

OPEN FORUM ON POVERTY

The Updated Consumer Price Index (CPI): The Need and Implications

A panel Discussion with

Mr. D.C.A Gunwardhana, *Department of Census and Statistics*,
Dr. Harsha De Silva, *LIRNEasia*
and
Deshal De Mel, *Institute of Policy Studies*

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Colombo, Sri Lanka**

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1. Introduction

CEPA's objective in hosting the Open Forum Series is to provide a platform for groups of professionals to enter into a discussion on the research/expertise shared by a colleague and also to create a medium for knowledge dissemination. The thirty-third Open Forum hosted by CEPA focused on a much discussed current issue - the updated Consumer Price Index, particularly the need for a new index and the potential impacts of switching to this new index.

The Central Bank of Sri Lanka has long been of the view that the current Colombo Price Index (CCPI) is outdated and emphasised the need to introduce a new Price Index. Economic analysts have also argued that a new CPI is needed to eliminate many inherent problems and limitations of the CCPI. Limitations regarding the representativeness and geographical coverage of the sample and the selection and weights of the items in the basket are some of the major reasons mentioned.

In response to these comments the Department of Census and Statistics (DCS) has recently announced the introduction of a new CPI, called the CCPI (N). The new index is based on 2002 HIES data and represents more up-to-date consumer patterns, as well as an increased coverage area for collection of price data. This index will be the new official CPI for measuring inflation in Sri Lanka. The objective of the Open Forum was to discuss whether and how the CCPI (N) addresses all the criticisms levelled at the CCPI - the previous official index, and also to discuss the advantages and disadvantages of switching to the new index.

The 33rd Open Forum was chaired by Nilakshi De Silva, Senior Professional of the Poverty Impact Monitoring (PIM) Programme at CEPA. Mr. D.C.A Gunawardhana, Deputy Director, DCS, made the keynote presentation introducing the new index [CCPI (N)]. Two panellists discussed the presentation in view of perspectives of private sector investors and social welfare recipients. Dr. Harsha De Silva, Lead Economist, LIRNE*asia*, discussed the new CCPI(N) in the light of macro economy, investment and the private sector, while Mr. Deshal de Mel, Research Officer, Institute of Policy Studies discussed its implications on social welfare.

2. Summary of Presentations

(A) Mr. D.C.A Gunawardhana, Department of Census and Statistics

Mr. D.C.A Gunawardhana provided a brief overview of the CPI, followed by a detailed presentation of the key features of the new CCPI (N) developed by the DCS.

A consumer price index measures the price changes of a fixed basket of goods and services which is commonly purchased by the majority of households over a period of time. The quantity and the quality of the basket are held constant at a base period, and thus the index solely depicts the changes in prices. The CPI is used to measure the changes in the general level of prices and Inflation in the country; it is a key factor of monetary policy formulation in relation to adjustments of salaries, wages and security benefits and also facilitates economic and social analysis.

However, the criticism on the existing CCPI has originated over a number of issues. It was designed in 1952 and is computed in accordance with average household expenditure of a sample of 455 working class households within the Colombo Municipal area, as per the family budget survey of 1949/1950. The weight structure was based on the average household expenditure of the given sample in the Colombo city limits. Therefore, the CCPI may not reflect current inflation as it does not represent actual changes in cost of items which are in line with the changed consumption patterns of today. The CCPI is also highly sensitive to price changes in a few items. Because it is limited to the Colombo city limits and to a particular income group, the index is also limited in scope, both in terms of geographical and income group coverage.

To address these limitations, the DCS has attempted several changes on many occasions in the past – revisions were introduced in 1960, 1972, 1978, 1983, and the Greater Colombo Price Index (GCPI) was introduced in 1991, Sri Lanka Consumer Price Index (SLCPI) was introduced in 2001 - but with limited success.

