

# STRENGTHEN SOCIAL SECURITY

## ...don't cut it.

### The Chained CPI Is a Benefit Cut: The Longer You Live, The Bigger the Cut

Social Security benefits are adjusted annually to keep pace with inflation. In 1972, Congress enacted the automatic cost-of-living adjustment (COLA) to assure that benefits, once received, maintain their purchasing power, regardless of inflation rates or how long someone lives. The Social Security COLA is based on the **CPI-W**, which measures the change in price of a representative basket of goods and services.<sup>1</sup> Unfortunately, because seniors and people with disabilities spend substantially more on health care than other population groups, the CPI-W usually understates the effects of inflation for these groups.<sup>2</sup>

Some propose a change that will erode the value of benefits even further. They would replace the CPI-W as the basis for the Social Security COLA with the “**chained CPI**,” a measure they argue is better because it takes into account the tendency for people to substitute cheaper goods for more expensive items as prices go up (e.g., taking vacations by automobile when the price of airline tickets goes up). This change has two problems: First, it is debatable whether purchasing power is maintained if an individual has to substitute goods and services on account of price. Second, elderly households spend about twice as much on health care as all other households,<sup>3</sup> and unlike discretionary expenditures, health care cannot be substituted or short-changed.

- **The chained CPI underestimates inflation for retirees and disabled workers.**

- The current CPI-W does not adequately account for the rising health care costs of seniors and people with disabilities. Health care costs have risen faster than prices for other goods and services for over three decades – 5.5 percent per year on average, compared to 3.1 percent for non-medical costs.<sup>4</sup> Health care expenditures also consume an increasingly larger proportion of household budgets. One study found that Medicare households spend a significantly larger share of income on health care than did non-Medicare households: 14.1 percent vs. 4.3 percent.<sup>5</sup> Not surprisingly, health care costs increase with age.<sup>6</sup>
- Using the chained CPI would make the current situation worse, since it assumes that consumers can substitute for cheaper products as some prices go up. But this is not true of the elderly and other groups with high medical expenses. Medical devices, procedures, and many medications are not interchangeable based on price like other consumer products. Even if they were, most patients rely on their physician’s advice on the optimal course of treatment in contrast to decisions about discretionary items, which are made from their own personal preferences.

- **Reducing the current COLA formula would be a significant benefit cut that affects every beneficiary, and hurts lower-income beneficiaries the most.**<sup>7</sup>
  - Basing the COLA on the chained CPI would cut benefits by *\$108 billion over 10 years*.<sup>8</sup>
  - An average earner retiring in 2011 at age 65 would lose over \$6,000 over 15 years if the chained CPI were adopted (compared with the CPI-W), amounting to a 2.2 percent benefit cut. This doubles to a 4.4 percent cut 15 years later (see Table 1).
  
- **The proposed “birthday bump” does not compensate for these across-the-board cuts.**
  - Some propose adopting the chained CPI with an added “birthday bump” – a 1 percent benefit increase for each of years 20 to 24 after initial retirement eligibility.<sup>9</sup> But this supposed “sweetener” *only affects those who live until becoming eligible for the birthday bump*. Wealthier seniors live longer than their lower-income counterparts, so the “birthday bump” does not adequately protect those who need Social Security benefits the most. Even with it, the birthday bump does not fully compensate for the cut the chained CPI entails.

## **A More Accurate Measure of Inflation for Elderly Households Exists – the CPI-E**

Recognizing that the expenditures of the elderly are different from those of the general population, Congress in 1987 directed the Bureau of Labor Statistics (BLS) to develop an index designed to more accurately reflect the inflation experienced by seniors. In response, BLS developed the Experimental Consumer Price Index for the Elderly, or **CPI-E**. The CPI-E is available for years beginning in 1982.

- **The CPI-E more accurately reflects the spending of persons aged 62 and over, giving greater weight to medical care and housing costs.**
  - The CPI-E has grown at a faster rate than the CPI-W. From 1983 through 2007, the CPI-E increased 126.5 percent while the CPI-W rose just 110 percent.<sup>10</sup>
  
- **Although some have asserted that the government should employ a single inflation index for all purposes, it should instead tailor the inflation adjustment it uses to its appropriate purpose.**
  - The government *already uses* different CPI measures: while the CPI-W is used for Social Security and other programs, the income tax brackets rely on the CPI-U, a different formula.<sup>11</sup> The government should not adopt a single CPI because in this case one size does not fit all.
  - Since Social Security affects such a specialized demographic group, the CPI measure that more accurately captures spending *for that group* should be used, which is the CPI-E.

