

FROM: P N SEDGWICK
DATE: 19 SEPTEMBER 1988

CHANCELLOR

cc Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Edwards
Mr Peretz
Mr Hibberd
Miss O'mara
Mr Price
Ms Wheldon - Tsy
Solicitor

OK?
AA
OK
in yr.

RPI - ABOLITION OF DOMESTIC RATES

Mr Fowler wrote to you on Friday proposing that he should now issue formal invitations to members of the RPI Advisory Committee and as well send them terms of references mentioning domestic rates.

2. Mr Fowler asked for a reply within a week of sending his letter. As we are not likely to hear from the Bank within that period on the upshot of their fresh discussions with their lawyers I think that there is no point in delaying a response to Mr Fowler to the end of the week. I have recast the draft letter setting out your opposition to any explicit reference to abolition of rates (copy attached).

3. It is perhaps worth pointing out that the proposed inclusion of the price of foreign holidays in the RPI - something that has been mooted for a little while - would unambiguously involve a change of coverage of the RPI. It is one of the "long-term recommendations" in the last RPIAC report to which Mr Fowler refers in his letter. I attach a copy of the recommendations section of the last report with manuscript comments on progress with each item.

4. Information that we have received in confidence at official level suggests that Mr Fowler is not likely to respond in the foreseeable future to your letter of July 25 (copy attached) on the RPI and mortgage interest payments. I have added a short paragraph in square brackets in the draft letter in case you want to take the opportunity to remind Mr Fowler that he owes you a reply.

I raised this with Fowler's office last week & he is planning to send you a reply. But we need answers to get ahead with publishing

P. N. S.
P N SEDGWICK

RPI & MI ourselves

AA

Plene loge
for signature

DRAFT LETTER FROM THE CHANCELLOR
TO THE SECRETARY OF STATE FOR EMPLOYMENT

RPI - ABOLITION OF DOMESTIC RATES

Thank you for your letter of September 15, in which you propose sending out formal invitations to those who will serve on the RPI Advisory Committee. You also propose announcing terms of reference that explicitly state that the effect of the abolition of domestic rates should be on the RPIAC's agenda.]

While I entirely agree that you should now issue the formal invitations to those who will serve on the RPIAC, I cannot agree to publication of an agenda that explicitly refers to the abolition of domestic rates. As you know this whole subject gives rise to some serious and sensitive problems for us. I am afraid that we have not yet resolved these, though I hope that matters will be clarified in the next month, and before the RPIAC has its first meeting.

^{would} I have no objection in principle to ^{your announcing} ~~announcement~~ of the other items ^{on} ~~for~~ the agenda ~~that you mention in your letter~~. But given that we will want the Committee to concentrate in the first instance on the implications of the abolition of domestic rates ^{it seems more sensible} ~~you might prefer~~ to tell prospective members that the agenda will be circulated with a paper before the first meeting. By that time we should have completed our initial discussions within ~~central~~ government.

PP I believe it would be very dangerous to announce that we wish the Committee to consider whether or not the comments charge shall be included in the RPI before we have established a common position with the Government. We would immediately be faced by all sorts of lobbying and it would be almost impossible to avoid comment.

CONFIDENTIAL

[Another matter of considerable current sensitivity relating to the RPI is the treatment of mortgage interest payments in a way that few other countries follow. In my letter to you of July 25 I suggested that we should make public the figures for the RPI less mortgage interest payments as well as those for the total RPI, numbers that commentators have great difficulty obtaining. If anything I feel even more strongly about this than I did in July, and look forward to hearing from you on it.]

I am copying this letter to the Prime Minister, the Secretaries of State for the Environment, Health, ~~and~~ Social Security, and ^{Scotland, and} ~~the Scottish Office as well as~~ to Sir Robin Butler and the Head of the Government Statistical Service.

[N L]

DEF V I



Sir T Burns
Mr Sedgwick
Mr Gieve
Mr P F L Allum
Mr S J Davies
Mr Matthews
Mr S Brooks

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Mr S P.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

25 July 1988

The Rt Hon Norman Fowler MP
Secretary of State for Employment
Department of Employment
Caxton House
Tothill Street
LONDON
SW1H 9NA

THE RPI AND MORTGAGE INTEREST PAYMENTS

We had a word about this recently, and you agreed to look again at publishing figures for the RPI excluding mortgage interest payments alongside the other material you publish.

... You may remember that I raised this with you a year ago, and gave you the attached note. We are certainly not seeking to do this for short-term reasons now that the mortgage rate has gone up: we have been pressing this for years! And we are not suggesting re-opening the composition of the RPI itself, simply that the figures for the RPI excluding mortgage interest payments should be made more widely available.

We have consistently used the RPI excluding mortgage interest payments in our briefing, but it is a source of considerable frustration to many of our customers that it is almost impossible for them to get hold of this information regularly, since it is not in the official statistics. I am sure it should be.

