

Public Service Pensioners' Council

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To: PSPC Executive Committee and Secretaries of Affiliated Organisations

10 September 2019

Dear Colleague

FUTURE OF THE RETAIL PRICES INDEX – GOVERNMENT RESPONSE

1. PSPC has for some years been closely monitoring policy developments on the appropriate index for measuring inflation, and particularly the impact on pensioners of different indices used for public sector pensions (CPI) and regulated price increases (RPI). Last week the Chancellor, Sajid Javid, published letters he has sent to the Chair of the UK Statistics Authority and also to the Chair of the House of Lords Economic Committee setting out the Government's current position towards the future use of RPI and announcing consultation on steps towards a single measure of inflation by aligning RPI methodology with the CPI (H) Index between 2025 and 2030. **Both letters are attached to this circular along with a statement from the Chair of the UK Statistics Authority.**

Background

2. The UK Statistics Authority announced in March 2013 that RPI was no longer appropriate as the measure of inflation and had its National Statistic status removed. In January 2015 an official review undertaken by Paul Johnson recommended that RPI should be considered a 'legacy measure' only and no further changes should be made to it. In January 2018 the Governor of the Bank of England stated that RPI "had known errors" and "should not be further embedded in Government contracts". This led to the House of Lords Economic Committee launching a full Inquiry in July 2018 into the methodology and uses of RPI and CPI.

3. PSPC submitted evidence to the House of Lords Inquiry arguing that there should be a single accurate and consistent measure of inflation and that the Government should cease "inflation shopping" between RPI and CPI. This became one of the key recommendations of the Inquiry report "Measuring Inflation" published in January 2019. Since that report the PSPC has been waiting on the Government's response to the House of Lords report which had been promised during a House of Lords debate on the subject on 1 July 2019.

CHANCELLOR'S ANNOUNCEMENT

4. The Chancellor responded on 4 September to the UK Statistics Authority's call (in March 2019) for publication of the RPI to be stopped at a future point; and for the shortcomings of RPI to be addressed by aligning with the methodology of the CPI (H) index. The Government reject

General Secretary: David Luxton

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the recommendation to cease publication of RPI as this “*would potentially be highly disruptive for the wide range of uses of RPI. In turn this could be highly damaging to the economy and public finances*”. The Government will however publicly consult (from January 2020) on whether changes to the calculation of RPI to align with CPI (H) should be introduced from a date other than 2030 (when Government permission for such a change expires), “*and if so, when between 2025 and 2030*”.

The response to the Chair of the House of Lords Economic Committee, the Chancellor states that he cannot consent to the introduction of the change UKSA have proposed “any earlier than February 2025” and argues that “*There would be significant effects of this approach for users of RPI and the authorities do not know the full extent of the effects...it must be appropriate that the private and public sectors, households, firms, and financial markets will need substantial time to prepare*”.

The Chancellor has also confirmed “*that the Government has no current plans to stop issuing gilts linked to RPI*”. This is in response to a recommendation from the House of Lords report that the Government should begin to issue gilts linked to CPI and stop issuing RPI-linked gilts.

It is clear from both letters that there will be no change towards a single measure of inflation before 2025 at the earliest, but more likely nearer to 2030.

The PSPC Executive Committee will be considering the Government’s response at its next meeting on 5 November.

Yours sincerely

DAVID LUXTON

General Secretary



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

4 September 2019

Sir David Norgrove
Chair of the UK Statistics Authority
1 Drummond Gate
London SW1V 2QQ

Dear Sir David,

Thank you for your letter to my predecessor of 4 March outlining the UK Statistics Authority's (UKSA) proposals for the Retail Prices Index (RPI). You have made two proposals. First, that the publication of RPI should cease, which would require primary legislation. Recognising that legislation would take time, you have proposed that RPI should be aligned with the Consumer Prices Index including owner occupiers' housing costs (CPIH). We have discussed your proposals, and you have decided to publish them today.

