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Ripping off needy seniors through the 'chained CPI'

Basing Social Security cost-of-living increases on the chained consumer price index, which presumes people will trade down to cheaper goods as costs rise, would force elderly people on fixed incomes to forgo essentials.

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Of all the ways policymakers in Washington show they have absolutely no conception of how their tinkerings with the federal budget affect average Americans, one stands alone. That's the proposal to change the formula that determines annual cost-of-living increases for people on Social Security.

At the heart of this particular change is an inflation indicator known as the chained consumer price index. You may have heard the term bandied about, along with the claim that it's more accurate at measuring inflation than the plain-vanilla versions of the CPI used today for inflation adjustments in Social Security, the income tax and other federal programs.

First published by the Bureau of Labor Statistics in 2002, the chained CPI was designed to adjust for the ways real-life consumers compensate when a product or service gets more expensive: They buy less of it, or find a cheaper brand, or find something different, or go without.

The phenomenon is known as "substitution." Economists fear that an inflation index that ignores substitution might overstate the real cost of living because it will include products in its market basket that consumers have tossed out of theirs. The example favored by BLS analysts is ice cream — as it rises in price, the analysts observe, consumers will buy a pint instead of a quart, or buy a store brand instead of Breyers, or shop for it at Costco instead of Ralphs.

For budget cutters, the charm of the chained CPI is that it consistently rises at a lower rate than the traditional CPI, differing by two- to three-tenths of a percentage point per year. Social Security's own actuaries have calculated that pegging cost-of-living increases to the chained CPI would cut seniors' benefits by nearly 10% over any 30-year span, compared with the current formula.

For the average retiree reaching age 85, the change would amount to an annual cut of nearly $1,000; by age 95, the reduction would rise to nearly $1,400. Over the next 10 years, according to the nonpartisan National Academy of Social Insurance, the change would cut total Social Security benefits by $112 billion.

The idea of using the chained CPI to cut Social Security benefits has built up a dangerous head of steam in Washington. It even came up during President Obama's news conference on Monday, though he nimbly dodged the issue. In the GOP-controlled House of Representatives, it's the flavor of the month in all budget debates.

It came up last week at a House Ways and Means Committee hearing on Social Security, for instance. Asked to illustrate how the chained CPI works, the eminent economist Sylvester Schieber skipped over the BLS' ice cream model and went with this one: "If the price of a Mercedes goes up … maybe you don't buy the Mercedes, you switch and you buy an Audi or something."

It's hard to say whether this was a real-life event for Schieber, who works for the corporate consulting firm Watson Wyatt Worldwide, or whether he thought that a parable about substitution in the luxury car market would hit the potentates on the Ways and Means Committee where they lived.

But here's the punch line: Schieber was wrong, or at least wildly misleading. The sort of substitution he was talking about, within categories of goods such as new cars, is already baked into the standard CPI and has been since 1999. The chained CPI addresses the more painful substitutions that occur *across* categories — a more accurate example might be that if the price of gas or medical care goes up, you cut back on food. But since members of Congress are often transported at government expense, receive government medical coverage and have lobbyists to pick up their restaurant tabs, maybe Schieber knew his audience.

A more important issue is whether the chained CPI really is the best measure of the cost of living for Social Security recipients. There are grounds to doubt that it is. It's not at all certain that elderly persons on fixed incomes can make the sort of lifestyle changes contemplated by the chained CPI, or even the standard CPI, as easily as other consumers.

That's because a larger portion of seniors' spending is concentrated in medical goods and services, which aren't as amenable to substitution as, say, oranges for apples; it's not as though you can forgo a prescribed heart bypass operation and opt for a cheaper hernia operation instead.

Indeed, the BLS has recognized that elderly consumers are a special case by developing an experimental CPI, known as the CPI-E, just for those 62 and older. Among other differences, the index overweights medical care as a factor in seniors' spending. That component, which has risen in cost at nearly twice the rate of overall inflation over the last couple of decades, counts for more than twice as much of the CPI-E as it does of the standard CPI used to calculate Social Security cost-of-living raises today.

That helps explain why the CPI-E rose nearly 7% faster than the standard CPI from 1998 through 2009, according to government estimates. It also tells you why, from the standpoint of seniors' real cost of living, the chained CPI is a rip-off.

When you factor in that two-thirds of our retirees get most of their income from Social Security — and for one-third of retirees the program accounts for 90% of their income — you can see that the chained-CPI proposal is nothing but a stealth benefit cut aimed at the neediest Americans, and one that weighs ever more heavily as people grow older, and needier.

But the sad truth is that the proposal to link Social Security inflation protection to the chained CPI isn't really about making annual cost-of-living increases more "accurate." That's mere window dressing. The goal is to cut benefits and thereby cut government costs. As has been the case throughout the discussion in Washington about the budget and the federal deficit, the guiding principle here has been to preserve benefits for the wealthy at the expense of everyone else.

How do we know this? If you use the chained CPI instead of the standard CPI for the annual adjustment in income tax brackets, over time that will create an effective tax increase, especially for wealthier taxpayers. (That's because the bracket thresholds will rise more slowly relative to inflation than they do now.) The gain for the Treasury would be about $72 billion over 10 years, according to the congressional Joint Committee on Taxation.

What do the agents of the wealthy say about that? Let's ask the right-wing Cato Institute, which cherishes both a sedulous admiration for free enterprise and a long-standing hostility to Social Security. Cato last year called switching to the chained CPI for Social Security a "sound and overdue reform." But when it came to using the chained CPI to adjust tax brackets, Cato called that "a very bad idea."

One would think it only fair that if you change the inflation index for one government program, you should do so for all of them. It's a measure of the cynicism that guides debate in the nation's capital that an "overdue reform" that would take $112 billion from the needy can be regarded as "a very bad idea" if it costs the rich $72 billion — and that no one pauses to ponder the rank injustice involved. Must be that they can't make out their own words over the purring of those Mercedes engines.

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