

**Submission
to the
Senate Community Affairs Committee
Inquiry into the Cost of Living Pressures on Older Australians**

The Committee is inquiring into a matter of importance to a large proportion of the Australian community.

All retirees, of whom I am one, are aware of the constant increases in the cost of living. We are left in the dark however when it comes to official statistical data. We have the Consumer Price Index (CPI) and a subsidiary index that claims to track the price of a basket of goods and services purchased by retirees.

My impression, and the impression of many in the community, is that both indices are poor indicators of how living costs are rising. That the CPI is an inadequate measure of what it costs to maintain a reasonably consistent standard of living is reflected in the extent to which it has been abandoned in the calculation of increases in the age pension and in the remuneration of some privileged groups.

The inadequacy of statistical data is a problem not only for retirees but also for people who are still working but are planning for retirement. Today Government policy encourages us all to provide for ourselves in retirement but it is difficult to estimate what will be our needs.

Much of the growing lack of confidence in the CPI as a meaningful indicator of changes in the cost of living stems from the substantial adjustments that are made to basic cost information to arrive at a price index.

We all have a broad understanding of the Basket of Goods and Services concept. Costs to consumers for the items in the Basket are regularly collected by the Australian Bureau of Statistics (ABS). What is not so well understood is that this data is subjected to a number of adjustments to pare movements in real consumer costs back to movements in what are seen to be the “underlying prices”. The concept of what are movements in underlying prices is based on economic theories that can lead to results that are quite abstract.

Some idea of what these adjustments might entail can be obtained from what is known as the United States Boskin Commission Report of December 1996. Reduced to a few words the Commission was concerned with what it saw as an overestimate at that time in the calculation of the United States CPI. It advocated downward adjustments that together it estimated to lie between 0.8 to 1.6 percentage points per year, i.e. a CPI increase of say 3% in a year should be adjusted to a figure that the Commission thought would lie somewhere between 1.4% and 2.2%¹.

¹ The Commission used terminology that is confusing in Australia. It wanted the US CPI which it saw as being seriously overstated to be adjusted downwards to produce what it called a “Cost of Living Index”. In Australia the term “Cost of Living” is commonly used to refer to the costs that are involved in maintaining a standard of living that keeps pace with community standards. People here use the phrase “Cost of Living” to mean something that is more than is provided by our CPI.

The adjustments that the Commission advocated were for:

- Substitution Bias (You can switch from beef to chicken when the cost of beef rises)
- Outlet Substitution Bias (You can find a cheaper outlet)
- Quality Change Bias (The market price of a basic TV today contains costs associated with the fact that the TV has more features than did a basic TV of several years ago. This is defined not to be a price movement.)
- Formula Bias

To the best of my knowledge the ABS has published very little information, let alone quantitative data, on the adjustments it makes to the Basket of Goods and Services cost data which it collects to produce our CPI. But there can be little doubt that the adjustments are substantial. Moreover it seems that this has not always been so. Large adjustments to basic cost data to produce the CPI appear to have only become a feature in the last fifteen years or so.

The result is a CPI in Australia that might meet tightly defined and abstract concepts of what is a movement in price but has little relevance to the day to day challenge of keeping body and soul together, particularly for retirees.

Recommendation

The ABS should be requested to maintain and regularly publish:

1. A Consumer Basket of Goods and Services Cost Index that reflects minimal interference with the real world cost data that the ABS collects, and
2. A subsidiary Cost Index tailored to the circumstances of retirees.

The intention here is to move away from what has become a fastidiously austere concept of what constitutes a movement in price. We need information that relates to the costs we all have to pay in the real world.

As the data required to do this is already collected by the ABS there should be very little additional cost involved.

Implementation of the recommendation would of course throw a lot of light on the adjustments that the ABS now makes to basic cost data to produce the CPI. That would not be at all a bad thing.

Prepared and submitted on 20 July 07 by:

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