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**Secretary of State**

The Rt Hon Nigel Lawson
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1

February 26

Dear Nigel

**RETAIL PRICES INDEX ADVISORY COMMITTEE REPORT**

I have now received the Advisory Committee's report on the Community Charge issue, and have announced that I intend to publish it shortly, together with my decision on the recommendations. Printing arrangements have been put in hand which would allow publication as a Command Paper on Friday 3 March, on which day I hope to make a substantive announcement by means of an Arranged PQ, with an accompanying Press Notice from my Department.

I enclose a copy of the report, whose main recommendation is that the Community Charge should be included in the RPI in future in a similar way to that in which rates are included at present. I understand that this conclusion was reached by consensus amongst the non-Government members of the Committee, who represent consumers and employees, retailers, business interest and the academic community. As we had agreed, officials representing Government Departments avoided expressing strong preferences on the issues before the Committee. However, the conclusion reached by the Advisory Committee seems likely to be acceptable in all the circumstances, and likely to command greater public acceptance than the alternative of excluding the Charge from the Index.

Though the Committee is only advisory, its recommendations have never been rejected in the past and my view is that we should accept them on this occasion. The arguments for including the Community Charge in the RPI, and, indeed, the

Secretary of State
for Employment

contrary case, are set out at some length in the report. It is precisely because the matter is a difficult one, which cannot be easily resolved on technical grounds, that we need the seal of approval which a recommendation from an independent body gives. In the past this has provided a good defence against criticism of the methodology followed in compiling the Index. It is helpful that the arguments both for and against inclusion have been set out so fully in the attached report. Nevertheless, there is a clearly stated consensus in favour of inclusion.

You know of the need for early publication, and since your officials have been involved in the discussions throughout, I now seek your early comments (and those of Nicholas Ridley, John Moore and Malcolm Rifkind, to whom I am copying this), by noon on Thursday, 2 March if at all possible, please.

I am also copying this letter and the report to the Prime Minister and the Head of the Governmental Statistical Service.

Yours ever

NORMAN FOWLER

DEPARTMENT OF EMPLOYMENT

RETAIL PRICES INDEX ADVISORY COMMITTEE

# TREATMENT OF THE COMMUNITY CHARGE IN THE RETAIL PRICES INDEX

Presented to the Secretary of State for Employment

February 1989

## MEMBERSHIP OF THE RPI ADVISORY COMMITTEE (1988-9)

| | |
|---|---|
| Chairman | Mr I T Manley (Deputy Secretary, Department of Employment) |
| Members | Professor A B Atkinson (London School of Economics) |
| | Miss Sheila Black OBE (nominated by the National Consumer Council) |
| | Mr B J Carroll (Director of Finance, Boots Opticians, nominated by the British Retailers Association) |
| | Mr P D Dworkin (Director of Statistics, Department of Employment) |
| | Mr D W Flaxen (Assistant Director, Central Statistical Office) |
| | Mr J S Flemming (Executive Director, Bank of England) |
| | Mr K H B Frere (nominated by the National Federation of Consumer Groups) |
| | Dr R J Gibbs (Director of Statistics, Department of Social Security) |
| | Mr D Lea OBE (Assistant General Secretary, Trades Union Congress) |
| | Mr E Lindop (Deputy Director, Pay and Manpower Division, Confederation of British Industry) |
| | Professor J F Pickering (Vice President, Portsmouth Polytechnic) |
| | Mr K V Powell, MBE (nominated by Age Concern) |
| | Mr G V J Pratt (Co-operative Union Limited) |
| | Mr J J Pullinger (Statistician, Department of the Environment) |
| | Dr W Robinson (Director, Institute for Fiscal Studies) |
| | Professor H B Rose (London Business School) |
| | Mr P N Sedgwick (Under Secretary, HM Treasury) |
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| | Mrs J Varnam (nominated by the National Federation of Women's Institutes) |
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| | Mr J Winward (Head of Policy Development, Consumers' Association) |
| Secretary | Mr D J Sellwood |
| Assistant Secretary | Mr M Hargreaves |

# TREATMENT OF THE COMMUNITY CHARGE IN THE RETAIL PRICES INDEX

## CHAPTER 1: INTRODUCTION

### Matters to be dealt with

1. We were appointed in October 1988 with the following terms of reference:

> "To advise the Secretary of State for Employment on the effect of the abolition of domestic rates on the construction of the retail prices index and on the way in which expenditure on holidays should be taken into account in the index; and to review progress on implementing longer-term recommendations made in the Advisory Committee's last report (Cmnd 9848, July 1986)".

2. The first item in these terms of reference is a matter of some urgency as rates are being abolished in Scotland in April 1989 (though not until April 1990 in England and Wales) and arrangements need to be made in advance to deal with this situation in constructing the retail prices index (RPI). We have therefore thought it right to address the rates question first, and submit a report dealing with this one issue. We will then turn to the other matters in our terms of reference in the expectation of completing a second report during 1989 in good time for the recommendations, if accepted, to be implemented at the beginning of 1990.

### General considerations

3. In the Committee's last report the general approach laid particular stress on two considerations which have also been prominent in our latest discussions. The first of these concerned the need for continuity and consistency in the construction of the RPI. For the index to fulfil its purpose it is essential that the concepts underlying it should not be changed without good reason and that any such changes should be fully explained and justified. In examining the question of the abolition of domestic rates we have found that consistency can be interpreted in a number of different ways, and we do not all attach the same importance to its various aspects; but we do agree that simply following past precedent is less important than the maintenance of a coherent underlying approach. From our different points of view we have sought to ensure that the RPI continues to measure changes in prices across the whole range of goods and services purchased for consumption by households covered by the index. The essential character of the index should therefore remain the same though the precise nature of its coverage will have changed in response to changing circumstances.

4. The second continuing theme in our discussions on this occasion, as on previous ones, has been the need to sustain public confidence in the RPI as a reliable measure. That is not to say that the public's reactions are necessarily a sound basis for determining index methodology, as they may not pass the test of consistency, but in deciding to reject some alternatives for which a case can be made on conceptual grounds we have taken into account (along with many other considerations) the likelihood that they would undermine confidence in the index.

5. As in the past, we have reached our conclusions by consensus: not by counting votes. We have no wish to conceal the fact that we are not unanimous in our view of the central issues, and a body of opinion within the Committee argued in favour of a different outcome from that which we recommend. However, the contentious matters are not all clear-cut, there being many overlapping ranges of opinion rather than two or three distinct alternatives. We believe we have reached an overall position which, while not completely satisfying all strands of thought, takes some account of each of the points of view which have been expressed.

Structure of the report

6. The structure of our report is as follows. In Chapter 2 we describe, by way of background, the nature of the RPI, the present situation as regards the inclusion of rates and the changes which are shortly to take place in the system of local government finance, involving the introduction of a new form of payment, the Community Charge. In Chapters 3 and 4 we go on to consider whether or not the Community Charge should be included in the RPI once domestic rates are abolished, rehearsing at some length the arguments on both sides and coming to a definite recommendation in favour of inclusion. We then address in Chapter 5 the question of how this recommendation could be put into effect: this involves defining an appropriate price indicator, taking a view on whether any allowance should be made for changes in the volume of local authority services and determining how to treat various grants, subsidies and discounts which will reduce the cost falling directly on consumers. Chapter 6 deals with a number of issues arising out of the transition from domestic rates to the Community Charge and the implications of this changeover for the structure of the RPI and the coverage of related indices. We end with a review of our conclusions and a summary of the changes in the RPI which would be apparent to users should our recommendations be accepted and implemented.