A periodic revision of the CPI basket and weighting patterns would enable it to maintain its relevance and reveal latest household expenditure and consumption patterns. Addressing this need, a more representative and up-to-date consumer price index based on the Household Income and Expenditure Survey of 2002, has now been constructed by the DCS. The new index is known as the “New Colombo Consumers’ Price Index (termed CCPI (N))”. The weighting pattern of this index is based on the expenditure of all urban households in the Colombo district. The expenditure weights are based on data from Household expenditure canvassed in the survey during the 12 month period January 2002 to December 2002. The survey covered 25,000 household from all over the island and over 1,300 households from the Colombo urban area. Therefore, the relevant consumption patterns, including seasonal variations, are captured in the CCPI (N).

Geographically the new index covers the total Urban Colombo District while covering all socio economic groups in terms of population. All goods and services bought by the reference population for the purpose of consumption goods and services are categorized into 10 groups. The CCPI (N) includes 334 items for a base period of 12 months. 12 price collection centres were identified to collect data within urban area of Colombo district.

In comparison to the old CCPI, which covered only the working class in the Colombo Municipal Council area, the CCPI (N) covers all households in the Colombo district. The average monthly expenditure per household was Rs.202.04 according to the CCPI, while it is Rs.17,996.38 according to the CCPI (N). Accordingly, the value of one index point in the CCPI was Rs.2.02, and in the CCPI (N) it is Rs.179.96.

Reflecting actual consumption patterns, the CCPI (N) places greater weight on non food items (53.29%), such as housing, water, electricity and fuel items. Food, items consist of 46.71% of the total value. However the comparison may vary from percentage of expenditure weights and some selected food and non food items. In terms of the movement of inflation, the CCPI (N) at the end of 2007 shows a smaller rate of inflation than the CCPI.

(B) Dr. Harsha De Silva, LIRNEasia

Dr. De Silva focused on two major points, i.e. changing the basket and changing the sample.

In terms of changed to the basket of items in the CCPI, the new index is more meaningful as it reflects current expenditure patterns. The core index is designed without price regulated items. It has less volatility which makes it more favourable for use in investment planning.

In terms of changed sample, the new index is less restrictive but it still reflects only partial reality as it does not cover the whole of the country. However, changing the sample in this manner has wider implications, in particular when the CCPI is used for inflation adjustment of salaries. The CCPI (N) may be less pro-poor because the expenditure patterns of the average household in the new sample may not reflect the expenditure patterns of the poor. For example, the food weight was 68.3% in the CCPI, but in the CCPI (N) it is 46.7%. This is because of the sample used in the CCPI (N) as the ratio of expenditure on food is lowest in the western province and is also relatively low among the higher the income of the household.

The solution therefore may be purpose – defined CPI indices, which is the case in several countries in the world including the USA.

(C) Deshal De Mel, Institute of Policy Studies

Mr. De Mel identified three main areas which need to be discussed in relation to CCPI (N):

- The extent to which the official CCPI index is actually used
- Whether it reflects the reality of different social groups?
- The accuracy of the determination of prices used to compile the index

With regards to the first question of the extent to which the CCPI is used, in most cases the market determines wages, not the CCPI. Particularly at lower levels within the private sector the market tends to drive wage rates. In the informal sector too, wages are unaffected by CCPI. At higher levels within the private sector there is more space for bargaining so the results of an index such as the CCPI become more important. However, on the whole few people's wages are impacted by the CCPI. Pensions also have no official link to the CCPI so do not go up or down with the changes in the index.

The second question refers to the basket of goods and services which has been used in the creation of the new index. Since the new index uses a cross-section of the population in Colombo rather than one socio-economic group, an averaged out consumption basket is unlikely to reflect average consumption patterns amongst the working class as the divergences in living standards are simply too wide. Poorer socio-economic groups are those most affected by inflation, particularly in the plantation sector, so this index should perhaps reflect the impacts on their basket of goods.

The accuracy of price collection should be increased now that the DCS has increased the number of markets from which it collects data. But this method of collection still does not always reflect the true prices that people pay. The methods used for collection and the prices should be publicised and made available for verification. Updating the basket of goods every five years is also a positive step, but the way that weights and goods are selected

needs to be made more transparent as it is difficult to make judgements on the validity of the basket of goods without such transparency.