## Effect of COLA Changes on Social Security Benefits for a Typical Retiree

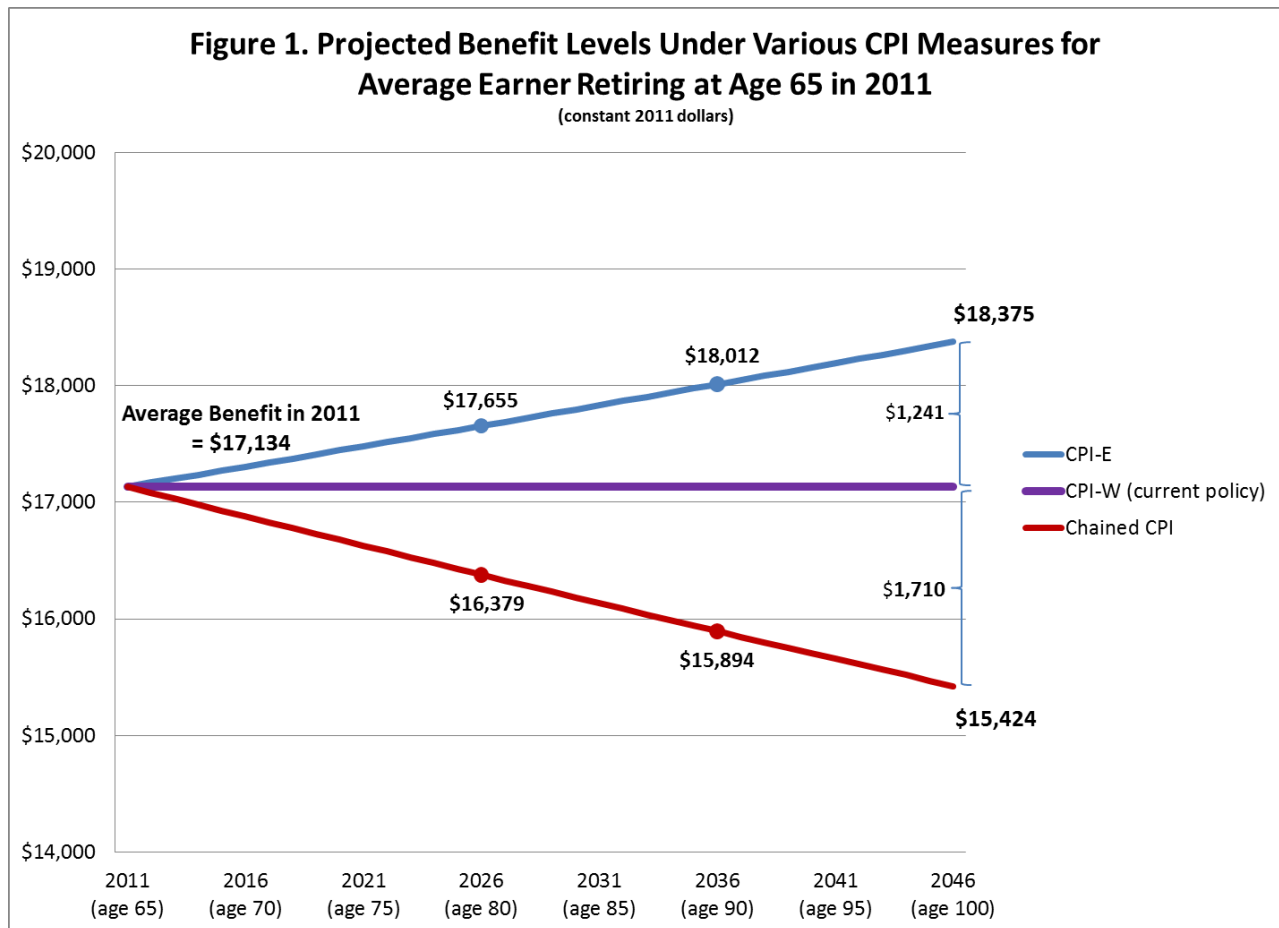
A worker with average lifetime earnings retiring at age 65 in 2011 is examined in the tables and chart below. Table 1 demonstrates the effect of switching from the CPI-W to the chained CPI, while Table 2 shows the difference between the CPI-E and the chained CPI. At age 80, this average earner's benefits would be more than \$750 less under the chained CPI compared to the current COLA, and \$6,000 less over the 15 years. This same earner at 80 would receive \$1,276 less from the chained CPI compared with the CPI-E, while the total lost over those 15 years would be over \$10,000. Both the real dollar amounts and percentages increase over time.<sup>12</sup> These results are displayed graphically in Figure 1.

