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Victor R. Fuchs

Robert T. Michael

Sharon R. Scott

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1050 Massachusetts Avenue
Cambridge MA 02138

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Abstract

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No cross-sectional consumer price index is currently available by state, and the BLS's cross-sectional "family budget" index for metropolitan areas is not well-suited for cross-state analyses. In this paper we propose an algorithm for constructing a state-specific Laspeyres price index using conveniently available information from the Census of Business and the Survey of Current Business.

The index is calculated for each state (and for Census divisions and regions) for 1967 and 1972. Its characteristics are discussed, and it is used to deflate nominal per capita income by state. Comparing "real" income by state with nominal income by state, the former has substantially less variation cross-sectionally but greater variation over time (between 1967 and 1972).

National Bureau of Economic Research
204 Junipero Serra Blvd.
Stanford, Calif. 94305
(415) 326-7160

Economic analyses using cross-sectional state data are frequently hampered by the absence of a reliable, easily computed consumer price index by state. The Bureau of Labor Statistics (BLS) publishes a "family budget" for 44 metropolitan and non-metropolitan areas with a varying market bundle, and Sherwood (1975) has provided a fixed bundle price index for these same 44 areas.¹ These indexes can be used for cross-state comparisons, but 21 states do not contain a metropolitan area for which the "family budget" is constructed, and only 7 states have as much as half their population in metropolitan areas covered by these BLS indexes.

In this note we propose a state price index which can easily be calculated for any year in which the Census of Business is conducted. The critical assumptions underlying our method are: (1) there is a composite set of goods sold at retail which has insignificant cross-state variation in price; (2) there is an insignificant amount of net cross-state buying of this set of goods; and (3) the ratio of the consumption of these goods to a composite of all other commodities including personal taxes and savings is constant across states.²

More formally, we assume that there are some consumption items for which cross-state price variation is substantial -- e.g., housing, services, food -- and that there are other items for which competition and transferability among states keeps price variation sufficiently small so that one can assume no cross-state price variation --

¹ The BLS also publishes separate consumer price indexes for several cities, but these are not designed for cross-city comparisons.

² Sufficient conditions for this are that the two composites have unitary income elasticities and zero compensated price elasticities.

e.g., durable goods including automobiles, furniture and general merchandise, wearing apparel, drugs. Call the composite good for which prices vary across states C_1 and the other good C_2 . Our state price index for state j is a Laspeyres price index, L_j , defined as

$$(1) \quad L_j = \frac{P_{1j}C_1 + P_{2j}C_2}{P_1C_1 + P_2C_2}$$

where U. S. averages of prices and quantities are taken as the base. By scaling each of the goods such that its average price is unity, $P_1 = P_2 = P_{2j} = 1.0$. For each state (and for the U. S.) income I is

$$(2) \quad I_j = P_{1j}C_{1j} + P_{2j}C_{2j} \quad .$$

Thus:

$$(3) \quad P_{1j} = \frac{\left(\frac{I_j}{C_{2j}} - 1 \right)}{\left(\frac{C_{1j}}{C_{2j}} \right)} \quad .$$

As we have no way of measuring C_{1j} we assume that behaviorally C_{1j}/C_{2j} is constant across states, hence $C_{1j}/C_{2j} = C_1/C_2$. Substituting this term into (3) and then (3) into (1) yields our estimable index

$$(4) \quad L_j = \frac{I_j}{C_{2j}} \cdot \frac{C_2}{I} \quad .$$

With data available in the U. S. Statistical Abstract we have used equation (4) to construct state price indexes for 1967 and, independently, for 1972. (See Table 1.) The variables are defined as follows:

I_j = state j's per capita personal income 1967 or 1972;

C_{2j} = state j's per capita retail sales 1967 or 1972

excluding sales of food stores, gasoline service stations, eating and drinking places, building materials, hardware, and farm equipment dealers; comparable definitions of I and C_2 for the U. S. are used. (Price indexes for each census division and region as well as for each state are calculated.)

To provide some assessment of the quality of the SPI, we note several of its characteristics. First, the SPI does not appear to be sensitive to moderate changes in the composition of C_2 . For instance, an alternative price series was derived from C'_2 , defined as C_2 plus sales of eating and drinking places and gasoline service stations, thus expanding the sales base by one-fourth. The coefficient of correlation³ between the C'_2 and C_2 series is .97.

Second, on a priori grounds we expect relative prices across states to be fairly stable over time. The correlation between the SPI (1967) and SPI (1972) is quite high, .94.