The CCPI (N) has tended to show lower inflation than the old CCPI – but is this due to better reflection of the reality, or just fiddling with the numbers? This is open to debate in the absence of more transparency about how the index is put together.

3. Summary of floor discussion

The first question posed to the panel was whose inflation is the CCPI(N) really capturing? Do we need purposive CPIs in Sri Lanka? Mr. D C A Gunwardhana acknowledged that there is now a sole reliance on the CCPI for statistics, partly caused by the demand for statistics to be ready by the last day of the month. This makes it difficult to collect data from outside Colombo, so it has now become the norm to collect prices from Colombo and to prepare the figures during the last week of the month. But he agreed that there is a need to have a national level index, and cited the existence of the Sri Lanka Consumer Price Index which was never officially adopted.

Another question raised was what makes an index an *official* index that impacts on Cost of Living Allowances (COLA)? For it to be made official, does legislation have to be amended? Mr. Gunwardhana confirmed that legislation would need to be changed, but that in his opinion it is unlikely to happen soon. He also highlighted that should the CCPI (N) become official, it would be difficult for the government to pay the new index point value, which is much higher than in the case of the old CCPI.

A Union representative pointed out that from the perspective of the private sector only a handful of employers are 'burdened' with the CCPI, as most wages are determined by collective bargaining. In the plantation sector too, wages were de-linked from the CCPI in 1992 and are now based on collective bargaining agreements. In the private sector most companies don't pay cost of living increases. Linking the CCPI to wages needs to be seriously thought through. Some employers pay an annual lump sum for cost of living, plus wage increases. Others pay a monthly cost of living allowance, and for them indices such as the CCPI would therefore have a huge fluctuating impact. It would not be sustainable for businesses to cope with. Employers are competing with the informal sector which does not pay cost of living increases, they would not be able to remain competitive. The important point here is to pay a living wage, there is a need for a forum to decide the basis of a living wage. Dr. Harsha De Silva pointed out that this is moving away from the *principle* behind the new CCPI, since the issue of high increases in cost of living allowances is linked to the problem of high inflation rates - not to the index itself. If inflation is rampant, this is not a reason not to pay the increases.

Consumer price indices usually leave out the richest and poorest households as they distort the figures – particularly the richest which skews the basket of goods. What was the rationale for the DCS including all socio-economic group households in this index? Mr. D C A Gunwardhana responded that the DCS had decided to try and cover all socio-economic levels in this revised index, using data from across the spectrum.

The publication of sub-price indices would give different organisations (e.g. unions) the opportunity to make up their own index based on the basket of goods that their constituency is most likely to be spending on. The averaging out involved in this index means that it shouldn't be used for indexation, but it is a good indicator of the heat in the

economy. It could be improved by collecting prices from more than one urban area from around the country rather than relying on Colombo market prices. Mr. Gunawardhana confirmed that sub-price indices are available on the DCS website. But it is difficult to collect information on prices for some goods which are not always available in markets outside Colombo.

Another question raised was does the index take into account the fact that people are substituting goods in order to survive? There are major changes in consumption patterns due to some price increases. Mr. Gunawardhana emphasized that the CCPI (N) is not a *cost of living* index, but a consumer prices index. Therefore it reflects the prices of the fixed basket of goods rather than reflecting changes in what people are buying on a day to day basis. However, the recognition of these changes is the reason why the new index will be revised every 5 years to prevent it becoming out-of-date in terms of consumption patterns.

Why were alcohol and cigarettes excluded from this index? They are likely to be a substantial proportion of what people spend on! Mr. Gunawardhana noted that the government did not want these items in the index since it is discouraging their purchase. It also does not want cost of living allowances to be affected by increases in the prices of these products since it does not want to subsidise these costs!

Whenever a new index is introduced, in any country, there is a tendency for it to show lower inflation. This was the case with the CCPI (N), however the trend line shows that it will soon eclipse the CCPI and show higher inflation. ***The panel agreed that whichever index one looks at,*** the pattern is the same. Even if an index is not representative of every group, ALL baskets are experiencing increases in price. It can, therefore, be a red herring to fiddle with the figures in new and different indices. It's good to have an updated index, but this mustn't detract from the obvious overall trend of increasing inflation. In this respect it would be good to have an all-country index which would avoid claims that the CCPI or CCPI(N) are flawed therefore do not reflect the reality. Finally, it was noted that it would be useful to have more information and transparency around how the figures are calculated for the consumer price index.

