CENTER ON BUDGET AND POLICY PRIORITIES
820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

May 18, 2004

A SIMPLE PROPOSAL THAT CAN YIELD SUBSTANTIAL SAVINGS OVER TIME

by Robert Greenstein

A number of federal entitlement programs, of which Social Security is the most prominent, provide benefits that are adjusted each year to keep pace with inflation as reflected in the Consumer Price Index. Similarly, a number of features of the tax code are adjusted annually for inflation, also as reflected in the CPI.

Research indicates, however, that the CPI slightly overstates inflation. This is a judgment that most experts — including analysts at the Bureau of Labor Statistics, which maintains the CPI — share.

As a result, BLS has recently developed an alternative CPI, sometimes known as the "superlative CPI," which takes into account the tendency for consumers to substitute products whose prices have increased more slowly for products for which prices have increased more rapidly. The BLS began to issue inflation estimates using both the traditional CPI and the new, superlative CPI in the summer of 2002. The superlative CPI is expected to rise, on average, about two-tenths of one percentage point less each year than the traditional CPI.[1]

It is a basic principle of federal policy that Social Security and other benefits should keep pace with inflation so that program beneficiaries do not lose ground as the years go by. Similarly, it is a basic principle that the tax code be adjusted so that taxpayers not be pushed into higher tax brackets or otherwise have their taxes raised by inflation. It is important that these principles be maintained. But there is no need to adjust benefits or tax-code features by more than inflation. Unless federal law is changed, that will continue to occur.

The Proposal

The proposal is a simple one. It consists of two elements. First, all programs and tax-code features that are adjusted for inflation each year in accordance with the CPI should henceforth be adjusted in accordance with the superlative CPI. Second, all savings achieved from this simple change on both the spending and the revenue sides of the budget should go solely for deficit reduction, not for financing program expansions or tax cuts.

Designing rules to preserve the savings is not hard to do; pay-as-you-go rules can suit this purpose admirably. Indeed, the pay-as-you-go rules that were first applied to entitlements and taxes as part of the 1990 bipartisan budget agreement were designed to lock in all entitlement and revenue savings achieved in that deficit-reduction package — to ensure that the savings would go only for deficit reduction and would not be spent. This can be accomplished by

[1] The Social Security actuaries estimate the average annual difference to be 0.22 percent.

stipulating that the savings achieved by enacting this proposal *not* be credited to any statutory or congressional pay-as-you-go "scorecards." This preserves the savings for deficit reduction.

This change should *not* be regarded as a benefit cut or a tax increase. It should be regarded more as a technical change to achieve Congress' stated goal of keeping pace with inflation in as accurate a way as possible. In any year, the effects will be very small — a cost-of-living adjustment that on average will be about two-tenths of a percentage point below what the adjustment would be if the old CPI were used.

Yet the long-term effects on the budget would be large, for the simple reason that the effects would compound. In the Brookings Institution volume *Restoring Fiscal Security*, which also proposes this change, Brookings analysts estimate that by 2014, this change would save about $35 billion a year from the application of the improved CPI to Social Security and the tax code, with the savings about equally divided between the Social Security and revenue sides of the budget. Application of the improved CPI to other programs that use the CPI for annual costs-of-living adjustments would produce some additional savings.[2]

The savings would continue to grow in years after 2014. Indeed, this proposal has the virtue of phasing in slowly and producing savings that grow over time just as the fiscal picture is darkening. In other words, the savings mount as the need for savings increases.

The proposal has a related virtue as well — by causing Social Security expenditures to be modestly lower than the level of expenditures that will occur if we maintain current law and continue using the current CPI, the proposal contributes to restoring long-term Social Security solvency. According to the Social Security actuaries, this proposal would close nearly one-fifth of Social Security's long-term financing shortfall.

Indeed, in a recent article, long-time Social Security sage Robert Ball endorses this change as one of the steps that should be taken to restore Social Security solvency. "COLAs have proved vitally important in maintaining the buying power of Social Security benefits, but they are not intended to do more than that," Ball writes. He states that "Improving the accuracy of the COLA is a change that defenders of Social Security should support on principle, and it also is a change supported by Alan Greenspan and some other critics of the present law."[3]

It should be noted that over the past decade, the Bureau of Labor Statistics has made a number of changes directly in the CPI that have significantly reduced the degree to which the CPI overstates inflation. These changes, which in combination were more than twice as large as the change discussed here, have been non-controversial. They have been incorporated directly into the "official" CPI and have affected the annual adjustments in Social Security, other programs, and the tax code without arousing opposition or protest. For technical reasons, the Bureau of Labor Statistics cannot make the modest improvement reflected in the superlative CPI directly into the official CPI, which is the reason it developed the superlative CPI alongside the traditional CPI. Given the daunting long-term fiscal problems that face the nation, this is a change that should be made. If policymakers cannot agree to make a change such as this, how can they agree to the far tougher choices throughout the budget that lie ahead?

---

[2] Alice M. Rivlin and Isabel Sawhill, eds., *Restoring Fiscal Security*, the Brookings Institution, 2004.

[3] Robert M. Ball, "How to Fix Social Security?" *Aging Today*, March-April, 2004.