## CHAPTER 2: CURRENT PRACTICE AND FORTHCOMING CHANGES

Essential features of the RPI

7. The RPI measures the change from month to month in the general level of prices charged to consumers for the goods and services they buy. Despite its name the index's coverage is not confined to items bought in retail outlets: for example it also covers housing costs, gas and electricity charges, motoring expenditure and the prices of a wide range of other services. It includes VAT, excise duties and similar taxes which form part of the prices of consumer goods and services, but excludes income tax, national insurance contributions and other taxes which are levied directly on people irrespective of their consumption. Saving and investment expenditure are also excluded.

8. The index is compiled by defining a "basket" of goods and services and calculating each month the percentage change in its cost. The contents of the basket are based on the actual expenditure of households, its scope comprising virtually everything on which money is spent (with small exceptions defined by our predecessors). The process of index calculation involves determining both the percentage change in representative prices for each category of expenditure (the "price indicators") and the relative importance (or "weighting") to be attached to each in deriving the overall index. The composition of the basket can be changed, normally at the beginning of a calendar year, in order to keep abreast of alterations in patterns of consumption. It is important to recognise that adding a new item or otherwise changing the contents of the basket does not in itself raise or lower the rate of inflation as the index measures the proportionate change in prices: not their absolute level. The eventual effect of the inclusion or exclusion of particular items cannot be predicted as it depends upon whether the prices of those items increase faster or less fast than prices in general.

9. The concept underlying such a price index is that an amount of expenditure is the product of two elements - a price and a quantity. For example, an expenditure of £1 might be made up of two units of a good priced at 50 pence per unit. Equally any *change* in expenditure on that good can be decomposed into a price change element and a quantity change element, and the intention in constructing a price index is to separate these out so as to show the extent to which expenditure has changed on account of prices alone. The index should not be affected by expenditure increases/decreases brought about by increases/decreases in the quantity or quality (technically the "volume") of the goods and services acquired.

10. In principle this decomposition can be applied to any item of expenditure but in practice it becomes difficult, particularly when the units of consumption are not well defined. Some such cases are mentioned later in this report, including standing charges for gas and electricity, licence fees for motor vehicles and television receivers and membership subscriptions of clubs and associations. In each case it is clear that households are making payments and receiving services in return but when the expenditure changes it is not always apparent how much of this is a price effect and how much due to a difference in volume.

Treatment of rates in the RPI

11. Domestic rates have been included in the RPI since its inception. Initially this was because they were generally paid by households as part of the

rent and were inseparable from it, but when owner-occupiers' housing costs were first incorporated in the index in 1956 it was decided to establish rates, together with water charges, as a separate section within the "Housing" group, though the index for this section was not published until 1962. Since the beginning of 1987, following recommendations in our last report, rates and water charges have been treated as separate sections with indices published for each. In January 1988 domestic rates accounted for 43 parts per thousand of the expenditure included in the RPI. (This is shown in relation to the weight for other items in Annex A of this report.) Non-domestic rates are not directly covered by the index, though of course they are reflected to the extent that they influence the prices of goods and services purchased by households.

12. The amount of rates payable by a household depends upon two factors: the "rateable value" of the property occupied (which is supposed to reflect the value of the "shelter" consumed) and the "rate poundage", expressed as an annual levy per £ of rateable value (which varies from one local authority to another according to the services provided and other factors). It is the rate poundage which provides the price indicator for the RPI: any increase in the average rateable value is regarded as a volume effect (which influences the "weight" for rates in the following year). This means in practice that the index increases slightly less than it would if based on the average rate payment; the procedure might be seen as indicating that rates are regarded as a tax on housing rather than a charge for services, unless the rateable value is seen as a proxy for the volume of local authority services consumed by a household. (Such a proxy would only be satisfactory if the aggregate rateable value actually moved in line with the volume of services over time.)

13. The justification for including domestic rates in the RPI has never been fully discussed by the Advisory Committee. In our 1986 report (paragraph 41) we put forward the suggestion that rates could be seen as a tax on the occupation of property and were therefore appropriate for inclusion as a housing cost (just as indirect taxes on the consumption of alcohol, tobacco etc are included in the indices for those items). However, as the purpose of rates is to finance the provision of local authority services their present inclusion in the RPI is not inconsistent with the view that they are a payment for these services, each household's contribution varying according to the size of the property it occupies and the aggregate payment being implicitly related to the amount of services assumed to be provided. Whichever of these standpoints is adopted it can only be a rationalisation of past practice: the fundamental question of whether or not local authority services should be within the scope of the RPI remains to be settled in this report.

Introduction of the Community Charge

14. Domestic rates are to be replaced by a new charge - the Community Charge - which will be payable by virtually all adults at a flat rate, though some eleven million people will receive assistance with payments, around a million students will pay only 20 per cent of the full Charge and certain groups will be completely exempted, including the severely mentally handicapped, those working for charities on low pay and homeless people who are "sleeping rough". The switch from rates is to take place in April 1989 for Scotland and a year later for England and Wales. (The rating system is to remain in place in Northern Ireland and non-domestic rates will continue to be levied in modified form throughout the United Kingdom.) As with rates, the level of the Community Charge will be set by the local authority, and the proceeds will contribute to the financing of locally-provided services. Rates vary between households according to the value of the housing shelter consumed (as represented by the rateable value) whereas the Charge will not vary according to the amount of

local services consumed, except to the extent that the number of adults in a household liable to pay can be taken as a proxy for that household's use of services.

15. The Community Charge, like domestic rates, will finance about a quarter of the cost of local authority services, the remainder coming mainly from non-domestic rates and government grants. The present system is that in most areas the local authority's block grant from central government is larger if it spends less than the centrally-assessed cost of meeting its needs and smaller if it spends more. In future each authority's grant will be fixed with reference to its needs and will not vary with expenditure. Under either system a given proportionate increase in the cost of providing services, above the level assumed in distributing grant, requires a much greater proportionate increase in the payments made by households - a feature which distinguishes these payments from most other charges for services.

<u>Alternative views of the Charge</u>

16. In this report, as in the discussions which led up to it, we have not concerned ourselves with the merits or demerits of the Community Charge as a means of financing local authority services. The relevant legislation having been passed by Parliament, the Charge is to be introduced shortly and our only role is to see that it is treated in an appropriate way in the RPI, but in discharging this remit we have had to look closely at the nature of this new type of payment.

17. The Government's naming of the new payment as a charge suggests in itself that it is being levied in respect of services rendered and, as the proceeds will be used exclusively for the provision of local services, there is clearly considerable justification for this view. On the other hand the Community Charge is widely referred to as a "poll tax" and it does have much in common with direct taxation of individuals. A middle way is to say that the Charge is something of a hybrid - a locally-oriented residence charge combining certain features both of a payment for services and of a direct tax.

18. These different ways of regarding the Community Charge underlie, even if they do not wholly determine, the alternative views as to whether or not it would be appropriate to include it in the RPI. In Chapters 3 and 4 we address this central question.

## CHAPTER 3: THE CASE FOR EXCLUDING THE COMMUNITY CHARGE FROM THE RPI

### Introduction

19. This and the following chapter consider whether the Community Charge should be included in the RPI or excluded from it, giving the arguments on both sides. We begin with the case for exclusion, which we all thought merited serious consideration and which a number of members positively supported.

### Arguments for exclusion

20. The main argument for excluding the Community Charge from the price index is that it is not a price - at least not in the sense in which this term has previously been applied in compiling the RPI. In other words it cannot be related to the purchase of specific units of service provided (in the way described in paragraph 9 above).

