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:
Mine Workers Pension Scheme Trustees Limited

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.:
Measures of prices paid by consumers should have two purposes. The first is as a means of measuring the rate of price increases in the economy so that wages, pensions and other benefits can be adjusted appropriately to maintain real purchasing power. RPI was designed with this purpose in mind.

RPI is specifically designed to be a measure of household inflation, taking into account more household expenditures than the CPI, such as mortgage interest costs, council tax, building insurance and indirect taxes. RPI also excludes the very wealthiest households and the over 75s in order to capture the costs facing wage earners. It can therefore be argued that it more effectively captures a wider range of household expenditures for the working age population of the UK.

CPI on the other hand is calculated in line with international standards so that cross border comparisons can be made. CPI is also the measure by which the effectiveness of Bank of England policy is measured.

We would argue that there is no single measure that could effectively measure price changes across the economy and thus as many of the existing measures should be maintained as possible in order to provide a complete picture of inflation in the UK.

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

Not Answered

Why? Please provide comments.:
Not applicable.

3. Should its production be governed by legislation?

Not Answered

Why? Please provide comments.:
No comment.

Section two: Measuring consumer price inflation for different household types

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

Not Answered

Why? How often? Please provide comments.:
No comment.

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

Not Answered

Why? Please provide comments.:
No comment.

Section three: The RPI

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

Any other RPI index

If yes, for what purposes? Please provide comments.:
The headline RPI.

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

Why? Please provide comments.:
We do not think any of the measures should be discontinued.

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

Yes

Why? Please provide comments.:
Freezing the RPI formula will mean that the usefulness of RPI as a reliable inflation indicator over time will become a more serious problem. It will meaningfully impact pensioners who believed they would enjoy protection in retirement against rising living costs.
Our pensioners will struggle to understand why their incomes will suddenly begin to erode on the back of a largely unnecessary political decision that does not impact the price inflation they observe in real life.

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.:
No comment.

10 Should ONS include council tax in the CPIH?

Not Answered

Why? Please provide comments.:
No comment.

Additional information

Do you have any further comments relevant to this consultation?

Do you have any further comments relevant to this consultation?:
The Johnson Review has recommended that the ONS should aim to make a variant of the consumer price index (CPIH) the UK's headline measure of inflation.

The Review also says that the ONS should "restate that the RPI is a flawed statistical measure of inflation…whose use should be discontinued for all purposes unless there are contractual commitments at stake." It calls for the "eventual discontinuation" of RPI although it acknowledges that this must be "carefully managed over an extended period" because there are many long-term RPI-linked contracts.

In contrast to the conclusions of the review, we would argue that there is no single perfect measure of inflation. RPI is far from an ideal measure but CPI or the proposed variant CPIH have as many flaws.

We believe that, RPI should be maintained in order to give us a better overall picture of the 'true' rate of inflation. We also believe that RPI should remain a mainstream economic statistic to ensure the credibility of contracts linked to it, the most significant of these being many of the liabilities of the Debt Management Office.

Government and statistical credibility

The most important consideration, as agreed by the review, is maintaining the large number of existing contracts which were purchased on the basis that the returns would be linked to RPI. These include defined benefit pension schemes, annuities and the UK index-linked gilt market.
If existing index linked gilt contracts were re-based to CPI or a re-calculated RPI that removed the upward bias caused by the formula effect, then this could

create a perception in the bond market that the government was defaulting on the terms of its sovereign debt. It seems sensible to assume that in this scenario investors in the UK index-linked market would require compensation in the form of higher coupons as the returns associated with a CPI-based measure would be assumed to be lower in the long-run. Therefore, the perceived benefit to the issuer of CPI-linked debt rather than RPI-linked may in reality disappear.

