Fact Sheet

AARP Public Policy Institute

Inflation Indexation in Major Federal Benefit Programs: Impact of the Chained CPI

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This Fact Sheet provides an overview of how changing the way the federal government measures inflation, by switching to a chained consumer price index (chained CPI), will affect benefits in a number of federal programs. The list of programs discussed is not exhaustive; rather, it is intended to highlight inflation indexation provisions in some of the major federal benefit programs. Where possible, the fact sheet provides estimates of some possible impacts on beneficiaries.

Concern over large federal budget deficits has prompted proposals to change the way the federal government measures inflation.[1] Replacing the current Consumer Price Index (CPI) with a new measure of inflation known as the chained CPI for All Urban Consumers (chained CPI-U; sometimes referred to as the superlative CPI) would reduce the rate of inflation[2] used in many federal benefits programs and have far-reaching effects on federal benefits.

Many federal benefit programs and the tax code include inflation adjustment provisions. For example, annual cost-of-living adjustments (COLAs) for Social Security, Supplemental Security Income (SSI), and Military Retirement and Veterans Pension benefits are based on changes in the CPI. Many other federal benefit programs are indexed to price inflation in ways that are less well known. For example, payments to certain Medicare providers and Medicaid disproportionate share hospital payments are indexed to price inflation. Eligibility for many federal benefits programs, such as SSI, Medicaid, and federal school breakfast and lunch programs, are linked to the federal poverty guidelines, which in turn are indexed to price inflation.[3]

Under current law, the Bureau of Labor Statistics (BLS) publishes two inflation measures that the government generally uses to adjust parameters in major federal benefit programs:

CPI-W: Consumer Price Index for Urban Wage Earners and Clerical Workers

CPI-U: Consumer Price Index for All Urban Consumers

The U.S. Bureau of Labor Statistics (BLS) developed the chained CPI-U to take a more complete account of the substitutions that consumers may make in response to changes in relative prices. The currently used CPI-U and CPI-W account for some “within-category” substitution; the chained CPI-U accounts for substitution between different categories of items. The chained CPI-U captures shifts in consumer spending from items whose prices have risen quickly toward items whose prices have risen more slowly.

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The chained CPI-U tends to rise more slowly than other price indices published by the BLS. The Social Security Administration estimates that using the chained CPI-U instead of the CPI-W would reduce annual Social Security COLAs by about 0.3 percentage point per year, on average. The Congressional Budget Office (CBO) assumes that the chained CPI-U would reduce annual Social Security COLAs by about 0.25 percentage point per year, on average.[4]

The chained CPI-U may be a more accurate reflection of the expenditure patterns of many Americans than either the CPI-W or the CPI-U. Some analysts, however, question whether the chained CPI-U is an accurate representation of the expenditure patterns of certain other groups, such as older Americans, persons with disabilities, or the poor. These groups may devote a higher-than-average share of their spending to health care, when health care prices tend to rise more quickly than other items. In addition, persons with low incomes may have limited opportunities for substitution among different goods and services.