21. Those who hold this view identify a number of features of the Community Charge which make it quite distinct from the prices already included in the RPI, notably:

a) The element of individual consumer choice is missing. With other items in the index it is possible to avoid paying the price by not consuming the good or service in question but in the case of the Community Charge the payment is imposed by law. It is true that the local community as a whole can choose (through the electoral process) to enjoy a higher or lower consumption of services in return for a higher or lower Community Charge, but that process is very remote from the individual consumer.

b) Besides being compulsory the Community Charge payable by each adult member of a household bears no direct relation to the volume of services actually consumed. Even for the *average* case the Charge cannot be regarded as the price for a given quantity of services since the quantity may well change over time, and the system for determining central government grants is such that the level of the Charge may not change directly in proportion to the cost of providing services above the level assumed in distributing grant.

c) It is generally accepted that income tax and national insurance contributions should be excluded from a consumer price index such as the RPI, and the Community Charge has much in common with them, being a direct levy on people for the purpose of financing public services. Moreover, income tax helps to pay, through central government grants, for the same services as will be financed by the Charge, so including the latter in the RPI while excluding the former might seem inconsistent.

22. For these reasons some Committee members thought that the Community Charge could not properly be regarded as a payment for goods and services but should be treated as the equivalent of a tax, albeit a tax which is hypothecated for the provision of local services and whose level is locally determined. These members pointed out that the "basket" of items covered by the RPI has never previously included public goods and public services which are provided on a collective basis. Including them now would, they suggested, change the essential character of the RPI and make it difficult to maintain a clear and unambiguous concept of "price" for use in future.

23. Those preferring to exclude the Community Charge from the RPI drew our attention to a passage in the Committee's 1986 report (paragraph 6) which attempted to define the nature of the RPI as follows:

> "We wish to reaffirm the view taken by our predecessors that the RPI is an index of *price* changes and not a "cost of living" index. It is not designed to measure the effect of changes in the kinds, amounts and quality of the goods and services people buy, or in the total amount which *needs* to be spent in order to live. Nor does it measure changes in the cost of maintaining a particular level of consumer satisfaction. The RPI measures the overall change in prices by reference to the cost of a fixed "basket" of goods and services ..."

It was argued that the inclusion of the Community Charge would be appropriate in a cost of living index, since it will clearly represent a significant part of households' outgoings, but has no place in a pure price index such as the RPI.

<u>Possible objections to exclusion</u>

24. Three possible objections to excluding the Community Charge from the RPI are that it would mean that official statistics took no account of this new form of payment by consumers, that it would be inconsistent with the long-standing inclusion of domestic rates in the RPI, and that it would lead to a spurious fall in the level of the index. These objections were responded to as follows.

25. Within the body of official statistics an index already exists which offers a means of reflecting changes in the Community Charge. Since 1979 the Central Statistical Office has compiled as a derivative of the RPI the "tax and price index" (TPI) which covers movements in income tax and national insurance contributions as well as prices. There is no doubt that the Community Charge should and will figure in the TPI, whether as a consequence of being in the RPI or as a separate element. This might attract greater attention to the TPI and we think this index should be subject to more outside scrutiny than it has received in the past, possibly through an extension of the Advisory Committee's role.

26. Those arguing against including the Community Charge in the RPI were not dissuaded by the fact that rates currently appear in it, as they were able to point to a number of differences between rates and the Charge. In the first place it is possible to reduce one's liability for rates by choosing a lower-valued property whereas in future households will have to meet the same costs wherever they live within any one local authority area. (There may also be some limited scope for deliberately joining one of the groups which are exempt from the Community Charge.) A further argument was that rates are an *indirect* tax (in that they are levied on the consumption of housing) and therefore form an acceptable part of a consumer price index, whereas the Community Charge is more like a direct tax (not associated with consumption but levied on individuals) and direct taxes are, as noted above, not generally included in price indices.

27. Though, as explained in paragraph 8 above, the removal of an item from the RPI does not generally lead to a fall in the level of the index, a possible precedent from the past might suggest that this should happen in the particular case of the abolition of rates. The point was made in discussion that in 1979 the Government increased VAT and reduced income tax, the result being a sharp rise in the level of the RPI. The rationale for this was that a direct tax (excluded from the index) had been replaced by an indirect tax (included in the index). It could be argued that the changeover from rates to the Community Charge is simply the opposite of this (a direct tax replacing an indirect one) and that the index should be allowed to fall on this account. However, the

and that the index should be allowed to fall on this account. However, the parallel is not exact since VAT forms part of a transaction price which consumers actually pay, whereas rates are levied on a notional consumption (represented by the rateable value) to which no other price is attached. Even those of us who were inclined to favour excluding the Community Charge from the RPI envisaged that this would be done in such a way as to have a neutral effect on the index as a whole.

28. We are therefore satisfied that it is feasible to exclude the Community Charge from the RPI in a way which would not leave a gap in official statistics or give rise to a step change in the index series and which could be seen as consistent with past practice. However, that is not to say that the arguments for exclusion are sufficiently strong to offset those in favour of including the Community Charge in the RPI, and it is to these that we now turn.

## CHAPTER 4: THE CASE FOR INCLUDING THE COMMUNITY CHARGE IN THE RPI

### Alternative rationalisations

29. The positive arguments in favour of including the Community Charge in the RPI rest on two pillars, corresponding to the different views of the nature of the Charge which we set out in Chapter 2. In the first place the Community Charge is an inescapable cost directly associated with residence and the occupation of property in a particular area. The link with property is strengthened by the fact that those occupying two houses will pay two Charges while homeless people will pay none. The Community Charge could therefore be said to have some characteristics of an indirect tax, just as rates have, and could be included in the index in a way which is as closely aligned as possible with the current treatment of rates. From this point of view the use made of the revenue is immaterial: it is the nature of the payment itself which dictates that it should be covered by the RPI.

30. The second school of thought reaches the same conclusion by a different route. According to this the link between the payment made to a local authority and the services received from it is relevant and important. The sole purpose of the Community Charge will be to finance local services, the aggregate payments made will be closely related to the amount of services provided, and individual consumers will see the Charge as the price they pay for this provision. Excluding the Charge would therefore cause widespread misgivings that the index was failing to reflect a significant element in the costs which consumers have to meet.

31. There are a number of more specific reasons for wanting to include the Charge. One is that the services provided by a local authority are of immediate relevance and direct benefit to the residents in its area and form a proper part of the "basket" of goods and services which is covered by the price index. It follows that the charges for these services should be part of the index whatever form it were to take, be it a tariff of item-of-service fees or a single omnibus payment such as the Community Charge.

32. This can be seen as justification for the present inclusion of rates in the RPI, and the case for including the Community Charge is perhaps stronger, because its stated purpose is to forge a closer link between the aggregate payments made and the services provided within any one local authority area. More consumers will be liable for the Charge than are liable for rates and those in areas where a high level of services is provided will pay more than those in areas with less provision. This makes the "deal" between consumers and their local authorities more like a conventional market transaction.

33. Whether or not the Community Charge is viewed as a price in some sense our general feeling is that it is no less so than domestic rates. We do not wish to argue that the present inclusion of rates necessarily means that the Community Charge should be in the RPI, but it clearly makes it more difficult to justify exclusion. From the consumers' point of view little will have changed once the Charge has been introduced - payments of similar size (on average) will be made to the same authorities supplying the same services as before - and it would be difficult to convince the public at large that the nature of the new charge was sufficiently different from that of the old to warrant what many would see as a break with past practice.

## Analogies with other items in the RPI

34. It must be acknowledged that if rates and the Community Charge are regarded as payments for services then it is a "package" of heterogeneous services which is being bought, and moreover a package over which the individual consumer has no direct control; but the same could be said of several items which are included in the RPI and whose appropriateness for inclusion has never been questioned.

35. For example television and motor vehicle licences are flat-rate charges levied on the consumers of television programmes and public roads and help finance their provision. These have always been included in the RPI though they are not expressed as prices per unit of service and there has been no adjustment for any changes in the quantity or quality of the services in question (though that is not to say that it would have been wrong to make such adjustments in these cases). Alternatively such payments might be seen as purchasing the *right of access* to whatever services are currently being provided. It could be argued that the Community Charge is a similar case, differing only in that individual consumers can choose not to watch television or run a car whereas they cannot avoid benefiting from, and paying for, the public services provided in the area where they live.

