

Senator the Hon Penny Wong  
Minister for Finance and Deregulation  
Parliament House  
Canberra ACT 2600

Dear Minister,

Thank you for your letter dated 30 May 2012.

Your letter relies heavily on the review conducted by Trevor Matthews and on advice rendered to that review by the ABS. For reasons I hope that will become clear I have to beg you to allow me to comment further on that aspect. You have also responded on the issue of cost estimates and the Future Fund and thank you for that.

Submissions to the Matthews inquiry sought to have it look into the increasing disparity that exists between the movement of the CPI and the movement in what I will call. here "street prices", The closest Matthews comes to addressing the issue is this

*... it would need to be generally accepted that an employer retains a responsibility to compensate former employees for improvements in productivity, as reflected in salary rises, which occur after an employee leaves them. This is not a generally accepted responsibility in Australia*

And elsewhere Matthews refers to ABS advice which you have quoted in your Letter.-

*The CPI "is a robust measure of general price inflation for the household sector and the best available broad measure of changes in the cost of living faced by Australian households*

Today what is defined as a price *increase* is absolutely central to our mutual problem.

If an increase in the street price for a particular product in the Statistician's basket is attributable to an increase in the quality of the product it is not an increase in price for the purpose of calculating the CPI.

If the street price for a particular product has not changed but the Statistician believes that the product has improved in quality the Statistician will make an estimate of the value of the quality improvement and record that the price of the product for the purposes of calculating the CPI has decreased by that amount.

As a result of these adjustments, called quality adjustments, the movement in the CPI these days understates by a significant and accumulating amount the movement in street prices. Implicit in the Matthews quote above is the idea that a pensioner on a CPI pension can maintain their purchasing power by choosing to buy the unimproved product. But this is not how the market operates. Very rarely does it continue to offer obsolete products. The general circumstance is that a pensioner has no option but to purchase current "improved" products, Often. the "improved" product is mandated by law for safety or other reasons.

We believe this situation is a far cry from what was the original intention for the CPI, a measure of how the street cost of a basket of goods purchased by a typical consumer changed over time. It is this view of the CPI that would still be the "generally accepted" one in the community today. It is reflected in the disarming simplicity of its full title "Consumer Price Index".

Taken at face value the ABS advice which Matthews relied on is misleading. It exploits the simplistic "generally accepted" understanding of the CPI. It fails to warn the reader that because of the current practice of stripping out all price movements that can be attributed to quality changes the CPI no longer measures the real world changes in the cost of living faced by Australian households.

In defence of the Statistician it has to be acknowledged that here and overseas the CPI is a critical economic figure and there is enormous pressure for it to be as low as possible. In response to this pressure the definition of the CPI has been regularly refined to the point where it has become an inappropriate index for a pension intended to be protected from increases in real world street prices.

If we are to progress this matter may I propose to you that the views that I am expressing here could be tested objectively were the Statistician to answer this simple question.

To what extent would movement in the CPI be increased if the CPI was based simply on street prices, without adjustments for changes in quality,

- a) over the last twelve months, and
- b) over a similar period in say the early 1970s?

Providing the answer should not involve the Statistician in having to collect new data. It should be easily derivable from the data that he already holds.

I hope that you will see your way clear to putting the question and securing a forthcoming response from the Statistician. We, of course, would be most interested in that response.

Yours faithfully,

Ron Dean National President

Australian Council of Public Sector Retiree Organisations Inc.

*The above letter from the President of our National Umbrella organisation ACPSRO to Senator Penny Wong argues well the real disadvantages suffered by those of us who have our pensions indexed by CPI. Ed.*