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Memorandum

to

Christopher Allsop

at HM Treasury

on

Official Indices on Prosperity

August 2003

Who we are

1. Our group arose out of meetings organised in the later years of the Major government for the purpose of self-education about alternative approaches to economic policy and sustainable development in a context where all the main political parties were gravitating towards the 'globalisation' agenda of big business. We had an affinity with the New Economics Foundation and formalised as a group in 1994.
2. The initial consultations of the Labour government saw our role evolve considerably. In an era where focus groups have come to play a central role in policy making we became a focus group of the committed. With a membership drawn from liberal, socialist and green traditions, we knew that ideas that achieved acceptance from people from all these backgrounds did have an important validity and strength and should be put in the public arena with appropriate confidence.
3. After responding to such initial consultations and many others by regional and local government, we have since been involved with the emerging regional governance in the West Midlands. We submitted memoranda to the inquiry on regional disparities conducted by the Select Committee on the Office of the Deputy Prime Minister (ODPM) in the first half of 2003. Our initial memorandum was published by the committee on 3 March 2003 as EVE. 14 (HC 492-II of Session 2002-03), and that memorandum gives some details of our involvement in regional affairs, which in the interests of brevity we will not rehearse again here – but some additional details are available on our website. Our supplementary memoranda which deal with most of the substance of this present memo were published on July 4 2003 as Ev 253 and Ev 300 in Volume III: Oral and written evidence.
4. We were pleased that the committee concluded in their report of 4 July 2003 that government cannot currently properly measure the impact of regional economic policies. We would insist that this is a problem that blights all aspects of economic policy making today.
5. We were not even very happy with some of the indicators that were put to the select committee as being significantly better than the much dismissed GDP per head as a target indicator. For example, 'household disposable income', as it is set out as a national indicator on the ONS website(1), suffers from the same most important flaw that we have argued flaws the GDP growth figure. We will explain this below.

Measuring a growth in prosperity.

6. In paragraph 7 of our original memo to the select committee we pointed out how in the years since Margaret Thatcher's second government, we are often told that the UK has been the beneficiary of many years of 'impressive' *GDP growth*. The generation setting up home in the 1990s were allegedly living in more prosperous times than their parental generation setting up home in the 1960s and 1970s. In our West Midlands region however, to achieve comparable forms of housing tenure, the norm now is for households to need the income of two adult earners where previously one adult earner (or one earner and a bit) could support a household in that comparable tenure in the 1960s and 1970s.

7. We went on to say that the falling real price of cars, computers and foreign holidays can, for some of the time, distract people from the basic fact that the household has to devote more of their lives to paid work to fulfil the most basic need of keeping a roof over one's head. **On this basis real wages in our part of the UK have fallen by maybe as much as a half since the mid 1970s.** We note how the London Development Agency did also pick-up on some of the elements of this argument (Ev 59). We said in our memorandum that people in London and the south-east could make a similar or more dramatic calculation. Much of the country could claim that we are now, on average, poorer than we were in the mid 1970s; and that is without bringing the unpredictability of tomorrow's pensions into the equation. GDP growth figures just seem to contradict what most families know in their bones.
8. For such reasons we never saw most of the ONS growth figures as meaningful economic indicators for peoples' welfare, we find it seriously inappropriate that such indicators are anybody's benchmark in assessing economic policies and initiatives.

If you get the Inflation wrong, you get any 'Growth' wrong.

9. *Household disposable income* like all such national statistics rely upon the flawed inflation statistics to identify whether there has been real income growth or contraction. In the jargon one would say that the flaw is in the 'deflator' that is assumed in making these calculations. None of the official inflation indexes or deflators make any credible attempt to bring the real full cost of housing into their estimation of inflation.
10. Take for example the *Retail Prices Index*. This is often said to be based on a 'basket' of purchases. The term basket plus images on the ONS website often gives people to understand that it is in some respects representative of somebody's shopping or spending. However, if you look at the technical manual for the RPI on the ONS website(2) you will see that the statisticians make clear that the RPI 'basket' is not based on any shopper's purchasing. That would, according to Chapter 6, Section 2 (6.2) of the manual, be a 'democratic' basket. Instead the RPI is based on what that section of the manual calls a 'plutocratic' basket. It reflects expenditure in the whole of the UK money economy.
11. Does this serve to explain why rents are only 4.7% of the RPI basket according to the current weightings assigned back in 1997 ? The only mortgage payments included in the RPI remain just 3.9 % of this basket, while alcohol is a more substantial 8.0% of the basket (Beer alone being 5.0%). Given that this 'basket', which is set out on the final two pages of this memo, is commonly taken to be representative of a consumer - it is illuminating to consider just what sort of consumer he/she would be. None of us know any independent adult whose costs and expenditure in any way resembles this. Frankly, it is a rather 'adolescent' pattern of expenditure if it were ever incarnated.
12. While we are told that the RPI is not used as the 'deflator' that gauges whether the change in the national income is growth or not, the elements that make up the various deflator calculations are even more 'adolescent' - in that what mortgage costs that are included in the RPI are taken out of the 'basket' used for a deflator. One must here even add, that this is also the case with the deflator used by the ONS in calculating the growth of their '*Household Disposable Income*'. This must be born in mind when assessing the ONS story, that 'households' have become more prosperous since 1971, which one finds on their webpage for this indicator.(1)

