

CPI vs RPI

Pensioners Factsheet

What does substituting CPI for RPI mean for local government pensioners?

In his June 2010 budget, the Chancellor of the Exchequer announced that public sector pensions would be index-linked to the Consumer Prices Index (CPI), rather than the Retail Prices Index (RPI). This change would be effective from 1 April 2011 (the expectation is that the pensions increase from 1 April 2011 will be based on the 12-month change in the CPI to September 2010).

In the 12 months from August 2009 to August 2010 the CPI increased by 3.1% compared with 4.7% for the RPI. A similar differential is likely to apply in September, so that the immediate benefit for a Government trying to reduce public expenditure is easy to see.

In the long run the CPI is expected to deliver, on average, an increase of around 0.5% per annum less than RPI just because of the way it is calculated. Other variations which may arise at any point in time because the weights of the two indices are not identical should, in principle, be unbiased. Anyone wishing to have a better understanding of the reasons for the difference - both now and in the long term - can refer to the **CPI vs RPI Technical Factsheet**.

Is the CPI fairer than the RPI or vice versa?

Given that neither the CPI or the RPI have been devised to capture the spending habits of pensioners, it is disingenuous to argue that the CPI is more appropriate than the RPI or vice versa. Both have their shortcomings. If the argument is that the index should be appropriate to pensioners, then the Government should construct a new index specifically for that purpose.

It should be noted that the EU is currently reviewing the CPI, with a view to including the costs associated with house ownership, so the basket of goods used to calculate the CPI may become closer to the RPI's basket.

In the absence of a customised index for pensioners, the only argument which can logically be advanced to support the use of the CPI instead of the RPI is that the geometric mean (used by the CPI), which implies a degree of substitution according to relative price movements, is more appropriate than the arithmetic mean, which does not. It is, of course, likely that substitution will be more prevalent in a recessionary environment.

Avon Pension Fund

There is, of course, a flipside to the fact that local government pensioners receive lower pensions because of the change to CPI. This is that the Avon Pension Fund's financial position improves and employer contribution rates will reflect this.

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