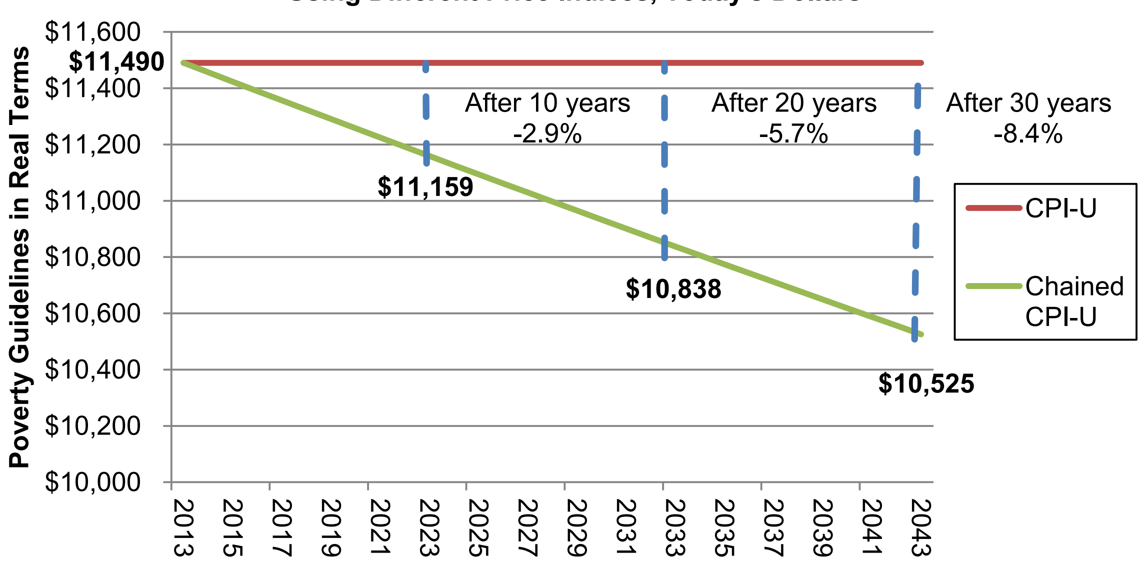
Federal Poverty Guidelines

Eligibility for many federal benefits programs is linked to the federal poverty guidelines. Under current law, the U.S. Department of Health and Human Services (HHS) updates the federal poverty guidelines every year in line with changes in the CPI-U. When estimating budgetary effects of a move to the chained CPI-U, CBO assumes that the chained CPI-U would be used to make annual adjustments to the federal poverty guidelines.

If the chained CPI-U were used instead of the CPI-U, income and asset eligibility thresholds for many federal benefits programs that are tied to the federal poverty guidelines would grow more slowly, reducing the number of eligible participants. Figure 1 shows the expected impact on the federal poverty guideline for a single person with no dependents as a result of a switch to the chained CPI-U.

Examples of programs with income-related eligibility criteria include Medicaid; the National School Lunch and

Figure 1
Federal Poverty Guideline for a Single Person with No Dependents Using Different Price Indices, Today's Dollars



Note: the figure begins with the 2013 federal poverty guideline for a single person with no dependents, which is $11,490, and adjusts this poverty guideline in subsequent years by the CPI-U and the chained CPI-U. Benefits are adjusted into real dollars using the CPI-U.

School Breakfast programs for lower-income children; and certain other free and reduced-price meal programs in daycare centers, after-school programs, and nonresidential adult care programs for elderly or chronically disabled persons.

Medicaid: Price-Indexed Provisions Affecting Beneficiaries and Health Care Providers

Income eligibility for Medicaid is linked to the federal poverty guidelines. Because the federal poverty guidelines change annually based on changes to the CPI-U, linking them to the chained CPI-U will slow the growth in the poverty guidelines and reduce the number of people eligible for Medicaid.

> The federal **Medicaid** program finances primary and acute medical services and long-term care for eligible persons. Federal and state governments share the cost of Medicaid.

To be eligible for long-term care coverage under Medicaid (whether in a nursing home, at home, or in a community-based setting), the value of an applicant's home equity cannot exceed $536,000 (up to $802,000 at states' option) in 2013. This amount is indexed to the CPI-U. Income and other asset limits also apply in determining eligibility for long-term care coverage. Under rules intended to prevent the impoverishment of the spouse of an individual seeking Medicaid coverage for long-term care, rules that govern the treatment of income and assets are indexed for inflation using the CPI-U. Indexing these thresholds to the chained CPI-U could restrict eligibility for these Medicaid programs and provide less financial protection to spouses.

Certain payments to Medicaid health care providers are also linked to the CPI-U. These include payments made on behalf of Medicaid beneficiaries to managed care plans, and federal payments to hospitals to fund uncompensated care for the uninsured—known as disproportionate share hospital payments. Both types of provider payments would rise more slowly under the chained CPI-U. Some providers may respond to this slower growth by reducing the availability of needed services to low-income persons. Federal appropriations for the Medicaid Integrity Program, which is intended to combat waste, fraud, and abuse, are increased annually by changes in the CPI-U. Applying the chained CPI-U in this context will reduce available resources to protect the financial integrity of the Medicaid program.

Medicare: Price-Indexed Provisions Affecting Beneficiaries and Health Care Providers

Several income and asset limits used to determine some aspects of Medicare eligibility are currently indexed to the CPI-U.

