

PRIME MINISTER

COMMUNITY CHARGE AND THE RPI

For some months discussions have been going on in Whitehall about how to handle the implications for the calculation of the RPI when the community charge comes into effect.

On grounds of statistical purity there is an argument that, although rates are in the RPI because they are an indirect tax, the community charge should be out of the RPI because it is a direct tax. But a change on this basis would lead to a major discontinuity in the series and a 4 per cent once for all drop in the RPI. All concerned agree that this approach - which has become known as Option A - would be politically unacceptable.

There are two other possible solutions:

- Option B, under which rates would be removed from back figures for the RPI and the community charge would not be included in future. This would avoid any major discontinuity, although it raises technical issues of timing because the abolition of rates is being phased;
- Option C, under which the community charge would be included in the RPI. Although arguably offending statistical purity, this is what might be termed the common sense approach.

Detailed arguments on the different approaches are set out in Mr. Fowler's letter of 28 July and the attached paper by officials (Flag A). These papers do not however include consideration of one factor of major importance - the implications for indexed gilts. The Chancellor's recent minute (Flag B) addresses this aspect.

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The indexed gilts point is a major problem. You will see from the Chancellor's minute that there is a danger of the Bank being required to redeem stock at a cost of some £3 billion if it could be held that there had been 'a fundamental change in the index which would be materially detrimental to the interests of policy holders'.

My impression is that, were it not for the indexed gilts point, the Chancellor would have favoured Option B. And this is probably also the approach the professional statisticians would favour. However, even though they are not aware of the indexed gilts complication, Messrs. Ridley and Moore take the 'common sense' view and argue for Option C.

And, having carefully weighted the indexed gilts complication, the Chancellor too comes down in favour of Option C. He proposes that the RPI Advisory Committee - which will have to consider this issue - should be told that Option A is definitely not favoured by the Government, and that as between the other two approaches, the Government's present view is that Option C is on balance preferable. There is of course no question of telling the Advisory Committee - or colleagues generally - about the indexed gilts point.

Content for the issue to be handled as the Chancellor proposes?

The cost of the WHS or some sound security comes into general consideration but we do NOT include it in the RPI. I would rather we look the proper course i.e. do not

PAUL GRAY

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but it is a device for the purpose of current index-linked files to have a spread R.P.I. including a national equivalent to retail. New index-linked issues would be on the new R.P.I.