36. A further analogy is with subscriptions or membership fees paid to trade unions, motoring associations, clubs and societies, where again the RPI practice has been to make no adjustments for changes over time in the benefits received by members. Perhaps it would have been right to attempt such adjustment but, on the other hand, the benefits could be seen as a unitary package which cannot be decomposed or analysed but which, taken as a whole, represents the collective view of what ought to be provided. In a sense it is the membership itself which is purchased: not the services ultimately financed. It might be thought that the Community Charge paid to the local authority is not intrinsically different from the subscription paid to a local amenity body, apart from the point already made that the Charge will be universal.

37. Finally, even some of the items of consumption whose cost does vary according to individual consumption (such as gas and electricity supply and telephone service) are paid for partly through standing charges which fall equally on all those with access to the facility in question. Water supply and sewerage charges are currently levied on the same basis as rates and in some cases will in future be levied on the same basis as the Community Charge or as a flat rate per household. It would be difficult to justify excluding such payments as these from the RPI, and the Charge evidently has much in common with them.

38. We do not claim that these parallels are exact - it is possible to identify aspects of the Community Charge which make it somewhat different from any of the other items cited here - but we do think they show that the Charge is not a unique case whose treatment needs to be quite distinct from that of those licences, subscriptions and flat-rate charges which are already in the RPI. The Advisory Committee in the past has always preferred to define the scope of the index as widely as possible and including the Community Charge may be seen as consistent with maintaining this stance. Of course a line has to be drawn somewhere and, wherever it is set, the cases which lie just to one side of the boundary will not look very different from those which lie just on the other side. If the Community Charge were to be included in the RPI then there might be a case for saying that (for example) national insurance contributions should likewise be included. On the whole, however, we think there are sufficient grounds for including the Community Charge but going no further. For example,

national insurance contributions are at least in part a form of saving. More generally the local character of the Community Charge and the nature of the services financed (being of direct and immediate benefit to the consumers paying it) make it more appropriate for inclusion in the RPI than any of the items which are currently excluded.

Conclusion

39. Our general conclusion is therefore that the Community Charge should be incorporated in the RPI in some form. Members opposing this, on the grounds set out in the previous chapter, did not abandon their opinion but they recognised that a strong case could be made on the other side and that this case might well carry more weight with users of the RPI and with public opinion in general. The conclusion having been reached, the Committee as a whole proceeded to discuss how best to implement this decision. It is to that stage in the process that we turn next.

## CHAPTER 5: METHODOLOGY FOR INCLUDING THE COMMUNITY CHARGE IN THE RPI

### Introduction

40. At the end of the preceding chapter we reached the conclusion that the Community Charge should be included in the RPI, but that is not the end of the matter as there are a number of ways in which this result could be achieved. In the present chapter we consider various methodological aspects of the question and put forward some more specific recommendations.

### Weighting

41. In constructing a price index it is necessary to consider not only the "price indicator" which measures the rate of change for each item but also the "weight" which determines the relative importance of the item in relation to all the others in the index. In the present case the weighting is straightforward. In conformity with the methodology defined by our predecessors the weight for the Community Charge should be based on the average payment to local authorities by households covered by the RPI. The appropriate payment is that relating to the latest 12-month period for which information is available, and the weight is obtained by adjusting for price changes between that period and the beginning of the year for which the weights are to be used. The necessary expenditure data will be obtainable from the Family Expenditure Survey and the price adjustment can be carried out using the price indicator we recommend in this report. In addition to the Personal Community Charge for which most adults will be liable, local authorities will also be able to levy a Collective Community Charge on the landlords of property where the occupants stay only for short periods and a Standard Community Charge on people with second homes whose main residence is in another area. All three types will be included in the weight, and in principle they should be separately distinguished within it so that an appropriate price indicator can be attached to each.

### Price indicator

42. In principle the composition of the average household which underlies the weight should be held constant throughout each year for purposes of calculating the price indicator. In other words the index reflects the expenditure of a household with a fixed liability for the different types of Community Charge. In fact the Standard Charge is to be a multiple of the Personal Charge (at the discretion of the charging authority) and the Collective Community Charge is to be calculated by multiplying the daily contribution rate related to the Personal Charge by the number of person-days. For purposes of measuring the overall proportionate change in price the Personal Community Charge can therefore stand as an indicator for all three, though if the average multiplier for calculating the Standard Charge were to change from year to year then an adjustment should be made for this.

43. As we explained in Chapter 2, the price indicator for rates in the RPI has been an index of the average domestic rate poundage: it has not increased on account of the slow progressive rise in the average rateable value between revaluations. Similarly, if our recommendations are accepted the Community Charge price indicator will not change in response to any alteration in the number of adults per household. As a point of information an index of "payments per adult" would have risen about 4 percentage points more over the last five years than the existing index of "payments per £ of rateable value" (by 56 per cent as against 52 per cent). This is on account of the greater buoyancy in aggregate rateable value than in the size of the adult population.

Volume adjustment

44. As we pointed out in Chapter 2, central to the concept of a price index is the decomposition of an expenditure change into two parts: a price element and a quantity element (of which only the former affects the index) and taking the Community Charge itself as the price could be seen as tantamount to assuming no change in the "quantum" being consumed. Whether this is appropriate depends, once again, upon the way the Charge is perceived. If it is seen as a tax on residence in an area then the Community Charge per adult is indeed the correct price indicator to take. On the other hand if the Charge is seen as a payment for services then the relevant quantum is the volume of services provided (this being understood to involve the quality of services as well as their amount). From this standpoint the Charge per adult is only the correct price to take if the volume of services per adult resident does not change.

45. The point can be made in more practical terms as follows. It is conceivable that local authorities might reduce their Community Charges very significantly by simply cutting services or reducing their standards, and if this were to happen then some of us think it would be quite unacceptable for the RPI to fall as a result. Equally it would be wrong for the index to show an increase just because some communities had decided to provide for themselves (and were prepared to pay for) a higher level of provision than they had previously enjoyed.

46. It may be that, even if in principle it is desirable to take volume changes into account, there is no real need to do so. It has been suggested to us that in practice local authorities do not have scope to expand or contract their main services to any great extent, and illustrative figures produced for us by the Department of the Environment showed that the volume changes which have taken place over the last five years have been small in relation to the errors which would have been associated with their measurement.

47. Our general view is that, for the future, even the direction of change cannot be foreseen with confidence. On average the volume increase in the five years to April 1988 was of the order of 1 per cent per annum but it cannot be assumed that this will continue and that ignoring it will impart an inflationary bias to the index. On the one hand it seems reasonable to expect that local services will share in the general growth of national output but on the other hand the Community Charge has been seen as a way of restraining their provision. All in all we prefer to say that the future change cannot be predicted but is unlikely to be on such a scale as to distort the index for the foreseeable future.

48. However, those members disposed in principle to take volume changes into account were reluctant to rely on a mere assumption that their effect would be negligible. We therefore examined ways in which adjustments might be made. Ideally one would want to calculate the change over time in the volume of services so that this could be discounted in working out the price change. For example if the Community Charge were to increase by 8 per cent but the volume of services were cut by 10 per cent then the true price change for local authority services would be a rise of 20 per cent (as 1.08 divided by 0.90 equals 1.20).

49. Some of us think a volume adjustment of this sort would be appropriate in an index of the price of local authority services, both from an intuitive point of view and as being in keeping with the fundamental index number principle of measuring the cost of purchasing a fixed quantity of goods or services. One could envisage making such an adjustment every month as the level of provision might be changing continuously, but, quite apart from the severe practical

difficulty of developing a satisfactory method of doing this, we are convinced that in the short term local authorities cannot make significant changes in the services they provide. Moreover we do not think users of the RPI would expect the component representing local authority services to go up or down at times of year when actual payments were not changing. In our view the most one could expect, were volume adjustment considered appropriate, is that in the months when Community Charges were altered (normally April of each year) the compilers of the index should make the best possible estimate of any change in the total volume of services which was associated with the alteration in payments. The adjusted index would then remain at the same level until the next alteration in the Community Charge, normally a year later.

