“Cost-of-Living Adjustments” and Federal Benefits

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Purpose of Benefit Adjustments

- What "level" do we intend to maintain?
  1) Standard-of-living increases?
  2) Pure price increases?
  3) Modified price increases?
  4) Price increases for the elderly?
- Adjustments *across generations*
  - ➢ Social Security: Standard-of-living increases
  - ➢ SSI: Modified price increases (lowered)
- Adjustments *after an individual's benefit starts*
  - ➢ Both: Modified price increases (lowered)

What Level Do We Intend to Maintain?

1) Standard-of-living increases

- – Change in average earnings level of workers
- – Reflects "real" income growth (about 1.1 percent per year)
  - Ability to increase consumption in line with workers
  - Consistent with lifetime income hypothesis
  - Maintain relative income position in the society
- – Social Security maintains ***initial*** benefit replacement rate across generations

What Level Do We Intend to Maintain?

2) Pure price increases

- Old-style CPI, without adjustments
- "Fixed market basket"
  - Nothing ***added*** for new items we purchase, but prices drop a lot after introduction
  - No effect for changing purchase weights
  - No effect for increasing average real income
- What we had in the 1970's when automatic COLAs started

What Level Do We Intend to Maintain?

3a) Modified price increases (lowered)

- Current CPI-W, includes *some* adjustments
- Presumes substitution within strata (categories)
  - Still nothing ***added*** for new items we consume, but dropping prices after introduction are reflected even more
  - Presumes shift to items inflating less; not necessarily from steak to hamburger, but to whatever has less price increase!
  - No effect for increasing average real income
- What we have now with “geometric means” adjustment within each of the 211 strata of goods and services
  - This has slowed CPI increase by about 0.2 percent per year

What Level Do We Intend to Maintain?

3b) ***Further*** modified price increases (lowered)

- Chained CPI-U, includes ***more*** adjustments
- Presumes substitution within ***and across*** strata
  - Still nothing ***added*** for new items we consume, but dropping prices after introduction are reflected much more
  - Incorporates any shift across *non-substitutable* strata
    - Reflects shifts by ***all urban consumers***
    - Not necessarily from luxuries to staples, but whatever happens
  - No effect for increasing average real income
- What we can have assuming that overall changes in distribution of consumption across broad strata of goods and services apply equally to beneficiaries
  - This would further slow CPI increase by about 0.3 percent per year

What Level Do We Intend to Maintain?

4) Price increases for those aged 62+

- CPI-E reflects “market basket” across 211 strata for those age 62+ (more medical and housing)
- Presumes substitution within strata
  - Still nothing ***added*** for new items we consume, but dropping prices after introduction are reflected more
  - Same weights and presumed substitution within strata as for all urban consumers; might be different for those age 62+
  - No effect for increasing average real income
- Experimental? Sample too small for CPI-E?

• 2006 (BLS)	CPI-W 37%	CPI-E 16%
• 2009-10 (BLS)	CPI-W 33%	CPI-E 24%
• 2020	CPI-W 30%?	CPI-E 30%?

Benefit Adjustment Options:

What do we intend and what is appropriate?

1) **Standard-of-living increase?** (average earnings increase)
   - Increase benefits at same rate as for workers
   - Annual increase 1.1-percent more than current CPI-W

