

Prime Minister
You will wish to see. I have discussed all this with the Treasury.

As regards this page I gather the Chancellor feels the point of X is as regards
and I see no redrafting CONFIDENTIAL option to agree. As regards the
next page, ~~the~~ Y seems an important precedential point which, if you agree,

PRIME MINISTER we will raise with D/Employment, 28 February 1989

Rec 6 1/3

COMMUNITY CHARGE: IMPACT ON RETAIL PRICE INDEX

CF-P
no other advice.

Note

Norman Fowler wishes to announce on Friday the Government's acceptance of the RPI Advisory Committee's Report on including the community charge in the RPI; and to publish the Report.

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Y.

One sensitive issue arises on this which you may care to discuss with the Chancellor tomorrow. This is a once-for-all impact on the RPI in April 1990 of 0.2 percentage points, for reason of index methodology rather than prices as such.

Rec 6
4/3

The question is, whether seeking to remove this impact on measured inflation is outweighed by the obvious difficulty of the Government's disagreeing (for the first time) with a recommendation of the RPI Advisory Committee. But if the matter is not tackled, the Government could be open to the charge that the community charge is inflationary.

X

The Advisory Committee refers (para 71) to a "small increase" in the level of the index. This is given as 0.2 percentage points maximum in para 41. Department of Employment statisticians think this is a fair estimate, but obviously some uncertainty remains. This relates to England and Wales in April 1990: Scotland alone in April 1989 is not expected to have a measurable impact on the RPI.

The increase arises from the exclusion from the RPI calculations of expenditure by pensioner and top income households, because they can be expected to pay a smaller share of the cost of local authority services (para 64). This seems a rather spurious reason, especially given the effect on "inflation", and it is not explained very well at all in the Report. Para 65 in fact states that a minority of Committee Members thought that this approach was wrong,

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and that price indicators for the index should not be restricted to any particular sub-group of the population. This does not seem a very good basis for conceding increases in the RPI which would otherwise be unnecessary, however small.

There is also some bad drafting in para 63 concerning the "base price" in rates (in January 1990) against which the community charge impact in April will be measured. The statistical assumption is that total rates payable to local authorities in January will be the same as total community charge payable in April and thus neutral in impact on the RPI save any annual adjustment. But para 63 does not really say this but rather implies that the base would be lower than otherwise through averaging rate payments among all adults not just ratepayers. Hence the measured impact of the Community charge on inflation would be the greater.

Y/ For the avoidance of doubt it needs to be confirmed by Norman Fowler that the position on the "base price" calculation is totally neutral as far as the index is concerned, and he should be requested to ensure that the position is made absolutely clear on this in the Government's response so that para 63 is not exploited as a further, hidden "inflationary" factor. It would therefore be useful in view of the sensitivities to see Norman Fowler's draft announcement in advance.

JFM

JOHN MILLS

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