

# Financial services

**Moderator:** Mick Silver, Cardiff University.

## Summary of session

Financial services other than insurance have typically been ignored or badly covered in consumer price indexes. This reflects the lack of a conceptual framework for their measurement and the difficulty of obtaining reliable data.

Fixler and Zieschang outlined the national accounts concept of the value of financial intermediation services to households (CPI) and by financial firms (PPI) which comprises an implicit measure of services (essentially interest margins) and explicit fees and charges. They then discussed the data required and presented three approaches for measuring the reference rate required for the implicit service charge.

Woolford addressed the question of which financial services fall within the domain or scope of the consumer price index. He argued that the answer depended on the principal purpose of the index, i.e. whether it is to measure changes in living standards, to assess changes in money incomes or is a measure of price inflation for households. Assuming the principal purpose is to measure price inflation, he considered the measurement of three types of financial service: currency exchange, stockbroking services and deposit and loan facilities. Particular attention was directed to areas where the 'quantum' was more difficult to grasp (e.g. maintaining a current account with a bank) and the price less explicit. While the measurement of deposit and loan facilities was similar to that outlined in Fixler and Zieschang, it was argued that measures of margins cannot be constructed independently from direct fees and charges (i.e. a total cost must be calculated at the individual product level).

In a useful paper, Frost elaborated on the approach taken by the ABS to construct price indexes for deposit and loan facilities along the lines outlined by Woolford. The approach involves collection of detailed data from major relevant institutions at the individual product level to measure price change in interest margins, establishment fees, other fees and charges, and indirect taxes. A sample of accounts is used to measure the latter two elements. The transactions in these accounts are revalued each period and current period fees, charges and taxes applied.

Interest engendered by the last two papers led to a presentation by Obst and a discussion of the 'Australian solution' to the setting of a reference rate for estimating the implicit component. The advantage of this approach is that it avoids the possibility of negative interest margins that is inherent in using an indicator rate as the reference rate.

John Greenlees presented a U.S Bureau of Labor Statistics paper on the direct pricing of health insurance. For health insurance the U.S. currently prices medical care inputs, such as physicians and hospital services, and assumes that the price of health insurance moves roughly in proportion to these prices. He outlined an alternative approach of directly pricing health insurance that is currently being investigated. The change would remove many obstacles to accurate quality adjustment in the current practice. It would, however, also introduce some new issues such as the appropriate handling of risk changes when, for example, the onset of a new disease leads to increases in premiums. A related question is whether employer funded insurance should be included (expenditure made on behalf of the household) or excluded (cost to business).

Participants were supportive of the approach to pricing deposit and loan facilities as outlined by Woolford and Frost. It provided a sound theoretical base for capturing all the prices associated with these services.

In discussions the use of customer (or hypothetical) profiles, rather than a sample of accounts, was considered as a simpler way of measuring explicit costs on deposit and loan transactions. From a practical perspective customer profiles are less data demanding than samples of accounts but still require a substantial resource input. However, the complex and multiple nature of financial charges might not be adequately captured in hypothetical accounts. With either approach it is still possible that account statements might not contain all the necessary information to capture the effects of a change in charging regimes.

There was discussion of the revaluation of the base period quantities of financial services, in particular the Woolford example of revaluing foreign currency purchases by use of the inflation rate of appropriate overseas countries. It was concluded that this was the correct approach.

Participants expressed various views and arguments for the treatment of health insurance and employer contributions. It was suggested that the principal purpose of the CPI should guide the measurement of insurance. Thus employer (and government) contributions to health care might be included in a cost of living index but excluded if the index was to measure changes in money incomes. In an inflation index the aim should be to represent the service provided by the industry. Another line of argument was that it depended on whether employees have any say in the selection of the insurance fund; if they did then employer contributions should be included. Participants also pointed out that whatever treatment is adopted for employer funded insurance, it may need to be also applied to other employer-provided benefits, such as the provision of motor vehicles.

### **Recommendations for statistical agencies**

The method of defining and measuring financial services for inclusion in the consumer price index requires further investigation leading to a universally accepted position. The papers in this session provide real insights into conceptual and practical issues.

Care needs to be paid to the dynamic changes within this sector as the emphasis given to explicit and implicit components change and interact and the quality of the service provided changes.

There is merit in the Australian approach to measuring financial services and their progress should be observed. However, the data demands are extensive and may not be realisable in many countries.