

Meeting of the Ottawa Group 15 – 17 November 1995, Stockholm, Sweden,

OPENING REMARKS

Mr. Gösta Guteland, Deputy Director General

Welcome to the second meeting of the International Working Group on Price Indices! We are very happy that so many and experienced experts have come to Stockholm. There are more countries represented at this meeting than at the first one in Canada. This is a very positive sign that can be interpreted in two ways. Either the first one was such a success that many want another meeting or a visit to Stockholm is very attractive. Personally, I believe in the first explanation. This time of the year is not the best one for a visit to Sweden and Stockholm, but we hope that you will have an opportunity to have some sightseeing in the surroundings.

Let me remind you of the closing remarks by Jacob Ryten at the first meeting of the group. He had five questions formulated in the following way: First do we believe that we could have another meeting? Second, what should be discussed at that second meeting? Third, should the format be similar to the first meeting? Fourth, who is willing to volunteer papers and fifth, where should the next meeting be held? The answers are obvious. A second meeting has just started. We have an agenda. We have a lot of inspiring contributions. Statistics Sweden is happy to be a host for the meeting.

Already at the meeting in Canada there was an agreement about the choice of topics. One was about the "Purposes and Concepts of consumer Price Indices", another was "Selected Difficult areas of Consumer Price Indices" and a third was about "Product Quality Adjustment to Prices". All of them are very relevant for the discussions both in Europe and in other parts of the world.

There might be some differences in the opinions about main problems of the measurement of prices today. If you ask statisticians in North America the answer will perhaps be that we have to reduce the bias in the CPI. If you ask the same question in Europe I suppose the answer will be that the main problem is to create an harmonised index, biased or not, that could be used in all European countries.

Personally, I am surprised to see how experts in statistics can come to so different views on how to measure prices as they have in the Community. I will not repeat all arguments for geometric or arithmetic mean prices that have been discussed in the Council, but I want to state the fact that there is need for compromises to come to an agreement. Compromises are however not always the best solutions. The problems do not disappear after the decisions.

In our internal committee on price indices we rather often go back to questions that were raised at least 40 years ago and that has not yet come to a final decision. I am sometimes supposed to see how much we have saved of protocols from that time. As a matter of fact it is possible to go back a lot in historical material about price indices in Sweden. Some of it is more than 100 years old. We do not solve the problems when are looking back but at least we can keep a distance to the problems we have to solve today. We have also old traditions to work carefully with the problems and to be anxious to have good quality in the measurements.

An important part in this work is to listen to other experts and to be active in the international co-operation. This is why we are so happy to have all of you here today.

TOPIC 1: PURPOSE AND CONCEPTS OF CONSUMER PRICE INDICES

Chair: Anders Klevmarcken (Sweden)

Several papers, each covering different aspects of this topic were presented and discussed during the first day.

The first paper - " UK RPI.- A Cost of Living Index or an Inflation Indicator?" - was presented by Marta Haworth. In her presentation, Haworth directed special attention to conceptual issues and the magnitude of bias in the present RPI. One of Haworth's conclusions was that the present British RPI is not a cost of living index. Mrs Haworth also outlined a system of indices ("Whole Economy Price Index") that could provide a more complete measure of inflation than the RPI.

Several delegates shared the view that present "multi-purpose" CPIs often are used for purposes, which involve conflicting requirements on the index construction. From a theoretical point of view different indices ought to be constructed for each purpose in such cases. However, it was also acknowledged that the existence of more than one "single-purpose" index may in itself be confusing for the users and negatively affect the credibility of the indices. Several speakers referred to this conflict between relevance and credibility and different opinions were expressed at what point the optimum balance between this conflicting interests was to be struck. Some delegates directed attention to the dangers of reduced relevance if concepts, that originally were defined to meet other requirements than those of a CPI, are uncritically adapted. This was said to be the case concerning, e.g., certain definitions within the systems of national accounts.

The second paper - "Three Kinds of Monthly CPF" - was presented by Ralph Turvey. The paper included a treatment of conceptual problems, similar to those that were discussed after the presentation of the previous paper. In his presentation, professor Turvey distinguished between a number of CPIs, each constructed in accordance with the requirements of a specific purpose.

Turvey invited opinions on the following three issues:

- How is a "market determined price" to be defined in the context of CPI as a measure of inflation?
- Is there any need for the construction of a CPI as a cohort measure? If so - how is such a measure to be defined?
- Pros and cons concerning the Rothwell-approach for the treatment of seasonal goods?.

Bert Balk presented the third paper; "The Consumer Price Index and Incomes Escalation". The starting-point of Balk's paper was that CPIs are frequently used to escalate incomes and transfer payments in situations of price inflation. Balk's conclusion was that the CPI is not an appropriate instrument in this context to protect households from welfare decrease. It was also claimed that no solution to this was offered by replacing the CPI by a cost of living index. Some delegates argued that this conclusion provided support to the earlier acknowledged merits of a single-purpose index.

The fourth paper - "Handbook of Inflation Accounting; Price and Quantity Measurement" – was presented by Peter Hill. The handbook has been compiled for OECD.

Erwin Diewert presented the fifth paper - "Seasonal Commodities, High Inflation and Index Number Theory". Various alternative methods for the treatment of seasonal price fluctuations

were discussed. A widespread opinion was that existing theoretical and practical problems will be difficult to solve and that more research is needed in this area.

