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11 March 2010

The Director
Prices Development, Economic Analysis and Reporting Branch
Australian Bureau of Statistics
PO Box 10
BELCONNEN ACT 2616

Dear Sir,

Please find attached the submission from the Superannuated Commonwealth Officer's Association (SCOA) to the 16th Series Australian Consumer Price Index Review.

Please direct any queries to Dr Annette Barbetti on (02) 6241 4579, or mobile 0407 262 404.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'Marita Linkson'.

Marita Linkson
Federal Secretary



Superannuated Commonwealth Officers' Association

Submission to 16th Series Consumer Price Index (CPI) Review



Building a secure retirement

Superannuated Commonwealth Officers' Association

The Superannuated Commonwealth Officers' Association (SCOA) is a not-for-profit member organisation which represents close to 500,000¹ people nationwide.

For more than 85 years, SCOA has been representing the interests of:

- Retired Australian and Territory Government employees and Government business enterprise employees;
- People in the public service who will receive a Commonwealth superannuation benefit or lump sum on retirement;
- Former employees who have deferred (preserved) their pension entitlement; and
- The dependants of all of the above.

SCOA aims to enhance the welfare of former Australian government employees and their dependants by pursuing favourable outcomes for members in areas such as indexation of pensions, taxation issues and legislative reform, and by enhancing relationships with relevant organisations such as ComSuper, the CPSU, and other public sector and retiree organisations.

SCOA has branches in each Australian State and the Australian Capital Territory and is managed nationally by a Federal Council with representation from each branch. Secretariat and operational support is provided by a Federal Office in Canberra, ACT.

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¹ Includes Commonwealth CSS, PSS, PSSap, 1922 and PNG scheme members who are contributors, have preserved benefits or are receiving a Commonwealth superannuation pension as at 30/06/09 (Source: ComSuper Annual Report 2008/09).

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Summary of Recommendations

SCOA has made thirteen recommendations, which are listed below.

- Recommendation 1.** The ABS should compile a separate measure of increase in the real world cost of living.
- Recommendation 2.** Legislation to ensure that Centrelink pensions and Commonwealth civilian and military pensions maintain purchasing power over time.
- Recommendation 3.** The ABS should explain adequately the purposes to which its price indexes are suited.
- Recommendation 4.** The principal purpose of the 16th Series CPI should continue to be as a measure of price inflation, to be used for macroeconomic policy purposes and for international comparisons.
- Recommendation 5.** SCOA believes that increasing the geographic coverage of the CPI should be accorded a higher priority than a monthly CPI.
- Recommendation 6.** SCOA recommends that the ABS conduct further investigation of the treatment of deposit and loan facilities in order to develop a more robust estimation method.
- Recommendation 7.** SCOA recommends that the ABS conduct further investigation into the treatment of computers in the CPI.
- Recommendation 8.** SCOA recommends three-yearly Household Expenditure Surveys and three-yearly updates of expenditure class weights.
- Recommendation 9.** SCOA recommends that the ABS explain to the public how it deals with major improvements in commonly purchased products, such as mobile phones, including providing examples.
- Recommendation 10.** SCOA supports the inclusion of more services in the CPI.
- Recommendation 11.** The ABS should record information about all price adjustments for quality improvement, including the reason for the adjustment and the percentage adjustment, and make such information publicly available.
- Recommendation 12.** SCOA recommends that in future the Alternative Living Cost Indexes be based on the proposed real world cost of living index described in SCOA's first recommendation.
- Recommendation 13.** SCOA recommends that the ABS should provide more information about how to use the Alternative Living Cost Indexes in an appropriate manner.

Recommendations & Rationales

1. A Separate Measure of Increase in the Real World Cost of Living

Since the 1970s, it has become increasingly apparent that the Australian CPI, a measure of price inflation, consistently understates the size of increases in the real world cost of living. SCOA believes that, while adjusting for quality improvement may be appropriate in a measure of price inflation, it is not appropriate in a measure of cost of living, because the items in the reference basket should correspond to goods and services that are actually available in the market place. SCOA is also concerned that in some cases consumers think that the so-called improvements are not improvements at all. For example, a major car manufacturer recently started selling cars with a new “improved” brake lining that produced no discernable improvement in performance and lasted only half as long as the previous type.

