Consumer Prices Stakeholder Advisory Panel response to HMT/ONS consultation on the reform of the RPI

The Stakeholder Panel discussed the consultation at a meeting on April 3. There was consensus on some of the issues – but also some deep disagreements. The Panel did not seek to answer in detail questions 2-4 which relate to the impact on the gilt market, but the debate was informed by a (commercially-sensitive) presentation on the impact on pension funds, their sponsors and their members. The HM Treasury and Bank of England representatives on the Panel did not contribute to this response.

Question 1: Do you agree that the proposed approach is statistically rigorous?

There was general support from the Panel for the proposed method for transition – which was recognised as straightforward – no alternative method was proposed. However, it was noted that it will take a year for the year-on-year changes (which attract the bulk of public commentary) to shift from RPI (old) to RPI (new). This will require careful communication.

One member pointed out that the RPI is always rounded off to one decimal point, with monthly and annual changes constructed from the rounded figures. This is not the case for CPIH. One solution would be to start using unrounded figures for the RPI changes before this transition takes place – and that would in any case be a welcome improvement.

The Panel reiterated their strong view that, were the changes to bring RPI in line with CPIH methodology to take place in 2025, there should be no subsequent divergence between RPI and CPIH in the period before 2030 (after which the ONS would be able to continue improvements to RPI and CPIH without needing to refer to the Bank of England and the Chancellor).

Questions 2-4:

These questions relate primarily to the gilts market, and the Panel is aware that many gilt-market participants are likely to respond with their views. The Panel's discussion here focused on the differential impacts across Defined Benefit (DB) pension funds. With regard to their gilt holdings – pension funds are of course losers – but those with primarily RPI linked liabilities which are not fully-hedged will be gainers overall. The losers will be pension funds with primarily CPI liabilities which have been hedged with RPI-linked gilts. Overall for DB funds it is probable that the gains will outweigh the losses if index-linked gilt assets and inflation-linked liabilities are considered.

However, the overall impact may be less favourable when other inflation-linked assets, such as rentals or infrastructure are taken into account. But the impact here will depend on how such contracts are able to be adjusted before the changes to RPI take effect.

Further, while as a whole DB funds may benefit, there will be some notable losers and these losses will have to be taken account of in upcoming valuations as the gilt and swap markets respond to RPI reform developments. For some pension sponsors (mainly corporates) this will be an additional strain during the period of recovery from the adverse effects of Covid-19.

The proposed changes will also have an impact on other parties (particularly life insurers) seeking to hedge long-term inflation-linked liabilities (some will likely end up losers and some gainers).

It was commented that, as far as the reaction of the index-linked gilt market to the announcement on September 4 2019 could be ascertained, it suggested only a partial response to the statements that had been made.

Question 5: What other impacts might the proposed changes to address the shortcomings of the RPI have in areas or contracts where the RPI is used?

As the longest-running and most familiar measure of inflation, the RPI is pervasive across the economy. There are the obvious public sector uses, such as for rail fare increases or to index the interest payments on student loans. It is widely used to uprate rents, in mobile phone contracts, as a measure of preserved value in some endowments and in many commercial contracts. Wage-bargainers frequently refer to the RPI in wage negotiations.

The Panel considers that there will prove to be a very wide range of uses and contracts. The ONS and HMT should ensure that in addition to this consultation it seeks out the fullest possible picture, and includes consideration of any legal implications around making alterations to these contracts so that the number of arbitrary winners and losers is reduced where possible. It might prove to be a lengthy and complex exercise; thinking through how to handle the various different contract types associated with RPI-linked annuities, and RPI-linked corporate bonds, are among the many problematic questions. A clear road map for handling these issues prior to any transition is essential.

Some of the economic regulators of price-controlled utilities (these include Ofwat, Ofgem, the CAA, Ofcom and the NI Utility Regulator) make use of RPI and/or RPI-derived market indicators in their control mechanisms. In general, the proposed changes should have minimal or no effect on current controls and, when we have clarity on timing, future control decisions can be designed to accommodate them. However, the existing price controls for electricity distribution networks in Great Britain effective through to 31 March 2023 include mechanisms for the remuneration of debt costs that employ market data on RPI-linked gilt yields for prospective periods. The proposed changes to RPI would be expected to affect these data. Ofgem expects to consider the consequences and any suitable remedies.

