Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

THE NEW TAX AND PRICE INDEX (TPI)

The final stage of the work has now been done. The figures which are shown at Annex 1 attached are in the form in which they would be published, subject to final checking. The figures in square brackets are for your information; they would not be published on 17th August.

The Calculations

2. You will be familiar with the main features of the new index and the broad principles underlying its calculation. These questions were discussed in my minute of 25th July. The calculations which officials have now completed produce a composite index which, like the RPI, reflects what is happening on average to all (tax paying) households. The previous figures related to specimen households (for example, a married couple on average earnings with two children). The figures which have now been calculated go back by months to January 1977, so that year-on-year changes in the index are available from January 1978 onwards.

3. The calculations show two important points. First, (this was also a feature of the specimen calculations submitted earlier) the year-on-year percentage changes in the TPI over the period covered are consistently below the corresponding changes in the RPI. Over the 12 months from July 1979 onwards, the TPI shows year-on-year changes some 2-3 percentage points below the RPI. However, going back before the General Election, the 'gap' between year-on-year changes in the two indices becomes even larger. This reflects the very large direct tax reductions introduced by the previous

except for March-June 1979

Government in October 1977 and April 1978. In time, figures going back to 1974 will be calculated and published. We would then have something which covered the whole period of the last Administration, revealing what happened to the TPI when direct taxes were raised in the early years, as well as what happened to it when they were reduced in the later years. Meanwhile, we will not release the 1977 figures; this will avoid revealing the year-on-year figures for 1978.

4. Secondly, the TPI increases marginally in July, compared with June (on present estimates of next week's figures for the RPI). This does not imply that the Budget changes have made people worse off, but that there is a substantial underlying rise in the July RPI (of the order of 1½%), independent of the VAT and other indirect tax changes. Even for this month the TPI rises significantly (2.6 per cent) less than the RPI, which is its main purpose.

Competing Indices

5. Since the last submission, both the Institute of Fiscal Studies and Lloyds Bank have produced versions of their own. While both are similar to the TPI, there are deficiencies in both of them. There would not be any difficulty in demonstrating the superiority of our own. As others have published their indices, we should go ahead with our own.

Presentation

6. The new index will need to be presented carefully. There is great public interest in it and a Ministerial launch is appropriate. The Financial Secretary is ready to hold a press conference on 17th August, when the July RPI (the first one to reflect the Budget measures) is published. A full technical exposition of the new index will be available to the public.

7. If the Government goes ahead, Ministers will want to refer to the new index in their speeches. But as Keith Joseph points out, it is most important that it should not be used as a starting point for wage bargaining. The TPI may be less "inflationary" for pay bargains than the RPI - but it is still not the right guide. Pay must depend primarily on production and performance subject always to money supply and cash limits. But the new index can help to de-throne the RPI.

8. Rising press and public interest in the new index makes it desirable to take a decision very soon on whether or not to go ahead. The arguments are not all one way. But I believe it would be right to go ahead.

9. I am copying this to the members of 'E' Committee, to Patrick Jenkin, and Sir John Hunt.

M Bassinni

P.P. (G.H.)

9th August 1979

[Approved by the Chancellor of the Exchequer and signed in his absence]

CONFIDENTIAL

ANNEX 1. COMPARISON OF TPI AND RPI, 1978-80

[PROVISIONAL - SUBJECT TO CHECKING]

Figures in square brackets would not be published on 17 August

		TPI 1978=100	TPI % change on year earlier	RPI 1978=100	RPI % change on year earlier
1978	J	100	[4.9]	100	9.9
	F	100.7	[4.5]	100.6	9.5
	M	101.5	[4.1]	101.2	9.1
	A	98.4	[2.1]	102.7	7.9
	M	99.0	[1.7]	103.3	7.7
	J	100.0	[1.5]	104.1	7.4
	J	100.5	[1.9]	104.6	7.8
	A	101.3	[2.1]	105.2	8.0
	S	101.8	[1.9]	105.6	7.8
	O	102.4	[4.4]	106.1	7.8
	N	103.2	[4.6]	106.8	8.1
	D	104.3	[5.0]	107.8	8.4
1979	J	106.1	6.1	109.3	9.3
	F	107.2	6.5	110.2	9.6
	M	108.2	6.6	111.1	9.8
	A	110.5	(12.3)	113.0	10.1
	M	111.6	(12.7)	113.9	10.3
	J	113.8	(13.8)	115.9	11.4
	J (estimate)	113.9	13.3	121.1	15.9
	A (estimate)	[114.6]	[13.1]	[121.6]	[15.6]
1979	Q3 (forecast)	[115.4]	[14.0]	[122.4]	[16.4]
	4 (forecast)	[119.3]	[15.5]	[125.9]	[17.7]
1980	Q1 (forecast)	[122.5]	[14.3]	[128.8]	[16.8]
	2 (forecast)	[124.8]	[(11.5)]	[135.2]	[18.3]
	3 (forecast)	[129.4]	[12.1]	[138.8]	[13.5]