Annexes

Annex 01: PowerPoint Presentation

(A) DCS Presentation

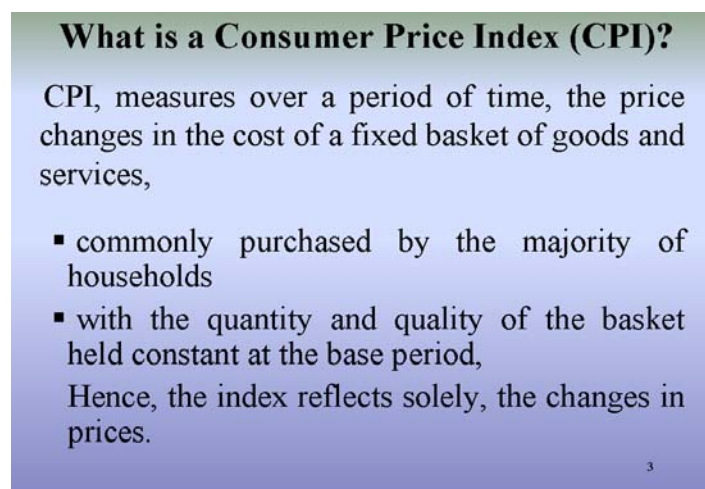
Slide 01



Slide 02



Slide 03



Slide 04

Purpose of a Consumer Price index

- A measure of the changes in the general level of prices and Inflation.
- Use for deflation of current value aggregates in national accounts
- Use for formulation of policy for the determination and evaluation of wages and other monetary incomes
- Use for indexation of wages, salaries and social security benefits and for economic and social analysis.

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Weaknesses of CCPI (1952 = 100)

- The current CCPI is the country's official Consumer Price Index and is computed monthly by the DCS.
- The current CCPI, having a base year as far back as 1952, was computed in accordance with the household consumption of the working class households within the Colombo Municipal area, as per the family budget survey of 1949/1950.
- The weight structure in the CCPI was based on the average household expenditure of a sample of 455 working class households in the Colombo City limits, enumerated in that survey.

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Weaknesses of CCPI (1952 = 100) ctd.....)

Consequently, the current CCPI could not be considered as the best measure of inflation prevailing at a particular time in the country since,

- It does not represent the true changes in the costs in line with the changing consumption patterns. The range and availability of goods and services have widened over the years, but these new items have not been included in the index.

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Weakness of CCPI (1952 = 100) ctd.....)

The index was highly sensitive to the prices of a few items, due to the outdated consumption pattern and unrealistic weights attached to such items, based on the outdated consumption pattern.

- It was limited in scope, both in terms of geographical and income group coverage.

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CPI – Current position

- Recognizing the need for a new and more reliable index of consumer prices, the DCS had attempted 6 previous occasions to revise the current CCPI in

1960 1983

1972 1991 - Greater Colombo Consumers' Price Index and

1978 2001 - Sri Lanka Consumers' Price Index

- However these were not adopted.
- The current CCPI, in spite of its limitations, has continued to be the sole index.

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CPI – Current position ctd....

- In order to maintain the relevance of the CPI and to reflect the latest household spending patterns, the new CPI basket and new weighting patterns should be introduced periodically to capture the current consumption pattern.
- Most countries adopt a 'five year rebasing' of the CPI.

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A NEW COLOMBO CONSUMERS' PRICE INDEX - CCPI(N)

Due to the above limitations,

- A more representative consumer price index based on the Household Income and Expenditure Survey of 2002 has now been constructed by the DCS, addressing the main deficiencies of the current CCPI.
- **The new index, known as the “New Colombo Consumers’ Price Index (termed CCPI(N))”.**
- The weighting pattern of this index is based on the expenditure of all urban households in the Colombo district.

