S. HRG. 100-1028

COST-OF-LIVING ADJUSTMENTS AND THE CPI: A QUESTION OF FAIRNESS

HEARING

BEFORE THE

SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

WASHINGTON, DC

OCTOBER 5, 1988

Serial No. 100-27

U.S. GOVERNMENT PRINTING OFFICE

95-361 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

SENATE SPECIAL COMMITTEE ON AGING

JOHN MELCHER, Montana, *Chairman*

JOHN GLENN, Ohio	JOHN HEINZ, Pennsylvania
LAWTON CHILES, Florida	WILLIAM S. COHEN, Maine
DAVID PRYOR, Arkansas	LARRY PRESSLER, South Dakota
BILL BRADLEY, New Jersey	CHARLES E. GRASSLEY, Iowa
QUENTIN N. BURDICK, North Dakota	PETE WILSON, California
J. BENNETT JOHNSTON, Louisiana	PETE V. DOMENICI, New Mexico
JOHN B. BREAUX, Louisiana	JOHN H. CHAFEE, Rhode Island
RICHARD SHELBY, Alabama	DAVE DURENBERGER, Minnesota
HARRY REID, Nevada	ALAN K. SIMPSON, Wyoming

MAX I. RICHTMAN, *Staff Director*
G. LAWRENCE ATKINS, *Minority Staff Director*
CHRISTINE DRAYTON, *Chief Clerk*

CONTENTS

CHRONOLOGICAL LIST OF WITNESSES

APPENDIXES

COST-OF-LIVING ADJUSTMENTS AND THE CPI: A QUESTION OF FAIRNESS

WEDNESDAY, OCTOBER 5, 1988

U.S. SENATE,
SPECIAL COMMITTEE ON AGING,
Washington, DC.

The committee met, pursuant to notice, at 10:00 a.m., in room 628, Dirksen Senate Office Building, Hon. John Melcher [chairman of the committee] presiding.

Present: Senators Melcher, Heinz, Burdick, Grassley, Shelby, and Chafee.

Staff present: Max Richtman, staff director; Bill Ritz, communications director; Chris Jennings, professional staff member; Jennifer McCarthy, professional staff member; Kelli Pronovost, hearing clerks; Larry Atkins, minority staff director; Caroleen Williams, minority professional staff member; Laura Erbs, minority professional staff member; and Dan Tuite, printing assistant.

OPENING STATEMENT OF SENATOR JOHN MELCHER, CHAIRMAN

The CHAIRMAN. The committee will come to order.

For nearly a year and a half, this committee has been interested in the Consumer Price Index, because the cost-of-living adjustment that is provided every year to recipients of federally administered retirement programs is based on the Index. Our concern is that those who depend on Social Security, railroad retirement, civil service retirement, military retirement, or veterans' pension payments are not surveyed in the Consumer Price Index, and that the COLA therefore may not be reflective of what their inflation has been for the previous year. Elderly Americans, who spend a disproportionate amount of their income on health care may be getting short-changed as a result.

Recently, we looked at the study that we asked the Bureau of Labor Statistics to carry out last year, and we find that if the costs of the elderly are figured in, the Consumer Price Index probably would be higher and therefore so would their cost-of-living adjustment. How much higher? Between $3.50 and $5 per month. Those for whom Social Security is their major or only source of income, these additional dollars are not insignificant.

First and foremost, this is a question of fairness. All that we are asking is that COLA's be fair. Not higher, but fair and accurate. This hearing is to bring us up to date on what is being done, what Congress is considering, to assure that elderly Americans are provided a fair and accurate cost-of-living adjustment.

We will hear today a number of witnesses discuss this matter, who perhaps will give us guidance so that we can then pursue a possible legislative correction, if needed. Again, I believe that in the final analysis, this committee, Congress itself, and the American public are only seeking fairness—no more, but certainly no less.

Out first witness is Dr. Norwood, Commissioner of the Bureau of Labor Statistics.

We welcome you to the committee, Dr. Norwood, and are anxious to hear your testimony.

[The prepared statement of Senator Melcher follows:]

United States Senate
SPECIAL COMMITTEE ON AGING
WASHINGTON, DC 20510-6400

OPENING STATEMENT

SENATOR JOHN MELCHER
Chairman
Senate Special Committee on Aging

October 5, 1988

COST OF LIVING ADJUSTMENTS AND THE CPI: A QUESTION OF FAIRNESS

Good morning. On behalf of myself and the other members of the Special Committee on Aging, I want to welcome everyone to this morning's hearing. Today, we will examine ways to assure that elderly Americans and other recipients of federal income security programs are receiving a cost-of-living adjustment or COLA that is based on the fairest measure of inflation available.

In June of last year, when the Committee first looked at this issue, we heard about the serious shortcomings of the consumer price index or CPI currently used to set COLAs and how difficult it is for retired persons to keep up with rising costs, particularly medical expenses, as a result. Since that time, the Bureau of Labor Statistics, the agency responsible for the CPI, has taken a good hard look at this problem and produced some important findings in this area. Today, we will be focusing on those findings. We also will discuss the advisability of efforts to replace the CPI with an index that more accurately reflects the elderly's inflation rate.

Without an accurate COLA, inflation slowly but surely erodes the standard of living of the elderly and others who live on fixed incomes. Unfortunately, there is strong evidence that COLAs for a wide range of federal income security programs -- including Social Security, civil service retirement, railroad retirement, military retirement, and veteran's pensions -- are unfair and inadequate. This means that millions of retireeswho depend on benefits or pensions from these programs may not be getting a square deal. The reason is that the CPI used to set COLAs -- namely, the CPI-W -- does not survey a single retired person. The CPI-W reflects only the spending patterns of the working population.

Clearly, there is no reason to assume that older and disabled Americans have the same buying patterns as the rest of the population. In fact, just the opposite is true. For example, few would dispute the fact that, on average, the medical needs of those 65 and older are far greater than for the rest of the population. If the inflation rate for these services paralleled the overall inflation rate, there would be less reason for concern. Unfortunately, the medical inflation rate each year has risen higher and faster than the general inflation rate.

For example, while the general inflation rate from August 1987 to August 1988 was 4 percent, the medical inflation rate was 6.6 percent -- a difference of more than 60 percent. As a result, because the elderly are not sampled in the CPI-W, the CPI-based inflation rate does not fully reflect the elderly's inflation rate. Sadly, as a number of witnesses testified at last year's hearing, older Americans are finding they have less money each year to pay for food, electricity and other necessities.

Soon after that hearing, I sponsored legislation to require BLS to develop a one-time reweighted index that specifically reflected the elderly's inflation rate. That legislation was incorporated in the Older Americans Act of 1987 and enacted into Public Law 100-175.

BLS's recently released study showed that Americans 65 or older appear to have experienced higher inflation than has the rest of the nation in the last five years. According to the study, the experimental index found that the inflation rate for the elderly they surveyed rose a total of 19.5 percent between and 1983 and 1988. That compares with 16.5 percent for the consumer price index that is used as a basis for the Social Security COLA and other federal retirement programs, the CPI-W. BLS concluded that it appeared that higher medical and housing costs were the primary factors for the difference.

While a 3 percent difference does not seem like much to some Americans, it certainly would make a major difference to the third of the elderly who derive 80 percent or more of their income from Social Security benefits. On average, the percentage difference would be a $3.50 to $5 per month shortfall, an amount not insignificant to many retirees.

BLS informs us that more extensive research on the special purchasing habits of the elderly, as well as additional sampling population studies, must be completed before the so-called "experimental" index is ready to be used. Nevertheless, in the interim, we should allow older Americans to be cheated by an index that doesn't truly measure the inflation they face.

Fortunately, there already exists an index in which BLS has complete confidence that does sample at least some retirees and some disabled persons. This index, known as the CPI-U, is the index used in most other government-wide calculations and surveys a broader and larger sample population. For this very reason, the General Accounting Office recommended using the CPI-U for COLA calculations in a 1982 report, as well as in testimony before the Aging Committee last year. Also, the Office of Management and Budget in 1980 recommended that the CPI-U replace the CPI-W for COLA calculations. In the words of then-director of OMB, James T. McIntyre:

> The new "all urban" index [CPI-U], in doubling the population covered compared with the current index, will include retirees and other recipients of Federal program benefits that are adjusted by the CPI, but who are not represented by the current index. It will thus not only reflect more accurately the changes in prices experienced by a larger proportion of the population, but will be a more appropriate base of adjustment of Federal benefits than the much more limited "wage and clerical" index [CPI-W] in current use.

Consistent with these OMB and GAO recommendations, Senators Heinz, Burdick, and Pressler joined me on September 26th in introducing S. 2831, a bill to require that federal COLAs be indexed to the CPI-U rather than the CPI-W.

Based on the most recent estimates of inflation, the effect of this policy change on the next COLA would be fairly modest, just over a one-tenth of a percent increase. However, there have been years when the CPI-U has been as much as seven-tenths of a percent greater than the CPI-W. In any case, to those on fixed incomes, even small differences add up and begin to cut into the the purchasing power of Social Security benefits and pensions under other federally administered programs.

Also on September 26th, Senators Burdick and Pressler joined me in introducing S. 2832, a bill to authorize funds to enable BLS to fine-tune the research tools and sampling methods needed to assess if a separate inflation index for federally administered COLA recipients is warranted.

This morning we will hear from Janet Norwood, Commissioner of the Bureau of Labor Statistics; Harry Ballantyne, Chief Actuary of the Social Security Administration; Gorham Black, National Legislative Council Member of the American Association of Retired Persons; and Mary Jane Yarrington, senior policy analyst of the National Committee to Preserve Social Security and Medicare.

I'd like to thank our witnesses for joining us today. I look foward to hearing your views on these issues of mutual concern.

STATEMENT OF DR. JANET L. NORWOOD, COMMISSIONER, BUREAU OF LABOR STATISTICS, ACCOMPANIED BY MR. PAUL ARMKNECHT, ASSISTANT COMMISSIONER FOR CONSUMER PRICES AND PRICE INDEXES

Ms. NORWOOD. Thank you very much. I have with me Paul Armknecht, who is our Assistant Commissioner for Consumer Prices and Price Indexes. We are happy to be here and appreciate the opportunity to testify this morning.

As you know, we have now two official Consumer Price Indexes, one for all urban consumers, which covers all of the people who live in urban communities, whether older or younger; and the wage earner and clerical worker index, which covers the expenditure experience of that group of the population.

At the request of this committee, the Bureau of Labor Statistics developed a reweighted experimental price index based on the expenditure experience of people who were 62 years of age and over. That experimental index rose 19.5 percent from the period December, 1982 to December, 1987, which was about 1.3 percentage points more than the CPI-U, the all urban index, and 3 percentage points more than the CPI-W.

In all three of the indexes over the 5-year period, medical care rose the most, and the 37.2 percent increase in the experimental index was slightly less than the increases for medical care in both the U and the W. The smallest advance was in transportation, but here the 10.5 increase in the experimental index was more than the increases in the other two indexes.

The inflationary experience of the last 5 years differed in many ways from that of the last decade or so, and there is of course no assurance that the results of this study would have been the same had the study covered the entire decade, or indeed whether the results will be similar in the years ahead. It is clear, however, that shelter and medical care had a large impact because their relative importances, especially in the experimental index, were so large. Energy was also significant, primarily because of the extreme volatility of price movement of energy products over that period, but virtually all of the difference between the experimental index and the two official measures during the 5-year period can be explained by shelter and medical care.

As we have discussed before, the experimental index has several limitations as an estimate of the inflation rate experienced by older Americans. The first is that the samples that were used in the reweighting are considerably smaller than those used for the expenditure patterns for either of the other official indexes. As a result, the experimental index has considerably larger sampling errors than the official measures.

Second, because the expenditure survey is designed to develop expenditure experience for the index population for the all urban and the wage earner/clerical worker index, we are not certain that the particular items, as well as the stores, the retail outlets in which data are collected, are as appropriate for the older population as they are for the U and the W populations.

