List of Responses

1. **G4S Ltd.**

The use of any ‘large economy’ formulae for small economies, namely the Isle of Man, invariably does not/cannot represent the local situation as they are designed for the smoothing influence of large economies with completely different dynamics. As such, the key element of any such measurement should be relativity to the local market. The obvious problem here is international/global comparisons and so a unilaterally comparable measure has to be used. A safeguard for ‘relativity’ could be a simple modifying factor, such as a variable weighting.

The over-riding factor should be clear guidance from government as to what it is using and why so my opinion is firmly in favour of CPI, which is used and understood internationally.

The IOM market, with one or two exceptions, does not have a proliferation of long term PFI type contracts. Those that do exist could be re-negotiated by exception so this argument falls at the first hurdle.

The trade unions will likely make a noise in favour of RPI as it secures a higher annual wage increase in comparison with CPI. However, as detailed in the consultation document, RPI creates an artificially high inflation rate and the current situation with public sector wage and pension costs is a consequence of using such a measure when in fact the ‘real’ world rate of inflation is markedly lower. The linking of benefits and minimum wage increase is a consequence of such measures and places even greater strain on resources.

Government need to be decisive and bold in adopting the generally agreed convention of CPI, which is what the international community, of which we are a part, clearly prefers.

2. **Isle of Man Office of Fair Trading**

This office preference would be option 3. Run all three indicators for the immediate future. Although RIPJ is more accurate, the RPI is much more well known to consumers and many legal agreement and contracts will have been made with reference to the RPI.

However we do have a suggestion with regards to option 3. Once the RIPJ has a few years’ data and becomes more widely accepted, the RPI at this point could then be discontinued.

In fact I think the UK actually did something similar a few years ago. Initially the UK ONS wanted to stop producing the RPI but again there were many criticisms and this indicator was continued at least for a few more years.

3. **Peel Commissioners**

The Manx RPI should be retained and operated alongside a Manx Consumer Price Index (CPI). This will permit existing agreements based upon RPI to be honoured and a move to CPI in the long term once sufficient evidence exists to prove CPI is truly representative of inflation on the Isle of Man.

4. **The Communications Union**

The RPI provides an important benchmark for trade unions and employers during the pay negotiating process because of its relevance to the costs facing working people. The CWU relies on monthly RPI statistics in pay discussions with employers on the Isle of Man to target cost of living pay settlements and to track how pay awards compare with price increases facing workers over time. Maintaining the value of pay in real terms is important not only for workers, but also for employers who understand the business benefits of decent pay, and for sustaining consumer spending and a healthy economy.
Therefore we are strongly opposed to the option of ceasing to publish RPI and relying solely on CPI. We are also opposed to publishing RPI calculated in line with the RPIJ, due to weaknesses with the ‘Jevons’ formula. We believe option 3 of publishing RPI alongside the UK RPIJ would be the most appropriate way to address any concerns about uncertainty around the level of inflation as a result of the “formula effect”.

**The importance of the RPI for determining cost of living pay settlements for workers**

The RPI covers all expenditure categories including the rise in the cost of mortgage interest payments and is therefore considered to be a relatively representative measure of living costs for the majority of households. In contrast, the CPI is likely to understate the real level of inflation for most working households because, as the consultation notes, it does not include mortgage interest payments, council tax and estate agents fees. Most households on the Isle of Man (66%) are owner occupiers\(^1\), yet CPI almost entirely excludes the housing costs of people with a mortgage.

Furthermore, the RPI excludes the top 4% of households by income, and pensioner households where 75% of income comes from the state pension and benefits. The CPI, however, is calculated in line with spending across all UK households and spending by visitors as noted in the consultation. Consequently, the RPI is considered to be more focused on the costs faced by workers.

**The advantages of having more than one consumer price index**

It is generally accepted that there is no one consumer price index that suits all purposes and consequently there are advantages to having more than one index because of the different uses to which they can be put. The two most important uses are as an indicator for monetary policy and as an uprating index, to measure the purchasing power of wages and pensions. The RPI was specifically designed as an uprating index to measure the price changes experienced by wage earners, whilst the CPI was developed as an index to guide monetary policy.\(^2\)

**Weaknesses with the Jevons formula for the purposes of an uprating index**

The consultation document identifies what it sees as weaknesses with the formula used to calculate the RPI (the Carli formula) which it says tends to overstate the price increases by giving weight to more items with a higher price.

