

## Background

Please confirm you have read and understood this important background information.

Yes, I have read and understood the information on this page.

## About you

### 1 What is your name?

Name:

### 2 What is your email address?

Email:

### 3 What is your organisation?

Organisation:

UNISON

## Section one: Measuring prices across the economy

### 1 Should ONS identify a main measure of price change across the economy?

No

#### Why? Please provide comments.:

[These comments are made by UNISON, which is one of the largest trade unions in the UK and represents in excess of 1.3 million members working across the public services.]

UNISON sees no value in identifying a main measure of price change across the economy. We believe that the crucial task is to establish measures of price change that are fit for purpose.

The measure for guiding macro-economic policy is different to that required for measuring the changes in prices of goods facing households.

The recent paper Towards a Household Inflation Index from the Royal Statistical Society, which was co-authored by a former Eurostat head of price comparisons, notes that the Harmonised Index of Consumer Prices (which has been renamed in the UK as the Consumer Prices Index) was specifically "designed in the 1990s for macroeconomic purposes" and its role is to act "as the principal inflation indicator for the Bank of England in its interest-setting rate role."

It also highlights the long-standing historic roots of the Retail Prices Index "as a means of measuring the increase in the cost of basic subsistence items of workers" which "developed over the years into a wider measure of changes in prices facing households."

The Office for National Statistics itself has consistently recognised the different roles that a consumer price index must fulfil and stated in its October 2011 paper, Implications of the differences between the Consumer Prices Index and Retail Prices Index, that a consumer price index is used for two main purposes, as an uprating index and as a monetary policy indicator.

To try to shoehorn these roles into one index would mean that the UK Statistics Authority would be failing in its fundamental purpose to "ensure production and publication of high quality statistics and analysis to help Britain make better decisions."

UNISON does not accept this can be glossed over by producing a main index based on CPI or CPIH and then producing sub-indices for particular groups because CPI and CPIH are fundamentally unfit as an uprating index.

As stated by the Royal Statistical Society:

"Why should the typical household accept an inflation index that: -

- fails to take account of, or does not track directly, one of their main expenditure items: mortgage payments and other costs of house purchase and renovation
- gives more weight to the expenditure patterns of wealthier households than of other households
- fails to take account of interest on loans for a wide variety of purposes, ranging from student loans to loans for car purchase
- includes the expenditure of foreign tourists in the UK but not their own expenditure outside the UK
- fails to include Council Tax
- includes only a small part of premiums paid for the insurance of cars, travel, health etc.

All of the above inadequacies reflect the designs of the CPI and CPIH as macroeconomic indices, for which they are well suited. Using them, or continuing to use them, for uprating purposes, and indeed as a general measure of inflation as it affects households, seems certain to give rise to a lack of public credibility and acceptability."

UNISON understands the value in reducing the number of price change measures, which have proliferated over time to around 12 different measures. However, we reject the establishment of a main measure based on CPI or CPIH.

### 2 If you answered 'yes' to question 1a, then what should this measure be?

Other (please provide details).

#### **Why? Please provide comments.:**

Although UNISON appreciates that different indices serve the different purposes of uprating and shaping monetary policy, the uprating role of an index is much more widely used. Therefore, we set out here why we believe that the Retail Prices Index serves this role most effectively and our concerns about the downgrading of RPI as a price change measure.

UNISON believes that the process adopted by the UK Statistics Authority over recent years in reviewing consumer price indices has been a very one sided approach that has put RPI under intense scrutiny and exaggerated its flaws while omitting CPI from any similar level of analysis and therefore failing to put its substantial flaws in the spotlight. Even when the subject went out to the Johnson Review, the analysis took critiques of RPI as a starting point rather than offering any re-examination of the techniques used to produce RPI and CPI.

This process of downgrading the status of RPI has been pursued in the face of overwhelming opposition from both general and statistical respondents when the subject has gone out to public consultation.

The justification put forward for CPI over RPI seems to have shifted over time. At one time "consumer substitution" was given great emphasis. However, this position appears to have been rightly abandoned. At other times, "price bounce" has been the statistical reason put forward, yet estimates from the research referred to below suggest that this adds much less than 0.1 per cent a year. Now the most common justification put forward appears to be that RPI is out of line with "international best practice." However, we believe that this position is conflating common international practice with best practice.

