INFLATION MEASURES AND PAY BARGAINING

The rate at which the cost of living is rising forms a significant backdrop to most pay negotiations. However, selecting the inflation measure that most accurately reflects changes in the cost of living has been complicated in recent years by a sudden surge of changes to established measures and the launch of new measures by the Office for National Statistics (ONS).

The Retail Price Index (RPI) was the undisputed measure of inflation in the UK for most of the period since the Second World War until the measure that was to become the Consumer Price Index (CPI) first appeared in official reports in 1996. Since then, the prominence of the CPI has grown and grown to the point that the press now routinely refer to it as the definitive measure of inflation.

In 2013, the RPI took another battering when it was officially "derecognised as a national statistic" and two entirely new inflation measures called the CPIH and RPIJ were launched.

These changes have encouraged some employers to switch to CPI as their main reference point for pay bargaining and the new measures may become reference points for others as they become more established.

Therefore this guidance note sets out the main arguments for defending RPI as the reference point for pay bargaining with employers.

Responding to an employer seeking to switch to CPI

The cost advantages to an employer of linking pay bargaining to CPI are clear, since on average CPI runs 0.8% lower than RPI. That may sound like pointless quibbling about fractions of a percentage, but when converted into the impact on pay packets, it makes hundreds of pounds worth of difference to staff every year.

However, the CPI is a hugely flawed measure of changes in the cost of living for many reasons -

- The most glaring fault in CPI is that if fails to adequately measure one of the main costs facing most households in the UK – housing. Almost two thirds of housing in the UK is owner occupied, yet CPI almost entirely excludes the housing costs of people with a mortgage.

- RPI captures the cost of living rises faced by workers much more precisely than CPI by excluding non-working groups such as pensioners, tourists and the ultra rich.
- CPI is calculated using a flawed statistical technique that consistently under-estimates the actual cost of living rises faced by employees. [A UNISON commissioned report by the economist Mark Courtney gives extensive evidence of this flaw. To see the main findings of the report click here]

Responding to an employer seeking to switch to CPIH

The CPIH is a measure of inflation that takes the CPI and adds an element of housing costs. Since the lack of housing costs has always been one of the main criticisms of CPI, some employers may seek to present it as a suitable alternative reference point for pay bargaining.

CPIH tries to provide an approximation of the costs faced by employees with mortgages by treating their housing as if they were paying rent for such a property. The problem with this approach is that rental prices often move very differently to house prices and as a result CPIH has actually been lower than CPI since the new measure was established in 2013.

Doubts about the accuracy of CPIH reached such a level that the UK Statistics Authority decided to reclassify it as an "experimental series" in 2014.

Responding to an employer seeking to switch to RPIJ

RPIJ is an adaptation of the RPI inflation measure which changes the statistical technique used for calculation to the same technique (called the geometric mean) used in the calculation of CPI.

Since it is the statistical method that counts for most of the difference between RPI and CPI, the RPIJ delivers much lower estimates of inflation. As set out above, the statistical method at the heart of CPI is fundamentally flawed [For a copy of the summary explaining why click here]

The UK Statistics Authority has derecognised RPI as a national statistic, so it can't be accurate?

The decision to derecognise RPI was not due to any fundamental flaw in the way it is calculated.

The decision resulted from sticking to the technicalities of the authority's code, which meant that RPI could no longer be classified as a national statistic when the ONS decided not to seek "continuous improvement" to the measure. The ONS made this decision despite overwhelming opposition to changing in the treatment of RPI by organisations that responded to its consultation on RPI.

Many government statistics are well regarded and widely used although they are not classified as a national statistic.