

The AIER Cost-of-Living Guide 1994 Update

The general price level, as measured by the Consumer Price Index (CPI), has increased at an annual rate of 3.1 percent thus far in 1994. Many people apparently regard this as an "acceptable" rate of price inflation, even though over the course of a decade it would cut the buying power of the dollar by 25 percent. (This may be an optimistic scenario; if, as some analysts are predicting, the rate of price inflation accelerates from its current level, the damage to the dollar could be much greater.) The experience of the U.S. economy since 1980, a period that includes 10 years of "moderate" price inflation, illustrates that the cumulative impact of chronic price increases can be enormous.

In today's heavily regulated economy, the prices of consumer goods and services depend on a bewildering variety of factors unrelated to market supply and demand *per se*. During the past half century and more, Government fiscal, economic, and monetary policies have shaped market pricing conditions in numerous ways,

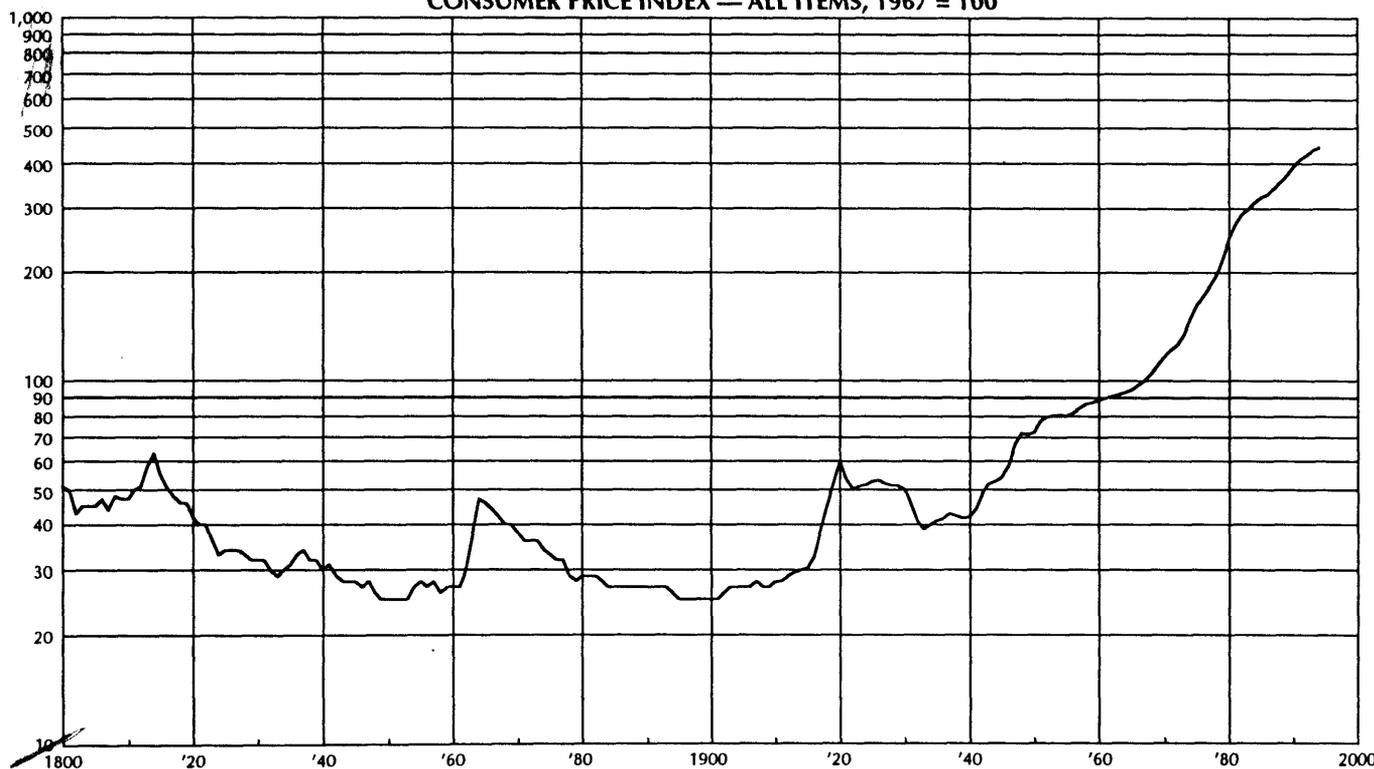
some of which we discuss in the pages that follow.

