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ROYAL STATISTICAL SOCIETY RESPONSE TO THE HM TREASURY/UK STATISTICS AUTHORITY CONSULTATION ON THE REFORM TO THE RETAIL PRICES INDEX (RPI) METHODOLOGY

This is the Royal Statistical Society's response to the consultation issued on 11 March 2020. The consultation poses eight specific questions, and we have grouped our comments under questions 1, 5 and 6, which are those where the Society most obviously has a remit.

In summary, the proposal to align the RPI with the CPIH is one with which the Society strongly disagrees – a conclusion reached after the issue was examined by RSS's National Statistics Advisory Group (NSAG). The RSS believes that the RPI should be maintained, according to its current broad definitions and coverage until 2030, when it should be aligned to the quarterly Household Costs Index (HCI), by which time the HCI, currently being developed, should be an established 'National Statistic'. These arguments are set out fully under Question 6.

The Society has reached this view for a range of reasons. As this submission shows, for example, the RPI as a 'cost of living' index is closer in concept to the HCI than the CPIH. We are also concerned that RPI's proposed alignment to CPIH has been planned with unnecessary haste – without sufficient account being taken of either UKSA's stakeholder panel or the key report on *Measuring Inflation* (January 2019) from the House of Lords Economic Affairs Committee. After being conceived in haste, there is a danger of repenting at leisure, with the planned changes potentially causing unintended consequences for business contracts – as our submission explains.

Finally, we are concerned that although this is a joint Treasury/UK Statistics Authority (UKSA) consultation, and the former takes responsibility for the critical question of the timing of the proposed change, it appears that the Treasury has not engaged positively in this consultation. It declined to take part in the official consultation meeting RSS was originally due to host, as an in-person one), in early April; it did not send a representative to the RSS open meeting on 21 July, reply to its invitation or provide any account of its views; and it did not participate, either, in an official online consultation meeting on 27 July, despite it being billed as a joint UKSA/Treasury event. The UKSA has generally treated this important consultation with due seriousness; it is regrettable that the Treasury seems not to have done so.

Question 1: Do you agree that this proposed approach [ie preserving monthly growth rates] is statistically rigorous?

Most public interest is in the year-on-year change in the RPI, the "annual rate of inflation". The proposal to preserve monthly growth rates has the disadvantage that it would take a year from implementation of the change before the year-on-year changes of the RPI and CPIH become equal, whereas under the alternatives it would happen immediately. However, the month-on-month changes would immediately become equal.

It should be borne in mind that the RPI is always rounded off to one decimal place for publication, and the monthly and annual percentage changes are calculated from the rounded figures, not the underlying figures calculated to several decimal places. If the levels of the RPI and CPIH are in a constant ratio, then rounding might cause the calculated percentage changes to differ. With this caveat, the method is statistically rigorous.

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?

The RPI is widely used, but outside the public sector and the pensions industry knowledge of how it is used is comparatively limited. So any assessment must be speculative, which is of concern. Other bodies may have specific expertise on particular areas, but concerns include:

- Its use in business contracts would result in arbitrary winners and losers if the proposed change occurs.
- Those who purchased RPI-linked annuities would have overpaid for what they get.
- Issuers and purchasers of corporate bonds which are linked to the RPI would be gainers and losers respectively. The government would need to consider how best to compensate those who would lose.
- The "new RPI" would provide many citizens with a misleading impression of their own inflation experience. They risk being confused and disenfranchised as the new series would not give the relevant information on price changes, which influence their day to day actions and longer-term opinion and decisions, that the RPI did in the past.

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?

Our President wrote to the Chair of the UK Statistics Authority on 21 October 2019, shortly after this consultation was announced, to express the RSS's concerns about its limited nature. She also met with him on 13 February 2020, together with NSAG's chair, to set out these concerns further.

The UKSA proposals follow on from 'Measuring Inflation', a report published in January 2019 by the House of Lords Economic Affairs Committee, which includes several former Chancellors of the Exchequer and Treasury Permanent Secretaries. This report recommended a single measure of inflation – the Committee was concerned at the extent to which the use of two measures, the RPI and CPI, had allowed governments to engage in 'inflation shopping', risking public confidence in official statistics.

A key area of difference between inflation models is the method used for capturing owner-occupier housing costs. The report clearly states that, "To have credibility, the single general measure must have a satisfactory measure of owner-occupier housing costs" (p 4). The report casts doubt on the method of rental-equivalence used in CPIH (paragraph 153) and recommends that this issue should be resolved through wide consultation before a single measure of inflation could be recommended.

The report recommended that once this issue has been resolved, then UKSA should consult with its stakeholder and technical panels before deciding which index to recommend to the Government as its single measure of inflation – with RPI considered a 'viable candidate' for this role. Finally, the UKSA and the Government should decide whether the RPI should continue to be published in its present form or should be adjusted so that it converges onto the single general measure.

