

Questions about the Chained CPI

One option on the table that has great potential to be included in a final deal is the chained CPI. As we explain in our updated paper on the chained CPI, "[Measuring Up](#)," the current CPI overstates inflation because it doesn't account for substitution between different categories as relative prices change.

Question: What is the Chained CPI?

Answer: The chained Consumer Price Index (C-CPI) is a superlative index developed by the Bureau of Labor and Statistics to address "substitution bias," one of the methodological flaws in the CPI-W that was identified by the independent "Advisory Commission to Study the Consumer Price Index" (Boskin Commission) and others. While BLS has been able to address the other flaws in the CPI-W through changes in the methodology for calculating the CPI-W, accounting for substitution bias required the development of a new index. BLS has published the chained CPI since 2002 and has refined the methodology in calculating it since it was introduced.

Question: Why is the chained CPI considered more accurate than CPI-W?

Answer: Economists have long noted that the CPI-W fails to take into account substitution bias, or the notion that when the prices of similar goods change, consumers often switch to the cheaper option. The chained CPI would address this bias by using a superlative index that updates the formulas in order to address substitution between categories.

Question: What would changing to the chained CPI for indexing government programs and provisions in the tax code mean for the federal budget?

Answer: Currently, many benefit programs and provisions in the tax code are indexed to CPI-W to ensure that the value of the benefits and tax provisions keep pace with inflation. However, using an index that overstates inflation results in larger increases in benefits and the value of tax breaks than necessary to keep pace with inflation, resulting in higher spending and lower revenues than would be the case if a more accurate measure of inflation were used. Using the chained CPI for indexation would eliminate \$216 billion in higher than justified spending increases in mandatory programs and \$124 billion in lost revenues from overstating inflation, resulting in \$340 billion in deficit reduction when interest savings are included. Social Security would only make up one third of the savings from the chained CPI. The vast majority would come from indexing tax brackets, other elements of the tax code, and other spending programs to a more accurate measure of inflation.

Question: Would my Social Security benefits really be cut?

Answer: Using a more accurate measure of inflation is not a benefit cut, but rather ensures that benefits increase by the proper amount to achieve the desired policy goal of keeping pace with overall prices. The change to the chained CPI would actually *strengthen* the Social Security program, closing close 20% of the Social Security shortfall and helping to shore up its finances for the long term.

Question: Would the elderly and least advantaged be hit hardest by the change?

Answer: With regards to both Social Security and the tax code, switching to chained CPI would be roughly distributionally neutral – meaning that individuals of different income levels are affected similarly. Overall, nearly 50 percent of the additional revenues generated by the chained CPI would come from the top quintile, although the very wealthiest households would face only modest changes relative to their incomes because a declining share of their income would be affected by the inflation-indexed portions of the tax code. In addition, most proposals to switch to the chained CPI include provisions providing benefit enhancements or other protections for disadvantaged Americans.

Question: Who supports the chained CPI?

Answer: Several bipartisan deficit-reduction proposals have recommended changing to the chained CPI, including the National Commission on Fiscal Responsibility and Reform (Bowles-Simpson Commission), the Bipartisan Policy Center’s Deficit Reduction Task Force (Domenici-Rivlin) plan, and proposals put forward by the Center for American Progress, the Heritage Foundation and American Enterprise Institute. President Obama’s proposed fiscal year 2014 budget proposes to switch to chained CPI for indexing provisions in the budget.

In addition, notable economists and experts, including Austin Goolsbee and Glenn Hubbard, former Chairs of the Council of Economic Advisors under President’s Obama and Bush respectively, Chuck Blahous, one of the two public Trustees of the Social Security Trust Fund, Robert Greenstein, President of the Center on Budget and Policy Priorities and others support the shift to the chained CPI as a more accurate measure of inflation, irrespective of its impact on the deficit.