Third, we expect an accurate state price index to be highly correlated with the residual from a wage equation which holds constant age, sex, color, education, and occupation. That residual should reflect geographic differences in nominal wages due to price difference and

³ All correlations are population-weighted.

perhaps other factors such as amenities. Fuchs (1976) constructed such an adjusted wage based price index for states in 1969, and it is quite highly correlated with SPI (1967) and SPI (1972): 0.85 and 0.83 respectively.

Finally, the BLS publishes a regional CPI of changes in prices over time based on population weighted metropolitan area price changes. If we accept that CPI measure of regional price changes as accurate, then the population weighted SPI over the same time period should show similar price movement, if the SPI is correct. We calculated such a regional SPI for the period 1967-1972, adjusted for the U. S. CPI=125.3 (1967=100). The comparison of those regional indexes is shown below:

<u>Region</u>	<u>BLS</u>	<u>SPI</u>
Northeast	128.5	129.0
North Central	124.0	127.7
South	124.8	122.8
West	122.1	121.4

Both indexes show a relatively rapid rise in prices in the Northeast and, relatively slow growth of prices in the West. The indexes do not conform as well for the North Central and the South.

One important application of SPI is to deflate nominal per capita income. (See Table 2.) We observe that there is much less geographical variation in "real" income than in nominal income. In 1967 the coefficient of variation across states was 10.5 percent for real income and 16.2 for nominal income. In 1972 the coefficients of variation was again lower in real terms: 8.4 percent versus 13.2 percent for nominal income. Table 2 also reveals that there is much less geographic stability in real income over time. The correlation between 1967 and 1972 across states is only

.74 for real income compared with .98 for nominal income. The correlation in income over time is exaggerated when measured in nominal terms because of the stability of geographic differences in price.

Deflating nominal income by the SPI has a strong effect on our perception of relative living standards in the Northeast compared with the South. According to the nominal measure, the average person in the Northeast had 37 percent more income than did the average person in the South in 1967 and 28 percent more in 1972. In real income, however, the difference was only 12 percent in 1967, and the regions were approximately equal in 1972.

Although no definitive test is possible, we conclude that the proposed SPI is a good index of price differences among states and probably the best one available at the present time. Using the method proposed here, further experimentation with alternative sets of commodities to measure C_2 is warranted. Since economic analyses usually assume no money illusion, the availability of the SPI should materially improve cross-state studies of economic behavior.

References

- Fuchs, Victor R. "The Earnings of Allied Health Personnel -- Are Health Workers Underpaid?," Explorations in Economic Research, vol. 3, No. 3, Summer 1976.
- Sherwood, Mark K. "Family Budgets and Geographic Differences in Price Levels," Monthly Labor Review, April 1975.

Table 1: State Price Index for 1967 and 1972 (also shown for Census Divisions and Regions).

Region/Division/State	1967	Year	1972	Region/Division/State	1967	Year	1972
Northeast				North Central			
New England	1.11		1.12	East North Central	1.01		1.03
Maine	1.05		1.03	Ohio	1.04		1.05
N. H.	.91		.84	Ind.	1.05		1.06
Vt.	.94		.79	Ill.	1.00		1.00
Mass.	.85		.84	Mich.	1.04		1.07
R. I.	1.04		1.05	Wis.	1.05		1.06
Conn.	1.04		1.05	West North Central	1.09		1.04
Middle Atlantic	1.11		1.13	Minn.	.94		.98
N. Y.	1.13		1.15	Iowa	.97		.98
N. J.	1.15		1.24	Mo.	.90		.97
Pa.	1.12		1.13	N. Dak.	.90		.94
	1.03		1.03	S. Dak.	.92		.95
				Neb.	.94		1.00
				Kan.	.91		1.00
					1.02		1.07
South				West			
South Atlantic	.91		.88	Mountain	1.03		1.00
Del.	.93		.89	Mont.	.95		.88
Md.	.98		.92	Idaho	.98		.94
Va.	1.08		1.01	Wyo.	.85		.82
W. Va.	1.00		.98	Colo.	1.06		.97
N. C.	1.01		.98	N. Mex.	.97		.88
S. C.	.88		.87	Ariz.	.93		.85
Ga.	.90		.89	Utah	.94		.89
Fla.	.88		.83	Nev.	.94		.87
East South Central	.84		.76	Pacific	.97		.88
Ky.	.90		.88	Wash.	1.05		1.03
Tenn.	.99		.98	Oreg.	1.03		1.05
Ala.	.85		.84	Calif.	.91		.92
Miss.	.90		.86	Alaska	1.05		1.04
West South Central	.87		.83	Hawaii	1.33		1.20
Ark.	.88		.88		1.17		1.13
La.	.80		.83				
Okla.	.95		.93				
Tex.	.90		.89				
	.85		.87				
				U.S.	1.00		1.00