I recognise that there are flaws in RPI and that maintaining public trust in official statistics is important. But RPI is used widely across the economy. UKSA's first proposal to end the publication of RPI would potentially be highly disruptive for the wide range of users of RPI. In turn, this could be damaging to the economy and the public finances. As we have discussed, the next few months are a critical period for the UK as we ready ourselves to leave the EU on 31 October. Given the potential disruption for users of a change to RPI and the Government's focus on Brexit, I am not minded to promote legislation that would remove the requirement for UKSA to produce and publish RPI.

I can see the statistical arguments for UKSA's second proposal to fix RPI by aligning its methodology with CPIH. The continued publication of a widely used, but flawed statistic could be seen to undermine the integrity and credibility of the UK statistical system. While your proposed fix goes well beyond the recommendation of the Lords Economic Affairs Committee, I understand you have taken this decision based on advice from the National Statistician. Aligning RPI with CPIH would ensure existing uses would automatically be based on the ONS's headline measure of inflation. Addressing the flaws in RPI in this way may be a more efficient approach than continuing to ask users to stop using it and rewriting existing contracts, but it does not remove many of the implications.

Due to provisions in legislation, my consent as Chancellor is required for you to change the calculation of RPI as proposed, because of its use as the reference index for some government debt. The requirement to seek my consent to certain changes to RPI expires in



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2030. You have signalled that, while you cannot commit your successors, it is unlikely that the UKSA in 2030 would take a different view from your proposal to align RPI with CPIH. In coming to a decision, I consider the integrity of the statistical system, the effect on the public finances and on the holders of specific index-linked gilts.

I am mindful that there would be significant effects of your approach for users of RPI. While we know that RPI is embedded across the economy, we do not know the full extent of the effects on users, how some will respond or how they might adjust contractual arrangements in advance of UKSA aligning RPI with CPIH. Given the potential for significant and diverse effects of the change you have proposed, it must be appropriate to start from the assumption that some or all users in the private and public sectors, households, firms and financial markets will need substantial time to prepare.

Therefore, I am unable to consent to the introduction of the change you have proposed any earlier than February 2025, based on the information I have available. To ensure better information about the potential effects, the Government will consult publicly on whether this change should be made at a date other than 2030, and if so, when between 2025 and 2030. As part of this consultation, UKSA will consult on technical matters concerning how to implement the proposed alignment of RPI with CPIH.

The Government has made some changes in its use of inflation indices over the past decade in areas of public policy. I can confirm, as set out at Budget 2018, that the Government will not introduce new uses of RPI. The Government will continue to consider its use of RPI further at future fiscal events, drawing on the evidence gleaned in the consultation, and considering the issues in the round.

I want to ensure that the Treasury, alongside the rest of government, has the time and space to focus on delivering Brexit. Therefore, we will begin our consultation in January 2020, and the Government and UKSA will publish a response to the consultation before the Spring Statement and the end of the financial year.

SAJID JAVID



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

4 September 2019

The Rt Hon the Lord Forsyth of Drumlean
Chairman of the Economic Affairs Committee
House of Lords
London SW1A 0PW

Dear Michael,

I am writing to respond to the Committee's inquiry into the Retail Prices Index (RPI). I am grateful to the Committee for its report and the detailed work that has been undertaken to consider RPI and its uses.

The issues your report raises are complex and wide-ranging, tackling one of the most important factors underpinning government policy-making – credible, reliable and accurate statistics. The breadth, complexity, and importance of the issues has meant that your report has required careful consideration jointly with the UK Statistics Authority (UKSA), and as a result the Government has not been in a position to respond sooner.

RPI

Your report was critical of the authorities for allowing the flaws in RPI to remain unaddressed. It concluded that UKSA, who under the Statistics and Registration Service Act 2007 are the sole body who can recommend changes to RPI, should propose a 'fix' to RPI. My consent is required for certain changes to RPI, and your report notes that my consent is only required up to 2030.

Since your report was published, the UKSA Board has made a proposal to fix RPI. UKSA have chosen to publish their proposal today. Specifically, they have proposed that RPI's methodology should be aligned with the Consumer Prices Index including owner occupiers' housing costs (CPIH). UKSA has signalled that, while it cannot commit its successors, it is unlikely that the UKSA in 2030 would take a different view from its proposal to align RPI with CPIH.

