



January 2018

Consumer Price Indexation (CPI)

There can be no argument that the CPI is our best measure of "inflation" and for that purpose is defined very precisely, by a standard endorsed by the ILO, the IMF, OECD, Eurostat, United Nations and the World Bank. However there has been a long held belief in the community that the "inflation" so measured is the degree that the retail prices they have to pay for goods and services have increased. This reflects an inadequate understanding of what the CPI measures.

The problem, in nutshell, is that movements in the CPI measure changes in the cost of items *at constant quality*, which is an ephemeral and abstract concept. "Constant quality" means that the statisticians attempt to compare the quality of the current item with the quality of the item when last assessed, and adjust the current retail cost (generally downwards), before recording it for CPI purposes. Some of these quality improvements are unavoidable, perhaps mandated by technology changes, eg the closure of the G2 mobile phone network, necessitating a switch to more modern phones, or by evolving custom, eg lunch for children in day care. *For the most part, purchasers cannot avoid these improvements and they pay the retail price, not the quality adjusted price.*

Even if a price in the shops has fallen, that is no protection from a further quality adjustment to that price for CPI calculations. This is common for consumer electronics. The price goes down AND the quality improves. The price that goes into the calculation of the CPI is the shop price reduced further for the sometimes unwanted quality improvement.

The reduction in the CPI for quality improvement accumulates with devastating consequences, particularly for recipients of a CPI indexed pension or benefit, like Centrelink's Newstart (unemployment) or some disability benefits, because those 'pensions' started from a very low base a long time ago. ACPSRO thinks that movement in the CPI is probably up to 1% pa less than the movement in prices facing real people on High St. Over thirty years a Centrelink benefit indexed by CPI would be at least 20% worse off than indexation that matched the indexation of the Age Pension. It is slowly dawning on our politicians that the compounding effect of using CPI indexation has turned the Newstart benefit into a joke.

It may come as a surprise that the Australian Bureau of Statistics does not keep any record of the individual retail prices that it so painstakingly collects from the market and then adjusts for changes in quality!

ACPSRO made requests in 2015 under Freedom of Information to the ABS for details of the training it provides to the extensive number of staff that it employs for making adjustments to prices for quality changes. Eventually we were provided with copies of hundreds of pages of training material that unfortunately are heavily redacted. (We have no idea why that was redacted apart, possibly, out of a wish to avoid public concern!) You can access that material [here](#). Clearly, making adjustments for quality change is a big business within the ABS.

The Treasurer and other MPs often assert that the CPI measures the cost of living, or that an income indexed to CPI maintains a constant value. That is only true if the statements are qualified by "at constant quality" and are untrue in the context of an ordinary citizen's understanding of "cost of living" or "constant quality". Ordinary citizens do not have the slightest understanding of how disconnected the CPI is from their real life spending experiences although now, with wage growth about the same as CPI, they are starting to wonder.

Overall, ACPSRO believes that there is no point in attempting to attack the composition or methodology used in preparation of the Consumer Price Index; CPI has a very specific purpose – to measure "inflation" as defined - and it is the product of international agreement. Our concern is that it is simply wrong for Governments to say that CPI measures the "cost of living" without acknowledging that is at "constant quality", and then use the CPI to set the incomes of those who have to live in the real world.