Eligibility for Part D Low-Income Subsidies depends on an applicant's assets

> **Medicare** is a federal benefits program that pays for covered health care services for persons aged 65 and older and for disabled individuals under age 65. Medicare consists of four parts (called Parts A–D) that cover, among other things, physician services, hospitalization, skilled nursing facility care, prescription drugs, home health visits, and hospice care. Medicare reimburses health care service providers through a variety of payment mechanisms.

falling below certain thresholds that are updated annually by the change in the CPI-U.[5] Adopting the chained CPI-U would result in fewer eligible beneficiaries for these programs than current law.

Generally, the high-income thresholds used to determine additional premiums paid under Medicare Parts B and D are indexed annually based on the CPI-U (between 2010 and 2019, the thresholds are fixed, but indexing will resume in 2020). Using the chained CPI-U instead of the CPI-U would result in more Part B and Part D enrollees paying higher income premiums.

Certain Medicare deductibles, cost-sharing (co-payment) amounts, and catastrophic coverage thresholds would rise more slowly under the chained CPI-U. Cost-sharing (co-payment) amounts paid by Part D Low-Income Subsidy beneficiaries for Part D outpatient drugs are indexed to the CPI-U. The annual adjustment to the Part D catastrophic coverage threshold is also partially linked to the CPI-U. A switch to the chained CPI-U could shift program costs from beneficiaries to Medigap providers (in the case of Medigap plans) or to the government (in the case of Part D cost-sharing and catastrophic cost thresholds).

Medicare reimbursement amounts to certain health care and equipment providers for the provision of services are also linked to the CPI-U. Many health care and equipment providers, including those who provide ambulance services, durable medical equipment (e.g., wheelchairs, hospital beds), prosthetics, and orthodontics, as well as those who perform surgeries in ambulatory surgery centers, could receive lower reimbursement amounts as a result of a switch to the chained CPI-U. Medicare payments to teaching hospitals are also based on a formula that includes the number of residents, per-resident costs, the hospital's Medicare patient load, geographic area, and the CPI-U.

Military and Veterans' Programs: Price-Indexed Provisions Affecting Beneficiaries

Most benefit programs affecting retired and disabled veterans, and their dependents and survivors, are indexed to price inflation. Linking these benefit amounts to the chained CPI-U would reduce the growth in benefits.[6]

Veterans are more likely than other groups to experience the long-term impact of cumulative COLA reductions. Many veterans are eligible to claim Military Retirement pensions by age 50, after having met the requirement for 20 years of service. These veterans could experience the effects of a reduced COLA over several decades.[7] Many retired and disabled veterans also receive Social Security benefits, and could experience the chained CPI-U's impact twice.[8]

Retired and disabled military personnel may be entitled to benefits from a number of different federal programs. **Military Retirement** benefits are available to veterans after 20 years of active or reserve service and are generally equal to 50 percent of military wages. **Veterans Pension benefits** are available to low-income veterans who are aged or severely disabled, and who have served in active combat duty. **Veterans Disability Compensation (VDC)** benefits are available for veterans with partial or full disability who served in active duty and can demonstrate that the injuries or illnesses were related to their military service.

A severely disabled, unmarried veteran who claims Veterans Disability Compensation (VDC) benefits at age 30 in 2013 would be entitled to benefits of about $2,816 per month, or $33,792 per year. This veteran would experience benefit cuts (in real terms) of $121 per month by age 45 (a cut of 4.3% compared to current law), $274 per month by age 65 (a 9.7% cut), and $418 per month by age 85 (a cut of 14.8%). The cumulative cut to this veteran's benefits would be $60,121 by age 65 and $144,189 by age 85.[9]

Military retirement benefits are indexed annually to changes in the CPI-W, using the same measuring period and formula for computing the COLA as under the Social Security program. Military personnel hired after August 1, 1986, may choose to receive a full COLA or accept a bonus after 15 years of service and receive annual COLAs that equal the percentage point increase in the CPI-W less 1 percentage point, with a bump-up at age 62.

The COLA for Veterans Pension benefits is identical to, and triggered by, the Social Security COLA. Each year, Congress approves COLAs for VDC and Dependency and Indemnity Compensation, equal to the Social Security COLA.

Several other programs for veterans, their survivors, and their dependents are also linked to inflation, including the subsistence allowance for veterans participating in vocational rehabilitation and employment services programs and monthly educational allowances provided under the Survivors' and Dependents' Educational Assistance Program.[10]

Poverty Relief Programs for Children, Adults, and Families: Price-Indexed Provisions Affecting Beneficiaries

SSI benefits are tied to the CPI-W. The federal SSI benefit standard ($710 for a single person and $1,066 for an eligible couple in 2013) is adjusted annually in line with the CPI-W. In addition, once receipt has started, SSI benefits receive the same COLA as Social Security benefits. If the chained CPI-U were used instead of the CPI-W to adjust the SSI federal benefit standard and subsequent COLAs, initial and subsequent monthly benefits would rise more slowly.