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A NEW COLOMBO CONSUMERS' PRICE INDEX - CCPI(N)

Source of Weights :

- Expenditure weights were obtained using data on HH expenditure canvassed in the survey during the 12 month period January 2002 to December 2002
- Since the survey covered 25,000 all island HHs during 1 year in 12 rounds and over 1300 HHs. from the Colombo urban area, it has captured the relevant consumption pattern including seasonal variations.

Geographical coverage

- Total Urban area of Colombo District

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CCPI(N) ctd.

Population Coverage :

- All Households, i.e. all socio-economic groups, in urban area of Colombo District.

Item Coverage :

- All goods and services bought by the reference population for the purpose of consumption goods and services are grouped in to 10 groups. The CCPI (N) includes 334 items.

Base period :

- The 12 month period
January 2002 – December 2002

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CCPI(N) ctd.

Price collection centers :

- Pettah
- Maradana
- Wellawatta
- Dematagoda
- Grandpass
- Borella
- Kirulapana
- Dehiwala
- Kotte
- Nugegoda
- Kolonnawa
- Rathmalana

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CCPI(N) ctd.

Salient Features :

- Base Year : 2002 = 100
- Geographical coverage : Urban area of Colombo District
- Reference population : All Households
- The average household size : 4.5 persons.
- The average monthly expenditure Per Household : Rs. 17,996.38
- Value of one index point : Rs. 179.96

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CCPI(N) ctd.

Comparison of CCPI and CCPI(N):

	CCPI(N)	CCPI
▪ Groups	: 10	5
▪ Sub Groups	: 83	38
▪ No. of items	: 334	220
▪ Base Year	: 2002 = 100	1952 = 100
▪ Geographical coverage	: Total Urban area of Colombo District	Colombo MC only
▪ Reference population	: All Households	Working class
▪ The average household size	: 4.5 persons.	5.8 persons
▪ The average monthly expenditure Per Household	: Rs. 17,996.38	Rs. 202.04
▪ Value of one index point	: Rs. 179.96	Rs. 2.02 ¹⁵

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CCPI(N) ctd.

Percentage and Expenditure Values for base period 2002
New Colombo Consumers' Price Index - CCPI(N)

Major Group	Exp. Value (Rs. Cts.)	% of Total (Weights)
Grand Total	17,996.38	100.00
Food	8,405.65	46.71
Non Food	9,590.73	53.29
1. Food and Non Alcoholic Beverages	8,405.65	46.71
2. Clothing and Footwear	554.86	3.08
3. Housing, Water, Electricity, Gas & Other Fuels	3,291.30	18.29
4. Furnishing, Household Equipment and Routine household Maintenance	580.16	3.22
5. Health	752.01	4.18
6. Transport	1,703.83	9.47
7. Communication	796.06	4.42
8. Recreation and Culture	393.21	2.18
9. Education	1,041.67	5.79
10. Miscellaneous Goods and Services	477.64	2.65

Source : Department of Census and Statistics.

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CCPI(N) ctd.

Comparison of percentage expenditure weights for some selected food and non-food items – CCPI and CCPI(N)

TABLE

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Slide 18

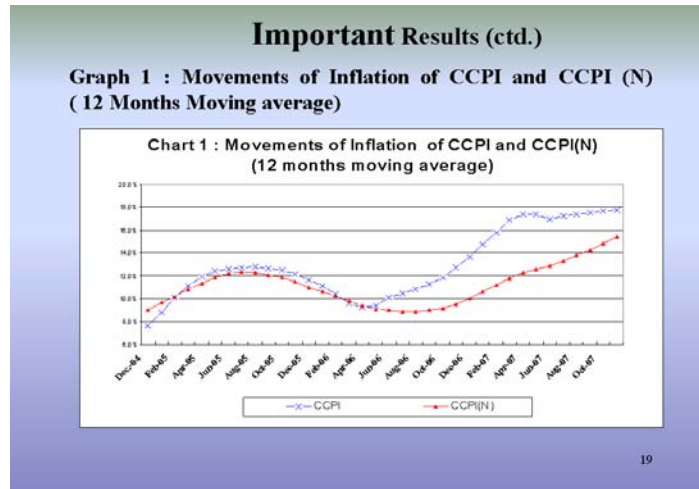
Important Results

Table 1 : MOVEMENTS OF THE CCPI and CCPI(N)
CCPI - Base : 1952 = 100 and CCPI (N) - Base 2002 = 100

