

Labor Contract: "Employer will increase workers' salaries **by** CPI Inflation"



Employer

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



Employee

Salaries must increase by
233% to "compensate
workers for the increase in
prices"

Workers substituted high
priced goods and did not
suffer a 233% increase in
prices



The CPI
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We do not calculate the CPI correctly: Substitution Bias