However, leading economist Mark Courtney concluded in a recent study on consumer price indices in the UK that the RPI is as good a consumer price index as one can get for uprating purposes.\(^3\) He also found that the statistical method used to calculate the CPI (the Jevons Formula) is biased downwards. This means that CPI is likely to under estimate inflation by around 0.9 percentage points on average.

One of the key weaknesses identified with the Jevons formula which contributes to this downward bias is that it makes assumptions about the way consumers behave which may not reflect the reality. For instance it assumes that consumers will substitute one product or service for another if an individual price jumps, when in fact there is no clear evidence to demonstrate this. Those criticising the use of Jevons in relation to the costs facing worse off groups argue that they may not be well placed to take advantage of lower prices (e.g. because they do not have access to a range of stores).\(^4\)


\(^3\) Consumer price indices in the UK, *ibid*, November 2014

\(^4\) JRF, *ibid*, July 2015
Economists including Altmann (2012) and Courtney (2014) have argued that, for the purposes of uprating low incomes, RPI remains the best measure available, because CPI underestimates the true increase in the costs people face.5

The RPI has not overstated the cost of living for working people
Contrary to the UK Office for National Statistics statement that the RPI has an upward bias, the RPI has not overstated the cost of living people face. For example, the Joseph Rowntree Foundation’s Minimum Income Standard for the UK, measuring basic living costs has increased by 27% between April 2008-20156, whereas the RPI increased by 21.5% over the same period.7

Differences between RPI and CPI are not sufficient justification for ceasing to publish RPI
We recognise the potential for confusion given the wide gap between CPI and RPI, but we believe that ceasing the publication of RPI would be an unnecessary and unhelpful response to this problem. The issue could be better resolved by ensuring that the public is provided with a clear explanation of the differences between the two measures. If necessary, the Government could also follow the UK practice of adopting one main measure of inflation to promote a consistency of messaging in the media, whilst continuing to publish a second measure.

The RPI continues to be published in the UK despite being delisted as an official statistic
The consultation document notes that the RPI was delisted as a UK national statistic in 2013 to conform with international standards. However, RPI continues to be published in the UK because of its ongoing importance for a number of purposes. For example, it is used to determine annual increases in the level of pension payments from defined benefit schemes, commuter train fares, government bond interest and student loan interest charges.

Furthermore, economists have raised doubts about the merits of other countries relying on indexes that use the Jevons formula. Marcus Courtney concludes that ‘Countries that have adopted the Geometric Mean8 for elementary aggregation on the basis that this is allowing for consumer price substitution should revisit their decisions’.9

6 JRF, ibid, July 2015
7 RPI All Items Index, Office for National Statistics, 12th April 2016, accessed at: https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/chaw
8 Also referred to as the Jevons
9 Courtney, ibid, 2014

5. Manx Utilities Authority

It is appropriate for Manx Utilities to be able to rely on credible, internationally recognised inflation measures. Such measures are used from time to time in contracts with suppliers and customers. They are also used to inform other decisions, such as the setting of prices (eg. Water Rate increases have been previously agreed by Tynwald to increase by RPI through to March 2019) and during pay negotiations. Manx Utilities notes that the consultation document states that the RPIJ basis of calculation is considered to be a better basis of calculation than that used for the current RPI index and therefore Manx Utilities would support the use of the RPIJ calculation.

However, due to the number of contracts currently in place, mainly in respect of wayleaves and leases, Manx Utilities would wish that the RPI index continues to be published alongside any new index to avoid the need to renegotiate existing contracts (new contracts would make reference to any new index), which would likely to increase operating costs.
6. Tynwald Mills

Like many businesses on the Isle of Man and in the UK we use RPI and Manx RPI as part of long term lease agreements, often with large multinational companies. (Agreements of up to twenty five years).

For example Next PLC and Top Shop Ltd have both signed twenty year leases which have rent reviews that include reference to Manx Retail Price with our company. Rent levels are reviewed every five years, any increase is usually capped at between a zero increase and two percent depending upon inflation as determined by The Manx Retail Price Index.