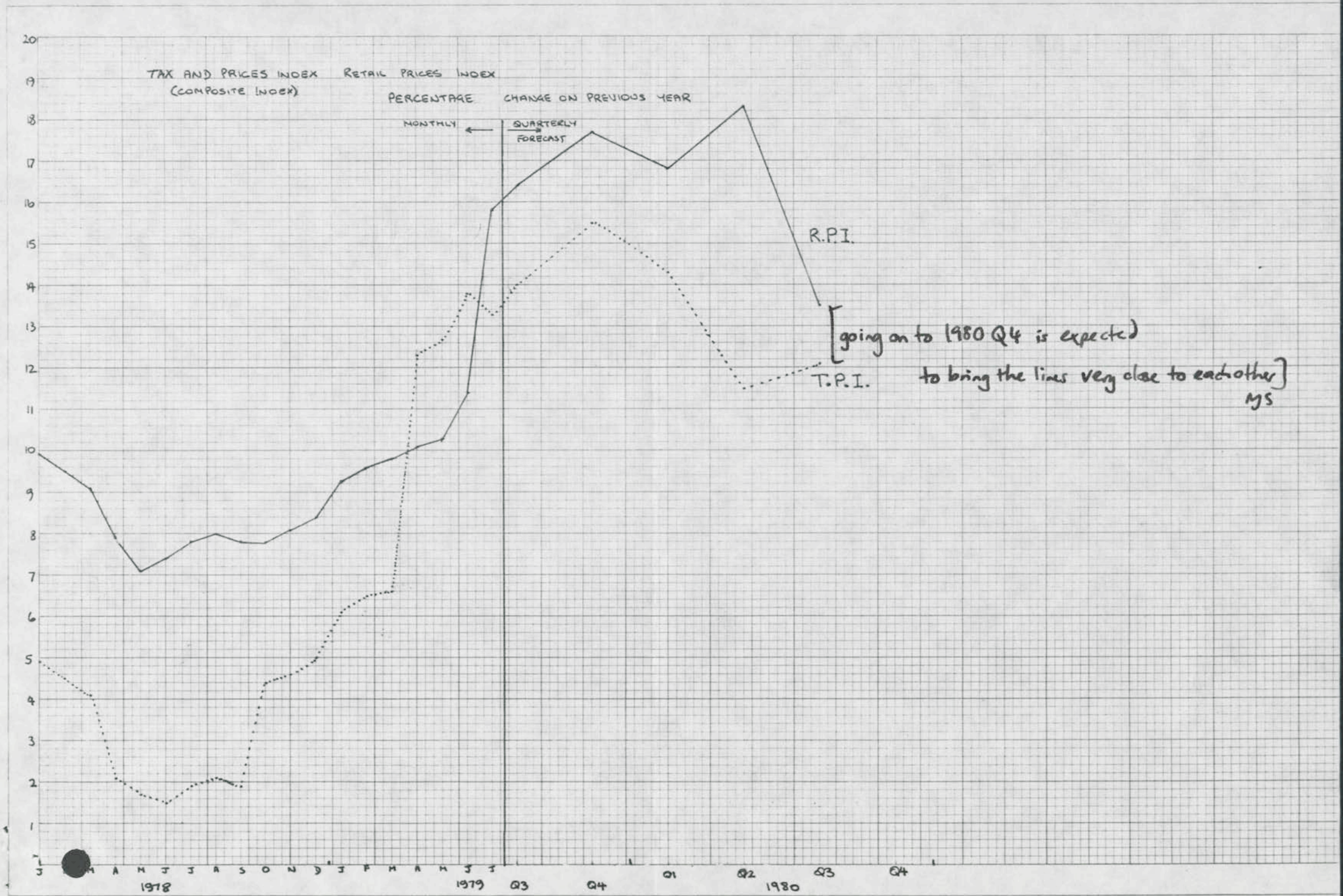
(a) The RPI figures for July and August 1979 are based on DE estimates. The quarterlyforecasts to 1980 Q3 are based on the figures published in the FSBR.

