



The CPI-E – A Better Option for Calculating Social Security COLAs

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President Obama's 2014 budget proposal includes a plan to change the way Social Security cost-of-living adjustments, or COLAs, are calculated by adopting the "chained" consumer price index (CPI). The National Committee has been vocal in its opposition to the chained CPI because it does not accurately measure the purchasing patterns of our elderly population. We urge the adoption of a CPI for the elderly, or CPI-E, as a more accurate means of calculating Social Security COLAs. An in-depth examination of the CPI-E follows.

History and Background

From the inception of the Social Security program in 1935, Congress periodically adjusted Social Security benefits so that beneficiaries' purchasing power would keep up with inflation. Beginning in 1972, Congress enacted a provision that requires benefits to be increased annually based on the amount the consumer price index has increased in the previous year. At the time this provision was enacted, there was only one CPI index available for use, the CPI-W, which reflects price increases for urban wage earners and clerical workers, based on a fixed market basket of goods and services. This index continues in use today as the basis for computation of Social Security COLAs.

Today, the CPI-W reflects the expenditures of about 31 percent of households nationally – those representing wage and clerical households in urban areas. By definition, this population is employed, unlike most retired Social Security beneficiaries, and displays patterns of consumer spending which are reflective of an employed demographic. Concerns about whether the CPI-W accurately reflects the spending patterns of those retired or disabled date back to the 1980s. In 1987, as part of amendments to the Older Americans Act of 1965, Congress directed the Bureau of Labor Statistics (BLS) to develop an index focused on the elderly. BLS then developed the Experimental CPI for Americans 62 Years of Age and Older (CPI-E), and calculated estimates of the index dating back to December 1982.

Seniors' Spending Patterns

To determine consumers' day-to-day living expenses and thus measure the rate of inflation consumers face in the marketplace, the government collects data on a "market basket" of goods and services. Market basket categories include: food and beverage, housing, apparel, recreation, education, transportation, and medical care. Research has shown that spending patterns differ between the elderly and the general population, especially in the health care category. Seniors 65 and older spend more than twice as much on health care, and those 75 and older spend nearly

three times more on health care than younger consumers. Not only do health care expenditures steadily increase with age but health care costs have also consistently risen much faster than other market basket categories. The current price index (CPI-W) does not take these critical differences in the elderly population into consideration.

How the CPI-E Compares to Other Indices

The CPI-E uses the same formulas and prices as the CPI-W, but their importance is determined, or weighted, differently. The CPI-E uses expenditure weights for households with individuals age 62 or older. This sample size is 26 percent of the size used for the other BLS indices, so is subject to a greater sampling error than the other indices. This is one reason the CPI-E continues to be classified as “experimental”.

From December 1982 to December 2011, the experimental CPI-E has tended to rise more rapidly than the CPI-W. Using the CPI-E to determine the Social Security COLA would increase the expected average COLA by about 0.2 percentage points per year. In contrast, using the chained CPI would result in COLAs lower than under current law. COLAs using the chained CPI are estimated to reduce expected average COLAs by 0.3 percentage points per year. That means a typical 65 year-old would see a decrease of about \$130 in Social Security benefits using the chained CPI after the change has been effective for three years. At age 95, the same senior would face a 9.2 percent reduction—almost \$1,400 per year. The BLS acknowledges the current CPI does not “produce official estimates for the rate of inflation experienced by subgroups of the population, such as the elderly or the poor.” Neither the current CPI-W nor the proposed chained CPI takes into account the spending patterns of America’s seniors. This is why we need an elderly index.

According to the BLS, in order to move to an “official” CPI-E, it would need to conduct additional research including where elderly households are located, where the elderly actually shop, and what mix of products the elderly purchase. The CPI-E has been under review for nearly three decades. It is time for the federal government to provide the resources for BLS to conduct this research and to expand the sample size of individuals age 62 and older, to conclude its analysis, and adopt a more accurate consumer price index for the elderly.

NATIONAL COMMITTEE POSITION

The National Committee believes accuracy must be the goal of changing the current consumer price index. The CPI-E represents the best alternative for correcting problems with the CPI-W for America’s seniors. In contrast, the proposed chained CPI does not account for the unique spending patterns of the elderly and would lead to a cut to the already inadequate COLA. In order to implement the CPI-E, the BLS will need sufficient funding to conduct the research and expand the sampling needed to enable the index to move from experimental to official. When the CPI-E becomes official it should, at last, finally represent the most accurate measure of the inflation affecting our nation’s seniors.

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