

Comparing the cost of living is not what it used to be

By John Kay

I remember, said a Christmas bore, when it was possible to take a friend to the cinema, buy a round of drinks, take a taxi home and still have change from £5. Those good old days are not so distant. In the early 1970s it would have been possible to do precisely that. Today a similar evening would leave some change from £50 but not much.

Such an increase is in line with official statistics of inflation, which suggest that prices in Britain have risen eightfold over the period.

The aggregate disguises the variability of the individual components. Cinema charges have increased by less than prices generally, a round of drinks by more, taxi fares by much more.

Theatre once cost little more than cinema but no longer. In 1970 the best seats to London's West End shows were about £2; the same ticket today will set you back between £40 and £50. But if you prefer to stay at home and watch television, you can get a better picture and a more reliable appliance for the £200 a set would have cost 35 years ago.

The Asian effect has driven down even the relative price of simple manufactures: a chisel that cost £3 in 1970 has risen, but to £10 not £25. Where global competition interacts with technological change, as with televisions, results are often dramatic.

A transatlantic telephone call in 1970 was about £1 per minute, so a 15-minute call once a week for a year would have cost more than a small car. If you shop around today – and you are able to shop around today – you can buy that service for much less than the price of a tank of fuel.

If you prefer to fly to New York, the cost in the early 1970s was about £200 return. Today there is a much wider choice of airlines and fares and, if you pick your way among them, you can make the same trip for about the same price – so long as you fly economy. In those days, a first-class fare was less than twice the cost of an economy ticket. No one imagined that you could charge some passengers more than 20 times as much as others for seats on the same plane.

A first-class seat is a positional good: it is available only in limited supply, is bought only by the affluent and serves as a symbol of their affluence. The price of positional goods has risen sharply, reflecting rising incomes and greater inequality. A two-bedroom

cottage in the heart of Notting Hill, on the market for £32,000 in 1972, would now fetch £1.5 million.

Technology, globalisation and competition drive prices down. The status of positional goods, the rising cost of domestically produced labour-intensive services and the absence of vigorous competition push prices up.

As with London theatres, so with restaurants. In 1970 you could have dined at a top London restaurant for less than £3 per head. But a top London restaurant then would seem pedestrian in 2007 and a Gordon Ramsay menu leaves little change from £100.

Economic growth in advanced societies largely takes the form of quality change and new goods. An entry-level car has risen in price from about £750 to something like £8,000. But comfort, performance and reliability are incomparably superior and that 1970 car would simply be unmarketable today. The desktop calculator has gone; desktop personal computers have arrived; the iPod has taken over from the gramophone. Video cassette recorders came and went in a single generation.

No one experiences averages, and that explains why many people – even Christmas bores – are sceptical about price indices. The variability of individual prices is so great that it is easy to think of items whose price has risen far more than inflation. Changes in product quality and the arrival of new goods confuse both consumers and official statisticians. The longer the period of price comparison, the more strained such comparison becomes.

David Landes, the New York-born economist, famously described how Nathan Rothschild – possibly the richest man in the world in 1836 – died, in spite of the costliest medical attention available, from an illness that could today be cured by antibiotics costing a few pence. What does that tell us about the cost of living?