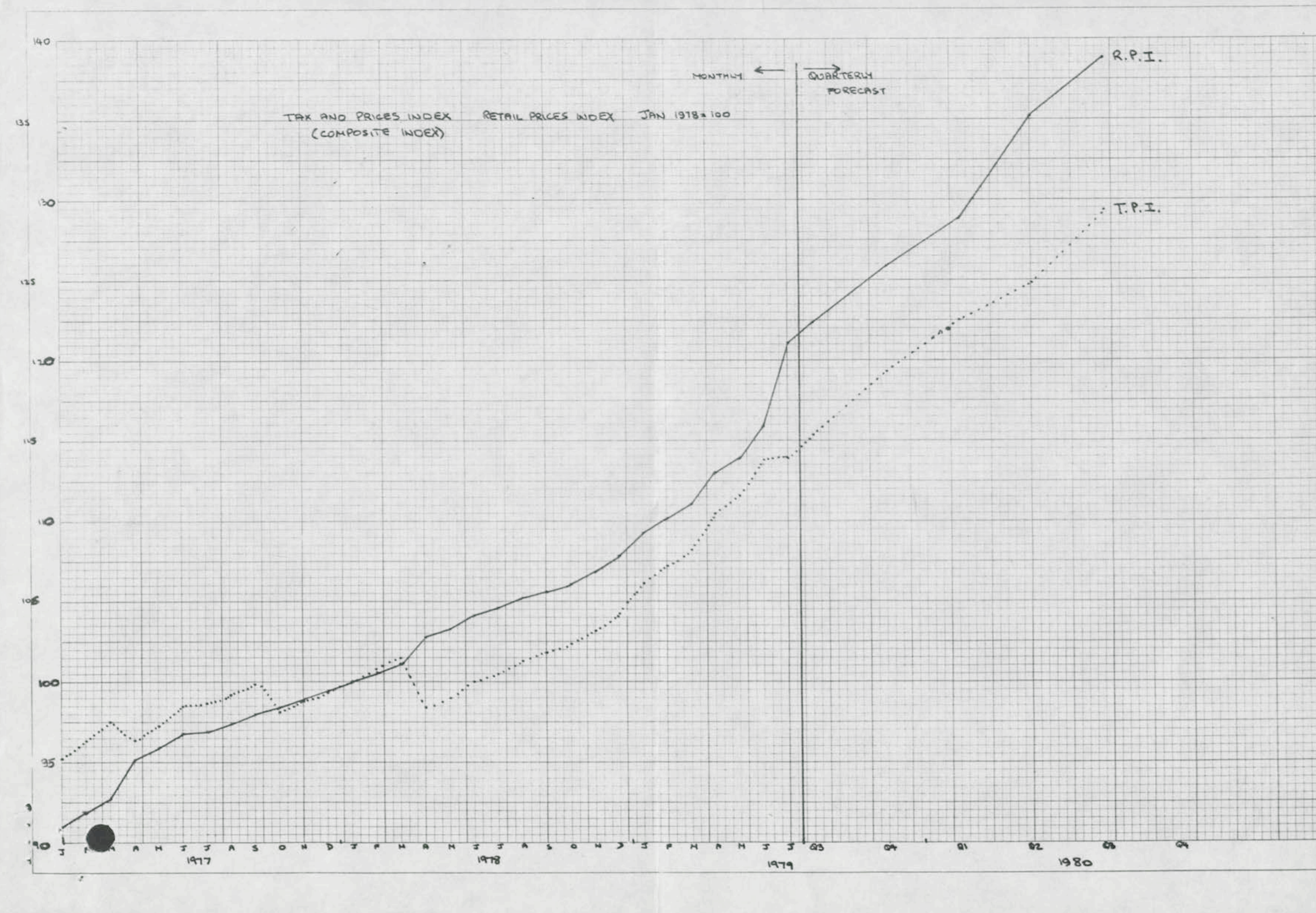
see also the notes overleaf

Annex 1 - contd. 2

(b) The figures for April, May and June 1979, and for Q.2 1980 have been put in parentheses because of the "peculiarities" introduced into the year-on-year figures by the fact that the 1979 Budget was in June rather than in April. The April, May, June 1979 figures are "artificially" high because they take no account of the 1979 Budget; the Q.2 1980 figure is "artificially" low for the same reason, namely the high TPI in Q.2 1979.

(c) The 1980 Budget is assumed to revalorise the main allowances by 17.5%. The effect of this Budget on the TPI is to reduce it by about 5 percentage points on what it would otherwise have shown.


TAX AND PRICES INDEX (COMPOSITE INDEX)
RETAIL PRICES INDEX
PERCENTAGE CHANGE ON PREVIOUS YEAR
MONTHLY
QUARTERLY FORECAST
R.P.I.
T.P.I.
[going on to 1980 Q4 is expected to bring the lines very close to eachother]
MJS
20
19
18
17
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
J F M A M J J A S O N D J F M A M J J
1978
1979
Q3
Q4
Q1
Q2
Q3
Q4
1980


TAX AND PRICES INDEX
(COMPOSITE INDEX)
RETAIL PRICES INDEX
JAN 1978 = 100
MONTHLY
QUARTERLY
FORECAST
R.P.I.
T.P.I.
140
135
130
125
120
115
110
105
100
95
90
1977
1978
1979
1980
Q3
Q4
Q1
Q2
Q3
Q4