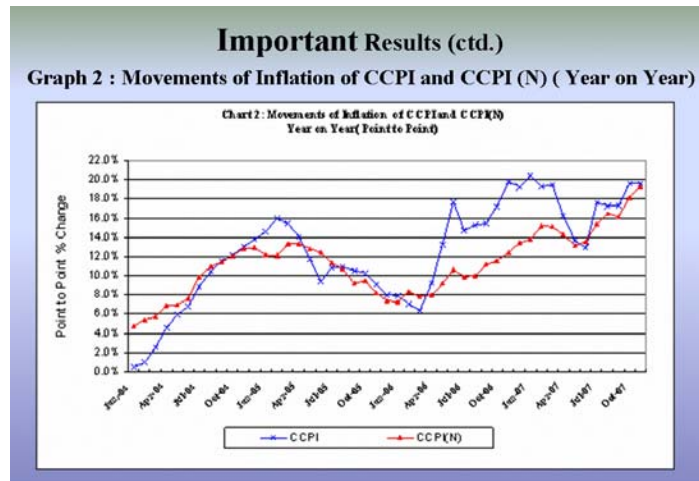
Year Month	Index Number		Point to Point		12 Months moving Average	
	CCPI	CCPI(N)	CCPI	CCPI(N)	CCPI	CCPI(N)
2003	3377.0	105.8			6.3%	5.8%
2004	3632.8	115.3			7.6%	9.0%
2005	4055.5	128.0			11.6%	11.0%
2006	4610.8	140.8			13.7%	10.0%
2007 Jun	5184.3	151.8	20.9%	13.7%	14.8%	10.6%
Feb	5116.0	155.2	19.2%	15.2%	15.8%	11.1%
Mar	5029.6	155.0	19.9%	15.1%	16.8%	11.7%
Apr	5025.4	156.3	16.3%	14.3%	17.4%	12.3%
May	5176.4	157.3	13.7%	13.2%	17.4%	12.6%
Jun	5344.3	160.6	13.0%	13.5%	17.0%	12.8%
Jul	5496.5	163.1	17.0%	15.4%	17.2%	13.3%
Aug	5453.2	165.2	17.3%	16.5%	17.3%	13.8%
Sep	5513.8	166.7	17.3%	16.1%	17.5%	14.2%
Oct	5723.0	171.8	19.6%	18.2%	17.7%	14.8%
Nov	5976.2	176.4	19.6%	19.3%	17.7%	15.4%
Dec	5954.9	178.1	16.4%	18.8%	17.5%	15.8%

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(B) Dr. Harsha De Silva's presentation.

Slide 01

Updating the CCPI Implications for the private sector

CEPA, 33rd Open Forum on Poverty

Harsha de Silva
Lead Economist, LIRNEasia

Slide 02

2 relevant points

- Changing the basket
 - Reflect reality through CCPI(N) → **No real problem**
 - CCPI(N) Core Index without items in CPA, NTC, TRC etc → **Not relevant outside CBSL**
- Changing the sample
 - From a key indicator perspective → **Better, but not best**
 - From an escalation agreement perspective → **Many problems**

Slide 03

Changing the basket Reflecting reality

- In line with actual expenditure of the sample
 - More meaningful
- Less volatility [with New] is better for investment planning
 - Across markets
 - Fixed income securities, annuities
 - Equities
 - Price-cost divergences
 - Inflation protection hedging instruments

Slide 04

Changing the basket

CCPI(N) Core Index

- If it helps CBSL manage MP better, so be it
 - Difficulties with changes in items covered in the many Acts
 - But, not to do this...
 - "Perhaps at the risk of being considered somewhat immodest, that we are reasonably satisfied with our past year's accomplishments..."
 - MP Road Map 2007
 - CCPI lower bound forecast 7.5% → actual 18.8%
 - Maintaining a constant relationship is important
-