As set out in my letter today to the Chair of the UKSA, I can see the statistical arguments for UKSA's proposal to fix RPI. In coming to a decision, I consider the effect of doing so on the integrity of the statistical system, and the effects on the public finances and on the holders of specific index-linked gilts.



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There would be significant effects of UKSA's approach for users of RPI and the authorities do not know the full extent of the effects. Given this, it must be appropriate that the private and public sectors, household, firms and financial markets will need substantial time to prepare.

Therefore, I am unable to consent to the introduction of the change UKSA have proposed any earlier than February 2025, based on the information I have available. To ensure better information about the potential effects, the Government will consult publicly on whether this change should be made at a date other than 2030, and if so, when between 2025 and 2030. As part of this consultation, UKSA will consult on technical matters concerning how to implement the proposed alignment of RPI with CPIH.

The next few months are a critical period for the UK as we ready ourselves to leave the EU on 31 October, and I want to ensure that the Treasury, alongside the rest of government, has the time and space to focus on delivering Brexit. Therefore, the Government and UKSA will begin our consultation in January 2020, and we will publish a response to the consultation before the Spring Statement and the end of the financial year.

A single general measure of inflation and index shopping

Your report recommends that the Government address the imbalance in its use of consumer price indices and that in the future, one general measure of inflation is used for all purposes. The Committee's report was also critical of the Government's use of different inflation measures for different policy areas.

As the report acknowledged, the Government has made some changes in its use of inflation indices over the past decade in areas of public policy. Over this period, CPIH has also been developed, and regained its status as a National Statistic in 2017. The proposal from UKSA to change RPI is a further development in the inflation statistics landscape.

As set out at Budget 2018, the Government views CPIH as conceptually the best measure of inflation and the Government's objective is that CPIH will become its headline measure over time. The Government will continue to consider its use of RPI further at future fiscal events, drawing on the evidence gleaned in the consultation, and considering the issues in the round.

Gilts

The Committee recommended that the Government begin to issue gilts linked to CPI and to stop issuing RPI-linked gilts. The Debt Management Office (DMO) consulted on issuing CPI-linked gilts in 2011, but decided against doing so at that time. Respondents highlighted



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concerns over the demand for CPI-linked gilts, which could limit their cost-effectiveness. These factors pointed to the continuing issuance of RPI-linked gilts as the most cost-effective way of selling inflation-indexed debt at the time.

Following today's announcement of UKSA's proposal to align RPI with CPIH, and the intention to consult on the timing, I can confirm that the Government has no current plans to stop issuing gilts linked to RPI.

Long-term future of RPI

Your report recommends that once a single general measure is established, the Government should decide whether UKSA should continue publishing RPI in its existing form for RPI-linked contracts or whether a programme of adjustments should be made to RPI so that it converges to the single general measure. Given the UKSA have today proposed aligning RPI with CPIH and the widespread use of RPI across the economy, I have rejected their proposal to promote legislation to remove the requirement on the UKSA to publish RPI.

I would like to thank you again for your Committee's examination of the UK's inflation statistics landscape.

SAJID JAVID

Economy (https://www.statisticsauthority.gov.uk/topic/economy/?post_type=news)
> UK Statistics Authority Statement on the future of the RPI

UK Statistics Authority Statement on the future of the RPI

Published

4 September 2019

In this theme

Economy (<https://www.statisticsauthority.gov.uk/themes/economy/>)

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.

Taking account of that advice, the then National Statistician concluded that the current position was unsatisfactory and put options for the future of the RPI to the UK Statistics Authority Board on 26 February 2019.

After receiving this advice, Sir David Norgrove, Chair of the UK Statistics Authority, wrote on behalf of the Board to the previous Chancellor of the Exchequer on 4 March 2019 with the following recommendations:

- that the publication of the RPI be stopped at a point in future; and
- in the interim, the shortcomings of the RPI should be addressed by bringing the methods of the CPIH into it.