If the chained CPI-U were implemented in 2014, a single person claiming the SSI federal benefit standard in 2030 would receive $32 less (-4.6%) per month in real terms, and a person claiming SSI benefits in 2050 would receive $71 less (-10%) per month in real terms, than if the CPI-W continued to be used to determine the SSI benefit standard. In addition, a Social Security COLA based on the CPI-W is applied to SSI benefits after receipt has

Many veterans would experience the chained CPI–U's impact twice.

Many veterans are eligible to receive benefits from both the Veterans Administration and the Social Security Administration (SSA). Individuals with active duty service or training have been covered under the Social Security program since 1957. According to the SSA, about 9.3 million veterans received Social Security retirement, disability, or survivor benefits in 2009—just over one fifth of adult Social Security beneficiaries. About 93 percent of veteran Social Security beneficiaries were aged 62 or older in 2009. About 771,000 veterans received Social Security Disability Insurance in 2009. In addition, about 91.8 percent of veterans who received Social Security benefits also received Medicare.

Supplemental Security Income (SSI) provides cash benefits to low-income aged, blind, and disabled persons. SSI benefits are means-tested; that is, income cannot exceed certain thresholds, and assets cannot exceed $2,000 for a single person and $3,000 for a couple (these asset limits are not adjusted for inflation). The average monthly SSI benefit payment was $526 in January 2013; for persons aged 65 and older, the average monthly benefit was $422.

started. After 10 years of SSI benefit receipt, the SSI benefits of a person who first claimed in 2030 would, by 2040, be $52 less (-7.3%) per month in real terms, and the benefits of a person claiming in 2050 would, by 2060, be $89 less (-12.6%) per month in real terms, than if the CPI-W had been used to determine the benefit standard and the COLA.

Eligibility for several federal nutrition programs is tied to federal poverty guidelines issued by HHS. These include the National School Lunch and School Breakfast programs for lower-income children, certain other free and reduced-price meal programs in daycare centers, after-school programs, and nonresidential adult care programs for elderly or chronically disabled persons.

Per-meal reimbursement amounts for providers participating in the National School Lunch and School Breakfast programs, child care centers, and nonresidential adult care centers are increased annually for inflation with the CPI-U for food away from home. CBO's cost estimates assume that programs that rely on CPI components for indexing, such as the CPI for food away from home, would use the chained version of these components.

Social Security: Price-Indexed Provisions Affecting Beneficiaries

More than 57 million Americans received Social Security cash benefits in 2012, including 37 million retired workers; 8.8 million disabled workers; and 11.3 million spouses, dependent children, and survivors.[11]

Under current law, Social Security beneficiaries receive an annual COLA based on the CPI-W. Annual reductions under the chained CPI-U would be cumulative, so that beneficiaries would experience deeper cuts as they age.

Retirees are likely to experience the long-term impact of cumulative COLA reductions, although in many cases health care costs increase, and assets are drawn down, with age. Today, the average 65-year-old can be expected to live about 19 additional years. If the chained CPI-U were implemented, a beneficiary receiving the average Social Security retirement benefit of $1,265 per month ($15,180 per year) would experience an annual cut of $651 (-4.3% of annual benefits) after 15 years of COLAs based on the chained CPI-U, and an annual cut of $862 (-5.7% of annual benefits) after 20 years of COLAs based on the chained CPI-U, relative to current law. Cumulatively, benefits would be reduced by $5,244 over 15 years, and by $9,133 over 20 years, relative to cumulative benefits under current law at these ages.[12]

Social Security is a key source of income for disabled and retired persons and their families. The average Social Security retirement benefit was $1,265 in February 2013.

Budget Impact of the Chained CPI-U

Table 1 illustrates the budget impact of a switch from the regular CPI-W and CPI-U to the chained CPI-U for federal benefits programs and revenues.