Recommendation 1:

The ABS should compile a separate measure of increase in the real world cost of living. SCOA recommends that the ABS compile a quarterly real world cost of living index, using the outlays approach, that does not adjust prices for quality improvements, only for quantity changes (such as smaller bars of chocolate at the same price). Such an index would be a real world cost of living index. A real world cost of living index would be a more suitable index for pensions, since it would preserve the purchasing power of the pension over time, which the CPI does not. In particular, it would be a more suitable index for Centrelink pensions, such as the disability pension, and defined benefit pensions such as the pensions of Commonwealth civilian and military superannuants.

2. Legislation to ensure that Centrelink pensions and Commonwealth civilian and military pensions maintain purchasing power over time.

Recommendation 2:

Once the recommended real world cost of living index has been implemented, the Government should legislate to ensure that Centrelink, military and civilian pensions maintain their purchasing power, by adopting that measure or a suitable alternative living cost index that uses real world prices, without quality adjustment.

3. Adequate Explanation of the Purposes to which Each Price Index is Suited

The ABS has consistently failed to provide an adequate explanation of the fact that the Australian CPI, a measure of price inflation, consistently understates the size of increases in the real world cost of living. Even some senior bureaucrats and politicians have failed to understand that. It is not surprising, therefore, that most members of the public are also unaware of it. However, people on CPI-indexed pensions soon become acutely aware of it. In the real world, people buy real things. Often they can no longer buy the earlier, less advanced versions of existing goods and services in the standard CPI basket of goods and services. They can only buy the goods and services that are available now (e.g. cars with airbags, 3G mobile phones, etc.).

Recommendation 3:

The ABS should explain adequately the purposes to which its price and cost of living indexes are suited. In particular, the ABS should explain more clearly that the CPI, a measure of price inflation, should be used only as a measure of price inflation for macroeconomic policy purposes and for international comparisons. It should explain that a general measure of price inflation is not a suitable index for any cost of living adjustments, and that it is particularly unsuitable for maintaining the purchasing power of a pension over a period of many years, as is the case for Centrelink benefits or military or civilian superannuation pensions.

4. Principal Purpose of the CPI

The 15th Series CPI is a general measure of price inflation of goods and services used by households. It is needed for macroeconomic policy purposes and for making international comparisons. SCOA agrees that the 16th Series CPI should retain that role.

Recommendation 4:

The principal purpose of the 16th Series CPI should continue to be as a measure of price inflation, to be used for macroeconomic policy purposes and for international comparisons.

5. Increase the Geographic Coverage Rather Than the Frequency of the CPI

SCOA believes that the geographical coverage of the CPI should be improved so that the Australian CPI can be compiled and released for major regions outside the eight capital cities. Examples of suitable regions would be the whole of Tasmania, and major regions of the larger States. Improving the geographical coverage of the Australian CPI would allow more adequate measurement of price rises due to increases in fuel prices than by restricting coverage to the capital cities. In addition, regional CPIs could be used to adjust zone allowances to encourage more people to move to regional areas where there are currently staff shortages.

SCOA believes that a quarterly CPI is adequate in times of comparatively low inflation like the present.

Recommendation 5:

SCOA believes that increasing the geographic coverage of the CPI should be accorded a higher priority than a monthly CPI.

