

Revision of the International Guidelines on Consumer Price Index

Background paper

1. Introduction

The Consumer Price Index (CPI) continues to play an important role in national policy making, both in the economic and in the social sphere. It is used for a wide variety of purposes. The CPI is the best and most well-known indicator of inflation. It is the barometer of the performance of the economy and a key indicator in evaluating the results of the monetary and fiscal policy in a country. A popular function is the use of CPI for indexation of wages and social security allowances (the adjustment of workers income in the form of wages and salaries, or as social security benefits (e.g. pensions)). CPI is also important for formulation of social policy measures and in the area of social security and welfare allowances. Beside these, CPI is used as a deflator in national account estimates for converting values at current prices to values at constant prices.

It has been the long standing tradition of the International Labour Office (ILO), the agency responsible for the subject of consumer price indexes within the UN system, to ensure the establishment of international standards on the topic. The first ILO recommendation dates back to 1925 in the second Inter-national Conference of Labour Statistics (ICLS). Further recommendations were made in 1947 (Sixth ICLS), in 1957 (Ninth ICLS), in 1962 (Tenth ICLS), and in 1987 (Fourteenth ICLS). The ICLS resolutions laid down certain international standards for methods for computation of the CPI which contributed to the international comparability of the CPI. The latest (1987) recommendation on CPI was followed by a manual on methods published in 1989. It is aimed at a global audience and covers such important aspects of CPI as its scope, definition of elementary aggregates, the derivation of weights, sampling, procedures for collecting price data, substitution problems, etc.

Since that time, significant developments have been made in the practice of CPI construction some of which are described in Section 2. It was in recognition of these developments that the joint ECE/ILO Meeting on CPI, November 1997 in its conclusions recommended the revision of the ILO manual. This proposal has also re-echoed at various other conferences and meetings of statisticians.

2. Specific Issues

The recent emergence of economies in transition and movements towards free market economies of many developing countries have raised new issues with respect to CPI measurement. Economies in transition are quite dynamic with a lot of peculiar problems. Many new products are introduced all the time, while others leave the market. Also there are big and frequent quality changes in the existing products, and changes in the relative prices of goods and services in response to changes in consumer demand. All this imposed the need for finding new methodological solutions for observing prices and calculating the price indexes.

Eurostat in conjunction with the Member States has developed procedures and standards for Harmonised Index of Consumer Prices (HICP). HICP is the inflation indicator which will be used in setting the monetary union interest rate. These recommendations are also being followed by the pre-accession countries of East Europe.

At the same time in the United States the Boskin Report has created an enormous amount of interest. It identified possible sources of bias in the CPI like substitution bias, retail outlet substitution bias, quality bias, new goods bias. This report has called into question the accuracy and relevancy of the consumer price index even when international standards are followed.

The reality that CPI may overstate the rate of inflation has drawn considerable attention from the variety of users in academic and business community as well as from politicians. Among countries in which major research projects have recently been undertaken to investigate possible upward bias in the CPI are Canada, UK, France, and Australia.

Furthermore, the Ottawa City Group, was created in 1994 with the objective of promoting technical discussions on conceptual aspects of the CPI and in particular on the possibility of estimating CPI biases. Many issues on CPI methodology, like those relating to quality changes, the appearance of new products, etc. have been the centre of considerable research and discussions in this Group.

Other issues that have arisen include the need for constructing and publishing more than one index that will meet specific requirements, because no single index can serve all purposes without having conceptual short-comings for some or all of them. Also there is the question of computing separate CPI for different population groups, because of the likelihood that these groups may have faster or slower growth in their cost of living than that recorded by changes in the general CPI. This could come from differences not only in expenditure share but also in the prices paid. Another point that needs to be addressed concerns the subsequent correction of an index that has already been published.

3. Conclusion

All these discussions and research have generated a wealth of information which should contribute to a comprehensive study of CPI construction and review of international standards.

Given the importance of the CPI, both as an economic indicator providing timely information on the trend in prices paid by consumers and as a measure used extensively for indexation, it is not surprising that measurement issues regarding CPI have gained substantial attention over the years. In order to provide more reliable, complete and comparable price statistics, there is now a raised awareness of the need to review:

- the formulae utilised

- the frequency, comprehensiveness and quality of household surveys
- the procedures for quality adjustment, introduction of new goods and new outlets
- the usage of probability sampling methods, etc,
- the use of a single index to serve various objectives;
- the demand for sub-population indices; etc.

A revision of the ILO manual is therefore required to incorporate these new developments, to remove those parts that have turned out to be less useful and to provide more relevant concepts and measurements in connection with price behaviour.

This need has been expressed at the joint ECE/ILO Meeting on CPI 1997 which in its conclusions recommended the holding an experts meeting in February, 1999 as part of the process of carrying out this revision. The proposal to establish an inter-secretariat working group was directed at coordinating the efforts and expertise of the major organisation concerned with CPI so as to successfully revise the international standards, in particular the ILO Manual on CPI.