Inflation 2024 – Are we using the right measures?

Report by Phyllis Macfarlane, Better Statistics CIC

A whole afternoon discussing the different Inflation measures might not be everyone's idea of fun – but to attendees at the Better Statistics Seminar held at the National Liberal Club on May 24th it was time well spent. Why? Because it provided an opportunity to review the issues surrounding the creation of some of the most important statistics produced by the National Statistics Office.

This is not just an academic discussion between Statisticians. It really matters; particularly if your income has been related to the official measure of inflation; an income of £10,000 in 2014 would have to be £15,300 now to kept up with the RPI measure – but only £13,350 to keep up with the CPI measure! That's quite a big difference, particularly for those dependent on benefits, which are now indexed on CPI as a result of the Coalition Government's decision to switch the index from RPI to CPI in June 2010; at the same time as they introduced the various austerity measures that have continued to affect people, influencing the results of the recent election. However, I'm getting ahead of myself!

Jill Leyland, co-author (with Jon Astin) of the influential *'Towards a Household Inflation Index'* provided the welcome talk, introducing the Keynote Speaker, Ed Humpherson, Director General of the Office for Statistics Regulation, who took us through the current regulatory issues in price statistics. He explained that the focus is on the "*three family*" approach: Price indices for understanding macroeconomic dynamics (CPI, CPIH); Price indices for understanding household cost experiences (HCIs); and a price index for inflation-linked bonds (RPI). In doing so, he seemed to implicitly acknowledge that CPI and CPIH may not be the most appropriate measures for index linking pensions and benefits. However, the current status has only the two macroeconomic measures classified as Accredited Statistics and his presentation was informative of the regulatory issues involved in making changes, including posing the following questions:

- *ONS is doing a lot of change around price indices. Is there a general transformation risk (think of attempts to transform the Labour Force Survey (LFS)...)?*

- *Is there an outstanding question about measurement of the contemporary economy (deflators, digital services, quality etc)?*
- *There is a multiplicity of indices – does this serve the public good (eg CPI and CPIH) or does this risk confusion?*

And so to our first topic: **'What are we measuring?**, also chaired by Jill Leyland, with Stephen Burgess, *Deputy Director Prices at the ONS*, providing us with more detail on CPIH, CPI and HCI and their separate use cases, explaining that "*RPI lies somewhere between these approaches, but arguably doesn't manage to capture the experience of a typical household"*. Stephen also provided a helpful timeline of the main events in measuring inflation, from the Government's decision in 2003 for the CPI to become the main inflation measure for judging the effectiveness of the Bank of England's monetary policies through to the more recent developments using more robust data sources for rail fares, used cars and rents. But, with regard to the question as to whether we are using the right measures, probably the most important point from Stephen's presentation was the confirmation from the HCI data that lower income households have experienced higher inflation since 2006.

This point was also emphasised by Martin Weale, Professor of Economics at King's Business School and member of the National Statistician's Technical Advisory Panel on Consumer Price Statistics. Martin explained that one important reason for the difference between the CPI/CPIH and the other indices is because they are based upon a plutocratic measure, giving more weight to the cost of living for people with relatively high incomes, whereas the HCI's are based on a democratic approach to price indices depending more upon the numbers of households involved. However, Martin's main point was to suggest that there is also a need for a democratic measure of household ***income*** growth. This would be very straightforward to produce and could then be reviewed alongside the HCI's to assist policy makers to make more informed decisions.

Then Tony Cox (Chair, Inflation Statistics User Group) took us through Session 2: **'Are there alternatives?'** in which Juliet Stone, research Fellow Centre for Research in Social Policy Loughborough University, introduced the Decent Living Index (DLI), which she defined as: *"A minimum standard of living in the UK today includes, but is more than just, food, clothes and* *shelter. It is about having what you need in order to have the opportunities and choices necessary to participate in society."* In developing the DLI they wish to establish a benchmark against which the adequacy of state support can be assessed and tracked over time. To illustrate the potential value of the DLI, Juliet provided examples of how it could be developed, and showed us comparisons of the index for 2 social groups – for both of which the DLI measure was higher than CPI and CPIH.

Juliet was followed by Shaun Richards, Economist and Journalist, who addressed the question '*Are HCI's a better replacement for the RPI than CPIH*?' In doing so Shaun was questioning the result of the consultation of 2020, which gave rise to the decision that CPIH would be re-named the RPI in 2030. Shaun began by confirming Juliet's point that the objective of an inflation index it is to measure the change in the cost of living, and preferably to be as up to date as possible. He then explained how the calculation of the CPIH fails to fulfil that obligation in a meaningful way by explaining that for mortgage holders, change in the cost of their housing is not directly related to changes in their mortgage terms but rather is estimated by a process known as '*rental equivalence*'. Not only is this process likely to be confusing for most persons paying their mortgage but the detail of the method ensured that the calculation actually reflects changes in rents experienced some months ago such that "*inflation numbers for April 2024, the rental numbers were based on 18 months before that, or somewhere in later 2022*". Since the concept behind the HCI's is to measure price changes as they are actually experienced by households, Shaun's answer to his question is that the HCI's are potentially a better replacement for the RPI than the CPIH, which he now considers to be based on a method proven to be unreliable.