We negotiated these inflation linked clauses as the other commonly used method of determining a rent review is by reference to local market rents, market rents are harder and more costly to determine and dare I say we can be a struggle with large companies in coming to an agreement. We preferred the certainty, consistency and history of The Manx Retail Price Index.

When the UK reviewed its policies and benchmark data in 2013 it concluded that whilst it could see other methods of measuring inflation RPI was still required whilst not as a key national statistic rather as an important element in a number of benefit calculations, long term agreements and in relation to treasury bonds. The consistent and long term nature of the information being important as with ourselves. We believe this is still the case in the UK and on the Isle of Man.

No Manx Retail Price Index data would have a significant impact on a number of our commercial leases and the performance of our property business into the future.

We understand that the UK still produces RPI figures but also alongside RPI it produces RPIJ and CPI. We aren't qualified to comment on the relative benefits of each benchmark suffice to say that there is still much debate out there as to each's relevance and accuracy and even talk recently of new benchmark of CPIH as being a further improvement. *(National Statistics Office are testing CPIH)*

In conclusion we would reiterate our position in that we would want to see the Manx Retail Price Index benchmark retained in the interests of consistency especially against a back drop of debate as how our economy is behaving. We would beg the question first as to why the MRPI and MCPI are moving so far apart..........

7. Unite Union

Having considered the paper I would promote option three ie keep Manx RPI but place alongside it the UK RPI as a comparator

8. Cains

Introduction

We have previously spoken (Katy) but by way of brief introduction I am head of Cains' Insurance and Pensions Unit and advise various occupational pension schemes that are resident in the Isle of Man.

Two of these schemes are the Main Fund and the Widows’ Fund which I shall collectively refer to as ‘the Schemes’. The trustees of the Schemes (the Trustees) have asked that I provide a response to the Consultation on their behalf and this response has also been shared with the actuary for the Schemes (the Actuary) and the sponsoring employer (the Employer).
If you would like to discuss in more detail any of the comments made, do let me know. I could also seek a call with the Trustees, Actuary and relevant officers of the Employer if you felt this would be appropriate.

Before providing more specific comment on the three options being considered by Economic Affairs (the Department), it would be helpful to explain how Manx RPI is typically used in the Schemes.

**Manx RPI in the Schemes**

1. The principal areas the Schemes apply measures of inflation are threefold:
   
   (a) for the purpose of revaluing a pension between the date a member ceases to accrue their pension and the date such pension comes into payment (deferred revaluation);
   
   (b) for the purpose of increasing pensions from year to year once those pensions are in payment (pension increases); and
   
   (c) for the purpose of determining discretionary increases (discretionary increases).

2. Taking these in turn:
   
   (a) deferred revaluation: rates of increase are Manx RPI capped at 5%.
   
   (b) pension increases: these are essentially statutory increases that reference UK CPI so that Manx RPI is not a relevant consideration.
   
   (c) discretionary increases:
      
      (i) for certain tranches of pensionable service which do not benefit from statutory deferred revaluation, discretionary increases can be granted capped at the lesser of Manx RPI and 3%; and
      
      (ii) for certain tranches of pensionable service, the trustees can give discretionary increases capped at Manx RPI or such greater amount as will not prejudice tax approval.

3. Sometimes a pension scheme will have a provision within its terms that, even if a specific index of inflation is used, allows an alternative measure of inflation to be adopted (or includes wording to the effect that alternative measures of inflation may apply to the extent the stated index comes to an end or is no longer viable). However, the Schemes do not contain provisions that offer alternatives to Manx RPI.

4. Given 3 above, the only way the Schemes will be able to adopt an alternative to Manx RPI (should it be stopped) would be via the Schemes’ respective powers of amendment. However, the exercise of these powers of amendment would not be straightforward. For the Main Fund, an amendment would require member consent. In particular, an amendment would require the consent of a majority of three-quarters of the members who may respectively be affected by it. For the Widows’ Fund the amendment would either require a similar widow consent or an actuarial certification that the amendment will not prejudicially affect any pension or allowance prospectively payable (which, technically, may be difficult to give if Manx RPI is no longer being published).