In our response, RSS welcomed the report and called on the Government and UKSA to develop plans to address the issues raised, including proper consultation with users. We agreed with their concern about 'inflation shopping' but did not support the idea of one single measure of inflation. We note that the Government has long been committed to the CPI as its 'headline' or main measure of inflation, but that is not the same as its being the single measure of inflation. We have reiterated our support for separate indices to measure macroeconomic inflation, and the impact on household budgets. Our response was guided by the RSS open meeting 'The Future of the Retail Prices Index', held in June 2018.

The origins of the CPI and RPI are very different. As the Annex of the consultation document makes clear, the RPI was a successor to the Cost of Living Index, and its main use has been as a compensation index. This use continues to the present day, with widespread use by government and businesses to make inflation adjustments for purchasers and sellers of goods, services and investments. By contrast the CPI, on which the CPIH is essentially based, was developed as the UK version of the EU's Harmonised Index of Consumer Prices (HICP), an EU/EEA-wide comparable index, which uses national accounts weights and is influenced by national accounts definitions. It was designed, as the preamble to the relevant EU Regulation makes clear, with the purpose of "providing comparisons of inflation in the macro-economic context as distinct from indexes for national and micro-economic purposes". [1] This has enabled it to be used as a GDP deflator, as the headline measure of macroeconomic inflation and an index for inflation targeting. Nearly all EU countries calculate their own national consumer price index separately from the HICP; the UK is unusual in giving the HICP this additional role.

In considering their response to the House of Lords report, the Authority asked John Pullinger, who was then the National Statistician, for his advice, which he gave in February 2019.

He had previously developed a model of three use cases for consumer inflation indices, which he presented at an open meeting in February 2017 and subsequently at the RSS open meeting in June 2018: a macroeconomic measure (CPIH); a households measure (HCI); and a legacy RPI measure. This clear distinction has had resonance with RSS members and was supported by us in our evidence to the House of Lords. The distinction between a macroeconomic measure and a household measure is recommended by international guidance and is supported by the National Statistician's Stakeholder Advisory Panel on Consumer Prices. That Panel, in its letter of 19 February 2019, supported the need for a long-term process to resolve the present shortcomings and uncertainties about the future of inflation measurement, and expected the government to give support to a major programme of work to resolve the many issues discussed in the House of Lords' report. Indeed, this was the wider expectation within the statistical community.

In his 2019 advice, the National Statistician confirmed his view that the RPI was not a good measure of inflation, and that the HCI and the CPI should continue to be developed to meet the various user needs for inflation statistics. He recommended against just 'fixing' the clothing problem, as his analysis had identified six categories of problems that would need to be addressed - some of them, he thought, significant. Fixing all of the problems would, in effect, amount to using the methods of

[1] Council Regulation (EC) no 2494/95 of 23rd October 1995, concerning harmonized indices of consumer prices.

one of the other indices. His approach was to 'construct statistically robust measures of inflation and to leave users to apply the approach that best meets their needs'. His view was that 'either [CPIH or the HCI] is statistically valid depending on the question being asked by the user'. If the RPI were to be aligned with CPIH, then users should have the option to use the HCI. His preferred approach was to abolish the RPI. He accepted that this was not legally possible, said he could support aligning the RPI with CPIH, and that he would provide advice to enable users to move to the HCI as appropriate.

The UKSA decided in February 2019 to favour linking the RPI to the CPIH, so that each has the same month-to-month forward movements. The RPI would become, in essence, the CPIH. As previously indicated, our view has consistently been that no one consumer price index can meet all user needs. [2] Different indices are needed for macroeconomic purposes, and for measuring the impact of inflation on households. This is also the view of the ONS, which continues to advise users to employ the statistically robust index that best meets their needs, whether it is CPIH or (in future) the HCI, or their components. [3] This is a clear recognition that users need both a macro-economic indicator and a cost of living indicator.

We strongly disagree with the decision to align the RPI with the CPIH. Before we set out the reasons why we disagree with the decision, we should state that we also believe the decision has been made too hastily, for the following reasons:

1. The UKSA Board has not demonstrated that it has fully considered the House of Lords' report. The decision of February 2019 to align the RPI with the CPIH was taken only one month after the publication of the House of Lords' report, without any demonstrable consideration of its content and without consultation with users (apart from the Stakeholder Panel which did not recommend the course of action taken). The UKSA decision was not made public until seven months later, when the decision to take forward the current consultation was announced. The UKSA's response to the House of Lords' report was not published until 4 September, the day of the announcement of the current consultation, giving no opportunity for stakeholders to make representations.

   The 4 September response is minimal in its detail. The Authority has still not published a satisfactory response to the points the House of Lords made.