And, third, we believe that there is evidence that the older population, particularly retirees, have the opportunity to get senior dis-

counts in a number of areas. We include those discounts insofar as they are represented in the Consumer Price Index for all urban consumers, but certainly we don't have a way of doing that at this point that would be reflective of the price experience of older Americans.

Now one of the bills that has been introduced by you, Senator, and others this year, refers to the entire group of Social Security recipients rather than persons age 62 and over. As you quite rightly pointed out in your introductory remarks, there are a number of younger people who are receiving Social Security benefits, and so for the purposes of this testimony we have tabulated in a preliminary way the expenditure patterns of Social Security recipients from the existing body of data that we have for consumer expenditures.

Now the Consumer Price Index for all urban consumers covers about 80 percent of the total noninstitutional population in the country because it was designed to represent only the urban population. Approximately 77 percent of the noninstitutionalized Social Security recipients reside in areas covered by the CPI-U. The remaining 23 percent of Social Security recipients live in rural areas which are not covered by the CPI program as it now stands.

Of the CPI-U reference population, about 24 percent of the households have at least one member who receives income from Social Security benefits. In contrast, the CPI-W, the wage earner/clerical worker reference population, has only 6 percent of its households with at least one member who receives income from Social Security payments. Approximately 4 percent of the Social Security beneficiaries are confined in nursing homes, which are entirely outside the scope of the consumer expenditure survey, so expenditures for those individuals are not represented either in the U or the W or the experimental index.

Now if we look at incomes, we find that median incomes for families—that is, two or more related people living together—who receive Social Security benefits are somewhat lower than the median for all families, about $19,300 versus $26,490 for the total for all families, but still 27 percent of the Social Security families had incomes over $30,000 and 9 percent had incomes over $50,000.

On the other hand, at the low end of the income scale, nearly one-fifth had family incomes less than $10,000 a year. And if we are to look at single persons, and that is particularly important for the older population, we find that those who were getting Social Security had a median income of a little over $7,000 a year, which is two-thirds of the median income of all single people.

So the income of households with Social Security recipients varies greatly and, as a result, their expenditure patterns can also be expected to vary significantly. As we have discussed before, indexes must by definition reflect averages, and may therefore not be particularly representative of a single individual within the group that is represented, but it does represent the average of the whole group.

If we look at item expenditures, we find that for food expenditures Social Security recipient households devote about the same share of their spending to food as do the broader CPI-U households, but they spend somewhat less than the wage earner index,

the CPI-W, and a little more than the experimental index for older consumers.

Social Security recipient households devote somewhat more of their spending to housing than do CPI-U households, and somewhat less than older consumers. They devote a substantially larger share, however, to housing than do the CPI-W households. Social Security households allocate much more—about two-thirds more—of their expenditures to medical care than either of the CPI index families. In this area Social Security recipients are very much like older consumers who spend a large portion of their income on medical care. For apparel and upkeep, transportation, and other goods and services, Social Security recipient households devote the smallest share of spending of any of the four population groups except for the older consumers, and for entertainment they do devote the smallest share of their income.

Thus, Social Security recipients have expenditure patterns most like older consumers and more similar to those of the CPI-U households than to those of the CPI-W. There is a chart that is attached to my testimony which shows that in nearly all of the CPI major categories, the expenditures of the Social Security recipients are closer to the U than to the W indexes, and you can see that in particular if you look at housing, at transportation, and at medical care.

Now given that 77 percent of Social Security beneficiaries are covered by the CPI-U population, and that those beneficiaries comprise almost a quarter of the CPI-U population, the similarity between Social Security recipient households and the CPI-U market basket should not surprise us. But there are, nevertheless, clear differences that are related to income, age, and family size characteristics of the two populations.

Now I might also point out that although most Federal entitlement programs are indexed to the CPI-W, there are significant programs which are indexed also instead to the U.

This committee requested that we discuss with you priorities for research for development of an index that would cover the expenditure experience and price experience of Social Security recipients. We believe that first we ought to look at all of the groups that you mentioned that would be included in the law, to examine the population characteristics and the availability of data from each of the federally funded retirement programs, but we think it is entirely possible that the Social Security recipients would provide a very representative sampling frame for this index. We also need to evaluate the effect on the price index of the expanded use of senior citizens' discounts.

I might add, by the way, that the CPI measures the change in price. It is not a measure of the level of price, so what we would be interested in is not the discount itself but whether the discount policy changes over time.

Secondly, we would need to design a series of tests to develop questionnaires that would be better suited to the population that we want to measure. The specific expenditure areas that we have identified for this research are medical care, apparel, food, and personal care.

Our current methods, we believe, may not be collecting sufficient details necessary to differentiate the purchasing experience of the Social Security subpopulation in these areas. What this means, of course, is that this research would then have to be incorporated into the development of an expanded consumer expenditure survey, which would have to be done in order to see to it that the accuracy of the expenditure weights was equal to that of the CPI-W, certainly, or of the U, if that were desired.

Third, we believe very strongly that there needs to be an exhaustive analysis of the medical care component for the subpopulation. It is probable that the mix of medical care purchased would differ for Social Security recipients if compared to the population as a whole, and we would also need to take a further look at the CPI's treatment of health insurance expenditures to evaluate its appropriateness in an index for this subpopulation.

There have also been questions raised, Mr. Chairman, about the treatment of housing in the index, and there I think the question revolves around the purposes of the index. We could also certainly review that situation, although many of the newer approaches to reverse mortgages for older people now suggest that the housing component approach that we are now using might well be appropriate, but that is something we would be glad to look at.

I hope, Mr. Chairman, that these few comments prove helpful, and we would be glad to try to answer any questions you have.

[The prepared statement of Ms. Norwood follows:]

STATEMENT OF
DR. JANET L. NORWOOD
COMMISSIONER
BUREAU OF LABOR STATISTICS
BEFORE THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE

October 5, 1988

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to testify this morning on the use of alternative Consumer Price Indexes in making Federal cost of living adjustments.

I would first like to review the report that we issued this past summer on an experimental index for older Americans. I believe this report can help to shed light on the issues before the Committee.

THE REWEIGHTED EXPERIMENTAL INDEX

In response to this Committee's request, the Bureau of Labor Statistics reweighted the CPI to reflect the expenditure experience of older Americans. The time period covered by the experiment was January 1983 through March 1988. The year 1983 was chosen as a beginning date for the reweighted index because technical changes in the treatment of homeowners' shelter costs introduced in that year made estimation of the index for earlier periods impractical.

The Bureau of Labor Statistics publishes Consumer Price Indexes for two population groups: ALL URBAN CONSUMERS (CPI-U) and URBAN WAGE EARNERS AND CLERICAL WORKERS (CPI-W). The experimental index reweights the price information for the various categories of spending routinely collected for the official CPI-U and CPI-W indexes using expenditure patterns of consumers aged 62 and over. The source of data for the spending patterns of older consumers was the Consumer Expenditure Survey (CE), a survey which is regularly conducted by the Bureau to provide data on how all U.S. consumers spend their income and which serves as the basis for periodic revisions of the official CPI's market baskets. The experimental index was reweighted using the same methods as those used in calculating the official CPI's, including use of the complete samples of geographic areas and items of the official measures. The reweighting thus is an improvement over earlier research examining the differences in living costs between older consumers and the general population.

RESULTS OF THE REWEIGHTED EXPERIMENTAL INDEX

Over the 5-year period from December 1982 to December 1987, the experimental index rose 19.5 percent. This compares with increases of 18.2 percent for the CPI-U and 16.5 percent for the CPI-W.

All Items percent change for alternative CPI definitions, 12 months ended in December, 1983-1987

	All Urban Consumers	Wage Earners and Clerical Workers	Experiment Index
1983	3.8	3.3	3.7
1984	3.9	3.5	4.1
1985	3.8	3.6	4.1
1986	1.1	0.6	1.8
1987	4.4	4.5	4.5
1982-1987	18.2	16.5	19.5

Examining the indexes in more detail, medical care costs registered the largest increase of the seven major expenditure groups for each of the three indexes. In the reweighted experimental index, this component rose 37.2 percent, slightly less than the 37.4 percent increase in the CPI-U and the 37.8 percent rise in the CPI-W. The smallest advance in the five-year period among the major groups for all three indexes was the transportation component, which rose 10.5 percent in the experimental index and 9.7 and 9.5 percent in the CPI-U and CPI-W, respectively.

The inflationary experience of the last 5 years differed in many ways from that of the last decade or so, and there is no assurance that the results of this study would have been the same had the study covered the entire decade -- or, indeed, whether the results will be similar in the years ahead. Shelter, energy and medical care stood out as significant sources of the inflationary experience of the past 5 years. Shelter and medical care had a large impact because their relative importances, especially in the experimental index, were so large. Energy was also significant--primarily because of its extreme volatility of price movement over the period.

Virtually all of the difference between the experimental index and the two official measures, during the 5-year period, can be explained by the differential effects of the shelter and medical care components. The shelter component accounted for about 40 percent of the difference between the CPI-U and the experimental index. Shelter accounted for even more of the

difference--about 50 percent--between the experimental index and the CPI-W, because the treatment of shelter costs in the CPI-W was improved and modernized 2 years later than the CPI-U.

Almost all of the remaining difference between the experimental index and the other two indexes was accounted for by the medical care component.

LIMITATIONS OF THE EXPERIMENTAL INDEX

The experimental index has several limitations as an estimate of the inflation rate experienced by older Americans.

One major limitation is that the expenditure patterns calculated for the experimental index are taken from the BLS Consumer Expenditure Survey, which is designed to provide reliable data for the wage earner and all urban populations. The reweighting was based upon samples that are considerably smaller than those from which expenditure patterns were calculated for the official indexes. As a result, the experimental index has considerably larger sampling errors than the official measures.

Another limitation is that the categories of items to be priced are also selected using expenditure weights calculated from the Consumer Expenditure surveys for the official index populations. Thus, the specific item groups selected for each expenditure category may not be representative of the experimental index population. Further, the specific items selected for pricing within a store, while appropriate for the official indexes, may not in fact, be equally appropriate for the older population. For example, surgeons selected for the CPI sample supply information on the relative proportions of procedures such as appendectomies, hernia repairs, and cyst excisions that they perform for all of their patients. To the extent that these proportions differ from the proportions of each treatment type performed for older patients, the sample selected for the CPI-U may be an inappropriate reflection of the price experience of older consumers.

In addition, the stores for pricing are selected based on data reported in a survey representing all urban households, the Point-of-Purchase Survey. The outlets may not be representative of the places of purchase of the older

population, however. The sample size of the current Point-of-Purchase Survey is not sufficient to determine whether older Americans typically shop in different types of stores or localities from the general population.

A further source of uncertainty about the appropriateness of using CPI-U prices in the index for older consumers concerns the availability of special prices for the older population. For example, senior-citizen discount rates are included in the CPI in proportion to their use by all urban consumers. In constructing a price index for the older population, however, senior-citizen discounts should be included in proportion to their use by that population.

COST OF LIVING ADJUSTMENTS (COLA'S)

While useful for study, the experimental index, targeted at persons 62 years of age and older, likely does not have the most appropriate population definition for an index to be used in indexing all Social Security payments or other Federally financed retirement income benefits.

For example, an estimated 25 percent of all Social Security beneficiaries are younger people who receive benefits because they are surviving spouses and/or minor children of covered workers or because of disability. In addition, we understand from data from the Social Security Administration that 42 percent of the population age 62 to 64, although eligible for retirement benefits, were not collecting them during the 1982-84 period. An index designed specifically to measure price change for beneficiaries -- i.e., one that excludes older persons not receiving benefits, but includes younger persons receiving survival and disability benefits -- might well show price movements different from those of the experimental index.

SOCIAL SECURITY BENEFICIARIES

We have tabulated preliminary expenditure patterns of Social Security recipients from the Consumer Expenditure Survey data. A comparison of that market basket with those of the two official CPI's and the experimental index is quite revealing. However, before we turn to that comparison, I'd like to take a moment to discuss some of the characteristics of the Social

Security beneficiaries population, and those of the CPI for all urban consumers and the CPI for urban wage earners and clerical workers. A better understanding of the characteristics of the families which comprise each population may prove beneficial in understanding the market basket comparison.