Probably most apparent have been the current-price effects of Government monetary policy. As shown in Chart 1, for more than a century the general price level, as captured by the all-items Consumer Price Index (CPI), fluctuated periodically

in response to a series of wars and panics. From the Revolutionary War through World War I, wartime monetary excesses were followed by postwar decreases in consumer prices (the sharp upturns in prices preceding the three peaks shown in the chart coincide with the War of 1812, the Civil War, and World War I). During each of those episodes when the dollar's purchasing power plunged, the currency's redeemability into monetary commodities (gold or silver) at fixed rates was impaired. After convertibility was restored, prices began to return to their prior levels. From the perspective of subsequent dollar price trends, for example, it may seem astonishing that *the all-items CPI for 1930 was exactly the same as it had been in 1801, 130 years earlier.* (The CPI for both years was 50.0, where 1967=100.)

However, a sea change in the movement of the general price level followed the abandonment of the domestic gold standard in 1933 and the subsequent suspension of all redeemability in 1971. As

Chart 1
CONSUMER PRICE INDEX — ALL ITEMS, 1967 = 100



Note: Prior to 1913 index is based largely on prices for goods rather than goods and services, and on wholesale rather than retail prices.

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Chart 2
SELECTED COMPONENTS OF THE CONSUMER PRICE INDEX
 (1967 = 100)

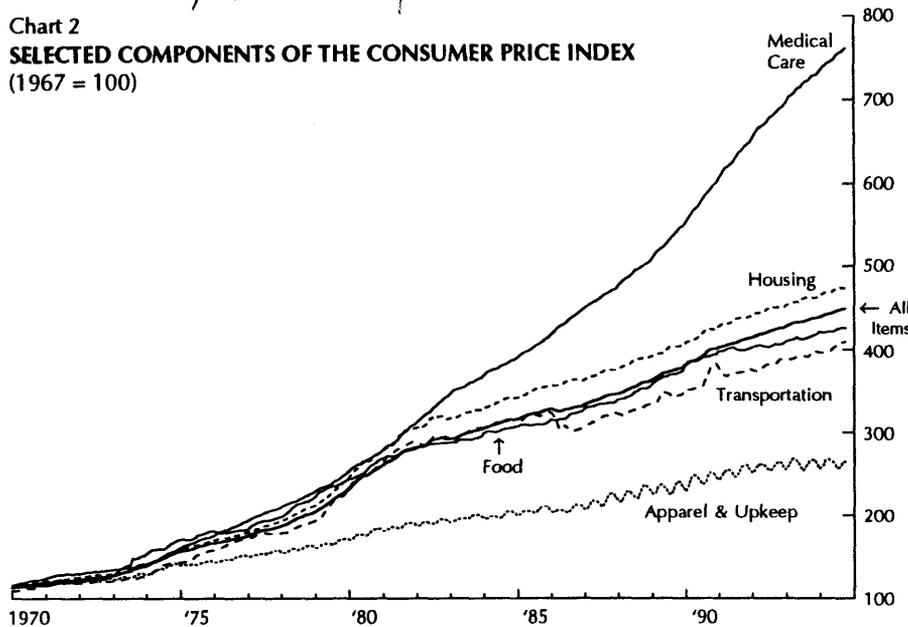


Chart 1 shows, the purchasing power of the dollar since the late 1930s has eroded almost continuously at rates previously associated only with national crises — and there has been no reversal of the price trend such as occurred previously when the dollar was returned to convertibility. As we have said many times, there *never* has been a paper currency that eventually has not become worthless.