6. Treatment of Financial Services Paid For Indirectly (FISIM) in the CPI

FISIM (deposit and loan facilities) makes up nearly half of the financial services component of the CPI. SCOA believes that the inclusion in the CPI of financial services paid for indirectly via interest margins is inappropriate because Australia has a very small bond market and it is therefore difficult to obtain a suitable reference rate. At present the ABS says that the reference rate is half way between the interest rate on deposits and the interest rate on loans – is that a valid assumption? In addition, SCOA does not understand how the consumption of FISIM by households can be estimated with any degree of accuracy, since it is often difficult to determine whether a particular loan is for household or business purposes. Given the relatively high weight given to this component (relative to the weight of similar components in other countries) and its observed volatility since the Global Financial Crisis, SCOA believes that it definitely needs further investigation.

Recommendation 6:

SCOA recommends that the ABS conduct further investigation of the treatment of deposit and loan facilities in order to develop a more robust estimation method.

7. Treatment of Computers in the CPI

Computers were added to the reference basket with the introduction of the 15th Series CPI. SCOA believes that computers are undoubtedly a significant expenditure item by household consumers and must be included in the basket. However, there may be problems associated with the reporting of purchases of these items. Some of the purchases of computers reported in the household survey

may really be for use in paid work, leading to too high a weight for computers in the CPI, and prices may have been discounted too aggressively for quality improvements claimed by manufacturers.

Recommendation 7:

SCOA recommends that the ABS conduct further investigation into the treatment of computers in the CPI.

8. Frequency of Expenditure Class Weight Updates

The present six-yearly updates mean that in the final year of the cycle, the CPI weights are based on expenditure data that are six years out-of-date. With the rapid changes in consumption patterns occurring at the present time and the ageing of the population, SCOA believes that a three-yearly frequency of expenditure class updates would be preferable. There would then be less need for the use of alternative weight sources between updates.

Recommendation 8:

SCOA recommends three-yearly Household Expenditure Surveys and three-yearly updates of expenditure class weights.

9. Introduction of New Products and Services

There is apparently no internationally recognised set of rules for deciding whether a product or service is a new item or an improved existing one.

Recommendation 9:

SCOA recommends that the ABS explain to the public how it deals with major improvements in commonly purchased products, such as mobile phones, and give examples. For example, will the proposed 4G phones be treated as improved 3G phones, or as a new item?

10. Inclusion of Additional Services in the CPI

SCOA supports the inclusion of services used by households in the CPI except for those services that are too difficult to measure with any degree of accuracy.

Recommendation 10:

SCOA supports the inclusion of more services in the CPI.

11. More Information about Adjustment for Quality Improvement

There is a need for greater transparency in this area. Very little information is available about how much the observed prices of items such as cars and computers are discounted for quality improvement. The lack of information has led to some public disquiet and unwarranted allegations of political interference in the compilation of the CPI.

Recommendation 11:

The ABS should record information about all price adjustments for quality improvement, including the reason for the adjustment and the percentage adjustment, and make such information publicly available.

12. Alternative Living Cost Indexes

SCOA believes that the Alternative Living Cost Indexes (ALCIs) produced by the ABS are not true cost of living indexes. This is because, although they use the outlays approach rather than the acquisitions approach, they use prices that have been adjusted for quality improvement, which is not appropriate in a true cost of living measure.

Recommendation 12:

SCOA recommends that in future the Alternative Living Cost Indexes be based on the proposed real world cost of living index described in SCOAs first recommendation.

13. Uses of Alternative Living Cost Indexes (ALCIs)

The correct ALCI for indexing a pension is the ALCI based on the expenditure for that particular sub-group of the population. The ABS should make that quite clear to users. For example, it would have been preferable to use the Age Pensioner ALCI rather than the broader based Pensioner and Beneficiary Living Cost Index (PBLCI) in the indexation of the Age Pension. Was the Government aware of that, or did they just go for the cheaper option? Similarly, the Department of Finance claims that increases in the living costs of Commonwealth military and civilian superannuants are best measured using the self-funded retiree ALCI, whereas the majority of those superannuants already receive a part Age pension and therefore the Age pensioner ALCI would be more appropriate.

Recommendation 13:

SCOA recommends that the ABS should provide more information about how to use the Alternative Living Cost Indexes in an appropriate manner.