The requirements of a price index

Measures of prices paid by consumers should have two purposes. The first is as a means of measuring the rate of price increases in the economy so that wages, pensions and other benefits can be adjusted appropriately to maintain real purchasing power. RPI was designed with this purpose in mind.
The second is as an indicator of the effectiveness of monetary policy where monetary policy makers are given a target for inflation as their policy goal. CPI is the measure of this.
The RPI is specifically designed to be a measure of household inflation, taking into account household expenditures, such as mortgage interest costs, council tax, building insurance and indirect taxes. RPI also excludes the very wealthiest households and the over 75s in order to capture the costs facing wage earners. It can therefore be argued that it more effectively captures a wider range of household expenditures for the working age population of the UK.
CPI on the other hand is calculated in line with international standards so that cross border comparisons can be made. CPI is also the measure by which the effectiveness of Bank of England policy is measured.

Statistical issues

As of March 2013, RPI lost its status as a National Statistic following a consultation by the National Statistician. The main purported flaw with the RPI is that items are weighted using an arithmetic mean (the Carli formula), instead of the geometric mean (the Jevons formula). The Johnson review agreed with the National Statistician that this flaw has caused an upward bias in the inflation recorded by the RPI.
This is true but it can also be shown that both CPI and CPIH have a downward bias. This is because the geometric average is always less or equal to the arithmetic average.
It is exaggerated by the fact that in the calculation of CPI the basket of goods is re-weighted as prices of individual goods rise and fall. The rationale is the consumer will adjust their purchases as prices move. Theoretically, this means that the consumer will normally buy more of products whose price has declined (or increased at a slower rate), and less of products whose prices have increased faster.
As there is an implied preference for good or services which have a slower rate of price increase, then there is a downward bias to the calculation of the index. This substitution effect was the initial reason given by the Treasury in 2003 for the switch of the inflation target from RPIX (the RPI excluding mortgage interest payments) to the CPI. However, it has since been questioned by the ONS (2011):
“The actual level of consumer substitution in the market place is not clear. If consumer substitution behaviour is prevalent and considered to be appropriate in the inclusion of an index used for compensation purposes then the CPI provides the closer match to this ideal. If consumer substitution behaviour is limited or is not considered to be appropriate for inclusion in an index used for compensation purposes then the RPI provides a closer match to this ideal.”
We would therefore hazard caution over using CPI or CPIH singularly in the UK due to this implicit downward bias which may be as much of a flaw as is the upward bias inherent with the calculation of RPI.

Impact on pensioners

A variety of commercial agreements exist which are linked to RPI increases. The consultation paper lists a number of these, including increases to occupational pensions which were in large part voluntarily agreed between employers and employees. This is our main area of concern, although some of our concerns apply equally to other types of private agreement.
Like pension increase rules, many of these agreements were established in good faith based on the RPI measure, owing to its objectivity and more importantly its durability as a consistent measure of inflation.
Pensioners with benefits tied to RPI would lose out if CPI or CPIH was used as an uprating measure as the index level increases would in general be lower.
Pensioners are particularly vulnerable to spikes in inflation due to the ‘fixed’ nature of their incomes. They also spend a larger proportion of their incomes on food and energy, two of the most volatile components of inflation indices. We believe that this is a particular problem for pensioners on low incomes, such as most members of our scheme. Over 70% of the 166,394 members in payment have pensions below £100 per week and 95% have pensions below £200.
As the RPI captures a broader spectrum of household expenditure and arguably captures more of the cost of living increases in the UK it could be argued that the RPI as an uprating index is a better buffer to maintain pensioner’s purchasing power.

Conclusion

We see strong merits to RPI, particularly as an uprating and cost of living index. No inflation index is perfect and we therefore believe RPI should be maintained as a mainstream UK statistic in parallel with CPI (or variants thereof).
There is undoubtedly public confusion about the many measures of consumer prices that exist. However, we think that is strange that the longest established measure and the one that arguably has the most public credibility, is being considered to be discontinued.
It is also the case that if the purpose of economic statistics is to gain insight into what is really happening in the real economy then a range of measures are more likely to give a clearer picture than a single measure. For something as important as inflation maintaining a range of measures seems sensible.