continues to operate on deficit spending (credit lines). Where are we to borrow in the future, for everyone has tapped every single line of credit to a point that nothing is left? The government may have to print more money and a massive bailout—to the determent of the dollar value and the increase in "real" inflation that could take decades to recover from.

Yet, we continue to here that inflation is at bay and the "Core" is moderate. However, the Fed's statements contradict his actions, as the Fed is in massive defense mode, trying to shore up liquidity as the financial firms. The liquidity is so tight that they are now borrowing frequently over-night from the Fed instead of reserves. Not a good sign as to liquidity or solvency of these firms.

Foreign nations have started to repatriate their currencies and sell U.S. backed assets. They have even demanded in the G7 meetings for the U.S. to get control of the problems. The problems are so enormous that the Treasury Sec. Paulson and Fed's time is fully consumed on the Superfund bailout, keep liquidity flowing and the financial institutions solvent. To such an extent that the Fed, along with its affiliates has ignored the affects to the economy and the consumers that has sent the dollar into a falling spiral and "real" inflation through the roof. They have only graced us with the presences from their busy bailout schedules to say "Readings on core inflation have improved modestly this year" as if that is to put our minds at ease.

Now doubt this is a great and resilient nation, but until our leaders take the "bull by the horns" to help resolve these issues, the continuing rate cuts and telling us that inflation is in check is only prolonging the problem.

A Suggested first step (if only):

Change the CPI back to a fixed basket of goods (with replacements made ONLY when the core product is not longer an impact to society—like Computers exchanged for Typewriters). Use this as the "true" measure inflation. Additionally, stop focusing or stating that the "Core" is the key measure of inflation, since that is unrealistic as to the effects on Main Street.

A new index, COLI (Cost of Living Index) based on the current substitution method, but to not use the term Standard of Living, instead clearly delineate the Utility of Living. Since it is obvious that the Standard of Living suffers in such an index.

Eliminate hedonic adjustments, they are too subjective and additionally don't represent any true monetary savings to Main Street.

Of course the numbers reported by the traditional CPI method may not be to our liking, but maybe it's time to face reality and report what is truly being felt on Main Street and not in the halls of academia of economists working for politically funded think tanks.

Additionally, make these changes permanent and so that no administration will ever be allowed to make adjustments to methods and/or formulas.

> *"No nation in the history of civilization has devalued themselves to prosperity"*

This nation is on the fast track to devaluation as the dollar continues to slide. Inflation is real; just look at oil, gold, commodities, and the dollar's weakness. No government math can change that fact. We are at a tipping point; the question is which way do we tip?

I will leave you with the definition of inflation, you decide if the changed substitution / hedonic method is an accurate gauge of inflation and what Main Street is feeling.

> **In-fla-tion:** Defined as a sustained increase in general price levels for some set of goods and services in a given economy over a period of time. It is measured as the percentage rate of change of a basket of goods.