INDEX COVERAGE AND SOCIAL SECURITY

The CPI-U covers 80 percent of the total noninstitutionalized population of the country since it was designed to represent only the urban population of the United States. Approximately 77 percent of the noninstitutionalized Social Security recipients reside in areas covered by the CPI-U. The remaining 23 percent of Social Security recipients live in rural areas not covered by the CPI.

Of the CPI-U reference population, 24 percent of the households (consumer units) have at least one member who receives income from Social Security benefits. In contrast, the CPI-W reference population has only 6 percent of its households (consumer units) with at least one member who receives income from Social Security benefits. That is not surprising since the CPI-W was designed to cover the urban working population (i.e., those whose primary income was from clerical and wage earner occupations).

Approximately 4 percent of the Social Security beneficiaries are confined to nursing homes which are outside the scope of the Consumer Expenditure Survey conducted for the CPI. Expenditures by these individuals are not represented in either the CPI-U, CPI-W, or experimental indexes.

INCOME OF SOCIAL SECURITY RECIPIENTS

Census Bureau statistics show that the median income for families (two or more persons) receiving Social Security benefits in 1984 was $ 19,307, less than the median income of all families with income at $ 26,491. However, 27 percent of the families who received Social Security benefits had a total family income in excess of $30,000, and 9 percent had incomes greater than $50,000.

At the lower end of the distribution scale, 18 percent of the families receiving Social Security benefits had incomes of less than $ 10,000.

If we look at single persons, (those not living in families), approximately one-third receive some kind of income from Social Security, and they had a median income of $ 7,256, which is two-thirds of the median income of all single persons ($ 11,448).

Thus, the income of households with Social Security recipients varies greatly, and, as a result, their expenditure patterns can also be expected to vary significantly. Regardless of the population group targeted for analysis, an index needs to represent the expenditure patterns for an average of families and individuals within the group. In the case of Social Security recipients, income levels--and, thus, expenditures--may vary considerably within the group, and of course, the average for the group may be higher or lower than that experienced by any one of the individuals represented in the group.

ITEM EXPENDITURES

Now let's look at some of the goods and services that comprise each market basket at CPI major group level. Social Security recipient households devote about the same share of their spending to food as the broader CPI-U households, less than the CPI-W households and more than older consumers. Social Security recipient households devote somewhat more of their spending to housing than do CPI-U households, and somewhat less than older consumers. They devote a substantially larger share, however, to housing than do the CPI-W households. Social Security households allocate much more (about two-thirds more) of their expenditures to medical care than either of the CPI index families. In this area, Social Security recipients are like older consumers who spend a large portion of their income on medical care. For apparel and upkeep, transportation, and other goods and services, Social Security recipient households devote the smallest share of spending of any of the four population groups, save for the older consumers; and for entertainment, they do devote the smallest share.

Thus Social Security recipients have expenditure patterns most like older consumers and more similar to those of the

CPI-U households than those of the CPI-W. As the chart attached to my testimony shows, in nearly all of the CPI major categories, the expenditures of the Social Security recipients are closer to the CPI-U than to the CPI-W.

Expenditure Patterns for Selected Household Groups, based on 1982-84 Consumer Expenditure Survey data

Category	Urban Households	Wage and Clerical Workers	Social Security Recipients	Older Americans
Food and Beverages	18.97	21.13	18.60	16.57
Housing	41.26	38.24	44.97	47.82
Apparel and Upkeep	6.74	6.71	5.44	4.92
Transportation	18.74	20.88	15.00	14.71
Medical Care	4.96	4.15	8.66	8.87
Entertainment	4.27	3.94	3.00	3.20
Other Goods and Services	5.06	4.94	4.33	3.91

Given what I indicated earlier -- that 77 percent of Social Security beneficiaries are covered by the CPI-U population and that those beneficiaries comprises 24 percent of the CPI-U population, the similarity between the Social Security recipient households and the CPI-U market basket should not be surprising. However clear differences between the expenditure patterns of Social Security recipients and the all urban population exist. These differences are related to income, age and family size characteristics of the two populations.

I might also point out that while most Federal entitlement programs are adjusted by the CPI-W, many Federal programs containing indexation provisions utilize the CPI-U. Among these are the Food Stamp program, Section 8 Housing, Community Health Services, HHS's Income Energy Assistance program, and the Economic Recovery Tax Act of 1981 which legislated the use of the CPI-U in indexation of the IRS tax code.

RESEARCH PRIORITIES

I believe that research in this area could include such topics as:

1. Estimation of a preliminary price index for the target population most appropriate for the intended use. Before constructing the index an examination of the population characteristics and the availability of data from each of the Federally funded retirement programs should be carried out. It

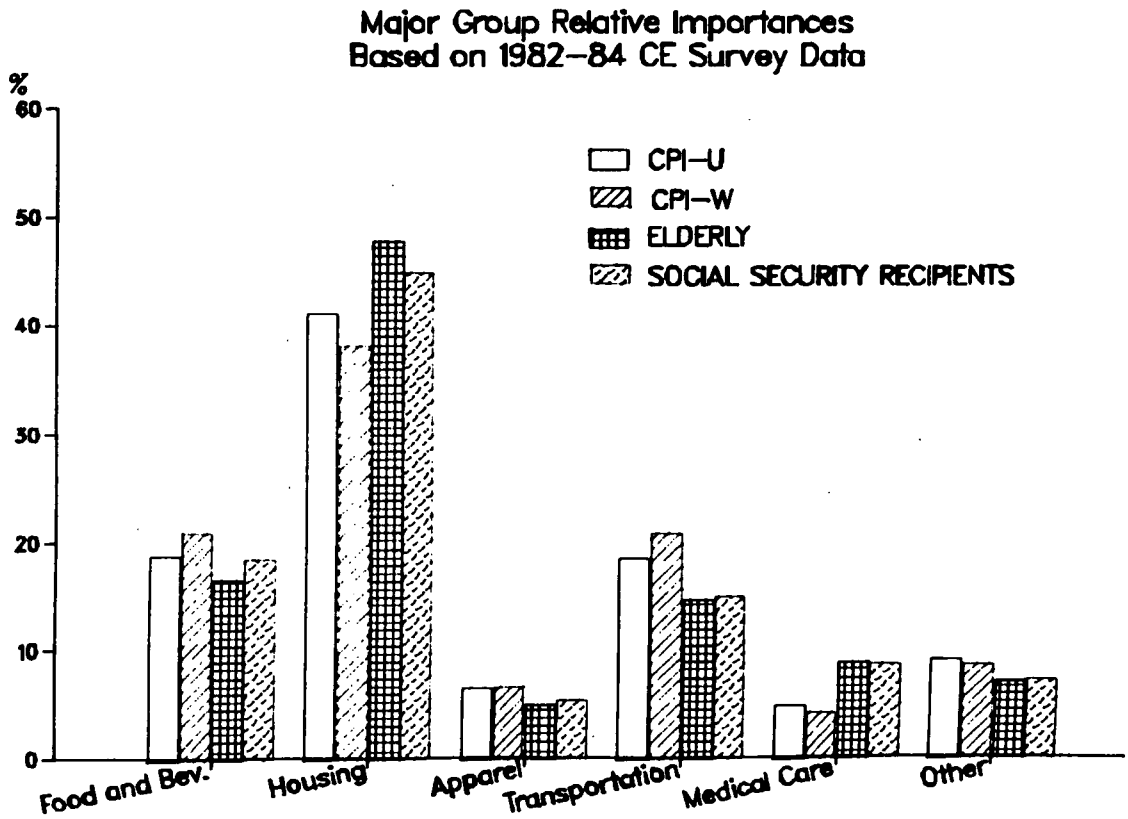
is possible that Social Security recipients would provide a sufficient and representative sampling frame for this index, but the other programs' beneficiaries should be examined prior to making that decision. An additional task would be an evaluation of the effect on the price index of the expanded use of Senior citizen discounts. Senior citizen discounts could be collected where available as an adjunct to our current pricing program.

2. Design of a series of collection procedure experiments to develop questionnaires that could be utilized in constructing the item and outlet samples required for an ongoing price index. The specific expenditure areas that BLS has identified for this research are medical care, apparel, food and personal care. In each of these areas our current methods may not be adequate to collect the level of data details necessary to differentiate the purchasing experience of the Social Security subpopulation. In addition, results of this research could be incorporated into development of an expanded Consumer Expenditures survey in the most cost effective manner.

3. Exhaustive analysis of the medical care component for the subpopulation. Medical care appears to represent a significant component of this group's expenditures and it is probable that the mix of medical care purchased would differ from that of the population at large. Among the projects that would be included in this analysis would be an examination of the detailed medical care utilization reports collected in the National Health Care Expenditure Survey, analysis of data compiled by the Health Care Financing Administration for medicare reporting purposes, and medical care pricing experiments using medical care practitioner reports as the sampling frame. The results of this analysis may provide results that could be incorporated into the proposed index, thereby improving its measurement of this important component of retirement beneficiaries expenditures. In addition, I believe that we should take a further look at the CPI's treatment of health insurance expenditures to evaluate its appropriateness in an index for this subpopulation.

CONCLUSION

I hope, Mr. Chairman, that my comments here today have provided useful to you and your committee as you explore alternative approaches for making cost of living adjustments in the Social Security program.


Major Group Relative Importances
Based on 1982–84 CE Survey Data
%
60
50
40
30
20
10
0
CPI–U
CPI–W
ELDERLY
SOCIAL SECURITY RECIPIENTS
Food and Bev.
Housing
Apparel
Transportation
Medical Care
Other

The CHAIRMAN. Certainly.

I will now recognize Senator Heinz, the ranking member of this committee.

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, first I want to apologize for not having been here at 10:00 o'clock when you started on time, as you always do.

I commend you on holding this hearing. This is the second such hearing that I recall. You held one in June of last year, and I am a cosponsor with you of legislation to change from the current CPI-W to CPI-U. I have a more lengthy opening statement. I would ask unanimous consent to put it in the record at this point.

The CHAIRMAN. Without objection, it will become part of the record at this point.

[The prepared statement of Senator Heinz follows:]

OPENING STATEMENT OF SENATOR JOHN HEINZ (R-PA)
SENATE AGING COMMITTEE HEARING ON THE CONSUMER PRICE INDEX
OCTOBER 5, 1988

MR. CHAIRMAN: TODAY THIS COMMITTEE CONTINUES ITS LONG-STANDING COMMITMENT TO REVIEW AND EVALUATE NATIONAL RETIREMENT INCOME POLICY. I BELIEVE AN INTEGRAL PART OF THAT POLICY INVOLVES ENSURING THAT THOSE BENEFITS PROVIDED AS THE BASIS FOR RETIREMENT INCOME IN THIS COUNTRY MAINTAIN THEIR PURCHASING POWER OVER TIME. I WANT TO COMMEND YOU FOR TAKING THE LEADERSHIP ON EXAMINING THE CONSUMER PRICE INDEX CURRENTLY BEING USED TO CALCULATE COST-OF-LIVING ADJUSTMENTS (COLAS) FOR SOCIAL SECURITY RECIPIENTS AND OTHER FEDERAL RETIREES. I BELIEVE THAT THE REVIEW BEGUN BY THIS COMMITTEE IN JUNE OF LAST YEAR WILL ULTIMATELY LEAD US TO BASE RETIREMENT COLAS ON A MEASURE THAT MORE ACCURATELY REFLECTS THE INCREASES IN INFLATION FACED BY BENEFICIARIES.

I AM CONCERNED THAT WE HAVE A SOUND ECONOMIC MEASURE FOR GRANTING COLAS SO THAT A RETIREE'S INCOME IS ABLE TO KEEP PACE WITH INFLATION DURING WHAT IS IN MANY CASES SEVERAL DECADES OF RETIREMENT. TODAY, TWO-THIRDS OF RETIREES LEAVE THE WORKFORCE BEFORE THEY REACH AGE 65. GIVEN THAT THE AVERAGE 65-YEAR-OLD CAN EXPECT TO LIVE ANOTHER 17 YEARS, EVEN SLIGHT DISCREPANCIES BETWEEN THE TRUE RATE OF INFLATION AND THE RATE AT WHICH COLAS ARE PAID CAN HAVE A DRAMATIC IMPACT ON RETIREMENT INCOME OVER A LENGTHY RETIREMENT. IF COLAS ARE MISCALCULATED BY ONE PERCENT EACH YEAR, BY THE END OF 15 YEARS, BENEFITS WILL BE ONLY 85 PERCENT OF WHAT THEY SHOULD BE.