13. One might therefore conclude that had a less *'adolescent'* calculation of inflation already been adopted, commentators today would be analysing how we had become a poorer people since the 1970s. They would be lamenting how in the intervening period our governments, while appearing to win a number of intense battles against inflation, lost the war. They would probably be exploring how inflation could have been and can be addressed with a greater diversity of strategies than the 'monetary' policies that proved such failures under the UK's successive monetarist governments. They would even be wondering why despite Lord Lawson's desire to reform what he called the 'ludicrous RPI' – detailed in his memoirs – nothing was ever done about it.(3)
14. So we argue that a break must be made with such adolescent inflation calculations in developing a new generation of **credible** economic indicators. We note that the Chancellor has charged you with considering the possibility of regional inflation indexes. Such indexes could serve a variety of purposes, some of which would be very useful. However, should these regional indexes merely register inflation on the rather 'adolescent' basis that has previously been the norm, these indexes will serve no other purpose than to be a crude and clumsy tool for driving down wages in the more northern regions in the UK. Should this happen it will definitely alienate ordinary people in most regions of the UK.
15. Such 'new' regional indicators will on this basis prove even less sustainable than the current generation of indicators, which we suspect are themselves part of the much discussed malaise of British democracy. Current concern about people becoming disengaged from the established democratic procedures is certainly well merited. Is not however, one of the things that would have been alienating voters, the fact that politicians of both main parties recite a story of 'growth' ? A story that from the standards of living they see around them, too many voters find unconvincing to say the least.
16. We note that in the press notice announcing their report on regional disparities, the chairman of the ODPM Select Committee Andrew Bennett MP said, 'The Office for National Statistics will need to carefully consider how to restore its credibility.' We would strongly agree with this. And we believe your current review at the Treasury could mean the difference between success or failure in this restoration.
17. We hope that in making recommendations to the Chancellor, you address the need for a better index for inflation in both the UK as a whole and the individual regions. It will only then be possible to have other credible indexes of value in our national statistics. Furthermore, only then can anyone be sure whether inflation in the UK has converged with inflation in the Euro-zone.

Andrew Lydon
Vice-Chairman

1. Household disposable income details are at <http://www.statistics.gov.uk/STATBASE/ssdataset.asp?vlnk=4927&More=Y>
2. See <http://www.statistics.gov.uk/statbase/Product.asp?vlnk=2328&More=N>
3. Nigel Lawson. The View from Number 11. (1992) P. 849. Lawson even insists that mortgage interest payments were only brought into the RPI in 1975 in order to dilute the impact of rent rises on the index when the then Labour-led Treasury was driving up municipal rents by withdrawing their long-standing subsidy that had enhanced the living standards of the less well off.

Retail Prices Index - current section structure and 1997 weights

(Appendix 3 of the current RPI Technical Manual)

Broad groups		Catering	49
Food and catering		Restaurant meals	24
Alcohol and tobacco		Canteen meals	7
Housing and household expenditure		Take-away meals and snacks	18
Personal expenditure		Alcoholic drink	80
Travel and leisure		Beer	50
		on sales	38
		off sales	12
		Wines and spirits	30
		on sales	11
		off sales	19
		Tobacco	34
		Cigarettes	31
		Other tobacco	3
		Housing	186
		Rent	47
		Mortgage interest payments	39
		Depreciation	29
		Council tax and rates	30
		Water and other charges	11
		Repairs & maintenance charges	10
		DIY materials	12
		Dwelling insurance and ground rent	8
		Fuel and light	41
		Coal and solid fuels	1
		Electricity	21
		Gas	17
		Oil and other fuels	2
		Household goods	72
		Furniture	20
		Furnishings	13
		Electrical appliances	9
		Other household equipment	7
		Household consumables	15
		Pet care	8
		Household services	52
		Postage	2
		Telephones, tele-messages etc	15
		Domestic services	10
		Fees and subscriptions	25

Groups and sections	Weight		
Total food	136		
Non-seasonal Food	117		
Seasonal Food *	19		
Bread	6		
Cereals	4		
biscuits and cakes	9		
Beef	4		
Lamb	2		
of which home-killed lamb *	1		
Pork	2		
Bacon	3		
Poultry	6		
Other meat	9		
Fish	4		
of which fresh fish *	2		
Butter	1		
Oils and fats	2		
Cheese	5		
Eggs *	2		
Milk, fresh	8		
Milk products	4		
Tea	2		
Coffee and other hot drinks	2		
Soft drinks	10		
Sugar and preserves	2		
Sweets and chocolates	13		
Potatoes	5		
of which unprocessed potatoes *	1		
Vegetables other than potatoes	10		
of which fresh vegetables *	7		
Fruit	7		
of which fresh fruit *	6		
Other foods	14		

Clothing and footwear	56	Fares and other travel costs	20
Men's outerwear	11	Rail fares	4
Women's outerwear	18	Bus and coach fares	5
Children's outerwear	7	Other travel costs	11
Other clothing	10		
Footwear	10	Leisure goods	47
Personal goods and services	40	Audio-visual equipment	10
Personal articles	11	CDs and tapes	6
Chemists goods	19	Toys, photographic and sports goods	11
Personal services	10	Books and newspapers	13
		Gardening products	7
Motoring expenditure	128	Leisure services	59
Purchase of motor vehicles	47	Television licence and rentals	10
Maintenance of motor vehicles	21	Entertainment and other recreation	19
Petrol and oil	39	Foreign holidays	23
Vehicle tax and insurance	21	UK holidays	7