Moment of Truth
PROJECT

The era of deficit denial is over.

The Case for the Chained CPI

In recent budget discussions, members of both parties have proposed utilizing a more accurate measure of inflation, switching price-indexed provisions throughout the federal budget from the standard Consumer Price Index (CPI) to the "chained CPI." While there is a lot of misinformation about this alternative measure of inflation, switching to the chained CPI represents a technical correction for measuring inflation that will also achieve significant deficit reduction.

The Chained CPI Is a More Accurate Measure of Inflation

- The chained CPI has been developed and refined by the Bureau of Labor Statistics to recognize that when the prices of similar goods change, consumers often switch to the cheaper option. The traditional CPI fails to account for this and thus suffers from "substitution bias".
    - E.g. If the price of apples goes up, people buy more oranges.
- According to the non-partisan Congressional Budget Office (CBO), the chained CPI "provides an unbiased estimate of changes in the cost of living from one month to the next" (CBO, Feb. 2010).

The Chained CPI Represents a Balanced Approach to Reduce the Debt

- Many tax and spending provisions (like the tax bracket thresholds and the amounts of Social Security benefits) are indexed to ensure their value keeps pace with inflation. Switching to the chained CPI would more accurately achieve that policy goal.
- Measuring inflation inaccurately results in higher than justified spending increases and tax breaks.
- Using a more accurate measure of inflation would save **$390 billion** over a decade – $215 billion from spending, $125 billion from revenue, and $50 billion from interest savings.
- The chained CPI would reduce the deficit by over $1 trillion in the second decade.
- The chained CPI would also reduce Social Security's 75-year funding gap by one fifth.

Any Distributional Concerns Could Be Addressed and Should Not Prevent Adopting the Chained CPI

- The chained CPI is roughly *distributionally neutral* across income groups for revenues and Social Security benefits, meaning that households at various income levels see after-tax income or Social Security benefits affected by similar percentages (Tax Policy Center, 2013; Social Security Administration, 2012).
- Any undesired distributional consequences can and should be addressed by setting aside a portion of the savings from the chained CPI to provide targeted changes for low-income populations
    - Most proposals to switch to the chained CPI include low-income protections for vulnerable populations, as well as for the very old.

The Chained CPI Has Broad Bipartisan Support

- Nearly all bipartisan budget discussions have called for enacting the chained CPI, including the Fiscal Commission, Super Committee, Domenici-Rivlin Commission, and the Gang of Six.
- Both President Obama and Speaker Boehner support switching to the chained CPI in the context of a bipartisan budget agreement.
- The chained CPI has broad support on the left from experts including Austan Goolsbee, Bob Greenstein, and Jared Bernstein and on the right from experts including Michael Boskin, David John, Reihan Salam, and Chuck Blahous.

For an in-depth analysis of the chained CPI, see CRFB's Moment of Truth Project policy paper at http://crfb.org/document/measuring-case-chained-cpi.