THE STUDY RECENTLY COMPLETED BY THE BUREAU OF LABOR STATISTICS POINTS OUT A SIMPLE TECHNICAL PROBLEM WITH THE CPI-W, THE MEASUREMENT CURRENTLY USED TO CALCULATE COLAS FOR RETIREMENT PROGRAMS. BLS RIGHTLY NOTES THAT THE CPI-U, WHICH SURVEYS A BROADER SPECTRUM OF HOUSEHOLDS -- INCLUDING RETIREES -- PROVIDES A MUCH MORE ACCURATE MEASURE ON WHICH TO BASE RETIREMENT COLAS. I AM PLEASED TO BE A COSPONSOR OF YOUR LEGISLATION, MR. CHAIRMAN, S.2831, WHICH WILL MANDATE A SWITCH TO THE CPI-U FOR SOCIAL SECURITY AS WELL AS OTHER FEDERAL RETIREMENT PROGRAMS. I AM HOPEFUL THAT THE GROUNDWORK WE HAVE LAID IN THIS CONGRESS WILL ENABLE US TO ACT QUICKLY TO PASS THIS LEGISLATION QUICKLY WHEN WE RECONVENE IN JANUARY.

The CHAIRMAN. Dr. Norwood, as you know, the CPI-W is the Consumer Price Index used to determine the cost-of-living adjustments for retirees. Do you think that it would be advisable for Congress to require that the CPI-U, the other Consumer Price Index that you have available, be used instead for this purpose since the survey upon which it is based includes the elderly?

Ms. NORWOOD. Senator, that is a question of policy for the Congress to decide. What I can tell you are the statistical properties of those two indexes. The Consumer Price Index for all urban consumers has larger samples than the wage earner index. It includes the experience of the retired. The wage earner/clerical index excludes—deliberately—the expenditure experience of retirees because it was designed to represent the experience of the working population.

When the Consumer Price Index for all urban Americans was first begun in 1978, legislation was considered by the Congress to shift from the W to the U, and at that time the Congress decided not to adopt that legislation. I think it is a useful issue to look at again.

The CHAIRMAN. How old was the CPI-U at that time, in 1978?

Ms. NORWOOD. Oh, it was new.

The CHAIRMAN. It was new?

Ms. NORWOOD. Yes.

The CHAIRMAN. Was it the recommendation of BLS that the CPI-U be allowed to go on for a few years to determine just how well it tracked?

Ms. NORWOOD. Well, BLS took no specific position on that legislation because we consider that is a policy issue, but of course you're right, that there was no historical experience for that and there was historical experience for the W index.

Since that time, of course, the U is being used to index tax brackets for income tax law and for several other programs, as I indicated in my testimony, but it is true that the major indexation of Federal Government entitlement programs is still based on the CPI-W.

The CHAIRMAN. I understand that in 1980 the Office of Management and Budget was in favor of indexing or computing the cost-of-living adjustment based on the CPI-U?

Ms. NORWOOD. I believe—and now I am digging in to my memory on this—but I believe that there was an administration proposal at that time to do that, to make that shift, and therefore the Office of Management and Budget—I guess it would have been in the Carter Administration—would have supported it.

The CHAIRMAN. Yes, that's true.

Your comparison of both of these Consumer Price Indexes would indicate that over the past several years, if the CPI-U were used, which does include sampling of the elderly, that cost-of-living adjustments would be slightly higher. Is that not correct?

Ms. NORWOOD. Yes, that's true. Now part of the reason for that is because we made a change in the treatment of home ownership in the CPI-U 2 years before we made that change in the W index, and the reason for that was that the W is used to index collective bargaining agreements, and they usually last for 2 or 3 years, and we felt we had to give them sufficient notice.

So really to compare those two indexes you need to look at the period since 1985—when they both have had the same treatment in the home ownership component. I think that the major difference probably has been in the price changes for energy, which have somewhat different weights in those two indexes. Generally, over time weights don't have a very large effect on an index, but they sometimes can, particularly when there are relative shifts of prices, and we have gone through a period of rather volatile energy price changes.

The CHAIRMAN. The question that comes up most often in discussing the inflationary rate of the elderly is the rising cost of health care. As we look at this over the past, say 5 years, it seems to have averaged about an 8 percent increase per year, yet cost-of-living adjustments are much less than that, of course, but we are of the opinion that the portion of income that the elderly must pay every month for health care needs is disproportionate to the rest of the population. Do you have any statistics that demonstrate how important that is or how significant that is?

Ms. NORWOOD. We know that the weight for medical care for an older worker's index, no matter how defined, would be somewhat larger generally, although one does have to take account of the effect of Medicare and particularly of the recent changes that have been introduced in the Medicare insurance programs, and that would perhaps reduce the expenditures for older workers some. We are not really sure about that.

The CHAIRMAN. Older retirees?

Ms. NORWOOD. Yes.

The CHAIRMAN. Or workers?

Ms. NORWOOD. I'm sorry. Older retirees.

The CHAIRMAN. Yes.

Ms. NORWOOD. The other problem, of course, is that we are very concerned about using CPI, either U or W samples as they now are, for physicians, for hospital procedures, and for drugs, because we believe that older Americans have different kinds of health problems and probably have a different experience there, and that is something we feel very strongly needs to be looked at.

The CHAIRMAN. Not only do they have different kinds of health problems, but they have a lot more of them.

Ms. NORWOOD. That's right.

The CHAIRMAN. And that is a significant thing.

Ms. NORWOOD. Yes, but the point is that they go to, say, different physicians, for example, and they have different kinds of surgical procedures. For those procedures, the prices may be very different and may change differently than for other things. I mean, heart surgery is one thing and tonsillectomies are another, and one needs to look at the price experience of these differences.

The CHAIRMAN. Well, there is one area, though, that sticks out like a sore thumb. It's the amount of prescription drugs that the elderly purchase month-in and month-out, as compared to the amount of prescription drugs that other age groups purchase. As we see it, that alone is so disproportionate that it almost begs for a complete survey for the elderly on what their health care needs are.

Ms. NORWOOD. I would agree with that, but of course there has been a change in the law, and so we would have to look at how that affects these expenditures.

The CHAIRMAN. Yes.

Senator Grassley?

STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. Mr. Chairman, before I ask questions, I want to put a statement in the record, please.

The CHAIRMAN. Yes, it will become part of the record.

[The prepared statement of Senator Grassley follows:]

STATEMENT OF SENATOR CHARLES E. GRASSLEY AT A HEARING OF THE SPECIAL COMMITTEE ON AGING ON THE SUBJECT OF CPI FOR THE ELDERLY, WEDNESDAY. OCTOBER 5, 1988

Thank you, Mr. Chairman.

I am looking forward to the testimony we will hear today on the question of whether we should institute a special consumer price index for those retired on pensions provided through the federal government.

I am aware, through my service on the Aging Committees, first in the House and then in the Senate, that there has been interest for some years in the question of whether the consumer price index on which retirement program COLA's are based leads to a fair inflation adjustment for retired persons.

I gather that, so far, the results of work done on this question have been inconclusive.

Nevertheless, it does seem to me that, from the point of view of fairness, we probably need to consider using the CPI-U instead of the CPI-W for indexation of retirement benefits. Given that the CPI-W represents only about 30 percent of the American population, and that very few retired persons are included in that index, whereas more are included in the CPI-U would more closely approximate the inflation experience of retirees.

The preliminary work done by the Bureau of Labor statistics on this question, in response to Senator Melcher's legislation of last year, would seem to indicate that his interest in this question was justified.

I understand that this work shows that the experimental index created by the Bureau of Labor statistics would have yielded inflation adjustments for the elderly somewhat larger than the CPI-U would have yielded, and would have yielded even larger adjustments than the currently used CPI-W yields.

Although these differences do not appear to be large, for individual social security and other retirees the differences would not necessarily have to be large to be important.

Insofar as we use the CPI-U as the basis for inflation adjustments in federal retirement programs, the differences could be important also for the social security trust fund balances. I hope our witnesses will address this question also.

That is all I have for the moment, Mr. Chairman. I am looking forward to the testimony.

Senator GRASSLEY. And then also explain to you that I am going to leave when I'm done asking my questions, because at the Budget Committee we have a hearing on the savings and loan insurance fund that I want to participate in. Also in that direction, I am only going to ask one question about the home ownership factor, and then I have some questions I want to submit to you.

Ms. NORWOOD. Fine.

Senator GRASSLEY. If you would answer them in writing, I would appreciate it very much.

Ms. NORWOOD. I would be glad to.

Senator GRASSLEY. Now you touched on it just a little bit here. I think over a long period of time that I have been in Congress, the general approach—right or wrong—has been that somehow because a majority, maybe a large majority of retired people owned their homes, that consequently housing wasn't as much of a factor in their cost of living, and that there was some justification for deemphasizing that.

Now it is my understanding from your studies that in this experimental index housing has shown up as a much larger factor, and I would like to have you explain that. I would particularly like to have this "homeowners' rental equivalency" explained to some extent. And I would appreciate it if you would try to take as common sense an approach as you can in explaining it. I would appreciate it very much.

Ms. NORWOOD. Well, I would be glad to try.

People buy houses, in general, to live in them, and so they have a cost of the shelter that is provided. Many Americans also buy houses because it is probably the most important investment they make over their lifetime. Particularly in the 1970s, there was a considerable run-up in the price of houses because people were turning over their houses and moving from smaller houses to bigger houses, and of course retirees were moving from bigger houses to smaller houses, and were therefore taking advantage of the increased asset value of that house.

What we have tried to do is to represent in the index not the asset value, because that is an investment which we don't feel really belongs in a consumer price index, but rather only the cost of the actual shelter that is provided. That includes things like the maintenance on the house. It includes things like heating a home or air conditioning a home, to the extent that people do that.

In addition, if you own a home—as many older people do—free and clear, having paid off the mortgage perhaps some years ago, then you have the opportunity cost of the capital that you have invested in your homes. If you were to sell the house, you could do something else with the money. If you were to sell the house, you would have the money that you would invest, say, in bank certificates or bonds or stocks, and you would rent somewhere. So we use a rental equivalence measure as a proxy, really, for that opportunity cost.

Now, older Americans are often faced with increased costs. As houses go up in value, there are reassessments, and property taxes go up. So do other outlays they pay to live in their homes. They could sell the homes and move to rental housing but they don't want to do that.

And so the question that comes up is whether this rental equivalence measure—which correctly, we believe, in terms of consumer behavior represents the cost of the shelter that people are buying—is the best measure for older Americans, particularly, who own their own homes and who don't want to move out of them.

Well, lately we have seen the bankers who are saying to those people, "You've got assets. You have an investment in this house. You don't have a mortgage on it, but we will give you a reverse mortgage." So the bank will pay to the individual who owns the home a certain amount of money each month, and the bank then will take a certain amount of the asset value of the house.

In those cases certainly the rental equivalence measure is a very good approximation of that cost. So I think we should be careful about assuming that we have a different kind of price experience for housing, but it certainly is something that could be looked at for older Americans.

Senator GRASSLEY. Was this in any way a surprise to you and your researchers, as you came up with the conclusion you just gave us, or was——

Ms. NORWOOD. No, not at all. We have spent many years at the Bureau of Labor Statistics worrying about housing and researching it. We have done a lot of work in this area, and we believe that the approach that we now have in the U and the W indexes is a very good approximation of the cost of shelter for those indexes. Obviously, if you look at new indexes you always want to look at other approaches, but I am not at all certain that it is not equally important for this index population.

Senator GRASSLEY. Somewhere along the line it seems like then in the last decade or less that that eluded us as policymakers, that fact, because I think it was pretty generally assumed that housing could be deemphasized, and I speak that from 14 years on either the House or Senate Aging Committee when we dealt with things like this.