Jörgen Dalén presented his paper "A statistical interpretation of CPI comparability". Dalén suggests an approach for quantifying differences, rather than errors, between the CPIs of different countries. One objective of such a model is to serve as a measure when establishing rules for harmonised CPIs within the EU. Dalén analyses e.g. the probability of what he ca a Maastricht error, i.e. the risk for an erroneous conclusion on the fulfilment of the inflation criterion for the entry of a member country into the EMU.

Participants from Eurostat added some further background and pointed out that the main objective is to identify where effort has to be put in to achieve comparability.

There seemed to be a general view that variance calculations and other approaches to detect non-comparability between different CPIs, as well as errors of a specific national CPI, should prove to be helpful tools. However it is not obvious how to identify the reference point: for international comparison as well as to a national ideal index. Given the reference points quantifying differences seemed more feasible than quantifying national bias.

TOPIC 2: SELECTED DIFFICULT AREAS OF CONSUMER PRICE INDICES.

Chair: Ralph Turvey (United Kingdom)

On the chairman's proposal it was agreed that the discussion should be organised by subject rather than by papers. Hence practices and principles were discussed in turn for:

- Insurance
- Income-dependent fees
- A British problem with a rebate on electricity bills
- Gambling
- Financial services

Most of the participating countries include **insurance** services in the CPI. All (?) of them do so on a gross basis - both for the weight and for the price indicator. Therefore the discussion focused on the valuation of the insurance with respect to the risk of a damage - or more specifically - the changing risk. Both views: that the household is willing to pay extra to meet additional risk and that the household just look to their cost of having the car at their disposal, irrespective of risk, found their advocates. The latter view, however, formed a majority. Does Free Rider induced premium increases, which have been observed for child insurance in Finland, increase the value of the insurance?

Very few countries have practical experience of **income-dependent fees** in their CPIs. In his paper Anders Klevmarken analyses the phenomenon within the cost-of-living framework.

The British **rebate on electricity bills** was to be given by The Regional Electricity Companies as a one-off adjustment of £ 50 on their charges to all their domestic customers on one bill. The rebate could be interpreted as being a dividend originating from the sale of the National Grid. There was a weak majority for the opinion that this was not a reduction of the current, or any previous, price for electricity, but rather a temporary increase of incomes of the households concerned.

Gambling is included in the CPIs of some of the participating countries. However, among them practices vary. The approach newly adopted in Sweden, where the index reflects changes in the percentage "take" (incl. taxes) of the organisers and changes in the cost of maintaining the real value of a bet, found some support.

Some countries might have excluded gambling on the argument that it is not consumption. However, given its expected negative return, the investment alternative, seemed odd too.

Keith Woolford made an oral work on **financial services** where he raised a number of questions and shed some light on different aspects of the subject.

TOPIC 3: PRODUCT QUALITY ADJUSTMENT TO PRICES

Chair: Jörgen Dalén (Sweden)

Turvey presented his paper "Item & outlet replacements and quality adjustment. A suggestion to avoid outlet bias by making explicit comparisons between outlets when I substituted caused some discussion. A Finnish study, which was referred to, had on average differences in price level could be explained by different "outlet quality".

Schultz presented the draft version of his paper "Treatment of changes in product quality in consumer price Indices", which discusses the frequently used method of "splicing" (link-to-show-no-change). He compared splicing to the Rothwell formula and found similarities. He reported that the index for clothing had been downward biased in Canada. There was another discussion on the possible size of outlet bias.

Based on his paper "The type and extent of quality changes in the Canadian CPI", Lowe described the impact on the index of quality change adjustments.

Norberg ("Quality adjustment in the Swedish price index for clothing") described the hedonic method used in Sweden but concentrated his oral report on the "Sales-price-effect": the last month of one (yearly) index link is more influenced by sales prices than is (overlapping) month (based on a new sample) of the subsequent link. The bias is adjusted for in the index calculation.

Haworth reported on recent work in Britain on the use of hedonic techniques for quality adjusting TV prices ("Quality adjustment of prices of audio-visual good in the U.K. RPI"). The following discussion focused on the use of weighted observations when the model is estimated. One argument for unweighted observations (or quantity weights) was that the model should be equally true for all varieties. Another argument, which pointed in the same direction, was that if very few observations account for a large proportion of the total weight there will be too few degrees of freedom in the parameter estimates. The argument for value weights was to achieve representativeness to the population (total value of transaction).

The discussion on hedonic regression, as well as other techniques, continued following an example based on Australian experience for cars, presented by Woolford.

Sellwood presented his paper "The Harmonisation of Quality Adjustment Practices in the European Union" and discussed different approaches to detect deficient treatment of quality changes in the member countries' CPIs.

CLOSING SESSION

Chair: Jörgen Dalén (Sweden)

It was decided that the name of the group should be the Ottawa Group and its area of interest restricted to Consumer Price Indices.

Balk invited the group to The Netherlands for its next conference, which was decided to be held in April 1997.

The following subjects were suggested for the next conference:

- 1) Inflation measurement (including alternative CPIs etc.)
- 2) CPI conceptual problems
 - Durables
 - Financial services
 - New goods/outlets
 - Quality change
- 3) CPI survey methodology, i.a. EDP, scanner data collection
- 4) New developments

However, the composition of the final agenda was left to Bert Balk and Statistics Netherlands to decide.