**Table 1. CPI-W vs. Chained CPI**  
**Difference in Benefits for Average Earner Retiring in 2011 at Age 65<sup>13</sup>**  
(In constant 2011 dollars)

Age	Years in Retirement	Difference in Annual Benefit <i>in this year</i>	Total Accumulated Difference in Annual Benefits	Cumulative Percentage of Benefit Lost by Switching to Chained CPI
70	5	\$256	\$768	0.7%
75	10	\$507	\$2,802	1.5%
80	15	\$755	\$6,083	2.2%
85	20	\$1,000	\$10,592	2.9%
90	25	\$1,240	\$16,312	3.7%
95	30	\$1,477	\$23,223	4.4%
100	35	\$1,710	\$31,309	5.1%

**Table 2. CPI-E vs. Chained CPI**  
**Difference in Benefits for Average Earner Retiring in 2011 at Age 65**  
(In constant 2011 dollars)

Age	Years in Retirement	Difference in Annual Benefit <i>in this year</i>	Total Accumulated Difference in Annual Benefits	Cumulative Percentage of Benefit Lost by Switching to Chained CPI
70	5	\$428	\$1,283	1.2%
75	10	\$853	\$4,698	2.5%
80	15	\$1,276	\$10,234	3.7%
85	20	\$1,698	\$17,880	4.9%
90	25	\$2,117	\$27,629	6.0%
95	30	\$2,535	\$39,470	7.2%
100	35	\$2,951	\$53,395	8.4%



To summarize, everyone who receives Social Security now or in the future has a lot at stake with regard to how the COLA is calculated.

- The CPI-E does a better job of maintaining the purchasing power of benefits than either the CPI-W or the proposed chained-CPI.
- Compared to the CPI-W, the chained CPI represents a \$6,000 loss over the first 15 years of retirement, and a \$16,000 loss over the first 25 years.
- Compared to the CPI-E, the chained CPI represents an even larger loss – a \$10,000 loss over the first 15 years of retirement, and a \$27,500 loss over the first 25 years.

Putting aside all the technocratic spin about the desire to find a more accurate measure of inflation, the only reason switching to the chained CPI has been proposed is that it will result in benefit cuts to Social Security and additional revenues to the federal budget. If Congress wants to cut Social Security, it should do so forthrightly so that it can be held politically accountable – not by asserting false claims of technical accuracy.

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<sup>1</sup> According to the Social Security Administration, “The [Social Security Act](#) specifies a formula for determining each COLA. According to the formula, COLAs are based on increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). CPI-Ws are calculated on a monthly basis by the Bureau of Labor Statistics. A COLA effective for December of the current year is equal to the percentage increase (if any) in the average CPI-W for the third quarter of the current year over the average for the third quarter of the last year in which a COLA became effective. If there is an increase, it must be rounded to the nearest tenth of one percent. If there is no increase, or if the rounded increase is zero, there is no COLA.”

<http://www.ssa.gov/oact/COLA/latestCOLA.html>

<sup>2</sup> An April 2011 fact sheet by the National Academy of Social Insurance notes that “[w]hen Congress enacted automatic Social Security COLAs in 1972, the Bureau of Labor Statistics (BLS) produced only one consumer price index (CPI). It measures inflation experienced by urban wage earners and clerical workers (about 32% of the population). The 1972 amendments used this CPI as the measure of inflation and it remains the basis for determining Social Security COLAs today.... In 1978, BLS expanded the CPI to cover all urban residents (about 87% of the population, including most retirees) and named it the CPI-U (the original CPI was renamed the CPI-W). The CPI-U is used to index personal income tax brackets and poverty thresholds, but is not used to determine Social Security COLAs. In 1988, BLS launched a third, experimental index, the CPI-E, which reflects the spending patterns of persons age 62 and older (about 18% of the population). All of these indexes measure changes over time in the price of a representative market basket of goods and services purchased by their respective populations” (see Benjamin W. Veghte, Virginia P. Reno, Thomas N. Bethell and Elisa A. Walker (April 2011). “Should Social Security’s Cost-of-Living Adjustment Be Changed?” *Social Security Fact Sheet No. 1*. National Academy of Social Insurance.