Mr. Chairman?

The CHAIRMAN. Senator Chafee?

STATEMENT OF SENATOR JOHN CHAFEE

Senator CHAFEE. I have no questions, Mr. Chairman, and I just want to commend you for holding these hearings. This is an interesting subject and I am glad to be here.

The CHAIRMAN. Thank you.

One further point, Dr. Norwood: It would take some time to determine what would be a good consumer price index for the elderly, but a bill that several of us have introduced would direct the Bureau of Labor Statistics to develop a new CPI for the elderly. How do you view that? I know that you don't make policy decisions. I am aware of that, but what is your personal view on developing such an index?

Ms. NORWOOD. I believe that we need to look at some of the issues that you and I have talked about, and in fact that your bill provides for, to determine how different they are before investing in an extensive program that would be ongoing, but I think that that research is extremely important. If it were desired for us to do

so, we certainly as a service agency are prepared to do whatever the Congress decides it wishes.

If a new index is desired, in addition to this research and building upon it, we would of course want to be certain that we expanded the consumer expenditure survey so that the expenditure weights for the new index would be at least as accurate as those for the CPI-W, or the CPI-U if that were desired. I am very pleased to see that you took account of some of the problems involved in that kind of data collection by suggesting in your bill that the Social Security records be used as a universe for that data collection. That is the other part that would need to be done.

The CHAIRMAN. What would be the cost of the research?

Ms. NORWOOD. I can't tell you exactly. Your bill talks about $1.5 million annually over a 3-year period. We think that is quite reasonable. If we were to go into expanded consumer expenditure survey work or expanded pricing—for example, if we were to find that we really should do extensive resampling and price collection for medical care, for different items and different procedures and different physicians—it might be that we would have to come back to you and talk about that. I can't estimate that fully until we do this basic research that your bill provides for.

The CHAIRMAN. You earlier mentioned that you would be required, under catastrophic, to be looking at how much the elderly pay, the elderly that are on Medicare pay for drugs. The catastrophic bill, now law, has a $600 exemption or deduction, first of all, and we are advised that only 14 percent of those on Medicare actually reach $600 per year expenditures in purchase of prescription drugs. Does that fit into what we are discussing right here?

Ms. NORWOOD. Yes, I believe so, because we would want to look at the treatment, the current treatment of medical insurance in our existing CPIs, to see whether it was proper for a new index population of this kind. We would also want to look at the method of financing of the insurance. You know, one of the problems is that, as I understand it—and I am not very expert on this, not having looked into it very carefully—but some of the cost of the catastrophic insurance is an additional tax and some of it is an actual insurance premium. We would have to look at what we do about something like that, because we usually do not take account of the tax effects, so we would have to look at some of those things.

The CHAIRMAN. Well, the elderly certainly do take account of it.

Ms. NORWOOD. Yes, all of us do, of course.

The CHAIRMAN. Some of them have to pinch every penny, and that is why, if the cost-of-living adjustment is not fair for them, lacks fairness, it becomes a very important, a very huge obstacle for those on the lower income levels.

Ms. NORWOOD. I understand that.

The CHAIRMAN. Thank you very much, Dr. Norwood.

Ms. NORWOOD. Thank you.

The CHAIRMAN. Our next witness this morning is Harry Ballantyne, chief actuary for the Social Security Administration.

Please proceed, Mr. Ballantyne.

STATEMENT OF MR. HARRY BALLANTYNE, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION

Mr. BALLANTYNE. Mr. Chairman, thank you. I am pleased to be here today to discuss the Consumer Price Index which is used to calculate the cost-of-living adjustments or, as they are commonly called, COLAs, under the Social Security and the Supplemental Security Income programs. My testimony is quite brief, so I plan to just go through that testimony with you.

Before Congress enacted the automatic COLAs in 1972, Social Security benefit increases were provided periodically by the Congress on an ad hoc basis. Between January 1940 and June 1974, 10 of these ad hoc increases became effective. The CPI was not directly used to compute any of the amount of these ad hoc increases, as it is in the case of the automatic COLAs.

The provision for the automatic COLAs was enacted into law in 1972. The law governing the mechanics of the COLAs has been changed a number of times since then, most recently in 1986, when the former 3 percent trigger which was required to generate a benefit increase was eliminated. However, during all of this time the same index, the CPI for urban wage earners and clerical workers, has been used for the automatic COLAs.

In 1978, as Dr. Norwood said, the Bureau of Labor Statistics revised the CPI by updating the market basket or the sample of items that are priced, and in addition a new index was introduced in 1978, the CPI for all urban consumers. The index for urban wage earners and clerical workers was labeled the CPI-W, and it covers about 32 percent of the U.S. population. The new index for all urban consumers was labeled the CPI-U, and it covers about 80 percent of the U.S. population. The CPI-W, as revised in 1978, was used for all of the Social Security COLAs since 1978 and is currently being used.

The COLA increase is reflected in the Social Security benefit for the month of December which is paid in the following January, and it is based on the increase in the CPI-W from the third quarter of the prior year through the third quarter of the current year. These increases are also reflected in the January payment for the Supplemental Security Income program.

The Social Security Act does not explicitly specify that the CPI-W should be used to adjust benefits. Rather, it simply refers to the CPI published by the Department of Labor. When the provisions for the automatic COLAs were enacted in 1972, there was only one index, the index that is now labeled the CPI-W. The Social Security and SSI COLAs have continued to be based on this index.

The COLA effective for December 1988, this upcoming increase, will be based on the percentage increase in the average CPI-W from the third quarter of 1987 through the third quarter of 1988, rounded to the nearest one-tenth of 1 percent. We have CPIs for 2 of the 3 months that we need to get an average CPI for the third quarter of 1988. The latest month, August 1988, has a CPI-W which is 3.9 percent higher than the average CPI-W for the third quarter of 1987. It is likely that the COLA for December 1988 will be 3.9 or 4 percent, depending on the CPI-W for the month of September 1988.

The CPI-U for August 1988 is 4 percent higher than the average CPI-U for the third quarter of 1987. If this year's Social Security COLA were based on the CPI-U instead of on the CPI-W, the benefit increase would probably be 4 or 4.1 percent, depending on the CPI-U for September 1988. The CPI-U increase will probably then be slightly larger than the CPI-W increase, only one-tenth of 1 percent, or it may possibly be two-tenths of 1 percent larger than the increase in the CPI-W.

If the increase were one-tenth of 1 percent larger, the average increase in benefits for retired workers under Social Security would be about $6 a year. OASDI benefit payments would be larger by an estimated $165 million in fiscal year 1989. Only 9 months of the year would be affected, because it is first paid in January. In calendar year 1989, the increased benefit payments would be an estimated $220 million.

In the future, the CPI-W and the CPI-U will probably not increase at significantly different rates over any long period of time, and the direction of any difference between the two is not predictable.

This concludes my prepared testimony. I hope it has been of some help, and I would be glad to answer any questions you may have.

STATEMENT OF SENATOR QUENTIN N. BURDICK

Senator BURDICK [acting chairman]. Thank you very much.

The question I have may be elementary to you, but I don't understand it. Why do we have a CPI-U and a CPI-W? Why don't we have a CPI-X and have it one category?

Mr. BALLANTYNE. Well, as Dr. Norwood said earlier, I believe, there was one CPI before January 1978. That was what is now called the CPI-W. It covers only urban wage earners and clerical workers, but the CPI-U, which was begun in January 1978, is a broader CPI covering all urban consumers. Both series have been continued since January 1978.

Senator BURDICK. Well, if the CPI-U covered all consumers, what did you need the other one for?

Mr. BALLANTYNE. Well, it has been continued. That is something that I think the Department of Labor had reasons for doing.

Senator BURDICK. I had better ask them?

Mr. BALLANTYNE. They could give you a better answer than I can, probably.

Senator BURDICK. The Senator from Rhode Island?

Senator CHAFEE. I would like to pursue that, if I might. I find it confusing. One apparently is oriented toward urban wage earners and clerical workers. I don't know why clerical workers are different than wage earners. It seems an odd definition, but in any event, CPI-W deals with wage earners, basically.

Mr. BALLANTYNE. Right.

Senator CHAFEE. Whereas the CPI-U deals with all urban consumers, meaning retirees, nonretirees, those who are not in the labor market but under retirement—for example, housewives, whatever it might be. Now it is interesting that they differ so very,

very little, I mean, one-tenth of 1 percent over this period that you are talking about.

Mr. BALLANTYNE. Right.

Senator CHAFEE. Just venturing a guess—well, you don't know why these were developed?

Mr. BALLANTYNE. My understanding is that the CPI–U was developed to——

Senator CHAFEE. Oh, I can understand the CPI–U. Somebody developed that, and that was it.

Mr. BALLANTYNE. Right.

Senator CHAFEE. But why then did they plunge into a CPI–W?

Mr. BALLANTYNE. Well, that was in existence before the CPI–U.

Senator CHAFEE. Oh, I'm sorry.

Mr. BALLANTYNE. The CPI–W was a continuation of the old CPI index.

Senator CHAFEE. The W came first?

Mr. BALLANTYNE. Right.

Senator CHAFEE. W comes before U. W–X–Y—okay. No, it doesn't. That makes it even more confusing. [Laughter.]

Senator CHAFEE. In any event, you don't know why they developed the U?

Mr. BALLANTYNE. Well, I think it was to have a broader population represented in the index. I can't recall all the various reasons that led into that, but it was certainly developed.

Senator CHAFEE. And that of course, as we said before, would include retirees?

Mr. BALLANTYNE. Urban retirees, right.

Senator CHAFEE. Well, I don't have any further questions. Can you tell me what U stands for, and W stands for? Maybe that would help a little.

Mr. BALLANTYNE. Well, the W, I think, stands for wage earners, and the U stands for urban. Of course, they are both urban. I don't know why it was CPI–U instead of CPI–C. I don't really know the reason for that.

Senator CHAFEE. All right. Do you know—this is all under the Labor Department, so this wasn't under your jurisdiction?

Mr. BALLANTYNE. That's right. Yes, sir.

Senator CHAFEE. For instance, you wouldn't know why—okay. I've got it. No, I shouldn't say I've got it. I understand your response.

Mr. BALLANTYNE. Thank you.

Senator CHAFEE. Or I heard your response. Thank you. [Laughter.]

Mr. BALLANTYNE. Thank you.

Senator CHAFEE. Thank you, Mr. Chairman.

Senator BURDICK. Why has the administration altered the 1980 OMB position that the CPI–U is the more appropriate base for adjustment of Federal benefits than the much more limited index in current use?

Mr. BALLANTYNE. Well, I don't think I am able to respond to that question. I am here only in a technical capacity, to explain how we use the CPI.

Senator BURDICK. I'll have to ask OMB for an answer, won't it?

Mr. BALLANTYNE. Right. I think so.

Senator CHAFEE. Well, I have one more question, Mr. Chairman.

If the retirees are under U and not under W, why doesn't Social Security base its COLAs on the U?

Mr. BALLANTYNE. Well, okay. At the time when the CPI–U was developed and published in 1978, of course I was very interested in which one we should use. It was looked at and the determination was made that the CPI–W should be used because it was a continuation of the only CPI that had been in existence and was being published by the Department of Labor at the time that the automatic COLAs were enacted. It was also decided that it would require legislation to change from the CPI–W to the CPI–U.

Senator CHAFEE. I get it. Okay, fine. Thank you.

Thank you, Mr. Chairman.

Senator BURDICK. For the worker that qualifies, what is the difference between U and W as far as this program is concerned?

Mr. BALLANTYNE. I'm sorry. Could you repeat the question, Mr. Chairman?

Senator BURDICK. I'm saying whatever methods you use, the U or the W, what does it mean to the worker, the average worker? He gets less or more? What is it?

Mr. BALLANTYNE. Well, on this particular one, if the increase this time were based on the CPI–U instead of the CPI–W, I think for the average retired worker it would probably mean a difference of about $6 per year if the difference is only one-tenth of 1 percent, which it looks like will probably be the case, but that is only for this increase.