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10 The Widows’ Fund relies on the Main Fund provisions in this regard.
11 The actual wording of the Scheme is “the Index of Retail Prices as published by the Isle of Man Treasury”.
12 The Widow consent includes affected widows whose pensions are in payment and affected members in respect of whom widow pensions are prospectively payable.
With this brief background, we comment on the options being considered by the Department as follows:

Option (1): stop publishing Manx RPI due to the acknowledged limitations in its calculation basis and rely solely on Manx CPI

5. If the Isle of Man (IOM) Government were to stop publishing Manx RPI, and given the absence of an inherent power for either party to select an alternative index, the options open to the Trustees and the Employer would, in this order, be:

(a) seek an amendment under the Schemes’ available powers (which in turn, is subject to the member consent provision\(^{13}\)); and

(b) failing a satisfactory amendment being viable, make an application to the Manx courts under section 61 of the Trustee Act 1961 (which allows a trustee to petition the court for a direction as to how to manage or administer a trust).

6. Obviously, with regard to 5, it will be for the Employer and the Trustees to agree and propose an alternative measure of inflation that will find favour with relevant Scheme members or the Manx courts. If Manx CPI were to be proposed, the immediate concerns from the perspective of the Trustees would be:

(a) as a measure of inflation, Manx CPI uses a materially different range of items as compared to Manx RPI (for example, it does not include general housing costs). Therefore, the underlying bases for the two measures are significantly different and, in the IOM, may not be easily mitigated (i.e. there is no equivalent of the UK CPIH etc. which might help balance out such differences); and

(b) historically, Manx CPI has tended to produce a lower rate of inflation as compared to Manx RPI over the time that Manx CPI has been in force. This will mean Manx CPI is going to be less attractive to members and could well be rejected by members on those grounds. In turn, the Manx courts may, following a rejection of Manx CPI by members, be less inclined to accept it as a suitable alternative.

7. Given 6(a) and (b), and to avoid deadlock in this regard, it may be that the Schemes are obliged to propose (via an amendment) some form of hybrid measure of inflation. However, consideration of this will be both potentially complex and potentially costly in terms of the actuarial and legal advice needed to (i) find a suitable bespoke measure and (ii) explain the rationale for such measure to members and/or the Manx courts as applicable.

8. Therefore, in conclusion, Option (1) is not particularly attractive as it results in the biggest change of position vis-à-vis the status quo. This, in turn, requires a bigger and more substantive response from those administering the Schemes which is likely to increase the costs associated with addressing any such change.

Option (2): Continue to publish Manx RPI but calculate it in line with UK RPIJ to remove the ‘formula effect’ (i.e. publish a Manx RPIJ)

9. Changing the basis of the calculation of Manx RPI appears to best address the issue that is at the heart of the Consultation (being the inadequacy of the Carli calculation formula) whilst causing the least disruption. In particular, the Trustees assume that the Jevons formula would simply be applied to the existing basket of Manx goods that are used to calculate Manx RPI meaning the coverage and items that are used to determine Manx inflation remain consistent. This seems a

\(^{13}\) Or, for the Widows’ Fund, a potentially difficult technical actuarial certification.
more surgically precise approach to resolving the central issue (which is principally a statistical one) than scrapping Manx RPI entirely.

10. From a legal perspective, changing the calculation basis but maintaining Manx RPI as a formally published index helps avoid the issues associated with Option (1). In particular, there would be no immediate onus on the Trustees and Employer to address any disconnect in respect of the Scheme's administration. The change, although potentially material over time, would have been implemented seamlessly and would, in effect, have been imposed upon the Schemes’ administrators.

11. In this regard, although the change would, over time, affect benefit levels, there would be no immediate need for the Trustees and/or the Principal Employer to take remedial action via scheme amendments or applications to the Manx courts: this is to be preferred.

12. Finally, Option (2) unlike, Option (1), maintains exactly the same coverage and items in terms of the basket of goods it references and, in this regard, is favoured by the Trustees over Option (1) as it remains more closely aligned with the existing formula found under the respective rules of the Schemes.

