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Dear Barry

RETAIL PRICE INDEX

In your letter of 23 April, you asked the Chancellor's views on a number of issues related to the Community Charge and the RPI.

The Chancellor has reflected on this carefully. He thinks our main objective must be to achieve a Retail Price Index which does not have the disadvantages of the present index for economic policy purposes but which continues to command wide public acceptance. This will require good timing and finesse and the potential costs of launching an initiative which fails on either count are very great both politically and financially.

Against that background he has come reluctantly to the conclusion that it is too late now to affect the April RPI which is published in May. The statistical treatment follows the recommendations of the present RPIAC which have been accepted publicly by Ministers. So far as the reliefs are concerned, the CSO's interpretation (from which they will not budge) is that transitional relief and Community Charge rebates do not score for RPI purposes because they are subsidies to a selected group from a third party. More helpfully, the Revenue Support Grant and the Safety Net do bring about price reductions in the RPI. And the CSO have now recommended that we should include the effects of capping in the April index, even though the legislation enforcing it will not by then by enacted.

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In the absence of any change to the index, the Chancellor does not think a statement from Sir Jack Hibbert dissociating himself from the decision of the Government and the advice of the RPIAC would be helpful. There are two reasons for this. Firstly, the propriety of such a statement would undoubtedly be questioned. More important it would precipitate a major row especially if it were followed by a Government statement that the coverage of the RPI was to be changed. That would start the debate on the future of the RPI prematurely and in the wrong way. The pressure to announce the Government's intentions on the indexation of benefits and indexed gilts would be intense. Moreover, it would risk getting the timing wrong so that we suffer from the <u>inclusion</u> of the Community Charge this year but lose the <u>benefit</u> next year when measures are planned which should keep the Charge down.

The Chancellor's view is that our prime aim should be the removal of the mortgage interest rate from the RPI in such a way that there is general acceptance of what is done. <u>To do this he is convinced that the RPIAC must be changed</u>. He sees a natural opportunity to do this when the present RPIAC finishes its work programme. Sir Jack Hibbert has now agreed that the last meeting of the present Committee <u>will be on 1 June</u>. The way will then be clear to appoint an expert Committee composed of carefully selected professional statisticians and economists. Work on identifying members is in hand. This alone will create a huge fuss as special interest groups have been on the Committee since its inception and Age Concern were only added in 1988. But the Chancellor thinks we should be able to carry it off without damage to our credibility.

He thinks that the best time to make a move would be the late summer or autumn, leaving a clear gap from the old Committee. The new Committee would be charged with producing an index more in line with that of our European Community partners. The remit could thus embrace both the mortgage rate and the Community Charge.

The CSO are already doing some work on these lines. The likely timetable should mean that the results would come after the fall in the RPI headline figure that is likely to occur when both the Community Charge and the recent increase in mortgage rates go into the base for the purpose of 12 month comparisons.

Meanwhile, the Chancellor plans an intensive briefing effort to accompany the April RPI to stress that the Community Charge treatment is <u>illogical</u> and that the underlying inflation rate is being overstated. In this we should be able to draw on some very helpful comments which we expect to come from the Treasury Select

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Committee. We should wish to avoid any suggestion at this stage that we might not use the present index for indexation purposes. The costs that this could involve - £5 billion PSBR cost and £3 billion loss for the Exchequer for IGs alone - are simply unthinkable at present.

Yours

JSG.

JOHN GIEVE