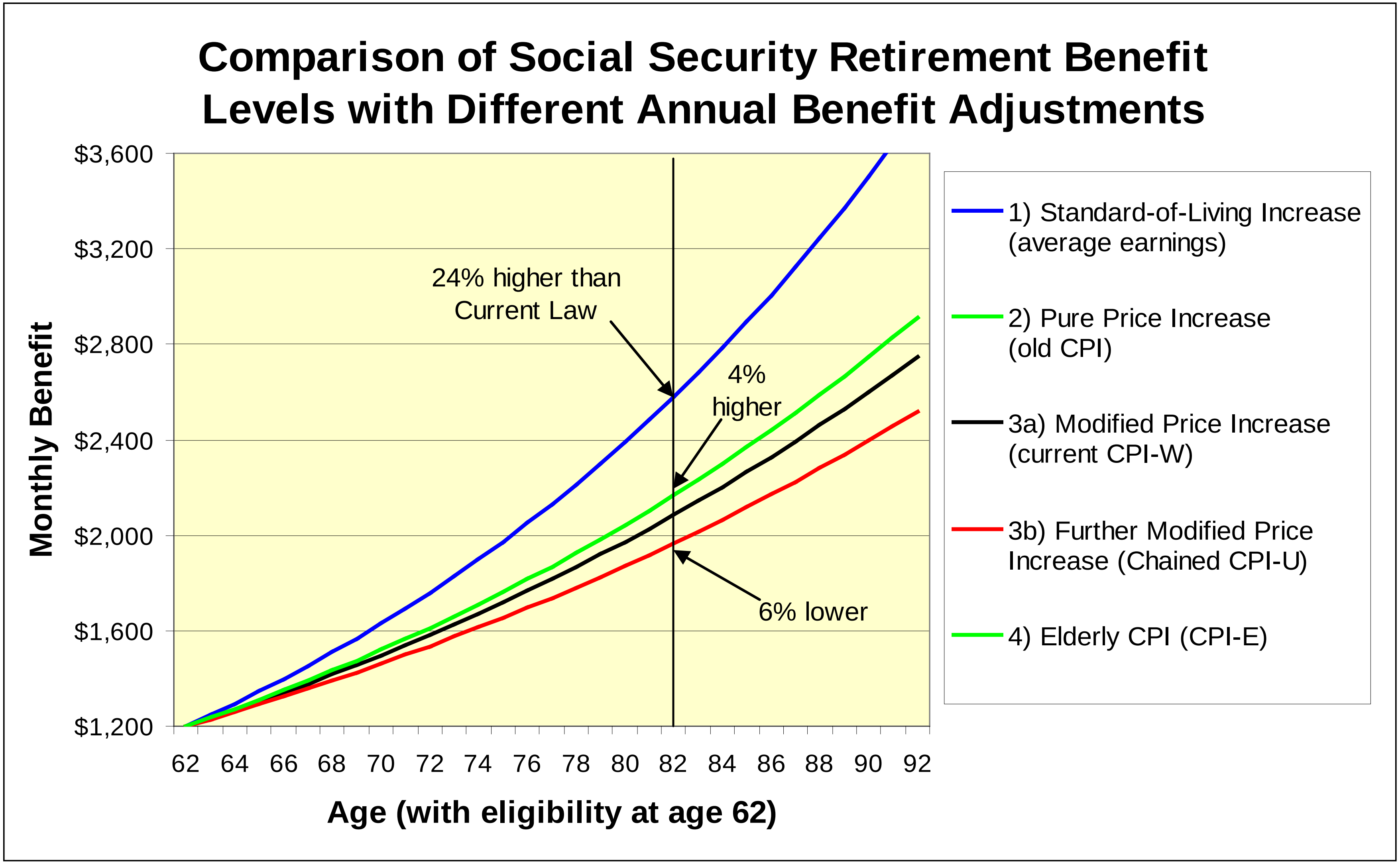
2) **Pure price increase?** (old-style CPI)
   - Would not presume behavioral shift to slower inflating items
   - Annual increase 0.2-percent more than current CPI-W

3a) **Modified price increase?** (current CPI-W)

3b) ***Further* modified price increase?** (chained CPI-U)
   - Reflects overall shifts across non-substitutable categories
   - Annual increase 0.3-percent less than current CPI-W

4) **Price increase for elderly?** (CPI-E)
   - Would reflect the actual market basket consumed by those age 62 and over; possibly more appropriate for disabled as well?
   - Annual increase 0.2-percent more than the current CPI-W

Increase in Benefit Levels Depends on Intended Adjustment Goal



Effects on Benefit Levels Accumulate with Age

(with time since eligibility)