There is, of course, no such thing as a “general price” of anything. The “general price level” that the CPI and other price indexes are said to reflect is a relatively crude attempt to capture in the aggregate changes in the prices of millions of different goods and services.

Even so, relative changes in several of the component price series may help to reveal how other Government policies may have influenced consumer price movements. As shown in Chart 2, the retail prices of some goods or services have tended to increase more rapidly than others. Since 1981, for example, consumer prices for medical services have increased much more rapidly than for other things, while the pump price of gasoline has shown little net change (see Chart 3). In these instances, Government policy has directly influenced price movements: burgeoning subsidies for elderly Medicare recipients and low-income Medicaid beneficiaries have created a classic “demand side” price squeeze that has forced prices for covered services upward despite numerous “cost containment” initiatives; and, oppositely, the partial deregulation of the energy industry despite the protests of “energy independence” advocates during the 1980s has fostered developments (namely, increased production) that favored lower market prices.

It is beyond the scope of this discuss-

ion to pursue in detail how literally thousands of “micro” and “macro” Government management policies may have influenced consumer costs. But it takes little insight to see that subsidies of any kind (rent-controlled housing, price supports for farmers, hospital and medical insurance, for example) and various “consumer safety” regulations over the long run *increase* the relative costs of food, housing, and health care for everyone. Note in Chart 2 that the CPI for apparel and upkeep, one of the least-regulated of consumer industries, also has one of the lowest rates of increase. And consumer prices in the deregulated communications industry and virtually unregulated electronics and computer industries (not shown in the charts) have plummeted in recent years.

Cost-of-Living Increase Since 1980

Chronic price inflation even at “moderate” rates leads to significant losses of buying power over time, a fact often obscured by media reports that focus on comparatively small monthly or annual price changes. For example, during the 1980s the average annual rate of price inflation was 5.1 percent — a level that many people apparently consider to be acceptable — but the buying power of the dollar decreased 40 percent during that decade. In the period since 1982, when the highest annual increase in the CPI from one December to the next was “only” 6.1 percent, the dollar has lost 37 percent of its purchasing power.

Such rapid debasement of the Nation’s currency ought not to be surprising. Rather, what many people now apparently believe to be “moderate” rates of price inflation posted during much of the 1980s were high by historic standards. Between

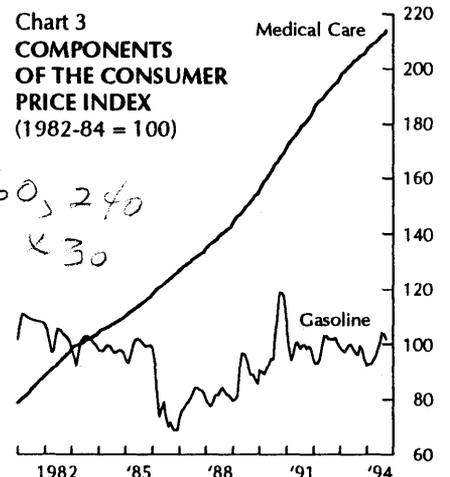
1982 and 1994, the average yearly increase in the CPI was 3.7 percent. In the 1950s and 1960s, by comparison, annual increases in the CPI averaged 2.2 and 2.5 percent, respectively.

The increase in the cost of living actually experienced by most consumers may have been more or less than the 95 percent increase registered by the CPI since the beginning of 1980, depending on how closely their spending habits resemble those typified by the “basket” of goods and services upon which the CPI is based. The “CPI for all Urban Consumers,” the most commonly cited index, measures the price changes of an “average” group of goods and services commonly purchased by about 80 percent of the population. The price inflation experienced by those who do not fall into this category, for example those in rural areas, may not be accurately measured by this index.

A breakdown of the CPI into its component goods and services, as shown in the accompanying table, reveals where price pressures were greatest during the past 15 years. Consumers who purchased relatively more of the items near the top of the list suffered a larger increase in their cost of living than that implied by the increase in the aggregate CPI. Those who purchased more of the items listed at the bottom experienced a relatively smaller increase.

