

Public Service Pensioners' Council

Hamilton House, Mabledon Place, London WC1H 9BD. Telephone: 020 7380 4765 FAX: 020 7383 3454
www.publicservicepensioners.org.uk

Sarju Mistry
Room 1.227
Office for National Statistics
Government Buildings
Cardiff Road
Newport
NP10 8XG

30th August 2012

Dear Sarju

PSPC RESPONSE TO ONS CPI OWNER OCCUPIER HOUSING COSTS CONSULTATION DOCUMENT JUNE 2012

The Public Service Pensioners' Council (PSPC) was established almost fifty years ago with the aim of protecting the interests of retired public servants. It brings together the various organisations of retired public servants and the retired members' sections of public sector unions to campaign on issues of concern to public service pensioners. This response is prepared on behalf of, and in consultation with, our constituent organisations.

Dealing with the suggested questions in turn:

Owner occupiers' housing costs –

Does the recommended method, which uses the rental equivalence approach for reflecting owner occupiers' housing costs in a new additional measure of consumer price inflation, best meet your needs?

The PSPC, as an umbrella body, will not be offering an opinion on the merit of net acquisitions versus rental equivalence as we recognise that our constituent organisations may have legitimately differing opinions on the subject.

The core 'need' of the PSPC is that any revised index be fit for purpose as an indexation method for pensions. We define this as allowing the real value of the pension to be maintained over time. It is important to have a measure that reflects people's personal experience of inflation, otherwise any index will not command the confidence of the public at large. We realise that the ONS does not decide the uses to which its statistics are put, but the ONS does not operate in a vacuum and should be mindful of the likely consequences of its actions.

The PSPC maintains its belief that the CPI is not fit for purpose as a compensation index for pensions. Even an amended CPI is not fit for purpose because it assumes that people substitute into cheaper goods as prices change. CPI was designed as a macroeconomic policy tool, but was shoe-horned into service as an indexation method for pensions and benefits primarily because it provided a lower average outcome than the RPI. Indexation methods have

General Secretary: ANDREW MORRIS

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consequences. RPI has been on average 0.7 per cent higher than CPI since 1989. If we assume RPI at 3 per cent and CPI at 2.3 per cent, a public service worker with a £10,000 pension will receive over £30,000 less because of the switch from RPI to CPI over the course of a 25-year retirement. This is a huge loss of purchasing power.

The PSpC agrees that housing costs should be included within CPI. It is a fundamental weakness that an index that purports to be a method for indexing pensions and benefits should exclude housing costs – a major constituent of household spending. Inclusion of housing costs does not, however, make CPI fit for purpose as a compensation index. There is still the outstanding problem of the ‘formula effect’, which currently means that CPI is around 1 per cent lower than RPI. The Office for Budget Responsibility assumes that the formula effect will grow to 1.4 per cent over the next few years.

The solution to the formula effect is not, however, to make the RPI more like the CPI. A large part of the CPI methodology includes the assumption that people switch to cheaper goods if prices change. This may be the correct assumption for a macroeconomic policy tool, but we think this concept is not suitable for a compensation index. The PSpC believes that a suitable compensation index should provide individuals with sufficient income to buy the same basket of goods. We do not think that ‘protection against inflation’ means that individuals should be forced to switch to cheaper goods.

Ultimately, the ‘recommended method’ of using rental equivalence to create a new CPIH does not meet our needs. The PSpC fears that this consultation could end with CPI being given greater ‘legitimacy’ when it is still not fit for purpose as a compensation index.

Strategy for Consumer Price statistics -

i. Once established over time, ONS proposes that CPIH become the main focus of its reporting on consumer price inflation in the UK. Is this appropriate or should the CPI remain as the main focus?

As previously stated, the PSpC believes that housing costs should be included within CPI, so we would welcome CPIH superseding CPI. It will appear extremely odd to the public if the Government kept on using CPI rather than CPIH given the work that has been done to include housing costs.

We would hope that the proposed CPIH measure will be fit for the purpose of uprating public pensions and state benefits. In this respect, it will be important to bear in mind that the basic intent of the current statutory provision is “*to ensure that the purchasing power of these benefits and pensions is protected against inflation*” [Witness statement on 07 September 2011 by Henry Francis Cunniffe on behalf of the Department of Work and Pensions] and that the actual statute requires the measurement of increases in “*the general level of prices*”, which implies a single index applicable to the public at large, rather than just to pensioners or benefit claimants. The law does not just apply to pensions already in payment. It also covers pension rights which will not come into payment for many years; for example, deferred pensions at a change in employment and also the new “average salary schemes”. These schemes require annual revalorisation up to the retirement age. Most of the people affected by deferred pensions and average salary schemes are relatively young. Most are owner occupiers and most have mortgages. Similar considerations will apply to many private sector pensions.

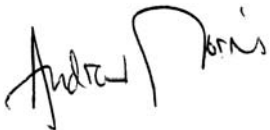
The PSpC believes that the CPI is still not fit for purpose as a compensation index because of the assumption that people must switch to cheaper goods. We therefore believe that RPI

should return to being the main focus of consumer price inflation in the UK. We note that the Government is capable of using RPI as an indexation measure when it suits, notably for regulated areas such as train fares and student loans. It should therefore be possible to reinstate RPI as the consistent focus for consumer price inflation. To do otherwise risks an element of double standards with RPI being used in areas where the Government is sanguine about price rises, and CPI (or CPIH) being used where the Government wishes to constrain expenditure.

ii. CPIH will be developed to meet the needs of UK users. Is this the correct strategy or is harmonisation of the UK measure with the HICP more important?

The PSPC believes that the needs of UK users are paramount. Our prime need with anything that purports to be an inflation index is that it measures price changes for UK consumers. We believe that part of the weakness of CPI is that it was conceived as a macroeconomic measure to measure prices consistently across Europe and was not designed to measure inflation as most people experience it. We would go further and state that harmonisation with HICP is utterly unimportant to non-specialist UK users.

Yours sincerely

A handwritten signature in black ink that reads "Andrew Morris". The signature is written in a cursive style with a large, sweeping initial 'A'.

ANDREW MORRIS
General Secretary