AgingToday

the bimonthly newspaper of the American Society on Aging

ISSN: 1043-1284 Page 1 JANUARY–FEBRUARY 2012

www.agingtoday.org volume xxxiii number 1

Chained CPI: A hidden benefit cut targeting the most vulnerable

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The Chained Consumer Price Index (CPI), a relatively new (2002) method of calculating annual cost of living adjustment (COLA), has recently gained favor in Washington as a means of cutting Social Security, Supplemental Security Income (SSI) and other benefits. The impact of such a change would be negligible at first, but would grow year by year, having the greatest effect on those least able to afford it.

Social Security beneficiaries, SSI recipients and those receiving other federal retirement and disability benefits received no cost-of-living increase for the past two years, because the Consumer Price Index (CPI-W), which serves as a basis for determining annual COLA, was flat. Yet most whose livelihood depends upon these benefits say their living expenses during that time went up, and many report strained finances. How can there be such a gap between the government's official measure of inflation and retiree households' experience?

The problem is CPI-W is designed to measure changes in the cost of living of urban wage earners and clerical workers—a younger and healthier group whose spending patterns differ substantially from those of the retirees and people with disabilities making up the bulk of those receiving SSI, federal retirement or veterans benefits. The biggest difference in patterns is that as people age or deal with disabilities, their healthcare costs as a share of total expenditures increase exponentially. And healthcare has the highest rate of inflation of any economic sector.

Chained CPI: A Way to Reduce the COLA

Despite evidence that the existing method of calculating COLA underestimates the rate of inflation for retirees and people with disabilities, there is a push in Washington to move to an alternative method that would result in an even lower and less accurate measure of inflation. This is Chained CPI, which was included among the recommendations of the National Commission on Fiscal Responsibility and Reform (Bowles-Simpson) for reducing money spent on Social Security.

Proponents of Chained CPI contend that the traditional CPI-W overestimates the rate of inflation because when the price for a particular item increases people will find a lower-cost substitute. Sylvester J. Schieber, former chair of the Social Security Advisory Board, justified Chained CPI in recent testimony before Congress by explaining that if the cost of a Mercedes goes up, a person may settle for an Audi. This example doesn't work for those living very modestly, like most retirees. If you already drive a clunker or have no car at all, and you're already cutting your pills in half, it's hard to find savings.

A Stealth Benefit Cut

The proposal to use Chained CPI is a stealth benefit cut affecting all beneficiaries. Any change in CPI formula on Social Security and federal retirement benefits is insignificant in the first year. But several years out it becomes noticeable as any COLA reduction impact is compounded year by year. The impact is far from uniform, and is greatest on those who have been receiving benefits for the longest time. Thus, certain demographic groups will suffer more than others.

If there were to be a change to Chained CPI, the result would be a much greater percentage of reductions to SSI benefits than to other federal retirement and disability benefit programs, because the way in which COLA is applied to SSI benefits is significantly different. With Social Security, an individual receives an initial benefit based on lifetime earnings, and the annual COLA is applied to that initial benefit rate to determine the benefit for the second and subsequent years.

SSI Recipients Would Feel the Greatest Impact

With SSI, COLA is applied, not to the individual's monthly benefit, but to the Federal Benefit Rate (FBR), which is the maximum number of federal dollars that can be paid. This is a very important difference. If an inadequate measure is used to determine COLA, an individual will feel the cumulative impact in the initial benefit, not just years later as with Social Security.

Let's compare how a switch to Chained CPI in 2012 would affect two individuals, Abigail and Bernice, both age 45 in 2012. Assume that both begin receiving benefits at age 65 in 2032. Because Abigail receives Social Security Retirement, Chained CPI will have no impact on her initial benefit. However, 20 years later in 2052 when she is 85, she will feel the cumulative impact of 20 years of a seriously deficient COLA. When Bernice receives her first SSI check in 2032, that initial benefit will already have been reduced by the same percentage that Abigail will experience at age 85. And when Bernice reaches age 85, the percentage reduction in her SSI check will be as great as what Abigail would experience with her Social Security benefit at 105.

A Serious Mistake

It would be a serious mistake to use Chained CPI to calculate COLA for any federal retirement or disability benefit—especially disastrous because the percentage reduction in benefit levels would be much greater on the most vulnerable group of older Americans. Instead of moving to Chained CPI, we need to start using a measure of inflation based on expenditure patterns of older people, such as the CPI-E, which is based on expenditure patterns of people 62 and older, and consistently shows higher rates of inflation than either CPI-W or Chained CPI. ■

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