This observation then naturally led to the third session asking the key question ***'Is the Governance right?'*** To which Geoff Tily, Chief Economist at the Trades Union Congress, gave '*A view from the Factory Floor*', quoting part of the text of Motion 19, as recently passed by the TUC: "*Congress believes the planned abolition of RPI represents an attack on millions of workers and pensioners' living standards and a permanent deepening of the cost- of-living crisis"* and "*Congress condemns… the withdrawal of the RPI link for public sector pay and pensions, which disproportionately lowered the incomes of women, ethnic minority, and disabled workers and pensioners*." Further Geoff provided examples to illustrate that the history of the changes made over recent years had largely been inspired by economists with an elitist agenda, finishing with reference to Simone Weil and quoting "*Scientists of the same class are equally enslaved by fashion, which rules over science even more despotically than over the shape of hats. For these men the collective opinion of specialists is practically a dictatorship*."

"*Group think*" was also considered to be a primary cause of some of the serious issues identified by Simon Briscoe in his challenging commentary on how changes in the cost of living have been reflected (or not) by the changes in measurement over recent years. Firstly, Simon recalled that he had been the statistics advisor to PACAC for the 7 years from 2012 to 2019, during which time PACAC had made many recommendations to UKSA, roughly 200 of which had not been implemented. He therefore lamented the fact that there was little genuine oversight to affect UKSA actions. One important result of poor governance has been that, instead of providing a measure that genuinely reflected changes in the cost of living, the Authority had provided an official inflation rate which desired by government to index link changes in wages for many workers, government debt, benefits and some pensions that was as low as possible. This has therefore affected millions of households, aggravating the impact of the cost of living crisis which so many people have experienced. Simon then drew a parallel with other failings which appear to have been similarly inspired by group think; for example the Horizon software scandal, affecting hundreds of Post Office Sub-postmasters and their families, and the infected blood scandal which had affected many thousands of individuals and their families. Simon therefore hypothesised that the use of the wrong inflation measure has had an even greater impact on society leading to distress for many millions of our fellow citizens. Simon felt that it was an imperative to improve UKSA governance and to introduce some genuine oversight by Parliament, but he expressed concern that the Lievesley report may have failed to inspire the changes he felt are required.

Finally to the **open forum**, chaired by Tony Dent, with contributions from Grant Fitzner **(**Chief Economist and Director, Macroeconomic and Environment Statistics and Analysis, Office for National Statistics); Vicky Pryce **(**Member Better Statistics Advisory Committee and Former Joint Head Government Economic Service) and Paul Allin (Visiting Professor in the Department of Mathematics, Imperial College and

Honorary Fellow for National Statistics, Royal Statistics Society). By way of introduction Tony, explained the background to Better Statistics interest in measuring inflation, emphasising that a statistic has value to society only if it is understood and accepted as being a reasonable approximation to whatever is being measured. Accordingly, he posed the question as to whether the existing two Advisory Panel structure (technical and stakeholder) was the right way to provide advice to the ONS on measuring inflation. Grant pointed out that the formation of the advisory committees is under active review in the light of the recommendation in the Lievesley Review and Vicky Pryce followed up by emphasising that it is not only 'group think' that influences decisions, but that it is often difficult to get the right information to enable informed decision making. A detail that Paul Allin further amplified by referring to the fact that the seminar subject refers to '*measures*' and the need for different measures of inflation to meet different purposes is an unavoidable complication.

The floor was then opened up for a lively question and answer session, extending the seminar until almost 5.30 pm, at which point all the contributors were warmly thanked for their efforts[1].

Summary

If there seems to be a pattern here, it's because there is. Although everyone agrees that measuring inflation is difficult, involving compromise at many levels, and that the different indices are useful for different things not everyone agrees that the CPI should be used as the index for benefits payments. Many attendees considered it to be fundamentally unjust because it does not accurately reflect the cost of living experienced by the poorer segments of society, and it is increasing inequality. Some would say that it is yet another example of British institutional defensiveness. So the questions remain should the CPIH be reconsidered as an accredited statistic and is it right to rename it the RPI[2]?

<u>Next Seminar</u>: Productivity and AI suggested as the topic for the next Better Statistics seminar to be held later in November.

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[1] See video for full details.

[2] The Office for National Statistics published its response to the **Consultation on the Reform to Retail Prices Index (RPI) Methodology,** on the 25th November 2023. This proposed to rename the CPIH as the RPI from 2030 resulted in the following commentary from Better Statistics CIC https://www.betterstats.net/commentary-on-a-response-to-the-consultation-on-the-reform-to-retail-prices-index-rpi-methodology/