Today the Chancellor has announced his intention to consult on whether to bring the methods in CPIH into RPI between 2025 and 2030, effectively aligning the measures. The UK Statistics Authority will consult on the method of making this change.

Speaking today, Sir David said:

“The role of the UK Statistics Authority is to promote and safeguard official statistics.

“We have been clear that the RPI is not a good measure, at times significantly overestimating inflation and at other times underestimating it, and have consistently urged all – in Government and the private sector – to stop using it. However, the RPI is unique as we need consent from the Chancellor to make certain changes, such as the one we have proposed.

“Although we regret that no change will occur before 2025, we welcome the Chancellor’s intention to consult on resolving current issues with the RPI.

“We continue to urge the Government and others to cease to use the RPI. It would be wrong for the Government to continue to use a measure of inflation which it itself accepts is flawed, where it has the opportunity to change.”

Notes to Editors

1. Under Section 21 of the Statistics and Registration Service Act 2007, before making any change to the coverage or the basic calculation of the RPI, the UK Statistics Authority must consult the Bank of England. Where proposed changes to the RPI are deemed material and detrimental to relevant gilt holders by the Bank of England, changes cannot be made without the consent of the Chancellor of the Exchequer.
2. Under Section 21, Sir David Norgrove wrote to the Governor of the Bank of England on 18 February (<https://www.statisticsauthority.gov.uk/correspondence/letter-to-the-governor-of-the-bank-of-england-section-21/>) and the Chancellor of the Exchequer on 4 March (<https://www.statisticsauthority.gov.uk/correspondence/letter-to-the-chancellor-of-the-exchequer-section-21/>), proposing:
 1. that the publication of the RPI be stopped at a point in future; and
 2. in the interim, that shortcomings of the RPI be addressed, by bringing the methods of the CPIH into the index.
3. His letters drew both on the formal advice of the UK’s National Statistician (<https://www.statisticsauthority.gov.uk/correspondence/national-statisticians-advice-to-the-uk-statistics-authority-board-on-the-retail-prices-index/>), and on the advice of the National Statistician’s Advisory Panel on Consumer Prices (<https://www.statisticsauthority.gov.uk/correspondence/comments-from-the-stakeholder-advisory-panel-on-consumer-prices/>).
4. The Bank of England responded on 4 March (<https://www.statisticsauthority.gov.uk/correspondence/response-from-the-bank-of-england-section-21/>) to confirm changes proposed were material and detrimental to holders of relevant gilts.

5. Following the appointment of a new Chancellor, Sir David Norgrove wrote to the Rt Hon Sajid Javid MP on 30 July 2019 (<https://www.statisticsauthority.gov.uk/correspondence/letter-to-the-incoming-chancellor-of-the-exchequer/>), highlighting the importance of the issue and the need to resolve at the earliest practical occasion.
6. The Chancellor responded (<https://www.statisticsauthority.gov.uk/correspondence/response-from-the-chancellor-of-the-exchequer-section-21/>) to the UK Statistics Authority's proposals on 4 September 2019. In his response, the Chancellor announced his intention to consult on the timing of when to bring the methods in CPIH into RPI, effectively aligning the measures, to give users time to prepare for the many complex effects such a change will have.
7. Sir David has responded to the Chancellor (<https://www.statisticsauthority.gov.uk/correspondence/response-to-the-chancellor-section-21/>) welcoming the intention to consult, while expressing regret that no change will occur before 2025. He has also urged users to cease using the RPI.
8. In 2030 the requirement for the Authority to consult the Chancellor before making changes to the coverage or calculation of the RPI falls away.
9. While the current Authority Board cannot commit its successors, the statistical weaknesses of the RPI make it unlikely that the Authority would take a different view from our recommendations in 2030
10. The Authority has also published its response to the House of Lords Economic Affairs Committee (<https://www.statisticsauthority.gov.uk/correspondence/authority-response-to-lords-economic-affairs-committees-report-measuring-inflation/>).

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