All these points and more are set out in the main findings of research conducted by Dr Mark Courtney, formerly Deputy Director and Head of Economics in the Regulatory Impact Unit, Cabinet Office. The main findings of the research are shown below. A fuller document containing the executive summary can be read at <https://www.unison.org.uk/content/uploads/2014/11/TowebMain-findings-Summary-of-Consumer-Price-Indices-Report2.pdf> and the complete document can be read at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2520056](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2520056).

#### **Consumer Price Indices in the UK**

##### **Main Findings**

The report Consumer Price Indices in the UK, written by Mark Courtney, assesses the array of official inflation indices in terms of their suitability as an uprating index that measures the purchasing power of wages and pensions. The main findings of this report are set out below:

- Overall, taking account of both coverage and formula effect differences and within the limitations of how price data is collected within the UK, the Retail Prices Index (RPI) is as good a consumer price index as one can get for uprating purposes. The systemic differences between the RPI and the Consumer Prices Index (CPI) are the result entirely of under-estimation by the CPI. This under-estimate is currently (2015) running at 1.0 percentage points per annum.
  - The coverage of the RPI is targeted on the working population, as it excludes pensioners, tourists and the wealthiest 4% of households. In contrast to CPI, it also includes the owner occupier housing costs that form a major element of most household expenditure. These differences in coverage have caused the CPI to be lower than the RPI by an average of 0.3 percentage points per annum over the seventeen years since the CPI was introduced.
  - The RPI and CPI use different statistical methods (known as aggregation formulae) for calculating average price changes for many of the items covered. The RPI uses an arithmetic average, usually in the form of the Average of Relatives, whereas the CPI, following the requirements of the EU's Harmonised Index of Consumer Prices, uses the Geometric Mean. Because the UK has unusually broad definitions of its items, with consequent variations of inflation within items, this formula effect difference is unusually large in the UK: it has averaged 0.6 percentage points a year since the introduction of the CPI. The choice of aggregation formula is therefore the most important difference between the RPI and CPI.
  - The "stochastic approach" used by statisticians as a method of assessing price indices shows that the Average of Relatives used by the RPI is an unbiased estimator of the average rate of inflation, whereas the Geometric Mean used by the CPI is biased downwards. This theoretical result has been supported by empirical research published by the Office for National Statistics (ONS). This means that the formula effect represents an additional under-estimate of inflation by the CPI by, on average, 0.6 percentage points.
  - This under-estimate when using the Geometric Mean has been defended in the past on the grounds that it is allowing for consumer substitution towards goods whose prices have risen more slowly. But this neglects the fact that price changes are driven by changes in both supply and demand, not in supply alone, so that trying to allow for consumer substitution does not favour one aggregation formula over another. The ONS now accepts that this Economic argument is no reason to modify the usual stochastic approach.
  - It is sometimes argued that the process of re-weighting the RPI and CPI every year to allow for changing patterns of expenditure will introduce an upward bias, due to "price-bouncing," in the RPI. However, there is no theoretical reason why any bias should be upwards and the available empirical evidence is that any such effect is very small – much less than 0.1 percentage points per annum.
  - Although the Average of Relatives is widely used internationally in the calculation of other price indices, such as producer price indices or trade price indices, the UK is almost alone in using it in a consumer price index, and it has been alleged that it is therefore not consistent with best international practice. In fact, few countries have ever used the Average of Relatives for their consumer price index, since many of them have tightly defined, homogeneous items, unlike the UK, and use the Ratio of Averages (a different formulation of the arithmetic average) throughout. Fifteen years ago Australia and the USA switched their consumer price indices from using the Average of Relatives to the Geometric Mean and their example might be relevant, except that their reason for switching was to account for consumer substitution, and the ONS now considers that the Economic approach that gave rise to the idea of consumer substitution does not provide even a weak reason for such a switch.
  - In March 2013, the UK Statistics Authority downgraded the classification of the RPI from National Statistic to official statistic. It made clear that it was doing so solely on the basis of evidence presented by the ONS, without following its usual practice of written consultation or discussion with outside experts, and the substantive reason for its decision was that the National Statistician had decided that the ONS would henceforth perform only routine updating of the RPI, which violated the UK Statistics Authority's requirement for continuous improvement. In the circumstances, the withdrawal of National Statistic designation from the RPI lacked a convincing statistical basis and cannot be regarded as a comment on its current accuracy.
  - Attempts have been made to add owner-occupier housing expenditure to the CPI by introducing a new, experimental price index, CPIH. This uses a rental equivalence measure for housing costs which is a very poor proxy for expenditure that home owners actually incur and has been accompanied by data problems. Consequently, CPIH has so far gained little acceptance.
- There is also a new price index RPIJ, which uses the Geometric Mean within the RPI, wherever it previously used the Average of Relatives. This effectively turns it into a CPI with an RPI-type measure of owner-occupier housing expenditure (and some other coverage changes). Since it still has the under-estimate of inflation inherent in its use of the Geometric Mean it is unlikely to gain acceptance as an uprating index.