Option (3): Continue to publish Manx RPI but publish UK RPIJ alongside it so that the formula effect can be clearly identified.

13. On the face of it, this option represents the least change in that the status quo is preserved. Given the potential the Carli calculation has toward overstating inflation, this method may be attractive to members (who will potentially benefit from that bias) and unattractive to the Employer (who will, in all likelihood, be the party that is most likely to foot the bill for the increase bias).

14. From a narrow Trustee perspective, the Trustees acknowledge that there are aspects of Manx RPI’s Carli calculation basis that are unsatisfactory (as per the helpful explanation in the Consultation). Specifically, the Trustees might reasonably take the view that, in adopting increases by reference to an ‘Index of Retail Prices’, the original architects of the Scheme were attempting to protect benefits against genuine increases in the cost of living rather than actively seeking a formula with a bias towards outpacing such inflation. In this regard, although the Carli effect that is inherent in Manx RPI may produce higher benefits for beneficiaries of the Schemes, it does not necessarily reflect a preferred model for the Trustees and it would not be unreasonable for individual Trustees to support some form of remedial action to address the Carli formula bias (i.e. for the Trustees to prefer Option (2) over Option (3)).

Conclusion

Given its application under the terms of the Schemes, a change to or the removal of Manx RPI will impact the benefits that are paid out of the Schemes and, depending on the Option chosen, that impact could be material.

To the extent Manx RPI is either published subject to a different calculation basis (Option (2)) or maintained alongside a UK RPIJ benchmark (Option (3)), the disruption to the Scheme (and the onus on the Trustees to address that disruption) will be far less than is the case with Option (1). For that reason, Options (2) and (3) are preferred over Option (1).

Out of Options (2) and (3) the Trustees’ respective positions will be informed by a number of diverse considerations which will range from (i) their view as to what existing the references to “Index of Retail Prices” was intended to convey, through to (ii) their overall view of the strength of the Employer’s covenant to potentially deliver inflation proofing increases to benefits that are higher than true cost of living. As such, it is difficult to prefer one over the other without specific input from the Trustees in this
regard. We have shared this response with the Trustees and can feed through the balance of the Trustee collective view in due course.

**Query**

One query we have is why the comparison under Option (3) is between Manx RPI and UK RPIJ. We would have anticipated that a more informative comparison would be between Manx RPI and Manx RPIJ.

As for the Employer, having shared this response with the Employer, the Employer’s preferred outcome is Option (3).

We trust this response is helpful and, as per our introduction, would be happy to consider any follow up queries you may have.

**9. Isle of Man Steam Packet Company Ltd**

We have a highly capital intensive business with long term commitments and supply contracts. RPI data is used in over 20 long term contracts in our business and none of our contracts use CPI. We do therefore consider it essential that RPI is calculated and published. We consider it would be disadvantageous for us and IOM for us to try to ‘renegotiate’ UK port agreements etc using CPI.

We cannot really comment on using the geometric mean (the Jevons method) for averaging the individual items in the RPI. However this is already done in the UK and IoM figures would then be more comparable with the UK. However, we understand the consultation document potentially goes too far in implying that this change will make IoM figures accurate and remove any bias in them. We are aware of sampling errors in the Manx RPI which suggest it can only ever give a broad indication of inflation and nothing more. We and others are aware of its limitations.

**10. Douglas Borough Council**

That the Council favours option 1 of the three suggested, that is, the cessation of the Manx RPI in its current form, subject to a lead-in period to enable the Council, and other parties affected, to re-negotiate legal agreements as necessary;

That such lead-in period should be no shorter than five years to facilitate the natural expiration of as many Manx RPI linked legal agreements as possible;

That the future calculation of Manx CPI should be based as closely as possible on the UK method, but with substitution of suitable alternatives for items such as tuition fees and Council tax which do not apply locally.

The Committee raised a concern that UK companies may request to use the UK CPI in place of Manx CPI and it is therefore suggested that although Manx RPI will no longer be published, it is important to continue measuring the RPI and for the index to be available.
List of Respondents Wishing Not to Comment

Note that only those who issued a response stating that they had no comments are included in this list.

1. Marown Parish Commissioners
2. Department of Infrastructure
3. Patrick Parish Commissioners