17th July 1996

OPINION OF THE EUROPEAN MONETARY INSTITUTE

on a consultation from the Commission of the European Communities under Article 105(4) and 109 f (8) of the Treaty and Article 5(3) of Council Regulation No 2494/95 of 23rd October 1995;

on a **draft Commission Regulation concerning Harmonised Indices of Consumer Prices giving measures on initial coverage, treatment of newly significant goods and services, minimum standards for procedures of quality adjustment, minimum standards for prices, price indices for elementary aggregates and minimum standard for sampling** (No XX/96) ("Draft Regulation").

CON/96/06

1. The present consultation was initiated on 8th July 1996 by the Commission of the European Communities which, for this purpose, transmitted to the EMI document [SG(96)D/165229] containing the Draft Regulation.

2. The Draft Regulation is a consolidation of six draft regulations. The EMI gave its opinion on four of these on 15th February 1996 **(CON/96/01)**. The following opinion thus refers to the two new parts 'treatment of newly significant goods and services' (part A) and 'minimum standards for sampling' (part B) only.

3. The EMI considers these two new parts of the Draft Regulation to be important initial steps towards harmonised indices of consumer prices and welcomes this initiative.

4. The EMI considers that the consultation obligation provided for by Article 105(4) combined with Article 109f(8) of the Treaty and, more specifically in this case, by Article 5.3 of the Council Regulation on HICP, is an essential tool which enables the EMI as a main user of future HICPs and as predecessor of the ECB to put forward its position on the envisaged harmonisation measures. Given the procedure provided for in Article 14 of the Council Regulation on HICP, which enables the Commission to adopt the measures envisaged only if they are in accordance with the opinion of the Statistical Programme Committee (SPC), it is highly desirable, in the opinion of the EMI, that the latter is formally consulted well in advance of the corresponding meeting of the SPC. A consultation at a later stage much reduces the effectiveness of the EMI's opinion.

A.   Treatment of newly significant goods and services

5.   The objective of Article 4 of the Draft Regulation is to ensure that Member States follow comparable practices for including newly significant goods and services ("new goods") in harmonised indices of consumer prices (HICPs). Present practices of Member States are likely not to meet the comparability requirement of Article 4 of the above Council Regulation.

6.   The EMI welcomes the fact that 'new goods' are subject to a Commission draft Regulation, since their treatment may not only be a source of non-comparability of HICPs, but also a potential source of bias in the indices, if new goods are not captured in a timely manner. Whenever the price development of new goods differs from that of the overall index, the practice followed for their inclusion is relevant for the reliability and comparability of HICPs.

7.   Article 4 of the Draft Regulation requires all Member States to *systematically* seek to identify new goods, to check the domestic importance of those reported to be newly significant in other Member States and to include a new good when it exceeds a given share on expenditures covered by the HICP within a specified time. These rules appear to be appropriate to improve HICPs.

8.   The background against which the Draft Regulation will be implemented differs considerably between Member States, mainly due to the close link between the inclusion of new goods and the present frequency at which the weighting structure of the index is updated. For the majority of Member States, which apply 'fixed' index weights over several years, this requires the resolution of two basic questions. First, statistical information on the current consumption pattern is needed for the decision on the significance of a new good. This information will not be available from the usual sources for the index weights, if these are collected in longer intervals only. Second, the frequent change of index weights as a consequence of the inclusion of new goods is not foreseen in the concept of a fixed weight index. The Draft Regulation takes the latter into account by leaving the decision on an *explicit* update of the index weights to the Member States. Member States applying 'fixed weights' are allowed to introduce new goods within a lowest index level category without changing the weight of this category. Though this rule does not lead to full comparability between the national HICPs, the EMI supports this approach, since this Regulation must neither challenge the existing fixed weight indices nor prejudge the harmonisation of the frequency for regularly updating the weighting structure of HICPs. However, this points to the importance of the frequency of the regular updating applied in the Member States. Further work is needed soon both to examine and to evaluate available options for their harmonisation, with a view to ensuring that updating occurs on a sufficiently timely basis across all Member States.

B.   Minimum standards for sampling

9.   The objective of Article 8 of the Draft Regulation is to ensure sufficiently reliable price sampling for HICPs for the purpose of international comparison and to provide information from which to set minimum standards for sampling. Present sample design across Member States is likely to fail the comparability requirement of Article 4 of the above Council Regulation.

10.   Both the HICPs and the national CPIs will benefit from efforts at EU level to evaluate and improve the reliability of consumer price statistics. Moreover, improving the reliability of samples can benefit the cost efficiency of consumer price statistics, if sample design can be improved by reallocating resources without increasing the overall sample size.

11.   The EMI welcomes the fact that this issue has been given higher priority than previously planned due to its close links to other important issues relevant for the harmonisation of CPIs (e.g. 'coverage' and 'monthly price collection') and acknowledges Article 8 and 9(f) as a first measure to identify the extent of non-comparability and to improve reliability of HICPs.

12.   Measures aiming at improving the reliability of HICP sampling procedures have to balance the different requirements resulting from the main uses of HICPs. First, for the purpose of assessing convergence, a sufficient level of reliability of the <u>national all item HICPs for each of the 15 Member States</u> has highest priority. Second, for conducting a future single monetary policy, the reliability of the <u>Monetary Union area-wide HICP</u> will gain importance. Though these two main uses of HICPs do not lead to one unique, optimal sample design, sufficiently reliable HICPs for all 15 Member States as they are required for assessing convergence will provide a good basis for a reliable area-wide Monetary Union HICP. The Draft Regulation takes this into account by giving priority to the 15 national all item HICPs.

13.   Moreover, the EMI supports the fact that the Draft Regulation requires sufficiently reliable sub-indices for each category of HICPs, taking into account the weight of the category. Reliable sub-indices are an indispensable precondition for the analysis of price developments.

14.   At the same time, the statistical evaluation of the reliability of consumer price indices is for most compilers of CPIs a largely new field. Therefore, the Draft Regulation at this juncture neither stipulates any detailed statistical standards nor requires any immediate sample adjustments from Member States. Instead, the Commission (Eurostat) will request from Member States information sufficient to evaluate reliability and to derive proposals for minimum standards for sampling for inclusion in the 'Review'-Report of HICPs required under Article 15 of the above Council Regulation due in autumn 1997. Given the complexity of the issue and the lack of experience with it, the EMI accepts this staged approach as a reasonable

way to improve reliability. However, as a consequence, the 'Review' of HICPs gains particular importance and the EMI expects from it satisfactory information on present sample design and concrete proposals for their improvement which will then have to be implemented.