

**ANNEXES TO PROPOSAL FOR COMMISSION REGULATION
CONCERNING HARMONISED INDICES OF CONSUMER PRICES:
MINIMUM STANDARDS FOR PROCEDURES OF QUALITY
ADJUSTMENT**

- Annex 1** Communication to the European Monetary Institute
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COMMUNICATION TO THE EUROPEAN MONETARY INSTITUTE

Reference : Proposed Commission Regulation concerning Harmonised Indices of Consumer Prices: Minimum Standards for Procedures of Quality Adjustment

Justification

1. Under the Treaty establishing the European Community (Article 109j) the European Monetary Institute (EMI) and the Commission are required to report to the Council on the progress made in fulfilment by the Member States of their obligations regarding the achievement of economic and monetary union. One criterion of such progress is a high degree of sustainable convergence in price stability as apparent in the rate of inflation in comparison with the three best performing Member States. Inflation has to be measured by means of the consumer price index on a comparable basis. The CPIs of Member States currently differ in concepts, methods and practices and a programme of harmonisation is therefore necessary to produce comparable indices. CPIs are politically, socially and economically sensitive statistics and cannot be readily changed. It will therefore be necessary to construct distinct CPIs which are comparable. The indices will be referred to as Harmonised Indices of Consumer Prices (HICPs).
2. The harmonisation project is in two steps: first the framework Council Regulation (EC) No. 2494/95 of 23 October 1995 published in the Official Journal No. L 257 on page 1; followed by a series of Commission Regulations containing detailed technical guidelines for progressing implementation in stages from March 1996 to January 1998 and thereafter if necessary. This Commission Regulation deals with Minimum Standards for Procedures of Quality Adjustment. The draft proposes that Member States agree to report adjustments to Eurostat which will maintain a database for access by the Member States. Eurostat will not itself estimate adjustments or arbitrate on them but would simply act as a clearing-house. In the event of an estimate being required but not available Eurostat might provide one after discussion with one or more Member States as deemed appropriate. This system will help to ensure that Member States adopt similar methods for quality adjustment.

Draft Regulation

3. The EMI is invited to give its opinion on the draft Commission Regulation.

EXPLANATORY MEMORANDUM

1. Council Regulation (EC) No. 2494/95 (Article 4) requires the Commission (Eurostat) to adopt rules to be followed to ensure the comparability of HICPs. Evidence suggests that quality adjustment is a major source of non-comparability between CPIs; the Working Party on Harmonisation has made this a priority issue. A large part of the differences can be attributed to the frequent use of "all" or "nothing" default adjustments in the absence of information on the "value" of quality changes identified. The application of minimum standards will thus contribute significantly towards improved comparability. Further improvements should be achieved as existing practices will be subjected to a greater degree of scrutiny than at present.
2. This Regulation will require Member States to examine quality adjustment procedures and to avoid the assumptions that quality changes either have no price or that they account for the whole of any price difference when these are not justified. Member States will be free to determine the methods of evaluating quality, helped by pooled information on the specific adjustments that have been made by other Member States. The HICP Working Party has supported the suggestion of sharing information on the quality adjustment of high-tech goods such as motor vehicles and electronic goods. Eurostat has accepted that it should gather such information together so that it is readily available to National Statistical Institutes seeking quality adjustments in these areas. It is also hoped that information obtained under Article 4 will be a source for determining and disseminating good practice.
3. Although "quality change" is defined in Article 2 of the Regulation it is left for Member States to decide whether a particular change in specification should be regarded as a "quality change" for the purpose of constructing the HICP. The definition given in the European System of Accounts (ESA) 1995 (paragraph 10.16) may be of some assistance.

**COMMISSION REGULATION (EC) No [XX/96]
OF [DATE]
CONCERNING HARMONISED INDICES OF CONSUMER PRICES:
MINIMUM STANDARDS FOR PROCEDURES OF QUALITY ADJUSTMENT**

The Commission of the European Communities

Having regard to the Council Regulation (EC) No 2494/95¹;

Whereas each Member State is required to produce a Harmonised Index of Consumer Prices starting with the index for January 1997;

Whereas procedures for adjusting prices for quality changes of the items priced differ between Member States to the extent that the resulting Consumer Price Indices fail to meet the comparability requirement of Article 4 of the above Council Regulation;

Whereas implementing measures are necessary for ensuring the comparability of Harmonised Indices of Consumer Prices in accordance with Article 5.3 of the above Council Regulation;

Whereas the envisaged measures are in accordance with the opinion of the Statistical Programme Committee (SPC), established by Council Decision 89/382/EEC²;

Whereas the European Monetary Institute has reached a favourable conclusion on the Commission proposal;

HAS ADOPTED THIS REGULATION :

Article 1 Aim

The aim of this Regulation is to establish minimum standards for the procedures of quality adjustment of Harmonised Indices of Consumer Prices (HICPs).

Article 2 Definition

(1) For the purpose of this Regulation "Quality change" occurs whenever the Member State judges that a change in specification

¹ OJ No L 257, 27.10.1995, p. 1.

² OJ No L 181, 28.6.1989, p. 47.

has resulted in a significant difference in utility to the consumer between a new variety or model of a good or service and a good or service previously selected for pricing in the HICP for which it is substituted. A "Quality change" does not arise when there is a comprehensive revision of the HICP sample.

- (2) "Quality adjustment" is the procedure of making an allowance for a quality change by increasing or decreasing the observed current or reference prices by a factor or an amount equivalent to the value of that quality change.

Article 3 Comparable Results

- (1) With reference to Article 4 of the above Council Regulation, HICPs for which appropriate quality adjustments are made shall be deemed to be comparable.
- (2) Where quality changes occur, Member States shall construct price indices by making appropriate quality adjustments based on explicit estimates of the value of the quality change. In the absence of national estimates, Member States shall use estimates based on information provided by Eurostat where these are available and relevant.
- (3) Where no estimates are available, price changes shall be estimated as the difference between the price of the selected substitute and that of the item it has replaced. In no case should a quality change be estimated as the whole of the difference in price between the two items, unless this can be justified as an appropriate estimate. Where replacements have to be made after goods or services have been offered at reduced prices, those replacements should be selected according to their similarity of utility to the consumer and not according to similarity of price.

Article 4 Quality Control

Member States shall monitor the incidence of quality changes and the adjustments made sufficient to demonstrate compliance with this Regulation and shall provide the Commission (Eurostat) at its request with such information.

Article 5 Entry into Force

This Regulation shall enter into force on the 20th day following its publication in the Official Journal of the European Communities.

This Regulation shall be binding in its entirety and directly applicable in all Member States.