50. It is one thing to specify the sort of volume adjustment which could in principle be applied and quite another to be satisfied that such an adjustment could actually be carried out using the data which are likely to be available. We have therefore examined with some care the methods which might be used, with the assistance of some helpful information and guidance which was provided by the Department of the Environment's representatives on the Committee and is summarised in Annex C to this report.

51. One way of measuring changes in the volume of local authority services would be to use manpower numbers as a proxy for the quantity of inputs, but we concluded that it would be difficult to take adequate account of changes in the quality of the services (for example through employing more highly qualified staff), the efficiency with which they were provided or the substitution of capital equipment for labour. There would also be serious problems in keeping track of numbers employed in providing services which had been contracted out by local authorities, and delays in providing information even on authorities' own staff.

52. Another way of measuring changes in the volume of local authority services is on the basis of the information prepared by local authority finance officers in planning their budgets. These budgets allow a projected change in the volume of services to be calculated, together with an estimate of the likely inflation in unit costs. Using existing data sources comparisons of actual expenditure could only be made two years in arrears, which we think would be unacceptable. The alternatives are to compare the budgeted expenditure for the forthcoming year either with the corresponding budget figure for the previous year or with the estimated out-turn for that year. Either of these might give rise to calls for the index itself to be "corrected" in due course. We reaffirm the view the Advisory Committee has always taken in the past that, while each month's index should be based on the most accurate and up-to-date information available at the time of its compilation, there should be no question of revising the figures once they have been published.

53. It therefore appears that there is no method currently available which would enable changes in the volume of local authority services to be estimated in a way which would command general confidence and approval. We are not convinced that it would be impossible to develop such a method, and in particular we think more use could be made of the wealth of raw data already available from local authorities and their organisations on the *outputs* of local authority services; for example the number of pupils educated in schools or the mileage of roads maintained. Such statistics would be intrinsically more appropriate for our purpose than the input measures discussed above, though they are less amenable to aggregation and analysis. Their main drawback is that they might not fully reflect changes in the quality of services provided but, given the tight control of standards exercised by central government, this might not be a serious problem. If significant changes were taking place in the provision

of local services then some of us would prefer an imperfect adjustment to none at all.

54. We cannot rule out the possibility of such adjustments becoming necessary in the future. If for example there were significant moves towards privatisation of what are currently local authority services, so that their cost were met directly by consumers rather than indirectly via the Community Charge, then in line with our concern for continuity we would want steps to be taken to prevent a spurious fall in the level of the RPI. This could be done by ensuring that the increase in the use of private facilities was reflected in the index as a price increase alongside the concomitant reduction in the cost of local authority services. We would also be concerned if there were a progressive diminution in the scale or standard of the services being provided by local authorities. We therefore think that the question of volume adjustment should be kept under review by the Department of Employment and the Department of the Environment, including the problem of allowing for quality changes, and that the Advisory Committee should be invited to look at the matter again in a few years' time. If necessary, we can then consider whether the situation has changed sufficiently for us to reconsider our present conclusion about allowing for volume changes. Keeping the situation under surveillance in this way would be consistent both with the status of the Community Charge as an innovative measure whose effect cannot be predicted, and with the Committee's continuing role as a reviewing body.

55. To sum up, the need for volume adjustments is in doubt for two reasons: if the Community Charge is seen as a residence tax then they would be inappropriate, while if the Charge is seen as a payment for services which in practice do not change significantly in quantity or quality then adjustments would be redundant. Even those members who believe that volume adjustments would be appropriate and might become necessary nevertheless accept that for the present it is not feasible to make them. Our conclusion is that the appropriate response to the introduction of the Community Charge is to treat it in a similar way to that in which rates are currently treated, without adjustment for changes in the volume of local authority services.

Treatment of grants, subsidies and discounts

56. We turn now to the treatment of government grants, subsidies and discounts which in one way or another reduce the extent to which the cost of local authority services falls directly on the residents of the area concerned.

57. In the first place we have considered how to treat that part of net local authority expenditure (roughly three-quarters of the total) which will not be financed from the Community Charge. Two sources of revenue are involved - non-domestic rates and government grant - and these are deducted from gross costs for the purpose of setting the Community Charge. They appear to us to be in the nature of general subsidies akin to (for example) grants towards the provision of uneconomic but socially-necessary railway services. In our 1986 report we decided that such transfers, which benefit all users of the service irrespective of their individual circumstances, should be regarded as reducing the price for the service. In conformity with this principle we think that the "price" for local services should not reflect the whole cost of supplying them but just that part of the cost which falls on local residents in the form of the Community Charge. It follows that, other things being equal, the RPI would increase if other sources of revenue were cut back (thereby causing the Community Charge to rise) and decrease if they were made more generous (allowing the Charge to be reduced).

58. Secondly we recognise that many residents with relatively low incomes will receive assistance, through rebates, in paying their Community Charge, just as they currently qualify for help with rates (though everyone will be expected to pay at least 20 per cent of the full amount). Again following current practice, as laid down in our 1986 report, we regard this assistance as a subvention on income rather than a price reduction. The supplier of services (that is the local authority) will receive the full amount of the Charge and we think it is this full amount which should be regarded as the price charged, even though part of it is being paid not by the consumer but by the social security system. This form of assistance differs from that referred to in the previous paragraph in being selective. Where a subsidy or grant is made available by a third party (not the supplier or the consumer) we would wish to see it treated as a price reduction if it benefited all consumers but not if it benefited only a selected group.

59. A similar case is that of students, who will only be required to pay 20 per cent of the full Community Charge in the area where they study. The residue will not be made up by a specific payment to the local authority on behalf of each individual but the number of students in an area will be taken into account each year in determining the local authority's grant from central government. Again therefore the supplier of the service will ultimately receive the full amount of the Personal Community Charge, and current practice dictates that it is this which should be regarded as the "price" for RPI purposes, even for students.

<u>Conclusion</u>

60. What we propose therefore is an index whose weight is based on actual liability for Community Charge (of all types) and whose price indicator is the full Personal Charge, ignoring the fact that in the cases of benefit recipients and students the full cost is not all paid by the consumers themselves. For the present the price indicator should not be adjusted for changes in the volume of services provided by local authorities.

## CHAPTER 6: DEALING WITH THE TRANSITION FROM RATES TO THE COMMUNITY CHARGE AND ITS IMPLICATIONS

### Relating the old and new regimes to one another

61. Having defined the index we should like to see established we now deal briefly with a number of issues related to the transition between the present situation in which rates are included in the RPI and a future one in which the Community Charge would be included. Normally such changes are handled by calculating the price indicator both ways for a single month, one figure ending the old series and the other initiating the new one. The two series can then be linked so that the change in coverage does not create any discontinuity. This method cannot be applied in the present case since there will not be a month in which (for any one part of the United Kingdom) *both* rates and the Community Charge are being paid simultaneously. Moreover, the changeover is taking place at the beginning of a financial year, when in the normal course of events there would be an increase in payments by households to local authorities. It would be wrong to construct the RPI in such a way that this increase was not reflected.

62. In practical terms the price indicator will need to be changed at some point from the average rate poundage (a percentage figure) to the average Personal Community Charge (an amount of money in £ per week). It was suggested to us at one point that there would be advantage in doing this at the beginning of 1989, so as to remove the need to modify the methodology part-way through the year and avoid a situation in which the index for Scotland was being calculated in one way and that for England and Wales in another (the Community Charge having been introduced in the former case but not yet in the latter). We are not persuaded by these arguments. There is no way of avoiding the need to bridge the gap between two different regimes (one applying to the present rating system and the other to the new Community Charge system) but we see no reason to introduce a third regime, applying in the interim between January 1989 and the time when rates are abolished. The proper approach would be to maintain the present procedures without any change whatsoever for as long as the rating system remains in being in each part of the United Kingdom, switching to the new procedures in April 1989 for Scotland and in April 1990 for England and Wales. From April 1989 onwards the index should be called "Rates and Community Charges" (this title being retained after March 1990 because the rating system is to continue in Northern Ireland).

