NARFE FACT SHEET: Cost-of-Living Adjustments and the Chained CPI

Cost-of-living adjustments (COLAs) to federal civilian and military retirement annuities, as well as Social Security benefits, veterans' benefits and disability benefits, currently are determined by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), which is computed by the Bureau of Labor Statistics (BLS) at the Department of Labor (DOL).

The President's Budget for Fiscal Year 2014 included a proposal to use the Chained Consumer Price Index for All Urban Consumers (Chained CPI-U) instead of the CPI-W as a way to limit the growth of the national debt. The proposal was also included in the Republican Study Committee budget, which received the support of 104 Republican members of the House of Representatives. Previously, the proposal was part of the Simpson-Bowles Fiscal Commission report and has received serious consideration in budget negotiations between the White House and congressional Republicans.

Chained CPI Cuts Earned, Promised Benefits

Individuals who have worked their whole lives to earn their retirement benefits will receive less money in the future, and that sounds like a real benefit cut to them, because it is.

Using the chained CPI instead of the CPI-W would reduce COLAs by an estimated 0.3 percent per year. Because this difference would compound over time, it would result in estimated yearly benefits 3 percent lower after 10 years, 6.2 percent lower after 20 years and 9.4 percent lower after 30 years.

Federal retirees under the Civil Service Retirement System (CSRS), which does not provide Social Security benefits, often rely on their federal annuity as their sole source of income. Therefore, a switch to the chained CPI would have a particularly acute impact on their retirement benefits. The median CSRS annuity is $31,440 per year. By using the chained CPI, someone earning that annuity would receive, in total actual dollars, an estimated:

- $6,155 less after 10 years;
- $28,531 less after 20 years;
- $77,013 less after 30 years; and, if lucky enough to enjoy a long life,
- $166,200 less after 40 years.

Federal employees covered by the Federal Employees Retirement System (FERS) would be hit twice by the switch, through their federal pensions and their Social Security benefit. Additionally, FERS does not even provide full inflation protection if inflation is greater than 2 percent. With a median annuity of $9,876 per year, FERS retirees also would receive an estimated:

- $1,933 less after 10 years;
- $8,962 less after 20 years;
- $24,191 less after 30 years; and, if lucky enough to enjoy a long life,
- $52,207 less after 40 years.

Chained CPI is Not a Better Measure of Inflation

Proponents of the chained CPI claim it provides a better measure of inflation by taking into account how consumers substitute one item when the price of another item increases; for example, by switching from steak to chicken when the price of steak rises. Accounting for this type of substitution, however, fails to measure lower standards of living that result from substituting a less desirable alternative. Seniors, in particular, as a result of living on a fixed income, often find such substitution impracticable, as they are already purchasing lower priced goods.

Second, neither the chained CPI nor the CPI-W accurately reflects changes in consumer prices experienced by the seniors who rely on the measures to adjust their incomes appropriately. Notably, while health care accounts for about 12 percent of spending for those 62 or older, it accounts for only 5 percent of spending for the general population. Meanwhile, health care costs are rising faster than other goods – last year, health care inflation was 3.7 percent while the CPI-W indicated the average price of consumer goods increased 1.7 percent.

When you measure costs experienced by Americans 62 years of age or older, as the BLS does when calculating an experimental price index for elderly consumers, the CPI-E, inflation is actually greater than the CPI-W reflects, a clear sign that switching to the chained CPI is a move in the wrong direction.

Chained CPI Hurts the Most Vulnerable

Using the chained CPI as an inflation measure would decrease benefits for low income seniors and the disabled, including disabled veterans, while simultaneously increasing taxes on lower and middle-income taxpayers. Current seniors, especially those who are older than 65, will be hit the hardest by a switch to the chained CPI – they are likely to have fewer sources of income, are unable to return to work given their age, and have higher medical expenses.

The average Social Security benefit is roughly $15,000 annually, which is, by itself, a low income. For seniors that rely solely on their Social Security benefits, every dollar the chained CPI reduces their income may be a vital one. While some proponents of the chained CPI have coupled their support for it with an increase in benefits for the poorest elderly, such as those receiving Supplemental Security Income (SSI), it is difficult to see how you save money for deficit reduction without hurting low income seniors when the average Social Security benefit is so low.

Individuals receiving veterans' benefits or disability benefits (SSI) will be hit particularly hard by a switch to the chained CPI. Because many of these individuals rely on benefits for a longer period of time, the compounding effect from reduced COLAs caused by a switch to the chained CPI will take a more substantial toll on their total benefits.
Finally, using the chained CPI to adjust tax brackets would increase taxes on lower and middle-income workers, making it harder to save more for retirement. According to a Joint Committee on Taxation report, by 2021, the tax liability for those with incomes between $10,000 and $20,000 would increase by 14.5 percent, and by 3.5 percent for incomes between $20,000 and $30,000, while those with incomes of $1 million and above would see an increase of only 0.1 percent. The chained CPI hits our nation's most vulnerable twice.

The impact of these combined changes would fall hardest on those who live the longest, as their savings dwindle, and on those whose sole source of retirement income is from their government benefit, including Social Security and civilian and military retirement annuities.

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