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CPI FIX WON'T SAVE SOCIAL SECURITY

Budget negotiators are eager to trim the rate of growth of the CPI to help balance the budget. Trimming the growth of the CPI would cut Social Security outlays by reducing the annual cost of living adjustments (COLAs) of Social Security retirement and disability benefits and federal employee pensions. Trimming the CPI would also raise income taxes by reducing the adjustments under tax indexing. Social Security recipients who pay income tax on their benefits would lose twice.

COLAs aren't the source of Social Security's looming deficits, and ... trimming COLAs won't save the System. CPI tinkering is not a substitute for major reform of Social Security or privatization of retirement saving.

It is critical that budget makers understand that COLAs aren't the source of Social Security's looming deficits, and that trimming COLAs won't save the System. CPI tinkering is not a substitute for major reform of Social Security or privatization of retirement saving.

Trimming the annual growth of the CPI by 0.4% would ... cut total Social Security ... outlays by about 4% ... This is small compared to projected System deficits of more than 30% of outlays. The System would still go broke.

The CPI does overdo Social Security COLAs, but only modestly. Moving to a more accurate CPI would probably reduce average lifetime benefits by somewhere between 3% and 11% compared to current procedures, with the lower end of the range more likely. Social Security's retirement and disability deficits, on the other hand, are projected to build to more than 30% of the System's outlays over time.

The Boskin Commission has estimated that the consumer price index (CPI) may overstate the rate of growth of consumer prices by 1.1 percent per year and recommends a significant overhaul of that index to assist in budget balance. Some portions of the Commissions' technical estimates are controversial, however. Budget negotiators are apparently considering a more modest assumption that the Bureau of Labor Statistics's ongoing reforms will lead to a reduction in CPI growth of about 0.4 percent per year by 2000 (an amount more nearly in line with the technical adjustments the BLS is likely to endorse).

Trimming the annual growth of the CPI by 0.4% would trim an individual's average Social Security retirement benefits by about 4% over an average retiree's lifetime, and would cut total Social Security System retirement outlays by about 4% in any given year, once the change was fully phased in.

For an individual retiring at age 62, the benefit cuts would be negligible the first year of retirement. By age 72, the retirement benefit would be about 4% less than under current CPI methods. By age 82 (currently about the average life expectancy for retirees at age 62), his or her benefit would be 7% to 8% below current policy levels. The lifetime average reduction would be about 4%. (Men have an average life expectancy at age 62 of

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about 18 years, women about 22 years.) People living longer than average in retirement would experience deeper percentage cuts in benefits compared to current procedures.

[U]nlike the ever-increasing percentage tax impact of CPI adjustment, the percentage savings with respect to Social Security outlays would eventually reach a sort of plateau.

In any given year, the retiree population consists of some people who have just retired, some who have been retired for a few years, and some who have been retired for many years. The reduction in total System outlays would eventually rise to be about the same in percentage terms as the average lifetime reduction for retirees. As life expectancy rises the savings might rise from 4% to 5% of outlays over time. This is small compared to projected System deficits of more than 30% of outlays. The System would still go broke.

[T]here are better ways to address those deficits. Therefore, if a larger change in the CPI is not adopted by the technicians at the BLS, it should not be imposed on Social Security beneficiaries just to trim outlays (or to raise taxes).

The savings for the retirement system would initially be less than 4%. Retirees who began drawing benefits before the CPI change would experience the cuts for only part of their retirement years. The savings would build as a percent of outlays as current retirees pass on. Eventually, after about 25 or 30 years, almost the entire beneficiary population would consist of people who had retired after the CPI change, and whose COLAs had been trimmed for all their retirement years. Savings for the system would then roughly match the average cut in benefits over retirees' lifetimes, about 4% to 5% for a 0.4% yearly CPI cut. (See note.)

Thus, unlike the ever-increasing percentage tax impact of CPI adjustment, the percentage savings with respect to Social Security outlays would eventually level off. Further percentage cuts in outlays would occur only slowly as life expectancy rose.

If the Boskin Commission's estimate of the overstatement of the CPI were accepted, and the index were trimmed by 1.1% per year, the ultimate Social Security savings would be larger, as much as 11% to 12% of projected System outlays. This is more significant when compared to projected System deficits. How-

Note: Total system savings each year would depend on the varying number of retirees in each age group in the beneficiary population, and would differ slightly from the average lifetime percentage benefit cuts for any given age group.

Percentage reduction in retirement benefits over an average retiree's lifetime due to CPI reduction			
Percentage reduction in CPI	Percentage cut in benefit		
	Age 62*	Age 72	Age 82
0.4%/year	0%	3.9%	7.3%
1.1%/year	0%	10.4%	19.7%

*Note: The CPI has a small impact on initial benefits if a worker delays claiming benefits past age 62, but the effect on lifetime benefits is largely offset because the worker will draw benefits for fewer years and receive fewer COLAs.

ever, there are better ways to address these deficits. Therefore, if a larger change in the CPI is not adopted by the technicians at the BLS, it should not be imposed on Social Security beneficiaries just to trim outlays (or to raise taxes).

Instead of attacking COLAs of current retirees, it would make more sense to slow the growth of the initial benefits that future retirees will get when they first begin to draw from the System. That can be done by amending the formula that sets those benefits, by raising the normal retirement age, or both. These changes could save several times as much money as trimming COLA's via changes in the CPI. The ultimate reform, privatization, would save even more money while leaving future workers and retirees better off.

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Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.