Question 6: Are there any other issues relevant to the proposal the Authority is minded to make of which the Authority or the Chancellor ought to be aware?

The members of the Stakeholder panel are divided on the merits of the proposal as it stands. A minority of the Panel feel strongly that the proposal is a mistake, and that not all the 'flaws' identified by the ONS are in fact flaws – for example the omission of the top 4% of households and pensioners dependent on state benefits arguably gives a better picture of inflation as experienced by the majority of the population.[1] Similarly the focus on spending at home and abroad by UK residents might be preferred to the spending of resident and non-residents within the UK, if the purpose of the index is uprating of various costs and benefits for the resident population.

In passing, there was some element of selectivity in the references to the Stakeholder Panel's advice to the National Statistician on February 19, 2019[2] in the paper from the National Statistician to the UKSA board on February 26, 2019[3]. In particular, the majority of the Panel did not support moving to one index for all purposes, and there is a risk that this will be the de facto outcome from the present proposal. It is notable that the consultation document does not refer to the Household Cost Indices (HCIs). And while the majority view favoured a move towards CPI or CPIH, the advice from the

[1] See also attached minority report from Geoff Tily, TUC

[2] https://osr.statisticsauthority.gov.uk/correspondence/comments-from-the-stakeholder-advisory-panel-on-consumer-prices/

[3] https://uksa.statisticsauthority.gov.uk/correspondence/national-statisticians-advice-to-the-uk-statistics-authority-board-on-the-retail-prices-index/

Panel was clear that a minority strongly disagreed. (The same division on the Panel existed at our meeting in April 2020).

Those in the minority observed that in their view this recommendation did not follow from the recommendations in the House of Lords Economic Affairs Committee (HLEAC) report on 'Measuring Inflation'. This report made a clear recommendation that the clothing prices formula issue in the RPI should be addressed by the ONS. However, in recommending that there should be a single measure of inflation, the HLEAC commented that, if certain improvements were made, the 'RPI would be a viable candidate for the single general measure of inflation'. Other members were less concerned about following the HLEAC report.

Among those who were generally content a number of additional points were raised:

- There was a need for clarity about who were the gainers and losers. In total the corporate sector (those who support DB schemes) looked to be a gainer at least initially – although some would be clear losers. It was also possible that lower DB pension contributions by companies would enable higher future investment, higher wages, or higher DC contributions to be paid to younger employees.
- Given the role of CPI, rather than CPIH, in relation to state pensions and public sector DB pensions, some consideration needs to be given to consistency.
- There should be more discussion of what the HCI and CPIH were each appropriate for – and greater clarity on the purpose of the HCIs, alongside continued development work.
- Regardless of the particular price index, there needed to be a picture of movement in living standards for different groups, and in particular a focus on intergenerational trends.
- It was clear that the large proportion of DB occupational scheme pensioners (4 million people were presently in receipt of such pensions, and a further 6 million would be in due course) with RPI-linked pensions were the key losers[4].
- Several members considered it could be helpful to allow replacement of the RPI with the pensioner HCI for pensions uprating, and also for uprating private annuity contracts. This meant it would be preferable to make the change to RPI only after the HCIs had been fully developed. It was noted that the ability to adjust indexation for DB pensioners rested on often rather small differences in the wording of pension trust deeds.
- It was important that CPIH should carry confidence. In that regard it was welcome that the ONS now had full access to the private rental data collected by the VOA, and would be able to conduct its own analysis.

On the question of what date was preferable – if the change were to take place there was agreement that 2030 would allow more time for the issues around long-term contracts to be resolved, and for people's expectations to adjust.

Almost all members of the group considered that the original six week period for the consultation, which now coincided with a period of 'lockdown' for pensioners, should be at least extended, and preferably postponed. The announcement of an extension to August 21 for the consultation was welcomed.

[4]Estimates from the Pensions Policy Institute suggested a 65 year-old man in 2020 with the median pension receipt of £7700 would receive 8% less DB benefit over the remainder of his lifetime if RPI and CPIH were aligned in 2025

Questions 7 and 8 – relating to lower level or supplementary sub-indices

Panel members made little use of the RPI lower level or supplementary indices – and had no views on Question 8. However, the ONS' commitment to maintain the richness of the supporting datasets was welcomed.

