

How life has become so much more expensive, even though the inflation rate has been low

[25. 05. 2020 | Many people perceive inflation as higher than it is actually measured. A US institute shows: The people are not wrong. It is indeed becoming increasingly difficult to lead a middle-class life on an average salary.](#)

The perception of the population and the figures in the statistics are rarely as far apart as in the case of inflation. According to an analysis by the European Central Bank (ECB) from 2017 based on EU-wide survey data, normal people estimate the rate of price increases in the past to be much higher than the statistics. In Germany, the perceived difference was a spectacular five percentage points for the period from 2004 to 2015, and this huge difference was still below average within the EU.

It does not seem to be due to complete ignorance on the part of the respondents. Although the data on the inflation rate were far above the officially measured inflation, they moved relatively parallel to the latter over time, as the ECB remarks.

Economists have so far explained the overshooting of inflation perceptions primarily by the fact that mainly such products become more expensive, that people buy more often, and hence whose price changes they particularly perceive. But the ECB analysis shows that this can explain only a small fraction of the deviations.

Cost of living vs. cost of thriving

Oren Cass, head of the newly founded research-institute American Compass, which could be described as family-value-oriented conservative, offers an analysis with another explanation. According to him, people have something different in mind than statisticians when they are asked about the cost of living. They are interested in what it costs to live a life that is the norm in their own social class. So far there is no yardstick for this. Cass wants to remedy this with a new index, after which he has named his essay: "[The Cost of Thriving Index](#)".

This "Cost of Thriving Index" is intended to measure the costs of a normal middle-class life. To simplify matters, Cass confines himself to large items of expenditure, on things that are important for social status: Rent for a house, a car, half a year's college tuition and family health insurance, all at levels typical of the lower to middle middle class. For the long-term comparison, he chooses the median weekly salary of a male employee as the standard of reference. The median salary is the salary at which half of the employees earn either more or less.

Costs quadrupled

The result is impressive. According to the usual inflation indices, the average salary of an adult male full-time employee in 2018 could buy up to ten percent more than about four decades ago, writes Cass. That is not much, but it would be a gain in prosperity.

However, Cass notes that the cost of the basic items he has chosen for a middle-class life of \$13,200 quadrupled to \$54,400. In contrast, the median weekly wage of an adult full-time employed man increased only two and a half times during the same period, according to his calculations. Whereas in 1985 the average man could finance the basic equipment of a middle-class life for a family of four with 30 weeks of work, today he has to work 53 weeks for it, more than the year has weeks.

Cass states in his conclusion: "The widening gulf that it depicts between what American life costs and what American jobs pay is a central fact of American political economy that the public appears to have understood

long before economists.”

Measuring inflation for the homo economicus

But why is it that this massive increase in prices is not visible in the official inflation data? Contrary to the strictly individualistic view of measuring inflation, Cass assumes social beings whose utility is derived from comparison and interaction with others. The official inflation measurement asks what it costs more to buy the goods needed to maintain a constant level of utility for a self-absorbed, consumption-oriented person.

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The basic consensus among economists that utility can neither be measured nor compared is eluded by making arbitrary assumptions. For example, it is assumed that a computer with twice the computing power would bring twice as much benefit. If a new television is as good as a top-of-the-range model of earlier years that had cost twice as much, then this is treated as a 50 percent price reduction.

In Cass's view, however, a new television set from 20 years ago offers much less benefit today than it did 20 year back, because it will not suite to host a Super Bowl party. With an old computer you can hardly interact with others anymore, because current apps no longer run on it.

It's stuck in the budget

If a family wants to maintain its social status, the budget must be sufficient to buy all the improved products. Cass makes this point using the example of the car. According to official inflation measurement, there is no inflation for cars.

According to statistics, a new car in 2018 cost no more than in 1996. In fact, the basic model of the Toyota Camry four-door 2018 cost 23,600 dollars, about 40 percent more than in 1996. Statistics attribute all this to better equipment and quality, hence no inflation. But the Camry in its basic version at that time for 16,800 dollars is no longer available. The almost 8,000 dollars extra for more accessories and better quality have to be paid somehow.

The reactions to Cass's essay show how much of value judgment is hidden within the apparently so objective measurement of inflation. Scott Winship, of the free-market,conservative Manhattan Institute of Policy Research, which Cass used to work for, criticizes the article from the individualistic perspective underlying the official methodology of measuring inflation.

He argues that people are free to buy more of one good and less of the other, if their budget is tight. One could buy used televisions and cars to actually realize the theoretical price reduction. Since a house in the lower market segment is of higher quality today than one in the middle 40 years ago, you can rent one without losing in comparison to the past, and within your budget. However, with this argument, Winship simply ignores the fact that a lower-class home by nowadays standards can hardly allow you to feel and act like you belong to the middle class.

That Cass takes a family as a benchmark is arbitrary for Winship, because more and more people could afford to live alone. Foremost, as most women earn money of their own today, one salary no longer needs to cover the expenses of the entire family. This additional income is the main reason why middle-class families today afford themselves a more expensive life than in earlier decades.

Money and more

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This diagnosis is convincing, to a point. There is a problem with the assumption of statistics that this is an outflow of individual utility maximization. This would mean that all people involved increase their utility. Yet, this is contradicted by the "Paradox of Declining Female Happiness", as one paper calls it, i.e. the fact that life satisfaction of US American women has decreased in the course of their integration into the labour market. It is quite possible that many mothers have entered the labour market out of the social necessity described by Cass and have suffered a loss of utility as a result.

Translated from German by Thomas Teichmann with support from www.DeepL.com. My thanks go to both. The [original German blogpost](#) appeared on May 4. 2020.