



COMMITTEE ON **WAYS AND MEANS** CHAIRMAN DAVE CAMP

Using the Chained Consumer Price Index (CPI) to Determine Social Security Cost of Living Adjustments and Benefit Increase for Long-Time Social Security Beneficiaries

Summary

Current Law

Under current law, Social Security recipients may receive an annual cost of living adjustment (COLA) to compensate for the effects of inflation. The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), updated monthly by the Department of Labor's Bureau of Labor Statistics (BLS), is the measure that can trigger a change. The Social Security COLA is based on the percentage change in the index from the highest third calendar quarter average CPI-W recorded (most often, from the previous year) to the average CPI-W for the third calendar quarter of the current year. The COLA becomes effective in December of the current year and is payable in January of the following year. If there is no percentage increase in the CPI-W between the measuring periods, no COLA is payable.

Since August 2002, BLS has published a supplemental measure known as the Chained Consumer Price Index for all Urban Consumers (C-CPI-U). The aim of the C-CPI-U is to produce a measure of change in consumer prices that is free of substitution bias. In other words it accounts for consumers changing their spending habits, for example buying pork when the price of beef rises, when the currently used measure does not. The C-CPI-U is released in three phases, initial, interim and final. The initial release occurs in the month after the reference month. The interim occurs in February of the following year and the final release in February of the next year. Thus, it can take up to 25 months for a chained CPI measurement to be finalized.

Assumptions

Staff assumes the initial release of the C-CPI-U would be used to calculate the COLA. As the Congressional Budget Office noted in its testimony before the Subcommittee on Social Security, using the initial release would be the simplest approach and would not require the Social Security Administration to develop cohort specific COLAs that would otherwise be necessary to accommodate the final C-CPI-U revision.

Provisions

President Obama:

This provision would replace the current inflation measure, the CPI-W, with the C-CPI-U, to determine COLAs for Social Security beneficiaries as of December 2014 and later. (Note: While this provision focuses on Social Security only, in his Fiscal Year 2014 budget, the President also proposed applying the C-CPI-U to the tax code and non-means tested programs.)

Also beginning in December 2019, a benefit increase would be provided equal to 5 percent of the average retired worker benefit, phased in over 10 years, beginning at age 76 (or 15th year of receiving benefits). Ten years after the increase is fully phased in, the beneficiary is eligible for a second increase beginning at age 95 (or 34th year of receiving benefits).

Simpson-Bowles Commission:

As introduced in December 2010, this provision would replace the current inflation measure, the CPI-W, with the C-CPI-U, to determine COLAs for Social Security beneficiaries effective December 2011 and later. Since the provision was effective one year after the proposal's announcement, an effective date of December 2014 and later is assumed. (Note: While this provision focuses on Social Security only, the Simpson-Bowles plan would apply the C-CPI-U to all federal programs and the tax code.)

Also effective in December 2014, a benefit increase would be provided equal to 5 percent of the benefit for a worker with average earnings after 20 years of benefit eligibility.

Domenici-Rivlin Task Force:

As introduced in November 2010, this provision would replace the current inflation measure, the CPI-W, with the C-CPI-U, to determine the COLA for Social Security beneficiaries as of December 2012 and later. Since the provision was effective two years after the proposal's announcement, an effective date of December 2015 and later is assumed. (Note: While this provision focuses on Social Security only, the Debt Reduction Task Force would apply the C-CPI-U to all federal programs and the tax code.)

Also beginning the same year, a benefit increase would be provided to retirees, survivors, and dependents equal to 5 percent of the average retired worker benefit phased in over 5 years, beginning at age 81.