[http://www.nasi.org/sites/default/files/research/SS%20Fact%20Sheet%20No.02\\_Should%20Social%20Security's%20Cost-of-%20Living%20Adjustment%20Be%20Changed.pdf](http://www.nasi.org/sites/default/files/research/SS%20Fact%20Sheet%20No.02_Should%20Social%20Security's%20Cost-of-%20Living%20Adjustment%20Be%20Changed.pdf) )

<sup>3</sup> Wider Opportunities for Women, “A Methodology to Determine Economic Security for Elders,” December 2006.

<http://www.wowonline.org/ourprograms/eesi/documents/FinalWOWGINationalMethodology.pdf>

<sup>4</sup> Bureau of Labor Statistics, 2011, “CPI-E Values Broken Down By Medical/Non-Medical,” U.S. Department of Labor (unpublished).

<sup>5</sup> Kaiser Family Foundation, “Health Care On a Budget: An Analysis of Spending By Medicare Households,” February 2009.

<http://www.kff.org/medicare/upload/7859.pdf>

<sup>6</sup> Federal Interagency Forum on Aging-Related Statistics, “Older Americans 2010: Key Indicators of Well-Being. Federal Interagency Forum on Aging-Related Statistics,” July, 2010, p. 56. Available at

[http://www.agingstats.gov/agingstatsdotnet/Main\\_Site/Data/2010\\_Documents/Docs/OA\\_2010.pdf](http://www.agingstats.gov/agingstatsdotnet/Main_Site/Data/2010_Documents/Docs/OA_2010.pdf)

<sup>7</sup> The chained CPI would cut benefits on average by 0.3% every year, a reduction that would compound by diminishing the benefit base on which every subsequent COLA is calculated.

<sup>8</sup> CBO, “Budget Options: Volume 2,” August, 2009, p. 147. Available at <http://www.cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf>

<sup>9</sup> National Commission on Fiscal Responsibility and Reform Co-Chairs’ Proposal, p. 50. December 2010. Available at

[http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12\\_1\\_2010.pdf](http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf)

<sup>10</sup> Kenneth J. Stewart, “The experimental consumer price index for elderly Americans (CPI-E): 1982-2007,” Monthly Labor Review Online, May, 2008. Available at <http://www.bls.gov/opub/mlr/2008/04/art2full.pdf>

<sup>11</sup> Bureau of Labor Statistics, Consume Price Index: Second Quarter, 2010. Volume 1, Number 6.

[http://www.bls.gov/opub/focus/volume1\\_number6/cpi\\_1\\_6.pdf](http://www.bls.gov/opub/focus/volume1_number6/cpi_1_6.pdf)

<sup>12</sup> All amounts in the tables and figures are calculated using constant 2011 dollars. Inflation is accounted for by factoring out the CPI-W rate of increase, since this is the current measure SSA uses to compute inflation for Social Security benefits. Average rates of increase for the CPI-W (2.8%) and CPI-E (3.0%) can be deduced from the SSA analysis of H.R. 5834, the ‘Preserving Our Promise to Seniors Act,’ October 8, 2010, available here: [http://ssa.gov/oact/solvency/TDeutch\\_20101008.pdf](http://ssa.gov/oact/solvency/TDeutch_20101008.pdf). The rate of increase for the chained CPI (2.5%) can be deduced from the SSA analysis of an illustrative proposal commissioned by Rep. Earl Pomeroy, October 18, 2010, available here: [http://ssa.gov/oact/solvency/EPomeroy\\_20101018.pdf](http://ssa.gov/oact/solvency/EPomeroy_20101018.pdf).

<sup>13</sup> The SSA’s illustrative “Medium” Earner, which had average annual earnings of \$43,084 in 2010, is about equivalent to the Average Wage Index (AWI), and is thus intended to represent the average earner at any given time. All mentions of the average earner in this fact sheet refer to this “Medium” Earner as designated by SSA.