63. The problem in April 1989 and 1990 will be that of finding an appropriate "base price" (for January) with which to compare the Community Charge which has just started to be levied. What we recommend is that this base price should be the amount of domestic rates payable in January averaged over all the adults subsequently becoming liable to pay the Community Charge. From a computational point of view, therefore, the Charge will be treated as a continuation of rates under a different name, and calculated in a slightly different way (as a payment per liable adult rather than a payment per £ of rateable value). The technical details of this methodology are set out in Annex D.

### The "index household effect"

64. A feature of the Community Charge which has not yet been mentioned is that it will redistribute liability for payments to local authorities as between different types of household. In particular, those households which consist of only one or two adults and have relatively high rateable values will in future

pay a smaller share of the cost of local authority services, while those with low rateable values and more than two adults will pay a larger share. The distinction between "gainers" and "losers" will be correlated to some extent with that between the households which are covered by the general RPI and those which are not. The latter comprise two categories: households whose total gross income is in the top 4 per cent of the distribution and one- or two-person pensioner households mainly dependent on state benefits. For different reasons these "non-index households" will, relative to other households, pay less in Community Charge than they have been paying in rates; correspondingly the households covered by the index will pay relatively more. (This is separate from the effect that, whether in the index category or not, households with a relatively large number of adults will in future pay a bigger share.) The once-for-all "index household effect" is expected to raise by about 3½ per cent the average payment per adult in index households, and we have considered whether this should feed through into the general RPI as a price increase. If it did so it would add between 0.1 and 0.2 per cent to the "all items" index.

65. Throughout most of the RPI's coverage it is unnecessary to distinguish between the price changes faced by index households and those faced by non-index households, since they can reasonably be assumed to be the same. However, in some cases there has been reason to expect differences (particularly in the area of housing costs) and efforts have been made in the past to obtain price indicators which are specifically relevant to *index* households, as opposed to all households. Most of us see no reason to depart from this convention in the case of the switch from rates to the Community Charge: if index households do indeed find themselves paying more as a result (over and above the normal annual increase in payments) then this should be reflected in the general RPI. There is a contrary view, that "index households" are defined only to prevent the *weighting* of the index from being unduly affected by those with untypical expenditure patterns, and that the *price indicators* should not be restricted to any particular sub-group of the population, but this was supported by only a minority of Committee members.

Index structure

66. The rates component of the RPI has always been included in the "Housing" group, together with rent, mortgage interest payments, water and sewerage charges and the costs of repairs and maintenance. The justification for this is that rates are charged on the value of the housing occupied (as measured by the rateable value) and can be seen as part of the price of occupation. The Community Charge is not so closely linked to housing, but its level does depend upon the administrative area in which one's dwelling is situated, those who are homeless pay no Charge and those with two homes pay twice. The Charge is therefore related to housing to some extent. A further point is that the Community Charge will have much in common with water and sewerage charges which (though the basis on which they are levied will change over the next few years) will continue to be a legitimate part of the "Housing" group.

67. We therefore recommend, in the interests of presentational continuity, that the index for "Rates and Community Charges" should form part of "Housing", though this will extend the meaning somewhat to embrace residence charges as well as the cost of shelter and maintenance. Since a separate index and weight will be published for this section it will be possible to calculate by subtraction indices which exclude rates and the Community Charge either from housing costs or from the "all items" index, should such indices be required.

Pensioner price indices

68. Finally we should mention the special quarterly price indices which are compiled for one- and two-person pensioner households mainly dependent on state benefits, which are not within the coverage of the general RPI. Since their inception these pensioner indices have excluded all housing costs (including rates), principally because they tend to occupy different types of property from index households and the housing costs they face are affected in a more significant way by social security benefits. If the pensioner indices were widely used for uprating and other purposes then we should want to look again at their coverage, and perhaps consider whether ways could be found of including housing costs. However, the amount of attention paid to them is small in relation to that given to the general RPI. For the present therefore we recommend no change in the way the pensioner indices are constructed: we think they should exclude the Community Charge just as they have excluded rates (together with rent, mortgage interest payments and other housing costs).

## CHAPTER 7: SUMMARY OF RECOMMENDATIONS

69. As we have already said, we are not unanimous in our view of the matters before us, or the outcome which we should favour, but a consensus has emerged which commands a wide measure of support. We recommend as follows:

i) No change should be made in the method of constructing the present index for domestic rates until their abolition makes this necessary, in April 1989 in Scotland and a year later in England and Wales.

ii) Once domestic rates have been abolished the Community Charge should be included in the RPI. It may be seen as a tax on residence in a particular local authority area or as a payment for services.

iii) The Community Charge index should form part of the "Housing" group within the RPI, as rates have always done.

iv) The price indicator should be the average liability for Personal Community Charge within the households covered by the general RPI. Under the new regime these households will have to meet a larger share of the cost of local authority services than they do under the rating system and this should be reflected in the RPI as a price increase.

v) The weight should be based on the liability of index households for Community Charge of all sorts (Personal, Collective and Standard).

vi) Some Committee members would ideally like changes in the Community Charge to be adjusted for RPI purposes to allow for alterations in the quantity and quality of services provided by local authorities. We do not think it is practicable or necessary to make such adjustments at present but the possibility of their being needed in future ought to be kept under review.

vii) The contributions towards paying for local authority services which are made by central government grants and by non-domestic rates should be treated as reducing the cost included in the RPI. However, income-related rebates and the concession whereby students pay only 20 per cent of the full Community Charge should be regarded as subventions on income rather than reductions in price.