In the future it's difficult to tell which one will be higher than the other. One-tenth of 1 percent is probably within what BLS, I think, would call "statistical noise." That is, it doesn't reflect a trend or any ongoing difference between the two CPIs in the future, and we believe that in the future there won't be any significant difference, and if there is, we won't know in which direction. The CPI–W may be larger than the CPI–U in the very next year.

Senator BURDICK. You say there may not be any difference in the future, and then you say right now the difference is $6. Are we talking about nothing?

Mr. BALLANTYNE. Well, $6 for this particular increase, that's right, and that of course would continue into the future for the beneficiaries.

Senator BURDICK. It would cost us more in clerk-hire to separate these two.

Mr. BALLANTYNE. Pardon me?

Senator BURDICK. It would cost us more in clerk-hire to keep this thing straight—only $6 a year.

Mr. BALLANTYNE. $6 a year is the difference due to a one-tenth of 1 percent increase, right, which is a very small difference.

Senator BURDICK. That's what I'm saying.

Mr. BALLANTYNE. Right.

Senator CHAFEE. Could I ask one more question?

Senator BURDICK. Certainly.

Senator CHAFEE. That's this year.

Mr. BALLANTYNE. Right.

Senator CHAFEE. That was the smallest difference. What has been the difference in past years? Has it varied, one being more

than the other, or is there a continual trend, the U being greater than the W? What is your experience?

Mr. BALLANTYNE. Well, in the past 5 years, for reasons that Dr. Norwood alluded to, the CPI–U has risen faster than the CPI–W. But this is largely because of the way interest rates and home prices were changing in that period and the treatment of housing costs in the index. The housing-cost component of the CPI–U was changed in 1983 to a rental equivalency basis, which did not put nearly as much weight on housing costs in general and excluded the effect of home mortgage interest rates and home prices, The CPI–W continued to reflect the effects of mortgage interest rates and home prices until 1985, when it was also changed to a rental equivalency basis for housing costs.

During that time, the cost of purchasing a house was rising more slowly than was the rental equivalency index largely because interest rates on home mortgages and/or home prices were generally dropping. The CPI–W increased at a slower rate because of the effect of this relatively slow rise in home ownership costs. Before the last 5 years there was very little difference. In fact, if the COLA in 1979 had been based on the CPI–U, it would have been one-tenth of 1 percent lower than the COLA that we actually gave on the CPI–W.

Senator CHAFEE. Are all the COLAs based on the W, military and everything?

Mr. BALLANTYNE. I believe all the COLAs in the Federal retirement programs, such as the civil service program and the military retirement system, are also based on the CPI–W.

Senator CHAFEE. Thank you.

Senator BURDICK. Thank you very much.

Mr. BALLANTYNE. Thank you.

Senator BURDICK. Our next witness is Mr. Gorham Black of the American Association of Retired Persons.

We look forward to your testimony, Mr. Black. Welcome to the committee.

STATEMENT OF MR. GORHAM L. BLACK, JR., MEMBER OF THE NATIONAL LEGISLATIVE COUNCIL OF THE AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY KATHLEEN SCHOLL, POLICY ANALYST

Mr. BLACK. Mr. Chairman, members of the committee, my name is Gorham Black and I am a member of AARP's National Legislative Council. I have with me Dr. Kathleen Scholl, policy analyst for AARP, and we are pleased to testify today in support of S. 2831 and S. 2832. AARP commends the chief sponsor of these pieces of legislation and the bills' cosponsors for pursuing actions to assure that the most accurate and appropriate inflation indices are used when calculating Social Security cost-of-living adjustments and other Government benefits.

The overriding concern of persons depending on income from Government benefits is the gradual erosion of their purchasing power. If the Consumer Price Index fails to reflect the price movements of items they purchase, then the recipients are unable to maintain their standard of living. Even small differences can, over

time, result in real benefit losses. If on the other hand the CPI overstates the changes in prices of items they purchase, their economic well-being improves, but at a high cost to the taxpayers.

AARP has a longstanding interest in the development and implementation of an accurate index for COLAs. We believe that S. 2831 and S. 2832 are important steps toward this goal. A detailed discussion of AARP's concerns about current indices and the development of any new index are contained in the written statement which we have submitted to the committee. Since time is short, I would briefly like to mention a few recommendations that the Association has on this topic.

First, AARP recommends that, as required in S. 2831, all Federal agencies begin using the CPI-U for COLAs. CPI-U is a more accurate measure of inflation for older persons than the currently used CPI-W, for several reasons. CPI-U is broader-based than CPI-W. It includes retirees in its population, and it more closely approximates the experimental index developed earlier this year by BLS.

AARP further recommends that 12-month averages be used in the calculations, as opposed to the 3-month averages now used. Currently, swings during the 3-month calculation period can skew the indices and affect the COLA. A 12-month average would permit recipients and program administrators to monitor over the year what the COLA will be in January.

AARP believes that these changes should be implemented as soon as possible following an impact analysis of how these changes affect the trust funds and Federal outlays.

Second, AARP recommends that, as required in S. 2832, BLS conduct a study to begin the development of a new CPI that will accurately reflect the inflation experienced by persons receiving Social Security benefits. The experimental index developed by BLS earlier this year shows differences between that index and both the CPI-U and CPI-W. A new index is necessary to assure that Social Security benefits are adjusted to the inflation actually experienced by beneficiaries.

AARP urges the BLS to carefully define the concepts that will be used for the housing component for any new index to assure that it truly represents housing expenditures. The preliminary BLS study indicates that nearly one-half of the weight of the new index would be assigned to changes in the prices associated with housing. The magnitude of this component merits further examination.

Finally, AARP recommends that BLS redefine and recalculate the medical care component of existing indices to more accurately reflect price movements and true costs for all Americans. Since older households spend proportionately twice as much on health care as other households, it is crucial that the inflation of medical costs be accurately represented in CPI calculations.

Again, I would like to thank the chairman and members of this committee for their leadership on these important issues. I would be glad to answer any questions you may have.

[The prepared statement of Mr. Black follows:]

STATEMENT

of the

AMERICAN ASSOCIATION OF RETIRED PERSONS

before the

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

on using

COST-OF-LIVING ADJUSTMENTS AND THE CPI: A QUESTION OF FAIRNESS

OCTOBER 5, 1988

The American Association of Retired Persons (AARP) is pleased to testify today on S. 2831 to use the Consumer Price Index for All Urban Consumers (CPI-U) in the determination of cost-of-living adjustments (COLAs) to government benefits and allowances. The Association also commends the chief sponsor of S. 2832 Senator Melcher and his cosponsors for their efforts to have the Bureau of Labor Statistics conduct a study that will lead to the development of a specific price index for adjusting Social Security benefits.

AARP supports S. 2831 and S. 2832 and specifically recommends:

- That all federal agencies use the CPI-U for cost of living adjustments. Prior to implementation, an impact analysis of the change on the trust funds and federal outlays should be done. Implementation would need to be consistent with overall deficit reduction targets and not trigger a sequester.

- That the Bureau of Labor Statistics (BLS) conduct a study to begin the development of a new CPI that will more accurately reflect the inflation experienced by persons receiving Social Security benefits.

- That the BLS redefine and recalculate the medical care component to more accurately reflect price movements and true costs for all Americans of medical goods and services, regardless of congressional action on S. 2832.

- Since the experimental index developed by BLS indicates that nearly one-half of the weight is assigned to housing costs, the concepts that will be used for the housing component in any new index should be carefully defined to assure that it truly represents the households' housing expenditures.

The overriding concern of persons who are dependent upon income from government benefits and allowances is a gradual erosion of their purchasing power. If the Consumer Price Index (CPI) fails to reflect the price movements of items they purchase, then the recipients are unable to maintain their level of living. If the opposite occurs, however, and their benefits are indexed to a CPI that overstates the changes in prices of the items they purchase, their economic well-being improves at a high cost to taxpayers.

AARP has a long-standing interest in the development of an accurate index for cost-of-living adjustments (COLAs). Ever since the automatic COLAs were begun, AARP has been concerned that the COLAs are based upon expenditure patterns that do not reflect those of Social Security beneficiaries. AARP has testified several times before the Special Committee on Aging in support of the development of an accurate inflation index. AARP has always sought the use of the most accurate available measure for COLAs and believes S. 2831 and S. 2832 will achieve this.

I. ORIGIN OF THE CPI AND NEEDED CORRECTIONS TO THE INDEX

The CPI was first published in 1919 to help set new wage levels for workers in shipbuilding yards. The Consumer Price Index for Wage Earners and Clerical Workers (CPI-W) is based upon the spending patterns of households in which more than one-half of the household's income is earned from clerical or wage occupations and at least one of the earners has been employed for at least 37 weeks during the year. The CPI-W population includes 32 percent of the total U.S. population.

A broader-based CPI index was developed in 1978. The Consumer Price Index for All Urban Consumers (CPI-U) includes professional employees, the self-employed, the poor, the unemployed, and retired persons. It excludes persons in the military services, the institutionalized, and persons living outside urban areas. The CPI-U represents approximately 80 percent of the total non-institutional civilian population of the United States. At the time of its development, BLS planned to drop the old urban wage earners and clerical workers CPI (CPI-W). Since so many labor union contracts used the old CPI to escalate wages and since no one could project whether an index for all urban consumers would rise more or less rapidly than an index for wage earners and clerical workers, the old CPI series was retained.

The indices have gradually changed over the years with most alterations occurring in benchmark years of 1940, 1953, 1964, 1978, and 1987 when the weights (also termed "relative importance") of the components are recalculated. A major change was made to the housing component in the 1980s. The two CPIs showed volatility to interest rates as a result of the manner in which the home ownership component was constructed. The housing component was thought to overstate the housing cost of older households since they generally owned mortgage-free homes.

The rental equivalence method was begun for CPI-U in 1983; CPI-W was changed in 1985. The result of this change was a decline in the weight for housing and a redistribution of the weight to the other CPI components. The CPIs now produce a lower index when mortgage interest rates are increasing. This change is of particular interest now that the BLS has calculated the weights for the "experimental" index for those 62 and older. The weights indicate that the homeowners' rental equivalence weight in the experimental index is much larger than that used in the CPI-U or CPI-W (a discussion of this is found in a later section of this testimony on the BLS experimental index). Indications are that the definition and conceptualization of the housing component of the CPI needs to be addressed again in the proposed BLS study.

AARP is very concerned about the manner in which the medical care component is defined. Medical care in the CPI only reflects out-of-pocket expenses for health-related commodities and services.

This may have been appropriate several years ago before the widespread use of employer-paid health insurance plans, government supported health insurance programs (Medicare and Medicaid), and the wide availability of health maintenance organizations. As a result, the relative importance of medical care remains low because consumers have fewer out-of-pocket expenses.

The problems resulting from the medical component conceptualization can be seen by the fact that although the inflation rate for medical goods and services has outpaced that for all items in the index, it has relatively limited influence on the general rate of inflation. Since older households spend proportionally twice as much on health care than the average household, it is crucial that the inflation of medical care be accurately represented in the CPI calculations.

The medical care component incorporates all of the medical expenditures of uninsured consumers, but these consumers may not be receiving the medical care they need because of the high cost of these goods and services. Also, only the employee-paid portion of health insurance premiums are incorporated into the CPI. These health insurance calculations are questionable for the following reasons:

1. A large portion of medical care expenses are not incorporated in the CPI since the employer-paid contributions for health insurance are considered income for the household. For example, if an employee has a pre-paid health insurance plan that costs the employer $200 per month, none of the medical care received by the family through the plan is included in the medical care component of the CPI.

2. Only the portion of the premium which is paid directly by the insurer to health care providers or as reimbursements to policy holders is incorporated into specific medical care items. For example, if a worker only pays one-half of the total cost of the insurance premium, only one-half of the medical costs covered by the insurance policy are included in the CPI calculations. Secondary data are used for these calculations.

3. The services of the insurance carriers in administering the policy are also indirectly calculated from secondary data. The health insurance subcomponent is the sum of all the retained earnings (premium revenue less benefit payment) of insurance carriers.