The accompanying table illustrates what consumers already know: the prices of some goods and services increased much faster than others. Price changes of individual items are influenced by countless forces of supply and demand, including changing technology, demography, and tastes, product innovation, international competition, etc. However, one of the chief sources of differential price pressures may have been Government policies that forced the prices of some goods and services up more than others.

The item for which prices increased



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1980 - 1999

**PERCENT CHANGES IN SELECTED PRICE INDEXES,
December 1979 — September 1994**

<i>Item</i>	<i>% Change</i>	<i>Item</i>	<i>% Change</i>	<i>Item</i>	<i>% Change</i>
Hospital room	281.9	Miscellaneous prepared foods,		Textile housefurnishings	56.5
College tuition	275.5	including baby food	89.6	Fats and oils	55.9
Elementary, high school tuition	256.4	Appliance and furniture repair	87.4	Living room chairs, tables	55.0
Prescription drugs	237.5	Other toilet goods		Toys, hobbies, and music equipment	53.1
Airline fares	225.5	and personal care appliances	86.8	Tableware, serving pieces,	
Tobacco and smoking products	225.4	Cosmetics	86.8	nonelectrical kitchenware	52.8
Other fresh fruits	217.6	Beauty parlor service—female	85.9	Coffee	52.2
School books and supplies	203.7	Haircuts, other barber service—male	85.5	Other poultry	51.3
Auto insurance	189.8	Lunch away from home	84.8	Men's footwear	50.6
Physicians' services	179.2	Electricity	84.0	Men's suits, sport coats, coats	
Cereal	172.8	Snacks	82.7	and jackets	50.1
Water/sewerage maintenance	172.1	Laundry and cleaning products,		Men's shirts	49.2
Dental services	169.9	including soap	81.8	Fresh milk and cream, excl. whole milk	48.2
Lodging while out of town	162.6	Household maintenance/repair services	81.4	Sport vehicles, including bicycles	48.0
Used cars	142.8	Dinner away from home	80.3	Sirloin steak	47.2
Intracity public transportation	141.6	Sweets including candy	79.7	Chuck roast	46.3
Lettuce	140.5	Automobile maintenance and servicing	78.5	Other furniture	46.0
Potatoes	140.2	Sugar and artificial sweeteners	77.9	Canned fish, seafood	45.6
Automobile registration, license,		Beer and ale at home	77.0	Boys' and girls' footwear	44.8
and inspection fees	137.2	Utility (piped) gas	76.3	Carbonated drinks	44.8
Other fresh vegetables	135.2	Fresh/frozen chicken parts	76.3	Clocks, lamps, and decor items	44.5
Internal and respiratory		Floor and window coverings	74.9	Fresh whole milk	43.7
over-the-counter drugs	134.6	Tomatoes	74.6	Other housing maintenance	
Newspapers	128.3	Frozen prepared foods	71.4	and repair goods	42.0
Fresh/frozen fish, seafood	126.5	Pork chops	71.3	Men's dungarees, jeans, trousers	41.9
Other automobile-related fees	125.0	Ice cream, related products	70.0	Sofas	40.8
Magazines, periodicals, and books	121.8	Other beef and veal	69.8	Round steak	39.4
Intercity public transportation,		Rice, pasta, cornmeal	69.7	Laundry equipment	37.6
excluding airlines	119.9	Processed vegetables, excluding frozen	69.3	Other sporting goods	37.4
Admissions for entertainment	118.0	Bedroom furniture	69.2	Other dairy products, including butter	36.4
Cookies, fresh cakes and cupcakes	117.7	Pet expense	67.2	Boys' apparel	35.9
Alcoholic beverages—away from home	117.4	Distilled spirits at home	65.9	Girls' apparel	35.8
Nonprescription medical supplies	115.9	Fruit juices and frozen fruit	65.7	Refrigerator, home freezer	33.8
Laundry and dry cleaning services	115.6	Fresh whole chicken	65.7	Women's separates and sportswear	32.1
Other bakery products	110.5	Bacon	65.4	Women's dresses	31.1
Auto drive train, front end repair	110.1	New cars	64.1	Lawn equipment, power tools,	
Automotive body work	108.0	Ham	63.7	and other hardware	29.8
Canned, packaged soup	107.8	Cheese	63.0	Women's footwear	29.7
Auto power plant repair	104.5	Other pork, including sausage	62.3	Round roast	29.3
Fresh other breads, biscuits, rolls,		Other noncarbonated drinks	62.2	Women's suits	28.5
muffins	101.2	Canned and dried fruits	61.6	Eggs	24.7
Other apparel services	100.9	Men's furnishings/special clothes	60.2	Motor fuel	21.6
Rent of dwelling	100.8	Household paper products		Automobile finance charges	17.9
Seasoning, condiments, sauces, spices	99.1	and stationery	59.4	Women's coats and jackets	17.3
Tenants' insurance	98.2	Infants', toddlers' apparel	59.3	Ground beef, excluding canned	15.5
White bread	98.1	Motor oil, coolant, and other products	58.5	Home fuel oil	13.4
Apples	95.2	Photo supplies, equipment	57.9	Tires	11.3
All-items CPI	94.8	Bananas	57.7	Telephone intrastate toll call	4.3
Other meals and snacks outside home	92.8	Women's nightwear, underwear,		Audio equipment	-3.2
Postage	90.7	hosiery, accessories	56.7	Telephone interstate calls	-7.7
Frozen vegetables	90.7	Wine at home	56.6	Televisions	-32.8

