

We do not calculate the CPI correctly: New Goods Bias

In the year when the basket was built, 10 Floppy disks were commonly used: For \$7 each floppy had 2MB of memory

CPI uses old quantity with new price

\$7/each

With time, **new goods** become
available: For the **same \$7**
consumers now get **256,000MB** of
memory: **a massive drop in price!**

Cost of
the basket

20 x 7

\$140

20 Floppy
Disks



1 Memory
Stick



Cost of
the basket

$$20 \times 7$$

\$140

\$7/each



The CPI
reports **no**
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prices

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To avoid a drop in **real** salary, the **nominal** salary
must increase by inflation