Another conceptual problem arises in how the costs of physicians' and hospital fees are determined in the monthly CPI item pricings. Physicians' fees are calculated from those paid by noninsured consumers only. Since 1985, BLS has been attempting to capture physicians' price discrimination. But these changes may not measure all the price structures and suggest the price movements prior to 1985 were biased. Price movements for hospital rooms are based upon published charges and are not collected from what consumers directly or indirectly pay.

Also, some medical services are not included in the medical component of the CPI. A new category was developed in the 1987 CPI weight revision to include the expenses paid for the care of invalids, elderly, and convalescents in the home. This category is located under housekeeping services in the housing component; therefore a major medical cost problem for older households is not reflected as such.

In its preliminary study of older Americans' purchasing behavior, BLS stated that older households have different illnesses, buy different drugs, have different insurance policies, and frequently see different medical specialists than the younger population. AARP agrees with BLS that a comprehensive reexamination must be done of the medical care component. AARP requests BLS include in its study a determination of whether a flow-of-services or out-of-pocket conceptualization is more appropriate for this component.

In summary, AARP supports the research efforts of BLS to examine the medical care and housing components that are currently used in the CPIs. This effort is needed to strengthen the existing indices as well as assure a true measure of these costs in any index that may be developed.

II. USE OF CPI-W FOR COLAS

The United States Code does not specify a particular CPI for COLAs to government program benefits. For example, Section 8331(15) of title 5 defines the price index to be used as the "Consumer Price Index (all items--United States city average) published monthly by the Bureau of Labor Statistics" for Civil Service COLAs. In 1978 when the new CPI-U was begun, federal agencies were uncertain as to the future movement in it and chose to use CPI-W in their regulations concerning escalation of benefits.

In the 1980s when the CPIs were adjusted to correct the home ownership component problems, the U.S. General Accounting Office recommended that Congress change to the CPI-U for COLAs because CPI-U included retirees and incorporated the rental equivalence 2 years before the CPI-W. Calculations for the Social Security Administration found the CPI with the rental equivalence adjustment to be slightly lower than the former CPI. Again, the federal agencies chose not to change to the CPI-U for COLAs.

Ten years after the development of the CPI-U, one can observe differences between the inflation rates as calculated from CPI-W and CPI-U (Table 1). With the exception of 1979, inflation as measured by CPI-U was the same or greater than inflation as measured by CPI-W. Although these differences appear to be small, they have a cumulative effect. For instance the May 1979 average monthly benefit of $265.16 for retired workers in current payment status escalated to $463.10 by January 1, 1988 using the CPI-W. The same benefit would be $469.00 if CPI-U was used. Although this $5.90 per month difference may seem small, an accumulation of underpayment over 20 to 30 years of retirement could be quite substantial.

Table 1. Consumer price indices by year.

Year	CPI-W	CPI-U
1979	11.5	11.3
1980	13.5	13.5
1981	10.2	10.4
1982	6.0	6.1
1983	3.0	3.2
1984	3.4	4.3
1985	3.5	3.6
1986	1.5	1.9
1987	3.6	3.6

The use of CPI-U to adjust retirement benefits may have a minimal annual effect on the benefits of the average retiree, but the effect on government outlays could be substantial. Since the CPI-U has been higher than CPI-W for 4 of 7 years (1983-84 are not directly comparable because of the rental equivalence delay), the costs of using the CPI-U for COLAs would be higher. For instance, each 1 percent change in the index triggered a $2.1 billion increase in costs for Old-Age, Survivors, and Disability Insurance (OASDI) January 1987 COLAs. The use of CPI-U would have cost an additional $6.3 million. The effect of the use of CPI-U on long-range projections for the trust funds has not been recently examined by the Social Security Administration actuaries.

III. WHY THE CPI-U DIFFERS FROM THE CPI-W

The reasons for differences between CPI-U and CPI-W center on the inclusion of retired persons in the CPI-U. BLS has identified six differences between the CPI-U and CPI-W populations (basic definitional differences were not included).

- CPI-U consumer unit is smaller in size because retired families are smaller,
- CPI-U reference person is older because of the inclusion of retired persons,
- CPI-U has fewer earners because retired persons are not in the labor force,
- CPI-U has a higher proportion of homeowners because of its higher average age of reference persons,
- CPI-U has a greater frequency of female reference persons because of women's greater longevity, and
- CPI-U has higher per capita income, but has a lower total income than CPI-W consumer units.

Reasons for difference in the relative importance of items in the CPI-U and CPI-W include the following:

- CPI-U has less importance on food at home because of smaller consumer unit sizes,
- CPI-U has more weight in the homeowner's equivalent rent component because consumer units in the CPI-U are more likely to be homeowners with homes of higher values than those in the CPI-W, and

- CPI-U has more weight on medical care because of the inclusion of retired persons and unemployed persons in the CPI-U. Out-of-pocket expenses are higher because employer paid health insurance is not available to many in the CPI-U. Also, the greater proportion of older persons causes more to be spent per capita on medical conditions associated with aging.

For these definition reasons alone, the CPI-U is more appropriate than the CPI-W for COLA calculations. AARP urges Congress to have all federal agencies use the CPI-U in the determination of COLAs to government benefits and allowances.

IV. RESULTS OF THE BLS EXPERIMENTAL STUDY

In June of this year, BLS released its results from the study to determine the rates of inflation affecting Americans 62 years and older. These results confirm the widely held opinion that the CPI-U is the more appropriate measure of inflation of this population. As indicated in the Table 2, the relative importance of the CPI-U, rather than the CPI-W, more nearly approximate the experimental index weights (only those for December 1986 are shown). BLS concluded that "the experimental index, reweighted to incorporate the experience of older consumers, behaved more like the CPI-U than the CPI-W." Clearly the CPI-U should be used in the determination of COLAs for government benefits and allowances.

Table 2. Relative importance of major categories of expenditures, December 1986.

	CPI-W	CPI-U	Experimental index
All items	100.00	100.00	100.00
Food and beverages	19.45	17.66	15.62
Housing	39.95	42.48	48.47
Apparel and upkeep	6.36	6.34	4.66
Transportation	19.41	17.45	14.24
Medical care	4.95	5.83	9.38
Entertainment	4.04	4.37	3.36
Other goods and services	5.84	5.93	4.27

Source: Bureau of Labor Statistics, U.S. Department of Labor, "An Analysis of the Rates of Inflation Affecting Older Americans Based on an Experimental Reweighted Consumer Price Index," June 1988.

The discrepancy in the relative importance (weights) for medical care (3.55 percent) was fairly well expected from previous studies regarding a Consumer Price Index for the Elderly. What was surprising in the BLS preliminary study was the degree of difference in the housing component (5.99 percent). Previously, researchers thought that the rental equivalence correction would diffuse the impact of the purchase of homes on the rate of inflation and the resulting overcompensation of COLAs that resulted from home ownership of older households. But nearly one-half of the difference between the CPI-U and the experimental index is attributed to shelter which includes homeowners' equivalent rent. The finding that nearly one-half (48.47 percent) of the experimental index weight is assigned to housing costs is adequate evidence to merit further examination into definitional concepts used for housing. Perhaps a flow-of-services consumed concept is not appropriate for older households. These definitional problems need to be carefully addressed and studied by the research community. AARP recommends that S. 2832 be amended to have BLS include the reconceptualization of the housing component as well as the medical component in the proposed research study.

The BLS evidence also suggests that the prices paid by older households may vary from the CPI-U population. When the weights were applied to the prices collected by BLS for the years 1983 through 1987, the results indicated that the experimental index rose 19.5 percent as compared with 18.2 percent for the CPI-U and 16.5 percent for the CPI-W. Although this specific 5-year time

span covers a period of declining or stabilzed inflation, the differences suggest that older households have not been adequately compensated for the inflation they experienced since 1983.

One thing must be kept in mind, however. BLS was limited in its preliminary study by the data that were available at the time. The market basket for an older household could not be accurately determined and priced according to the elderly's purchasing behavior. To do this the Consumer Expenditure Survey must be expanded to included enough older households to identify the accurate market basket. Then a Point-of-Purchase (POP) Survey must be conducted to determine where that population shops. Finally, these market basket items must be priced at outlets designated in the POP survey before calculations can be made for a new index.

S. 2832 takes the first step toward the development of such an index. The Association supports additional funding for BLS to conduct research to determine how to develop the appropriate market basket for the new index.

The eventual development of the new index could be costly. Reflecting that a 1 percent overstatement of the COLAs costs $2.1 billion in OASDI COLAs, the annual cost of a new index is minimal. But, if the new index shows a much higher rate of inflation, the costs of the COLAs could be extremely high and may affect the reserves held in the OASDI trust funds and be difficult to implement during a period of large federal deficits.

V. COLA CALCULATIONS

In order to implement the COLAs on January 1 of the given year, a formula is used to calculate the rate of inflation as measured in the third quarter of the year. The average of seasonally unadjusted monthly CPI-Ws for July, August, and September is divided by the average for those months in the prior year. The Association recommends that S. 2831 be amended to include a provision to change the calculation to incorporate a 12-month average instead of the 3-month average. Changing to a 12-month average will assure that the most accurate measure that is currently available will be used.

The 3-month average has its origin in the 1965 amendments to the Civil Service Retirement Act that triggered an increase whenever the CPI rose 3 percent above the level of the base month and remained at least 3 percent above the base level for three consecutive months. The pensions were to be escalated within two months after the end of the 3-month period. Although the timeliness of the COLAs changed to automatic annual adjustments, inflation as measured in a 3-month period remained in the calculations.

The present third quarter calculation does not use seasonally adjusted data. A 12-month average would correct this problem. Also it is no more difficult to calculate a 12-month average than it is to calculate a 3-month average. A 12-month average would permit recipients as well as program administrators to monitor over the year what the COLA will be in January. Currently, swings during the 3-month calculation period can skew the indexes and affect the COLA. As shown in the attached Chart, the discrepancy is considerable. (Note that the 1988 quarter calculation is very sensitive to what the September index will be). In times of rapidly rising inflation, the 3-month average records a higher rate of inflation. The reverse is true when the rate of inflation is declining, such as was true in 1982 and 1983.

VI. CONCLUSIONS AND RECOMMENDATIONS

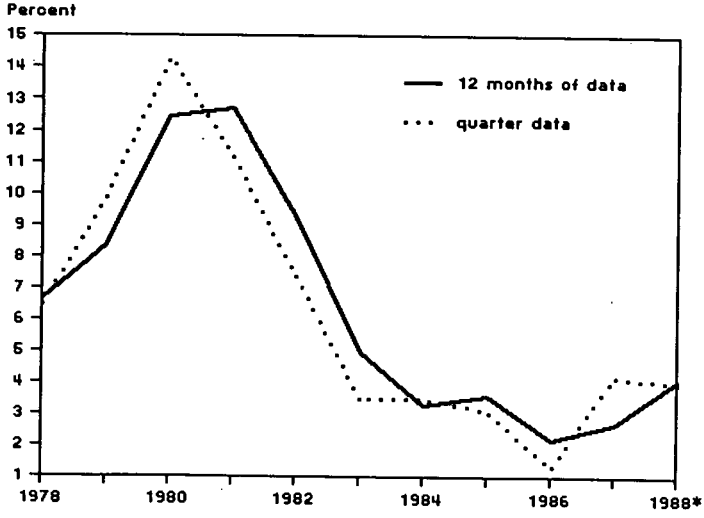
AARP recommends that federal agencies change as soon as possible to the CPI-U in the determination of COLAs to government benefits and allowances. We also strongly recommend that 12-month averages, ending with the third quarter, be used in the calculations. Prior to such implementation, the Social Security Administration, the Office of Management and Budget, and the Congressional Budget Office should provide impact analysis reports to the pertinent congressional committees on the use of CPI-U data and the use of 12 months of CPI indices for COLA calculations. Since BLS already computes CPI-U, there would be no additional cost to develop the calculations as would be entailed with the development of a new index.

AARP recommends that the Bureau of Labor Statistics give priority to revising its concepts and calculations for the medical care component so it will be more representative of price movements for medical goods and services. This reconceptualization may lead to a series of experimental indices as was done to address the home ownership problems.

