

The Truth about the Chained CPI

Both President Obama and Congressional Republicans have called for using the “chained CPI” to help certain benefits and provisions in the income tax code keep pace with inflation. As we explain in our updated paper on the chained CPI, "[Measuring Up](#)," the current measure used to index benefits and tax brackets overstates inflation and thus leads to higher spending and lower revenue collection than is intended under current policy.

Unfortunately, a number of myths and substantial hyperbole exist about chained CPI. Below, we refute many of these claims.

COMMON MISCONCEPTIONS:

CLAIM: Chained CPI is not really a more accurate measure of inflation, but instead hidden way to cut Social Security benefits and increase taxes.

FACT: The chained CPI accounts for a broadly-recognized flaw in the current CPI measure known as substitution bias. A report by the nonpartisan Congressional Budget Office concluded that unlike current CPI measures used to index provisions in the budget to inflation, the “chained CPI-U provides an unbiased estimate of changes in the cost of living,” and economists from across the spectrum – including former Chairmen of President Bush’s and of President Obama’s Council of Economic Advisors – agree with this assessment.

Using chained CPI to index spending programs and provisions in the tax code to inflation is not a “benefit cut” or a “tax increase,” but rather a way to ensure that the promised increases in benefits and adjustments in the tax code to keep pace with inflation are calculated more accurately. Currently we are adjusting benefits and provisions in the tax code by more than is necessary to keep pace with inflation, meaning we are spending more and collecting less revenues than we should under current policies because of the inaccurate measure of inflation.

CLAIM: Switching to the chained CPI singles out Social Security for deficit reduction.

FACT: Proposals to switch to the chained CPI would do so not just for Social Security, but for all provisions in the budget currently indexed to changes in the cost of living based on CPI. In fact, Social Security would only make up only one third of the savings from switching to the chained CPI over the next decade. Another one third of the savings would come from new revenue and the remaining third from other spending programs and interest savings.

CLAIM: The chained CPI is regressive and unfair to lower- and middle-income households.

FACT: 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. In fact, nearly half of the revenue from switching to the chained CPI would come from the top fifth of earners. To the extent policymakers desire a more progressive outcome, this could be achieved through policy changes to offset the impact on low and middle income household rather than overstating inflation for everyone.

CLAIM: Switching to the chained CPI would cut Social Security benefits by 6% after 20 years.

FACT: Indexing Social Security benefits to chained CPI would not represent a cut in benefits, but rather a more accurate indexation of benefits. Benefits would continue to grow in nominal terms, but they would grow – as intended – with inflation.

It is true that adopting the chained CPI will lead benefits to grow more slowly than under the current, less accurate, measure of inflation – by about 0.25 to 0.3 percent per year – and thus save the program money. These savings would accrue to the Social Security trust fund, closing 20% of its funding gap and helping to prevent a 25 percent deep benefit cut in 2033, which will happen if we do nothing. In fact, switching to the chained CPI by itself would *increase* benefits by 25% in 2033 relative to doing nothing, not reduce them by 6%.

CLAIM: The oldest seniors are hit hardest under the chained CPI.

FACT: It is true that the effects of chained CPI compound over time; or thought of another way, the effects of over-measuring inflation today compound over time. However, using an incorrect inflation index is neither a sensible nor well-targeted way to help the oldest seniors. Many plans which propose chained CPI instead call for targeted reforms to help those groups – such as a flat-dollar benefit bump up for those who have been on the program for 20 years or more.

CLAIM: The chained CPI is a stealth tax increase that would push families into higher tax brackets more quickly over time, thereby raising effective tax rates.

FACT: Indexation of the tax code is intended to ensure that tax bracket break points keep pace with inflation. By overstating inflation, the current tax code lowers taxes for a given income over time. In addition, it expands the size of various tax preferences beyond their intended value. Adopting the chained CPI would more accurately index the tax code to inflation, avoiding unintended and overly-expensive tax breaks.

MYTH: Chained CPI does not accurately reflect inflation for seniors, and Social Security should instead be indexed to CPI-E, which more accurately measures inflation for seniors' cost of living.

FACT: According to the non-partisan and independent Congressional Budget Office “it is unclear...whether the cost of living actually grows at a faster rate for the elderly than for younger people.” While some of the differences in consumption patterns of seniors may increase inflation for seniors, other differences would result in lower inflation. There is no evidence to suggest that the substitution bias addressed by chained CPI applies to seniors any differently than other groups. The CPI-E is a highly experimental index with a number of flaws. It likely mismeasures housing costs, and exacerbates the overstatement of health inflation in the CPI-W. It doesn't account for senior discounts or other purchasing habits common amount seniors. The Bureau of Labor Statistics notes these and other shortcomings and warns that “any conclusions drawn from the data should be interpreted with caution.”