



Submission to the Australian Bureau of Statistics
on the 13th review of the Consumer Price Index

July 1997

ACOSS appreciates the opportunity to participate in this review and wishes to make the following responses to key questions raised in the Information Paper.

I. Principal purpose of the CPI

We consider that the principle purpose of the CPI should be to provide timely information on changes in the living costs of Australian households, as distinct from a broader measure of inflation. This implies that the CPI should be calculated on a outlays basis rather than an acquisitions basis.

We argue this on two grounds:

First, the CPI is widely used for income adjustment purposes, and a fundamental change in the basis for its calculation would generate confusion and potentially undermine the credibility of the present indexation arrangements for government income support payments.

Most income support payments are indexed in accordance with movements in the CPI, and approximately one third of the Australian population relies mainly on these payments for their income.

Although the government has submitted legislation which would tie pension rates to movements in average weekly male earnings, it is important to note that this would occur *in conjunction with* 6 monthly indexation based on movements in the CPI. The practical effect of the legislation would be to ensure that pensions were increased on an irregular basis at times when movements in average earnings significantly exceed movements in the CPI.

If the CPI no longer reflected actual movements in actual costs of living, then the validity of indexing income support payments to the CPI would be widely, and legitimately questioned. One solution to this problem would be to continue to produce the present CPI under another name, as a supplementary index for income adjustment purposes only. However, this could also undermine the credibility of the indexation process, as key interests might question why income support payments are not indexed according to movements in the principal measure of inflation. At best, it would lead to confusion among income support recipients, and to claims for higher increases to the extent that the "principle measure of inflation" is higher than the index used for income adjustment purposes.

Furthermore, we are not convinced by arguments that the CPI has to a large extent lost its relevance as a means of adjusting wages. It is still a significant factor in the calculation of Safety Net Adjustments. In addition, it is very likely that participants in enterprise bargaining factor movements in the CPI into their negotiations.

Second, a broader measure of inflation that does not accurately track actual movements in the costs facing households could not legitimately be used for income adjustment purposes. This is an extension of the first argument.

It is argued in the Treasury submission that:

“To the extent that the aggregate outlays CPI remains a factor in informal indexation of wages and other contracts in the economy, a tightening of monetary policy to pre-empt inflation pressures may itself - in the first instance - lead to some higher wage claims.”

(Treasury submission. page 10)

This would presumably occur because the CPI includes interest payments, especially home mortgage interest payments, and these payments would increase in step with any substantial tightening of monetary policy.

However, to the extent that wages do increase in response to monetary tightening, this is due to the impact of actual increases in the costs facing wage-earners, not the choice of instruments used to measure them.

It follows that simply changing the basis for measurement of the cost of living (or moving towards a broader measure of inflation) will not resolve the underlying policy problem identified in the Treasury submission. To the extent that the CPI fails to take factors such as interest payments into account, it will simply lose credibility as a measure of changes in the costs of living, and wage earners will rely on alternative measures.

These problems would be amplified if a change to an acquisitions basis were introduced at the bottom of the interest rate cycle. If introduced at this time, a “new” CPI which excluded mortgage interest payments would probably be consistently lower for a number of years than one calculated on an outlays basis (including mortgage interest payments).

For the above reasons, ACOSS considers that the CPI should continue to be calculated on an outlays basis. There may also be value in publishing, alongside the CPI, a broader measure of inflation which is calculated on an acquisitions basis. However, it should be made clear that the latter is not a measure of changes in the cost of living of Australian households.

2. Frequency of compilation

While we acknowledge the potential benefits of a monthly CPI publication, this would be a costly option, and we would not give this a high priority by comparison with other enhancements.

3. Population and regional coverage

ACOSS supports the option of extending the population coverage of the CPI to all households, on the grounds that this would:

- better reflect the important role the index plays in adjusting income support payments;
- ease distortions arising from the present focus on wage and salary earners, in particular the greater weight this places on mortgage interest payments.

Another issue for consideration is the proposal, which emerged from some of the consultations, for a separate index for pensioner households or income support recipients.

Notwithstanding our comments in favour of an outlays approach to constructing the CPI, it is likely that an index which excludes home loan interest payments would more accurately reflect movements in the cost of living of most income support recipients. This is because the majority of income support recipients are not home purchasers.

However, the use of a separate index (or indices) to adjust income support payments poses serious conceptual and practical problems.

The main conceptual problem is that it would be very difficult to construct an index that represents the diverse circumstances of pensioners and other income support recipients. It is likely, for example, that an index which is appropriate for families with children would not be appropriate for an age pensioner household. There are also likely to be significant differences in household expenditure patterns among retirees of different ages and income levels.

This gives rise to a major practical problem. Income support payments for a diverse range of households are linked through a series of statutory benchmarks. For example, Family Payment rates for low income households with children are linked to the married rate of pension. For important social policy and equity reasons, these relativities should not be disturbed once they are established on a robust and equitable basis. Adjusting income support payments according to separate indices for different groups would disrupt these relativities.

On the other hand, a single index based on the expenditure patterns of a particular group (such as age pensioners), or all income support recipients, would not accurately reflect the diversity of circumstances of all income support recipients.

Under these circumstances, an index which represents changes in the cost of living of *all* Australian households is a more appropriate, and probably more acceptable basis for the adjustment of income support payments than a separate index for income support recipients or a series of separate indices for specific groups of recipients.

However, it is important for social policy purposes (including the adjustment of income support payments) to test the sensitivity of a broadly based CPI to movements in the cost of living of particular groups.

We therefore propose that the ABS continue to produce experimental indices such as that relating to the cost of living of pensioners. A further option for consideration is to publish, on an irregular basis, experimental indices for each of the following major life cycle groups¹:

- lone person, under 35 years
- couple only, reference person under 35 years
- couple with dependent children
- sole parent
- lone person above pensionable age
- couple only, above pensionable age

ACOSS does not have a strong view on the desirability or otherwise of extending the coverage of the CPI to households living outside major capital cities. We note the comments in the information paper that the inclusion of these areas may not make a substantial difference to overall movements in the index.

4. Commodity classification and item coverage

ACOSS supports suggestions that the CPI be extended to include home computer equipment, financial charges, tertiary education fees, and domestic and home care services.

The ABS should closely track the emergence and growth of user charges for community services (for example, home care services), as these charges are likely to form an increasing proportion of household expenditures in coming years. Moreover, the movement towards user charges raises important issues for public policy, especially with regard to its distributional effects. Accurate data on the changing impact of these user charges on the cost of living of households would inform debate on these issues.

With regard to financial charges, ACOSS considers that housing loan interest payments should continue to separately classified, at least for the time being. This is important for the purpose of clearly identifying changes in the cost of housing, in view of Australia's relatively high home ownership rate.

5. State and local government charges

We support the continuation of a separate index of movements in the cost of state and local public utilities, but consider that its scope should be changed. Given that some public utilities have been privatised, it makes sense to develop an index covering movements in prices charged by both public and private utilities. This would assist in assessing the impact on consumers of policies with regard to privatisation of utilities, and the various systems of public regulation of fees and charges.

Consideration should also be given to the future inclusion of Federal government utilities, and to the development of an index of movements in prices in fees and charges for community services such as health, education and social welfare services.

¹ This is similar to the list of life cycle groups in table 42 of the 1993-94 Household Expenditure Survey.