Kate Barker

Advisory Panel Chairman

MINORITY OPINION BY DR GEOFF TILY OF THE TRADES UNION CONGRESS

In the main text the cited 'flaws' that not everyone considers to be flaws (under Question 6) omit the formula effect, by far the most material and controversial issue in recent (and past) debate.

Highly relevant here is the position of the House of Lords Economic Affairs Committee, who contested the official position and regarded the formula debate as unresolved. Their recommendation to repair clothing is in effect a compromise that should secure the viability of the RPI. Honouring a long-established measure that commands public confidence, the Lords argued "… the RPI had the potential to become a good measure of inflation". Ahead of the present response, the Advisory Panel wrote to the Chancellor (on 19 February 2019) supporting the repair (though the majority of the Panel disagreed with the Lords Committee about the potential of the RPI measure).

The present consultation (and as a consequence the APCP–S response) has been framed in a way suggesting the Lords Report does not exist or is of only incidental interest. This has been the standard practice of the statistical authorities and other official bodies over more than a decade of controversy. Repeatedly, consultation responses and other interventions have been ignored in a manner that suggests an official 'agenda' all along. The Lords Committee were apparently sympathetic to my comments about 'groupthink' (report para 105).

At a theoretical level this is apparent in the case of the formula effect. Since the US Boskin Report of 1996 the Jevons approach has attracted economists and some theoretical statisticians. As well as his own contributions in refereed journals, Dr Mark Courtney has shown most *specialists* have subsequently found Carli less problematic than Jevons in practice[5]. And members of the Royal Statistical Society have repeatedly contested the official position on the formula, most recently at their 'Open Meeting on the Retail Prices Index (RPI)' on 21st July 2020. On this rival view, the relevant approach is empirical on an item-by-item basis; previously this was the approach of the ONS, but has been discontinued. Conversely the UKSA justification for rejecting the position of the Lords Committee is tenuous: rejecting a compromise on the tautological grounds that it is only a partial fix, and over-playing other small issues with the RPI that could be easily handled.

The debate has not been aided by the processes for the newly constituted Advisory Panels. Previous Committees have made "recommendations",[6] the present Panels provide "independent advice". Unfortunately official opinion has throughout been disproportionately represented on the Stakeholder Panel. Moreover when the Panels were convened the direction of travel had already been set by the (February 2014) 'UK Consumer Price Statistics: A Review' by Paul Johnson of the Institute for Fiscal Studies. Under the Terms of Reference for the Stakeholder Panel, the first of several 'functions' is to "consider and take forward the outcomes of the Johnson review of the range of price statistics and subsequent consultation on measuring consumer statistics".[7]

Nonetheless in the case of the current decision to dismantle the RPI, as above, the Panel's advice was at odds with the present UKSA position. While recognising "major areas of disagreement", the Panel "agree[d] that the clothing issue needs to be fixed". Yet the UKSA chose to begin and motivate their statement of 4 September 2019 as follows: "The Advisory Panel on Consumer Prices provided advice to the National Statistician on the composition of the Retail Prices Index (RPI) in light of the House of Lords Economic Affairs Committee report Measuring Inflation, published in January 2019".

[5] https://www.unison.org.uk/content/uploads/2020/04/Arguments-in-Favour-of-the-RPI-v2.pdf
[6] E.g. The Retail Prices Index Advisory Committee on the 'Treatment of Holiday Expenditure and Other Matters in the Retail Prices Index' which reported in July 1990.
[7] https://uksa.statisticsauthority.gov.uk/wp-content/uploads/2020/07/APCP-S_Terms_of_Reference_2020.pdf

The UKSA statement did not mention that the Committee supported the compromise, and had not considered the present nuclear option.

The Lords Committee took the exceptional step of warning of a dereliction of duty on the part of the UK Statistics Authority. Trade unions want those with the final decision to be clear sighted on the controversial nature of the process to date. Our prime concern is a measure that is fit for purpose and that does not understate inflation. But we warn too that the UKSA proposal will gravely damage the integrity of inflation measurement and the institutions involved.

At the meeting of Friday 24 July, the other members of the Stakeholder Panel were offered the opportunity to sign this minority opinion. The minutes report “Although several Panel members were sympathetic to some of the points raised in the minority report, the attending Panel members decided against signing the report”.

Geoff Tily
Trades Union Congress
10 August 2020