### Practical effect of implementing the recommendations

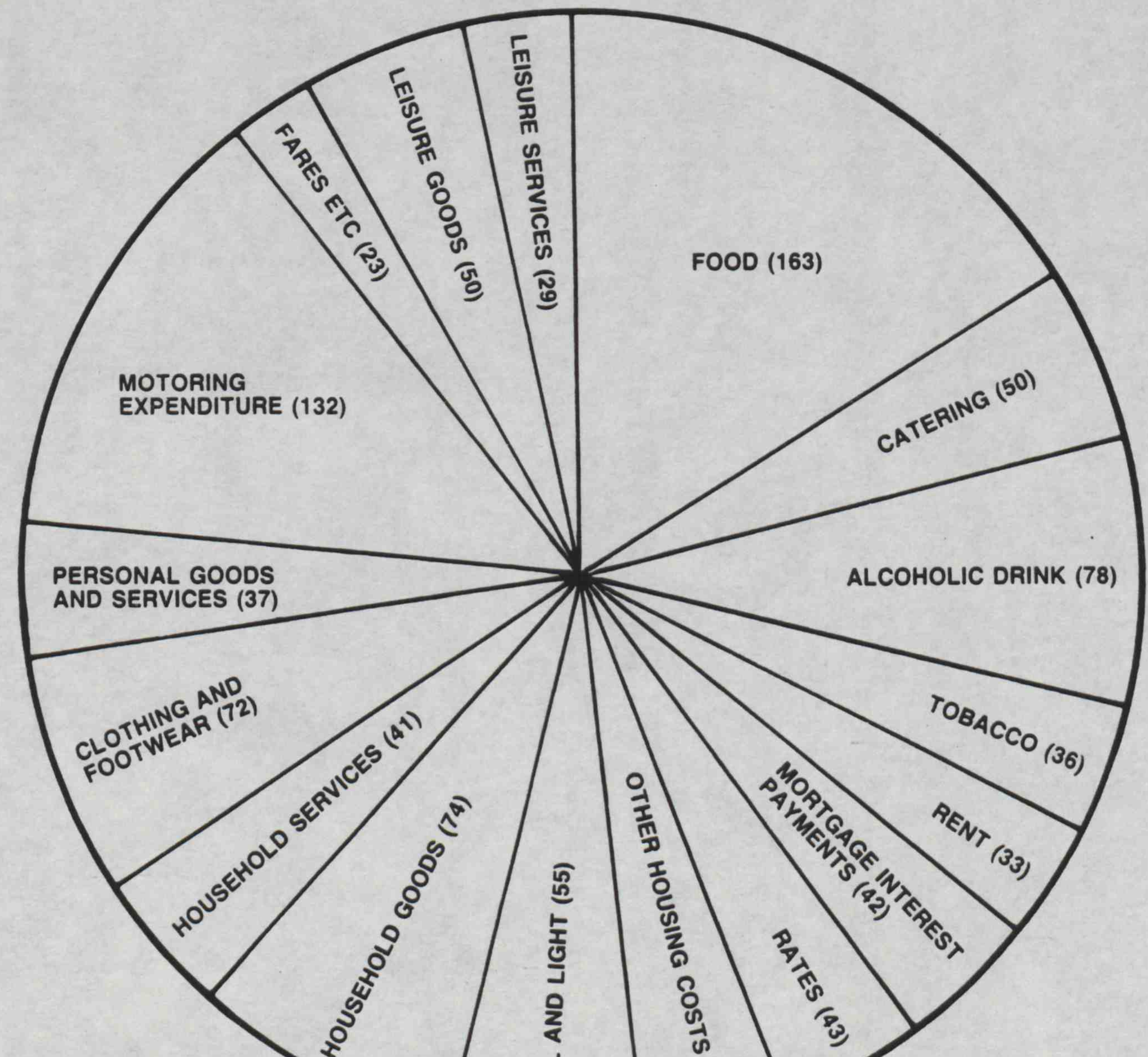
70. If our recommendations are accepted and implemented then the RPI will be left looking very much as it does now. The component index for rates which is published at present would then include the Community Charge and appear in the "Housing" sub-group of the index, slightly broadening the concept of housing costs but in a way which we think most people would accept as reasonable.

71. The way in which we propose that changes in the Community Charge should be measured is simple and straightforward: indeed it is probably the way in which most consumers would at first sight expect the Charge to be reflected. Its introduction would lead to a small increase in the level of the index; thereafter the movements in the Charge would contribute, along with all other price movements, to the change in the RPI from year to year.

72. As we have shown in the body of our report, the introduction of the Community Charge raises issues of principle and concept for the construction of the RPI which are difficult to resolve, but we believe that our recommendations represent a solution which will be widely acceptable. We commend them for consideration.

## ANNEX A

**WEIGHTING OF DOMESTIC RATES IN THE RPI (1988)**

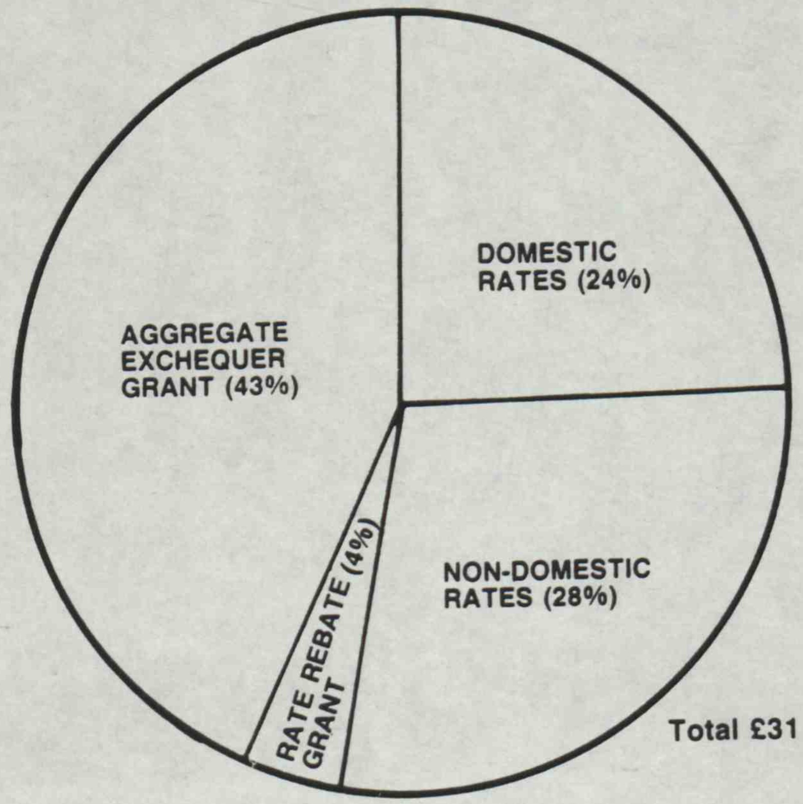



*Figures are parts per thousand in the general index*

## ANNEX B

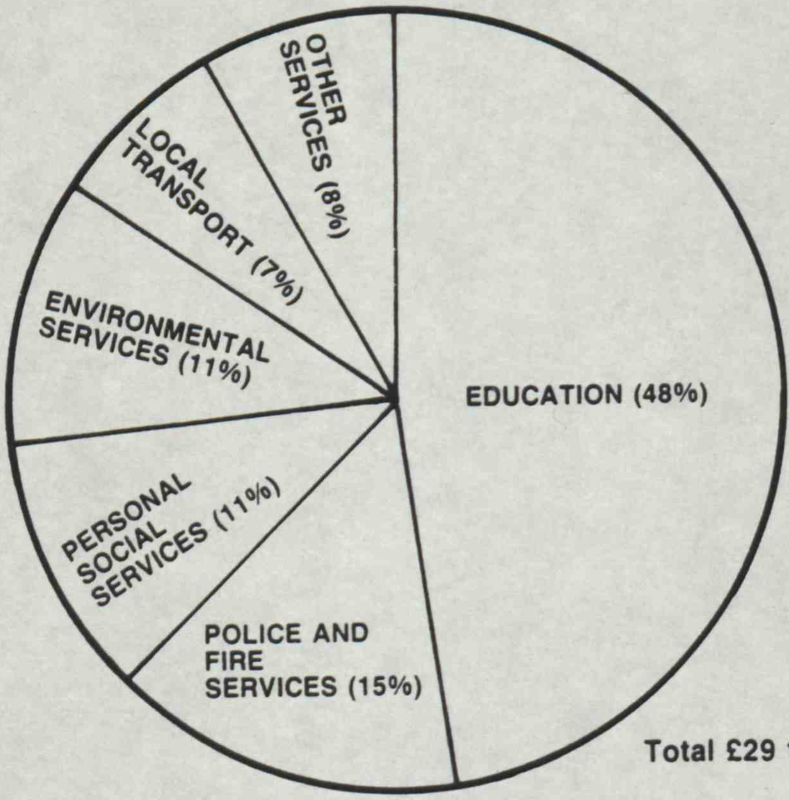
### MAKE-UP OF LOCAL AUTHORITY REVENUE AND EXPENDITURE

RATE FUND REVENUE
ACCOUNT NET INCOME 1988-89




Total £31 thousand million

CURRENT EXPENDITURE
BUDGET FIGURES 1988-89




Total £29 thousand million

## ANNEX C: MEASURING CHANGES IN THE PROVISION OF LOCAL AUTHORITY SERVICES

### Introduction

1. This annex describes the available methods of measuring changes in the provision of local authority services, which are mentioned briefly in paragraphs 51 and 52 of the report. One method is to proxy the quantity of inputs by using local authorities' reported expenditure deflated by a pay and prices index for local authority services, while the other is to use local authority manpower data as a proxy quantity measure. There are technical difficulties inherent in both options, which were regarded as insuperable in the short term. The following paragraphs set out the problems in more detail.