Table 1
CBO Preliminary Estimate of the Budgetary Effects of Using the Chained CPI-U (billions of dollars)

Type of Impact	Program	10-Year Estimate (2014–2023)
Changes in Direct Spending	Social Security	-127.2
	Other COLA Programs	-37.5
	SNAP Interactions (COLA programs)	2.8
	Health Programs	-28.5
	Refundable Tax Credits	-17.9
	Other Federal Spending	-7.8
	Total, Direct Spending	-216.0
Changes in Revenues	Total, Revenues	123.7
	Net Decrease (-) in the Deficit	-339.8

Source: Congressional Budget Office, February 2013

Note: "Other COLA Programs" includes civil service retirement, military retirement, SSI, veterans' pensions and compensations, and other retirement programs with COLAs triggered directly by Social Security or civil service retirement. "Other Federal Spending" includes changes to various benefits and levels in other federal programs, such as Pell grants and student loans, Supplemental Nutrition Assistance Program (SNAP), and child nutrition programs. It also includes the effects in non-health programs of using the chained CPI-U for updates to the federal poverty guidelines. For more information, please see CBO, *Preliminary Estimate of the Budgetary Effects of Using the Chained CPI for Mandatory Programs and the Tax Code Starting in 2014*, http://www.cbo.gov/sites/default/files/cbofiles/attachments/Government-wide_chained_CPI_estimate-2014_effective.pdf.

Endnotes

[1] See, for example, proposals from the National Commission on Fiscal Responsibility and Reform (http://www.fiscalcommission.gov) and the Bipartisan Policy Center (http://www.bipartisanpolicy.org).

[2] For more information on the chained CPI-U, see G. Koenig and M. Waid, *Proposed Changes to Social Security's Cost of Living Adjustment*, AARP, October 2012, at http://www.aarp.org/work/social-security/info-10-2012/proposed-changes-to-cola-insight-AARP-ppi-econ-sec.html.

[3] This report does not address the many parameters in the federal tax code that are indexed to price inflation, including income tax brackets and provisions of the Earned Income Tax Credit (EITC) and the Child Tax Credit. The Congressional Budget Office estimates that replacing the CPI-U with the chained CPI-U for all adjustments that are statutorily tied to the CPI in the tax code, beginning in tax year that begins after December 2013, would increase revenues by $141.6 billion over 10 years, including $17.9 billion in refundable tax credits. See Congressional Budget Office, "The Budget and Economic Outlook, Fiscal Years 2013 to 2023," February 2013, at http://www.cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf.

[4] Congressional Budget Office, "The Budget and Economic Outlook, Fiscal Years 2013 to 2023," February 2013, http://www.cbo.gov/sites/default/files/cbofiles/attachments/43907-BudgetOutlook.pdf.

[5] U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, "2013 Medicare Part D Low-Income Subsidy (LIS) Income and Resource Standards," February 14, 2013.

[6] The description of military and veterans programs in this section is drawn from Nuschler, D., et al., "Inflation-Indexing Elements in Federal Entitlement Programs," Congressional Research Service Report R42000, available at http://www.hsdl.org/?view&did=719075.

[7] Strengthen Social Security, "Social Security and VA COLA Cuts Will Have Big Effects on Veterans and Their Families," http://www.strengthensocialsecurity.org/sites/default/files/VA%20COLA%20Cuts%20Fact%20Sheet%2011.28.2012.pdf.

[8] Olsen, A., and S. O'Leary, "Military Veterans and Social Security: 2010 Update," *Social Security Bulletin*, Vol. 71, No. 2 (2011). http://www.ssa.gov/policy/docs/ssb/v71n2/v71n2p1.pdf.

[9] Calculations by AARP Public Policy Institute using the Veterans Compensation Benefits Rate Tables effective December 1, 2012, available at http://www.benefits.va.gov/COMPENSATION/resources_comp01.asp.

[10] More information on benefits for veterans and their families may be found on the U.S. Department of Veterans Affairs website, http://www.benefits.va.gov/COMPENSATION/types-dependency_and_indemnity.asp.

[11] Social Security Administration, "Social Security Basic Facts," February 7, 2013, http://www.ssa.gov/pressoffice/basicfact.htm.

[12] AARP's estimates follow the Social Security Administration's assumption that the chained-CPI-U will reduce the annual COLA by about 0.3 percentage point per year, on average, relative to the CPI-W. See, for example, Social Security Administration at http://www.ssa.gov/OACT/solvency/provisions/cola.html.

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