2. There has been no 'wide consultation' on the issue of owner-occupier housing costs, as recommended by the House of Lords. In their 4 September response, UKSA say that '*ONS are not minded to undertake any further engagement with users and experts specifically on rental equivalence and owner-occupier housing costs. There is never likely to be agreement on a single approach. ONS views rental equivalence as the correct approach conceptually for*

[2] See RSS evidence to the House of Lords Economic Affairs Committee into the use of the Retail Prices Index. http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/economic-affairs-committee/the-use-of-rpi/written/85622.html

[3] See Measuring changing prices and costs for consumers and households, proposed updates: March 2020 https://www.ons.gov.uk/economy/inflationandpriceindices/articles/measuringchangingpricesandcostsforconsumersandhouseholdsproposedupdates/march2020

an *economic*[4] *measure of inflation, and one where sufficient data is available to make it practical.'* This is despite the fact that ONS is committed to producing two measures of inflation, and what might be appropriate for an economic measure of inflation may not be appropriate for a household index. The House of Lords Economic Affairs Committee cautioned that proceeding without consulting on this issue risked the credibility of any single measure of inflation.

3. There has not been a '*long-term process to resolve the present shortcomings and uncertainties about the future of inflation measurement*', or a '*major programme of work to determine how to resolve the many issues discussed in the House of Lords report*', as recommended by the National Statistician's Stakeholder Panel.
4. Insufficient consideration has been given to the statistical validity of the decision, which has focused on the economic impacts of the change.
5. The Treasury does not appear to have actively engaged in the consultation.

We disagree with the decision and believe that there is the potential for it to be damaging for the following reasons:

1. The RPI as a 'cost of living' index is closer in concept to the HCI than the CPIH. The current proposal would encourage users of the RPI, who are mainly concerned with uprating payments to compensate for inflation, to use an index not designed for that purpose. This is contrary to the UKSA's objective of 'promoting and safeguarding the production and publication of official statistics that serve the public good.' Although the HCI is being developed, and the National Statistician said that he would provide advice to enable users to move to the HCI as appropriate, many users are likely to continue to use the RPI as before. Since the new series will be called the RPI many will use it anyway, whether or not it is the best option for them.
2. As previously indicated in our response to Q5, the "new RPI" risks providing many citizens with a misleading impression of their own inflation experience. They risk being confused and disenfranchised as the new series will not give the relevant information on price changes, which influence their day to day actions and longer-term opinion and decisions, that the RPI did in the past.
3. The extent of the use of the RPI for uprating business contracts is not fully known, potentially leading to unintended consequences.

The decision to align the RPI to CPIH is a very substantial change and was not foreseen by the House of Lords' report. It is easily the most radical change in the history of the index and would have a significant effect for users. We therefore feel it is completely wrong to impose this change without full consultation; this, we maintain, is contrary to the requirements of UKSA's Code of Practice on Statistics. Getting this decision wrong would have an adverse impact on wider public trust in official statistics.

The ONS has been developing a system of Household Cost Indices, which could, we believe, be a suitable replacement for the RPI, to which it is closer in concept. HCIs are under development with

[4] Our underlining

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plans to produce quarterly indices in 2022, and to seek 'National Statistic' status in 2023. They are calculated on a monthly basis and we would expect them to be published every month in due course. Rather than move towards a single measure of inflation, the RSS continues to believe that it is more appropriate to maintain a macro-economic measure of inflation and an inflation measure reflecting the cost of living. HCI should be developed as quickly as possible for this latter purpose.

We note also that in its recent report, following a round table discussion of leading industry figures, the Pensions Policy Institute said: "An ideal index for pensioner benefits to be inflated by would be worth further investigation."[5] An HCI for pensioners, or something closely related, would seem to fit the need perfectly.

There is a strong argument for not making any change to the RPI until 2030, at which time the need to go through the statutory process with the Bank of England and Chancellor for each methodological improvement to the index will have ended. Before that time the HCI should have achieved 'National Statistic' status and will have been published on a monthly basis for some time. The HCI has the important benefit of allowing us to see the impact of inflation on different income and demographic groups.

This timescale leaves scope for further review and consideration of the future of all consumer price indices. This could include further investigation into the uses of and requirements for consumer price indices, a topic which was only covered to a limited extent in the Johnson review.[6] This would help to ensure that from 2030 the UK had the best possible system of consumer price indices.

On the question of the formula for elementary (low level) indices, views are mixed; much depends on the assumptions about how consumers respond to changing price relativities, and whether these changes are valid in price index terms. We welcome the potential use of scanner data which by providing low level weights, as well as price movements, avoids this problem.

Our view is that the RPI should be maintained, according to its current broad definitions and coverage until 2030, when it should be aligned to the quarterly HCI, which by that point should have had status as a 'National Statistic' for a number of years. But if the CPIH is to replace the RPI in all, or nearly all, its uses then it should be subject to a full-scale review to ensure that it is the best index possible to meet this expanded role. This should include the formulae used, among other points.

To minimise the risk of 'inflation shopping', there must be transparency around the reasons for which a particular measure of inflation is selected: whenever Government, a business or other body selects a particular measure of inflation, they should issue a public statement explaining why that measure is appropriate for the purpose for which it is being used.

[5] PPI Briefing Note Number 118. https://www.pensionspolicyinstitute.org.uk/media/3466/20200401-how-could-changes-to-price-indices-affect-db-schemes.pdf Page 3, first paragraph.

[6] For example, of the 15 organisations listed as having contributed to the review only four were outside the official sector.