### General issues

2. Any method based on resource cost has the disadvantage that no account is taken either of changes in the efficiency with which resources are used or of changes in the quality of the services provided. Such effects may be regarded as intrinsically unquantifiable, though there could be a tendency for efficiency effects and quality effects to be offsetting.

3. The Charge is to be paid by each individual in respect of the whole range of community services but it will not relate to all expenditure by local authorities (as included in the national accounts): only to that met from their "general funds". For example, local authority trading services such as markets or toll bridges are almost entirely funded from sales, fees and specific charges. Another example is council housing which, it is proposed, local authorities will not be able to subsidise from their general funds (and hence from the Community Charge) after 1990.

4. For those services which *are* financed by the Community Charge there is also a distinction between current and capital expenditure, the latter arising mainly from debt charges on past capital projects rather than the actual costs of new capital investment. It would be difficult to separate price and quantity effects for capital financing items: the only realistic measures of quantity for the purpose of the RPI would be those derived from current expenditure on local authority general fund services.

### Measuring the quantity of inputs to local authority services

5. Subject to the general points made above, two possible ways of devising proxies for changes in the quantity of inputs are:

a) Estimating planned increases in the volume of inputs by comparing budgets for the year to which the Community Charge relates with estimated out-turns for the previous year (on the same price base);

b) Estimating increases in the volume of inputs between successive years' plans by comparing budgets for the year to which the Community Charge relates with budgets for the previous year (on the same price base);

c) Estimating increases in the volume of inputs between the latest available figures for actual expenditure by comparing final out-turns (on the same price base) two years in arrears.

6. In the cases of (a) and (b) the main problem is that planned (or budgeted) increases in quantity may not be achieved for a variety of reasons, including changes in the demand for services and errors in the inflation forecasts. In principle such errors could be dealt with by revising previously-published RPI indices, by making an adjustment to the level of the RPI when the next figure was published or by specifying that the data to be used for purposes of the RPI should be those contained in the budget returns, whatever the eventual outcome. The first of these options could be absolutely ruled out while the others were thought to be highly unsatisfactory.

7. Option (c) above might also appear superior to (a) and (b) in that it uses actual rather than planned increases in quantity, but deflating changes in the Community Charge in one year by changes in quantity which had taken place two years earlier might produce a perverse result. For example if a retrenchment in services were followed two years later by an increase in services then, under option (c), the price indicator for the Community Charge would be seriously overstated in the later year. The reverse effect would apply if there were an increase in services followed by a retrenchment. Over a run of years such distortions are likely to cancel one another out but for individual years the errors might be uncomfortably large.

Manpower

8. The second possibility considered by the Committee involved the use of manpower as a volume indicator. Manpower data are collected by the Local Authority Conditions of Service Advisory Board on a quarterly basis under the aegis of the Joint Manpower Watch. It would be possible to use the latest annual percentage change in manpower as a proxy quantity change, based on the aggregate number of full-time equivalent employees (excluding special employment and training measures). However, the figures cover all employees of each authority: it is not possible to split them into those working on trading services, council housing and general fund services. In addition, for contracted-out services there is no information on the numbers employed outside local authorities, even though Community Charge payers will meet the cost of these services. It would be difficult to make appropriate adjustments for these deficiencies of coverage. The use of manpower as a proxy quantity indicator would also ignore any changes in running expenses and other costs such as accommodation, transport and supplies. The evidence is that in recent years growth in manpower has been less than that in the quantity of inputs discussed in the previous section.

9. The latest information on manpower available in time for the April RPI is for December of the previous year, though this is subject to some revision. The latest final figures relate to December a year earlier.

10. To sum up, a problem common to both the options described above is that at the time when changes in the Community Charge are being taken into the RPI there will be no information on the precise level of services that will actually be provided to Community Charge payers. Proxy measures would have to be used instead. These proxies are imperfect and on occasion there are likely to be significant differences between them and the actual change in the provision of services.

11. Apart from this general difficulty each of the options raises specific problems. The expenditure method measures inputs rather than the outputs which are what the RPI is concerned with, and it could overstate Community Charge inflation if authorities were making efficiency or quality improvements. All the proxies are effectively *forecasts* of change, there are bound to be differ-

ences (which might be substantial) between forecasts and out-turns, and none of the ways which have been suggested for dealing with these discrepancies is wholly satisfactory. Also, because there is no realistic way of measuring quantity change for capital expenditure, the methods suggested would ignore this part of the Community Charge's coverage.

12. In addition to these difficulties the manpower option has the drawback of being based on only one of the various inputs to local authority services. The level of manpower can change, within a fixed total of inputs, as a result of substitution of bought-in services or goods.

13. It can be seen that each of the attempts to identify a proxy quantity effect for purposes of adjusting the RPI is open to serious practical objections. Against this background it was decided to recommend against the use of such proxies, at least for the foreseeable future.

## ANNEX D: WEIGHT AND PRICE INDICATOR FOR THE COMMUNITY CHARGE

Introduction

1. This annex sets out in more detail than is possible in the body of the report the method by which the weight and price indicator for the Community Charge will be calculated if the recommendations of the report are accepted.

2. The RPI is a weighted average of changes in the prices of practically all the items bought by index households for consumption. The weight attaching to any item is the average weekly expenditure on that item relative to the average weekly expenditure on all items, and is expressed in parts per thousand. For purposes of presentation the items are combined into sections (for example bread, beer and furniture) and the sections into groups (such as food, drink and household goods), each section and group having its own weight - the sum of the component item weights - and its own price index - the weighted average of the component item indices. In terms of index construction each item index is itself a weighted average of different price changes: for the various types and brands of that item, the various sorts of outlet in which it can be bought and the various parts of the country in which different prices might be charged.

3. At present local authority rates are a section of the index, with an overall weight of 43 parts per thousand and two component items: one for Great Britain and another for Northern Ireland. The index for Great Britain is a weighted average of changes in rate poundages across England, Scotland and Wales and it is proposed that the index for the Community Charge should be constructed in a similar way. As there will be a period when the Community Charge is in payment in Scotland but not in England and Wales these will be defined as separate items, for which separate indices will be calculated (but not published) and a separate item index will continue to be calculated (but again not published) for rates in Northern Ireland

The weight to be attached to the Community Charge index

4. This should be the average weekly expenditure of index households on the Community Charge (including the Standard and Collective Charges) as a proportion of their average expenditure on all items. It should be based, as for rates and almost everything else in the RPI, on the 12-month period ending in the middle of the previous calendar year, revalued to the price levels ruling in the latest January using the RPI component price index for the section in question.

5. The information required for weighting purposes will be obtainable from the Family Expenditure Survey. It will relate to liability to pay the Community Charge rather than actual payments, and be recorded before any allowance is made for rebates or concessions for which some Charge-payers will be eligible.

Price indicator

6. As stated in the report, changes in the Personal Community Charge per adult can be taken as the price indicator for changes in the Charge as a whole, including the Collective and Standard elements. In principle the indicator should be the average across all local authorities of the change in the Personal Charge per index household. Because the Charge is levied per eligible adult, *actual* payments per household may change slightly over time with changes in household composition. It would not be appropriate, however, for this to be reflected in the index. The appropriate "price" is the Charge per *household of fixed composition*, which is the same as the Charge per eligible adult.

7. Information will be available centrally each April about the average Personal Charge for all local authorities, on which the index for Great Britain can be based. Once information starts to become available from the Family Expenditure Survey it may be possible to take account of variations between areas in the proportion of eligible adults who are in index households. It is expected that the Community Charge will change only in April but, should adjustments take place in any other month, these will be treated in the same way.