the most since 1980 — a hospital room, up 281.9 percent — is associated with a sector that is subject to enormous Government interference in the form of oversight, regulation, subsidies, and social policy. In contrast, three items for which prices actually decreased — televisions, telephone interstate calls, and audio equipment — are the products of industries that have been deregulated or are largely free from regulation. The disproportionately high increases in the prices of other items, such as tuition and physicians' services, may be further evidence that Government intervention in the marketplace is not costless to consumers.

The relationship between Government policy and the costs of obtaining goods and services is, of course, not as simple as these examples might suggest. For one, myriad Government policies distort prices. (In one way or another, almost all the items listed in the table are influenced by such

policies.) Some of the effects, as in the case of farm price supports, are direct, some indirect; some are intentional, some not. It is difficult, if not impossible, to identify the relative impacts of different (sometimes conflicting) policies.

In addition, the effects of Government actions are reflected not only in the price of an item but also in its availability. Policies that artificially limit price increases also tend to limit supply. When this happens, low prices do not necessarily reflect a lower cost of living, or a higher standard of living. (Witness the long lines in Eastern Europe for "cheap" goods, or the limited availability of medical services in countries with nationalized "low cost" health insurance.)

Oppositely, higher prices do not always imply a commensurate increase in the cost of living. (In this respect, reports of sharply higher price inflation in Eastern European countries that have abandoned central

planning may overstate the impact of price increases on the standard of living. The higher prices are offset, to some extent, by the freeing of time formerly spent standing in lines. This time can now be invested more productively.) To take an example from the table, the large reported increase in list-price airline fares since 1980 may suggest that the deregulation of the industry was not a success — until one realizes that fare discounts are widely available now, "frequent-flyer" mileage bonuses further reduce the effective price of flying, and the choice of flights available today is much greater than 15 years ago.

Be that as it may, the larger point to be gained from the table is simple: no matter what the politicians and monetary authorities say, the buying power of the currency continues to sink in this era of inflating. The obvious question would seem to be: how little will a dollar be worth 15 years from now?