NIGEL LAWSON

Principal recommendations

9. We now summarise briefly our main recommendations for change, leaving to later sections of this report discussion of the considerations we took into account in reaching our collective view. They fall into two groups: those we would wish to see implemented as from the beginning of 1987 and those for which we recognise that further work and feasibility testing are required before implementation can take place. The recommendations for implementation from the beginning of 1987 are:

- (a) The RPI should be re-referenced to 100 and the compilation of regular time series on the present base discontinued once the index for January 1987 has been published. This would have no material effect upon the percentage changes shown by the index. (See Section A.)
- (b) The definition of the "index households" covered by the RPI should be adjusted so as to exclude those households with the highest incomes, as opposed to the present convention of excluding those whose heads of household have the highest incomes. The cut-off point should be set so as to continue to exclude about 4 per cent of households at the upper end of the income distribution. (See Section C.)
- (c) The special price indices for pensioner households with low incomes should be continued and, where relevant, all the changes recommended for the general index should be applied to them. (See Section D.)
- (d) The structure of published component indices below the "all items" RPI should be recast in the way shown in Annex 1 of this report. (See Section E.)
- (e) The general aim should be to publish indices for all categories of expenditure having a weight of 5 or more parts per thousand in the general index, and for any others which are of general interest, subject to their being of sufficient reliability. As regards indices for smaller categories which are not of general interest, the Department of Employment should be prepared to release these to particular users provided the reliability criterion is satisfied. (See Section E.)
- (f) If the recommendations in this report are accepted the Department of Employment should publish at the time of implementation a succinct and authoritative statement of the principles and concepts underlying the construction of the RPI, as laid down by ourselves and our predecessors. (See Section E.)
- (g) The RPI should be based on prices charged. In establishing the prices charged subsidies and discounts should be deducted where they are funded by the seller, or where they are available to all purchasers, but not in the case of selective benefits funded by a third party. (See Section F.)
- (h) Mortgage interest payments should continue to be in the index as a proxy for the housing costs of owner-occupiers (other than rates, repairs, etc which are separately covered). Changes in the weight attached to mortgage interest payments (in relation to other goods and services in the RPI) should reflect changes in house prices, interest rates and the extent of owner-occupation (as opposed to the actual amount of mortgage debt). Both the price indicator and the weight should be based on a standardised mortgage, so limiting the effect of changes in financial arrangements. (See Section G.)
- (j) The range of price indicators for fruit and vegetables should be extended to cover more items, including some which are not available throughout the year. The use of variable monthly weights for fruit and vegetables should be continued for fresh produce, but not for processed items. (See Section H.)
- (k) For RPI items where problems are caused by articles selected for pricing becoming unavailable the Department should experiment with the collection at the beginning of each year of quotations for additional items, which would not be followed up in subsequent months unless the original article became unavailable, in which case the "reserve" could be substituted in order to provide a direct "like with like" comparison. (See Section J.)

RECOMMENDATION

OF 1986

RPI AC.

Fully implemented.

Fully implemented.

Fully implemented.

Fully implemented.

Accepted as standard practice.

Fully implemented.

Fully implemented.

Fully implemented.

Fully implemented.

Has been attempted, but with limited success.

- (l) Where prices do not change from month to month but are charged for a period of time (such as rates and electricity charges) any adjustments which are announced after the start of the period should be taken into the index at the earliest opportunity. No allowance should be made to compensate for their previous exclusion. (See Section K.)

Fully implemented.

10. We recommend the following changes for implementation as soon as possible after the foregoing proposals have been put into effect at the beginning of 1987:

- (m) The RPI should be extended to cover certain types of expenditure not currently included, notably holiday accommodation and package holidays, various fees and subscriptions paid by consumers, the prices of financial services (but not of credit as such) and some other small items. The objective should be to introduce appropriate price indicators for each of these, and for items which are currently covered only by somewhat unsatisfactory proxy measures (most notably new cars). (See Section B.)
- (n) Regular indices should not be produced for any individual type of household other than low-income pensioners but the Department of Employment should revive its past practice of periodically carrying out and publishing historical analyses of the impact of price changes on different household types. It should also make available to outside users the information they would need to construct their own price indices on alternative bases. (See Section D.)
- (p) A technical manual describing in detail the sources and methods used in constructing the RPI should be published. (See Section E.)
- (q) The Department should seek to divide the range of articles used for pricing into "specification bands" grouping together those with similar characteristics. Differences between the average price levels of these bands should be taken as indicating the value of the quality difference between them, which should then be discounted when an article from one band has to be replaced by one from another because it is impossible to make a direct comparison with a January "base price". (See Section J.)
- (r) The Department should seek ways of obtaining from the Family Expenditure Survey (FES) information classified by type of retail outlet, to provide a sound basis for the "stratification" of price quotations collected for the RPI. In the meanwhile the existing "stratification weights" should be kept as up-to-date as possible using statistics of retail sales. (See Section L.)
- (s) The Department should also pursue the possibility of extending the record-keeping period used in the FES, particularly for those items for which large sampling errors make it necessary to base RPI weights on three years' data. The aim should be to base all the RPI weights on the latest available 12-month period. (See Section L.)

This is the main outstanding issue; some fees and subscriptions now included.

Has not been seriously implemented.

Not implemented.

Has been attempted, but without a practical payoff.

Work still continues on methodology: not yet implemented.

Work still continues on methodology: not yet implemented.

11. Finally we suggest that the Advisory Committee should be convened more frequently in future than in the past, and consulted on any significant proposals for changing the coverage and construction of the RPI. It might also be helpful if certain of our members—in particular those who have served on the Technical Working Party—were to be consulted on matters of statistical methodology as and when these arise, without waiting for a formal meeting of the Committee to be arranged.