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Does the Social Security COLA Need to be Changed?

Background

Social Security beneficiaries and recipients of other federal retirement benefits have not received a cost of living increase for the last two years. This is because the Consumer Price Index (CPI-W) which serves as a basis for determining the annual cost of living adjustment (COLA) has been flat. Yet most people on Social Security say their living expenses have gone up over that period and many report their finances are strained. How can there be such a disconnect between the government's official measure of inflation used to calculate benefits and the actual experience of countless retiree households?

The Issue

The problem is that the CPI-W is specifically 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 who make up the bulk of Social Security beneficiaries. The biggest difference is that as people age or deal with disabilities, their health care costs increase exponentially as a share of their total expenditures. And health care consistently has the highest rate of inflation of any sector of our economy.

The Solution

Fortunately, the government has developed a measure of inflation that is based exclusively on the expenditure patterns of elderly households. This is the CPI-E

which pretty consistently shows a higher rate of inflation than the CPI-U. *It is time to switch to the CPI-E as the basis for calculating the COLA for Social Security, veterans and other federal benefits.*

Some object to the use of the CPI-E on the ground that, in spite of the thirty years that have gone into its development, it is still considered experimental and possibly might not be 100% accurate. However, we are comparing it to an existing measure which we know to be inaccurate for Social Security beneficiaries and which has a consistent bias toward underestimating the rate of inflation for elderly households. The most sensible course would be to switch to the CPI-E now while efforts to improve the measure continue.

A Move is Underway to Reduce the COLA

In spite of the evidence that the existing method of calculating the Social Security COLA underestimates the rate of inflation for Social Security beneficiaries, there is a strong push to move to an alternative method which will result in an even lower and less accurate measure of inflation. This is the Chained CPI which is included among the recommendations of the National Commission on Fiscal Responsibility and Reform (Bowles-Simpson) for reducing the amount of money spent on Social Security.

Proponents of the chained CPI contend that the traditional CPI-W overestimates the rate of inflation because the reality is that when the price for a particular item increases people will find a lower cost substitute. Thus the person who would ordinarily purchase a luxury automobile, will seek a more modest vehicle. Similarly people will eat at home instead of in a restaurant or will buy a cheaper cut of meat. The problem is that this does not work nearly as well for those who are already living very modestly as most retirees are already forced to do. If you are already driving a clunker or have no car at all and you are already cutting your pills in half, there is no money to be saved there.

The proposal to use the Chained CPI is a stealth benefit cut affecting all beneficiaries. The impact of any change in the CPI formula is insignificant in the first year. It is not until several years out that the change becomes noticeable as the impact of any

COLA reduction is compounded year by year. This means 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 from a COLA which consistently underestimates the rate of inflation.

Who has the most to lose by switching to the chained CPI? The following groups will suffer the greatest loss of benefits from an inadequate COLA:

- The very old both because of the compounding effect of the inadequate COLA and because this segment of the population spends an even higher percentage of their income on health care.
- Women because they live longer.
- People with disabilities, especially people who become disabled earlier in life since they will be receiving benefits for a longer period.
- Asian-Americans and Hispanic Americans because they have higher life expectancy.

Recommendations

- Adopt the CPI-E as the measure for calculating the Social Security COLA in order to assure that the purchasing power of the benefit is maintained as beneficiaries age.
- Oppose any proposal to use the Chained CPI which will reduce benefits for all and have its greatest impact on those least able to afford lower benefits.

The National Senior Citizens Law Center is a non-profit organization whose principal mission is to protect the rights of low-income older adults. Through advocacy, litigation and the education and counseling of local advocates, we seek to ensure the health and economic security of older adults with limited income and resources, and access to the courts for all.