PURCHASING POWER CONVERSION FACTORS

To Convert:			To Convert:			To Convert:		
Past Dollars to 1994 Dollars		1994 Dollars to Past Dollars	Past Dollars to 1994 Dollars		1994 Dollars to Past Dollars	Past Dollars to 1994 Dollars		1994 Dollars to Past Dollars
Year	Multiplier A	Multiplier B	Year	Multiplier A	Multiplier B	Year	Multiplier A	Multiplier B
1920	7.3850	0.1354	1945	8.2208	0.1216	1970	3.8100	0.2625
21	8.2822	0.1207	46	7.5873	0.1318	71	3.6529	0.2738
22	8.8267	0.1133	47	6.6233	0.1510	72	3.5363	0.2828
23	8.6712	0.1153	48	6.1542	0.1625	73	3.3291	0.3004
24	8.6374	0.1158	49	6.2146	0.1609	74	3.0000	0.3333
1925	8.4240	0.1187	1950	6.1456	0.1627	1975	2.7488	0.3638
26	8.3604	0.1196	51	5.6954	0.1756	76	2.5988	0.3848
27	8.5212	0.1174	52	5.5666	0.1796	77	2.4413	0.4096
28	8.6206	0.1160	53	5.5249	0.1810	78	2.2677	0.4410
29	8.6206	0.1160	54	5.5043	0.1817	79	2.0382	0.4906
1930	8.8620	0.1128	1955	5.5181	0.1812	1980	1.7954	0.5570
31	9.7385	0.1027	56	5.4368	0.1839	81	1.6267	0.6148
32	10.8337	0.0923	57	5.2625	0.1900	82	1.5327	0.6524
33	11.4496	0.0873	58	5.1225	0.1952	83	1.4849	0.6734
34	11.0499	0.0905	59	5.0756	0.1970	84	1.4243	0.7021
1935	10.7810	0.0928	1960	5.0011	0.2000	1985	1.3752	0.7271
36	10.6771	0.0937	61	4.9453	0.2022	86	1.3493	0.7411
37	10.3047	0.0970	62	4.8907	0.2045	87	1.3017	0.7682
38	10.5000	0.0952	63	4.8268	0.2072	88	1.2506	0.7996
39	10.6259	0.0941	64	4.7645	0.2099	89	1.1934	0.8380
1940	10.5500	0.0948	1965	4.6889	0.2133	1990	1.1321	0.8833
41	10.0476	0.0995	66	4.5540	0.2196	91	1.0860	0.9208
42	9.0799	0.1101	67	4.4310	0.2257	92	1.0542	0.9485
43	8.5541	0.1169	68	4.2524	0.2352	93	1.0240	0.9765
44	8.4080	0.1189	69	4.0355	0.2478	94	1.0000	1.0000

How to Convert Past and Present Prices

Our readers often ask us what prices their property might have commanded at some earlier date — or what price would have to be paid today for something purchased years ago. The table above, "Purchasing Power Conversion Factors," provides a simple way for anyone interested to obtain a rough estimate of what the purchase price of goods, services, or real estate is in terms of present and past dollars.

To convert past-dollar prices into 1994-dollar prices, simply multiply the original price by the conversion factor **Multiplier A** shown in the table for the appropriate year. Say that you want to know if the house you bought years ago has "kept pace with inflation." Simply multiply the price of the house in the year that you purchased it by the Multiplier A factor shown for that year. *Example:* A California house purchased in 1954 for \$17,000 has a current market value of \$525,000. Has it enjoyed a *real* gain or suffered a *real* loss in terms of its market value's purchasing power? The \$17,000 original purchase price in terms of 1994 dollars is $\$17,000 \times 5.5043 = \$93,573$ — or a *real* gain of about \$431,427.

Oppositely, to convert 1994 dollars into past dollars, simply multiply today's price by the conversion factor **Multiplier B** shown in the table for the appropriate year. *Example:* Today the price of a pound-and-a-half loaf of white bread is about \$1.50 here in Western Massachu-

setts. What was the equivalent expenditure in, say, 1965? Today's \$1.50 purchase price in terms of 1965 dollars is $\$1.50 \times 0.2133 = \0.32 . Who in 1965 expected that bread might cost \$1.50 by 1994? And who today would believe that the \$1.50 loaf of today might cost \$7.00 or more 25 years from now? We did and we do.

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