### **3. Should its production be governed by legislation?**

Not Answered

**Why? Please provide comments.:**

UNISON is not necessarily committed to a requirement for legislation, we are simply concerned that production works to rigorous, clear rules that inspire public confidence among users.

**Section two: Measuring consumer price inflation for different household types**

**4 Should ONS seek to measure changes in prices as experienced by different households?**

Yes

**Why? How often? Please provide comments.:**

UNISON sees value in measuring price changes by different households according to income levels to understand the different rates of inflation experienced by low income groups in particular.

The 2014 Office for National Statistics study, Variation in the Inflation Experience of UK households: 2003-2014, provided a very valuable insight into how average annual inflation for the lowest-spending households ran 1% higher than among the highest-spending households between 2003 and 2013.

It is possible to see that production of these rates would have a valuable role in informing decision making in policies for welfare spending, pension rates and wage bargaining.

**5 If yes, how should ONS seek to do so?**

Using a payments-based approach.

**Why? Please provide comments.:**

There is a good case for making greater use of the payments approach in all the current consumer indices when there is a considerable time lag between acquisition and payment. This applies most of all to housing, particularly in CPIH, which uses the unsatisfactory rental equivalence approach: the resulting anomalies may show up more acutely in sub-indices for particular income classes, but that is an argument for reforming treatment across the board, rather than for introducing a different treatment between the main indices and the sub-indices.

The RPI, which is UNISON's preferred uprating index, and the sub-indices based upon it, have a better and more easily partitioned treatment of housing costs, so there is less need for making greater use of the payments approach. Even so, there may be advantages in doing so in some cases, such as university fees.

**Section three: The RPI**

**6 Do you use the following indices? (Please select those that you use)**

RPI pensioner indices, Component indices of the RPI

**If yes, for what purposes? Please provide comments.:**

UNISON uses RPI extensively as it remains the dominant rate used as a reference point for pay bargaining in the UK.

Of the sub-indices, the pensioner indices can be of value to us on occasion in our bargaining over pension schemes and campaigning around pension policy.

If by "component indices of the RPI" the UK Statistics Authority is referring to the detailed rates for such goods and services as food, travel and utilities, we use these extensively as part of our bargaining and campaigning work on pay rates and pensions.

**7 Do you agree that the following indices should be discontinued? (Please select those that you suggest should be discontinued)**

**Why? Please provide comments.:**

As per response to question 6, our main concern is retention of component indices and pensioner indices.

**8 Do you have any views on what 'freezing' changes to the RPI should mean in practice?**

Not Answered

**Why? Please provide comments.:**

In line with our response to question 2, UNISON believes that there is no substantial, sound statistical case for the removal of RPI's status as a "national statistic." Therefore, we believe that RPI should have its full status restored and return to acting as the UK's main uprating index – a position that it has held for most of the period since the Second World War.

We do not claim that RPI is perfect. Like any measure it needs to evolve, making improvements and adjustments as necessary. However, we believe that the core methods of RPI remain the most accurate available.

Any decision to "freeze" changes to the RPI would plainly undermine its accuracy and would essentially constitute a decision by the UK Statistics Authority to administer a slow death to the measure.

Even given the UK Statistics Authority's position on RPI, we believe that the authority has a duty to ensure that RPI is measured in the most accurate way possible. It is undeniable that RPI remains a widely used measure by many users across the UK and therefore there is a duty to those users to maintain the measure properly.

**Section four: Evolving consumer price statistics**

**9 Are the priorities identified by ONS in its forward work plan appropriate?**

Not Answered

**Why? Please provide comments.:**

**10 Should ONS include council tax in the CPIH?**

Not Answered

**Why? Please provide comments.:**

**Additional information**

**Do you have any further comments relevant to this consultation?**

**Do you have any further comments relevant to this consultation?:**

**User satisfaction**

**Overall, how satisfied were you with this online consultation service today?**

Satisfied

**Please tell us if there are any specific areas for improvement, or if you have any other comments.:**