Slide 05

Changing the sample

Key economic indicator

- In line with actual expenditure of all urban households in the Colombo district
 - Better than the restrictive sample earlier from a robust indicator point-of-view
 - Partial reality?
 - Why Colombo; and not Sri Lanka [1997]
 - Other samples
-

Slide 06

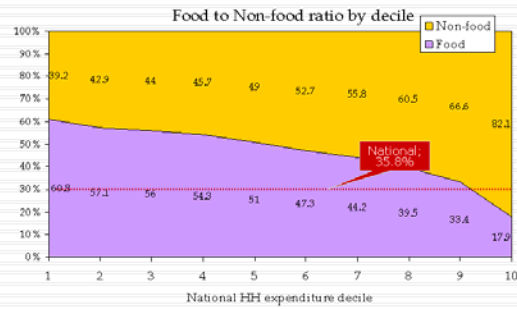
Changing the sample

Escalation agreement perspective

- Escalation or adjustment agreements
 - GOSL specified COLA
 - Private sector collective bargaining agreements
 - Many others
 - Employees
 - New index less pro-poor [CEPA!!]
 - Divergence between COL and COLA for lower level workers
 - Employers
 - Impact dependent on worker ratios
-

Slide 07

Lower level workers across LK have higher food component



HIES 2006/07

Slide 08

Double whammy!!

New basket and sample both impact negatively

- Executives in Colombo tilt the index further against the working class
- Food Ratio lowest in WP; Colombo District [HIES 2006/07]
 - Western 29.7%
 - Central 42.5%; Southern 36.1%; Eastern 47.5%; NWP 41.6%; NCP 33.7%; Uva 42.2%; Sabaragamuwa 45.6%
- CCPI food weight 68.3%; CCPI (N) 46.7%
- The Nielsen Company RPI: Oct 2006 to Oct 2007
 - Branded goods 22%
 - Unbranded 30%

Slide 09

Possible alternatives

- Purpose defined CPI index
 - US and many others
 - CPI-U: All urban consumers
 - 87% of US population
 - CPI-W: Urban wage earners and clerical workers
 - 32% US population
 - To determine blue-collar worker COLA
 - Social Security Payments
- So, after all, there **was** a reason for the sample of 455 working class households

Annex 02: List of Attendees

Name	Organisation
01. Subash Amaratunga	AC Nielsen Sri Lanka
02. Therica Miyenadeniya	AC Nielsen Sri Lanka
03. Ravi Peiris	EFC
04. Meghamali Aluvihare	EFC
05. K.B.G Kamalanie	EFC
06. Romeshum Kulasabanathan	SIDA
07. Induni de Silva	UNDP Regional Centre
08. Neil Fernando	UNDP Regional Centre
09. Claus Astrup	The World Bank
10. Natasha Guneratne	Sunday Times Financial
11. J.Weerasekara	Sunday Times Financial
12. Deshal De Mel	IPS
13. W. G.Somarathne	Oxfam-Australia
14. D.C.A.Gunawardhana	DCS
15. Dr. Harsha De Silva	LIRNE <i>asia</i>
16. Sanath Manage	UNDP
17. Lionel Siriwardhana	UNDP
18. Leon Joseph	Progress Union
19. Amala de Silva	University of Colombo
20. W.D.Laxman	University of Colombo
21. Ramani Kangaraarachchi	Daily News
22. Murtaza Jafferjee	JB Securities Ltd.
23. Dr. Palitha Ekanayake	Freelance Consultant
24. Azra Jafferjee	Freelance Consultant
25. S. Shivakumaran	CEPA
26. Lakmini Premarathne	CEPA
27. Prashan Thalayasingham	CEPA
28. Azra Abdul Cader	CEPA
29. Priyanthi Fernando	CEPA
30. Mansi Kumarasri	CEPA
31. Amila Balasooriya	CEPA
32. Naguleswaran Sivatheepan	CEPA
33. Arunika Meedeniya	CEPA
34. Neranjana Gunetilleke	CEPA