

June 21, 2019

Nancy Potok, Chief Statistician
Office of Management and Budget (OMB)
725 17th Street, NW
Washington, DC 20503

Attention: Directive No. 14

Re: OMB-2019-0002;

Attention: Directive No. 14; Consumer Inflation Measures Produced by Federal Statistical Agencies

Submitted electronically via Regulations.gov

Dear Ms. Potok,

The Office of Management and Budget (OMB) has requested comment on potential changes to the inflation index used to adjust the poverty threshold over time. I argue that changing the inflation index from the Consumer Price Index for All Urban Consumers (CPI-U) to the Chained Consumer Price Index for All Urban Consumers (C-CPI-U) is not appropriate. Any changes considered should be paired with a broader re-analysis of the poverty threshold and the ways low-income and higher-income families differ in their consumption habits and inflation experiences. **Recent research in behavioral science demonstrates that the experience of living in poverty changes how people evaluate their consumption choices, suggesting that converting to chained CPI will not accurately reflect the daily financial reality of people living in poverty.**

Behavioral science shows that poverty is not merely a matter of resources. The absence of material wealth is closely linked to the absence of other forms of capital: human capital (one's level of education, skills, and experiences), social capital (one's network of interpersonal connections and relationships), and health capital (one's physical and mental well-being). To permanently escape poverty, families must build capital in all of these various forms.

In this broader view, poverty is a context:

“Emerging research has shown that living in poverty means living in chronic scarcity—and scarcity comes with a set of cognitive consequences that may be beneficial or adaptive in the short term but that are highly deleterious when experienced chronically. Key features of life in poverty interact with human psychology in ways that make it difficult to solve problems, make plans and decisions, and exert self-control. While all humans have limited attention, poverty imposes an additional attentional burden on those facing poverty”

- Poverty Interrupted (Daminger et al, 2015).

As such, poverty imposes a cognitive load that often results in suboptimal decision making across a variety of contexts (Mani, et al 2013). Poverty captures the mind, forcing people to spend their limited cognitive resources solving immediate problems. For example, farmers will score better on measures of fluid intelligence such as Raven's Progressive Matrices immediately after harvest (when they have sufficient financial resources to meet their needs), compared to their scores taken before the harvest

(when they have a tight budget). Similarly, laboratory experiments that prime financial scarcity (by asking participants how they would finance a necessary and expensive car repair) reduce the measured intelligence of low-income subjects, but not high income subjects. This leaves fewer resources available for other tasks. Anyone experiencing a context of scarcity, such as the one created by poverty, would be subject to the same effects (Mullainathan and Shafir, 2013).

One potential consequence of this is that people experiencing poverty may be less likely to switch to substitute goods in the presence of price shifts. To give an example, proponents of a move to a chained CPI index argue for the change because it incorporates the effects from substitution to alternative goods. The classic example is that as prices rise for luxury goods such as steaks, consumers will instead purchase substitute items, like hamburgers.

However, consumers living in poverty face structural barriers that prevent effective substitution. They have limited choice in where they shop, some may lack access to the internet and online shopping, and even with an array of shopping venues, living in poverty is often more expensive--they lack the financial slack needed to ultimately save by buying in bulk. Consumers facing poverty also face behavioral barriers that prevent them from effective substitution of goods.

Additionally, consumers will only switch to substitute goods if they notice and react to price shifts, but this is not consistently the case across all consumers (Chetty et al., 2009). Poverty may make it less likely that people notice and react to the price changes. As discussed above, poverty acts as a drain on cognitive resources, causing a decrease in fluid intelligence for as long as poverty persists. This reduction in fluid intelligence could result in people experiencing poverty being less likely to switch to substitute goods in response to price shocks (DeAcunto et al, 2019).

As poverty dampens cognitive abilities, we should expect that those facing poverty may be less able to attend to price shifts and shift their consumption in response. This would result in those facing poverty experiencing higher effective inflation rates than the general population. This corresponds with household-level findings, which suggest that low income households experience an annual inflation rate 0.6 percentage points higher than high income households (Kaplan and Schulhofer-Wohl, 2017).

These findings suggest that moving to chain CPI may result in a less accurate measure of the poverty rate. Before moving to a chain CPI, OMB should further investigate how substitution rates differs across households, especially households experiencing poverty. Additionally, it is possible that there is an interaction between poverty and spending categories. While people experiencing scarcity may be less likely to attend to price shifts in aggregate, there is also evidence suggesting that experiencing scarcity can focus attention in specific instances (Shah et al., 2015).

As the poverty threshold determines eligibility for a wide variety of federal and state programs, such as Medicaid and SNAP, a change to poverty threshold calculations could result in many families losing access to federal benefits. The families rely on these benefits in order to make basic needs. Access to SNAP, for example, has been shown to have substantial benefits; increasing families' economic self-sufficiency. Children who receive SNAP see increased health as adults (Hoynes et al, 2016).

The OMB should instead consider introducing a new poverty line based on a better understanding of the needs and barriers faced by those experiencing poverty. At minimum, this means updating the threshold to better reflect the actual consumption needs of families experiencing poverty, reflecting changes to the

typical consumption bundle across the last five decades. But, more ambitiously, we should consider broader measures that incorporate factors beyond material needs to broader definitions of capacity (Sen 1999).

Sincerely,

Matthew Darling
Vice President, ideas42

About ideas42

At ideas42 we believe that a deep understanding of human behavior will help us improve millions of lives. For more than a decade, we've been at the forefront of applying behavioral science in the real world. We create innovative solutions to tough problems, ultimately striving to generate lasting social impact and create a future where the universal application of behavioral science powers a world with optimal health, equitable wealth, and environments and systems that are sustainable and just for all. Our efforts have so far extended to 40 countries as we've partnered with governments, foundations, NGOs, private enterprises, and a wide array of public institutions.

About Matthew Darling

Matthew Darling is a Vice President at ideas42. He has contributed to ideas42 projects in poverty, health care, early childhood education, financial literacy, mortgage default reduction, climate change, and labor economics. Matt graduated from Hampshire College with a self-designed concentration in economics and cognitive science, and from Tufts University with a MS in economics. He has previously worked as a consultant at Kohlberg and Associates, and as a research assistant at the Stanford Neuroeconomics Lab.

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