AARP also requests that BLS examine the concepts used to determine the relative importance for the housing component in the new index. The preliminary BLS study indicates that nearly one-half of the weight of the new index would be assigned to changes in the prices associated with housing. The magnitude of this component merits further examination.

AARP supports the funding of further study by the BLS that will lead to the development of a specific price index for adjusting Social Security benefits. Before it is used as a benefit income escalator, however, it should be tracked for 3 years and the definitions and calculations used in it should be published and available for critical review by nongovernment researchers.

Consumer Price Index Growth Rates Using Alternative Change Calculations



Calculated from monthly CPI-W data; 1988 calculations are preliminary.
Quarter changes from 1978-83 are calculated with 1st quarter data; 1984-88 quarter changes use 3rd quarter data.
The 12-month changes end with the respective quarters.

Source: Bureau of Labor Statistics data
Prepared by AARP Public Policy Institute

Senator BURDICK. Senator Chafee.

Senator CHAFEE. Well, thank you, Mr. Chairman.

Well, Mr. Black, you have laid it out very well here, and I don't have any questions. What you have done is explain the situation. I was particularly interested in page 7 of the submission here, where it shows the difference of the categories, just choosing 1 month, between W and U.

Mr. BLACK. Yes, sir.

Senator CHAFEE. That is interesting. It shows some things less—all of course working on the basis of 100 percent—some things less and some things more. Housing more, primarily, I presume, because of the rental factor? Is that the reason the housing is more?

Mr. BLACK. It's the costs that are associated with the housing, and I guess the rental equivalence is the chief one that represents the differential.

Senator CHAFEE. Next medical care probably percentage-wise is the biggest difference, but housing is pretty substantial.

Mr. BLACK. Housing is the biggest difference, Senator.

Senator CHAFEE. All right. Fine. Well, thank you very much, and I must say you have had a most interesting career. I was reading your biography.

Mr. BLACK. Thank you. I have enjoyed it.

Senator CHAFEE. Well, you have certainly done a lot of things, and congratulations to you.

Mr. BLACK. Thank you, sir.

Senator CHAFEE. That's all I have, Mr. Chairman.

Senator BURDICK. Mr. Black, in your prepared testimony you use this language. Would you provide an explanation of what you mean by "a flow-of-services" and "out-of-pocket conceptualization"? Would you explain them a little better?

Mr. BLACK. That's why I brought Dr. Scholl, sir. She will explain that to you, I am sure.

Senator BURDICK. Well, doctor, will you please explain it?

Ms. SCHOLL. Well, until the change was made in the housing component, it was all out-of-pocket expense. In other words, whatever the household spent is how the weights were allocated. When the housing component was changed to a rental equivalent measure, that particular component of the CPI was changed to what they call a flow-of-services consumed measure. It no longer records actual expenditures on housing, but valuations were made—as Dr. Norwood explained earlier—on how much housing they consumed, not what they spent on housing. That is the difference between the two concepts. One is actual expenses; the other one estimates items that are consumed.

Senator BURDICK. So the out-of-pocket conceptualization is actual expenditures, then?

Ms. SCHOLL. Yes.

Senator BURDICK. Well, wouldn't it have been just as nice or just as easy and just as convenient to say out-of-pocket expense?

Ms. SCHOLL. Yes, you could say out-of-pocket expense.

Senator BURDICK. Some of the farmer boys like me, you know, we don't quite understand all that conceptualization.

Thank you very much.

Our next witness is Mary Jane Yarrington of the National Committee to Preserve Social Security and Medicare.

Welcome to the committee.

STATEMENT OF MS. MARY JANE YARRINGTON, SENIOR POLICY ANALYST, NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

Ms. YARRINGTON. Thank you, sir, and good morning. I am Mary Jane Yarrington, and I am senior policy analyst for the National Committee to Preserve Social Security and Medicare. I am here today on behalf of our 5 million members and supporters to emphasize the critical importance of COLAs—Social Security COLAs, and to urge that those COLAs as accurately as possible reflect the market basket of goods and services purchased by the elderly.

Whether or not there is a need for a special index for the elderly has long been debated. That debate will never be resolved until more facts are known about the spending patterns of the elderly compared with those of the general population. We believe the preliminary research that Dr. Norwood talked about this morning substantiated enough major differences to justify additional research.

The National Committee strongly supports the chairman's legislation calling for that research. If currently used indexes are inadequate to assure that the standard of living of retirees does not deteriorate, the Government has an obligation, we believe, to develop and implement an appropriate index. Food, housing, medical care, and energy take a substantially larger percentage of the income of elderly consumers than they do of other surveyed populations. COLAs are the only safeguards the elderly have against those increases.

The BLS study thus far confirms the long-standing contention of this committee, and particularly your chairman, that Social Security COLAs right now do not adequately compensate for inflation in goods and services purchased by the elderly. More importantly, the experimental index highlights serious deficiencies in the CPI-W which is now being used. Had COLAs for the period 1982 through 1987 been based on the experimental index, the average retiree on the rolls continuously from December 1982 through the last COLA would have received an additional $528 in Social Security benefits.

The chief weakness of the CPI-W, in our view, is that it surveys only a working population. That population is not representative of an over-age-62 population which is largely out of the work force.

It would be hard to overemphasize the importance of COLAs to Social Security recipients. Over and over, our members tell us that that January 3 index in their benefits doesn't begin to make up for the price increase they have already endured, and BLS has confirmed that.

Mr. Huffman, a National Committee member from Royal Oak, Michigan, explained how his COLA evaporated. He told us: "I wonder if any Members of Congress really understand what is taking place. Of the big Social Security raise of 4.2 percent last January, they took $7.90 from each of my wife's and my checks, leaving a net of $31. Then they lowered the amount Medicare paid,

so Blue Cross raised our premium $50 a month. Our $31 raise is now a loss of $19."

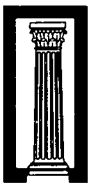
The Bureau of Labor Statistics found that from 1982 to 1987 the CPI-W fell 3 percent behind their experimental index. The more broadly based CPI-U differed from the experimental index by only 1.3 percent. That is not surprising. The CPI-U measures the spending patterns of approximately 80 percent of the population, where the CPI-W only measures 32 percent.

The National Committee endorses legislation to mandate the use of the CPI-U for COLAs until research establishes whether or not a separate retiree index is necessary or appropriate. However, we don't know of any prohibition in current law that would prohibit the administration from simply immediately recommending that all COLAs for 1989 and future years be implemented on the basis of the CPI-U.

This committee has fought against efforts to weaken COLA protection for a number of years. The efforts of this committee have highlighted the fact that better COLA protection is needed, not less protection, and seniors are indebted to this committee.

Thank you.

[The prepared statement of Ms. Yarrington follows:]



NATIONAL COMMITTEE TO PRESERVE
SOCIAL SECURITY AND MEDICARE

2000 K Street, N.W., Suite 800, Washington, D.C. 20006 (202) 822-9459

STATEMENT OF

MARY JANE YARRINGTON

REPRESENTING THE

NATIONAL COMMITTEE TO PRESERVE
SOCIAL SECURITY AND MEDICARE

PRESENTED TO THE

SPECIAL COMMITTEE ON AGING
U. S. SENATE

COST OF LIVING ADJUSTMENTS AND THE CPI: A QUESTION OF FAIRNESS

OCTOBER 5, 1988

I am Mary Jane Yarrington, Senior Policy Analyst for the National Committee to Preserve Social Security and Medicare. I am here today on behalf of our five million members and supporters to emphasize the critical importance of cost of living adjustments (COLAs) to Social Security beneficiaries and to urge that COLAs reflect as accurately as possible the market basket of goods and services purchased by the elderly.

The need for a special index for the elderly has long been debated. That debate will never be resolved until more facts are known about spending patterns of the elderly compared with those of the general population. We believe preliminary Bureau of Labor Statistics (BLS) findings substantiate enough major differences to justify additional research.

Mr. Chairman, the National Committee strongly supports your legislation calling for additional research on spending patterns of Social Security beneficiaries. If currently used indexes are inadequate to assure that the standard of living of retirees does not deteriorate over the years, the government has an obligation to develop and implement an appropriate retiree COLA index.

Food, housing and medical care take a substantially larger percentage of the income of elderly consumers than they do of other measured populations. The drought which has devastated the midwest this year is already showing up in grocery store prices across this land. The cost of medical care mounts steadily in spite of the best efforts of this body to restrain increases. Medicare premiums alone will go up another 29 percent next January. Housing costs continue their relentless climb. Additionally, because of their higher vulnerability to heat and cold, the elderly use more fuel oil and electricity than the general population.

The prices of these essential items in the Consumer Price Index (CPI) market basket consistently rise faster than overall prices. Mr. Chairman, there are, of course, numerous market basket items which take a smaller share of elderly income, but, on balance, the elderly spend more of their income on high priced items and services than younger individuals and families. COLAs are the only safeguard the elderly have against these increases. But the BLS study, which your Committee requested and from which this data is taken, confirms your longstanding contention, Mr. Chairman, that Social Security COLAs do not adequately compensate for inflation in goods and services purchased by the elderly.

More important to this hearing today, the experimental index for the elderly developed by the BLS to compare the spending habits of persons over age 62 with populations used in standard indexes highlights serious deficiencies in the CPI-W index now used to adjust retiree benefits.

The BLS compared the CPI-W with the experimental index for the years from 1983 to 1987. Had COLAs for those years been based on the experimental index, the average retiree on the benefit rolls in December, 1982, would have received an additional $528 in Social Security benefits.

The chief weakness of the CPI-W, in our view, is that it is limited to a survey of the spending patterns of Urban Wage Earners and Clerical Workers and includes only 32 percent of the population. This is clearly not a group that is representative of an over-age-62 population which has largely left the work force.

It would be hard to over-emphasize the importance of COLAs to Social Security recipients. Many seniors who are experiencing difficulty in meeting their bills late in a calendar year know that if they can just put off needed goods or services for a little while, hang on a few more months, they will get a little relief. But over and over they have told us that the COLA in that January 3 check -- partially, and in some cases, fully, offset by Medicare increases -- doesn't begin to make up for the price increases they have absorbed over the previous year. BLS has found they were right.

Mr. Walter Huffman, a National Committee member from Royal Oak, Michigan, told us how his COLA more than evaporated:

> "I wonder if any members in Congress really understand what is taking place in this country as to Social Security and Medicare. Of the big raise of 4.2% last January, they took $7.90 from each of my wife's and my checks which amounted to $15.80 - leaving a net raise of $31.00. Then they lowered the amount Medicare paid (thanks to Gramm-Rudman), thus raising the amount our insurance company had to pick up. So

Blue Cross raised our premium $50 a month. So you see our $31 raise is now a loss of $19 a month."

Historically, the CPI-W has been used for determining retiree COLAs. BLS has concluded the CPI-W from 1982 to 1987 fell three percent behind the experimental elderly index, while the more broad-based CPI-U differed from the experimental index by only 1.3 percent over the same period. The difference is at least partially explained by the fact that the CPI-U measures the spending patterns of All Urban Consumers, including retirees, and covers approximately 80 percent of the population.

Though differences between the CPI-W and the CPI-U can be small, cumulatively they are significant to persons who must rely primarily on Social Security income. The history of those differences since the development of the CPI-U supports your legislation requiring use of the more representative CPI-U for determining Social Security COLAs until research establishes whether a separate retiree index is necessary or appropriate.

The National Committee endorses your bill to mandate use of the CPI-U for COLAs, Mr. Chairman, though we do not believe legislation should be required. We know of no prohibition in current law which would prevent the Administration from using its regulatory authority to immediately recognize the inappropriateness of the CPI-W and recommend that all COLAs for 1989 and future years be implemented on the basis of changes in the consumer price index as measured by the CPI-U.

Mr. Chairman, over the last few years, you have fought against efforts to weaken COLA protection. Your efforts have highlighted the fact that seniors need better COLA protection, not less, and senior citizens are indebted to you for what you have done.

Thank you.

Senator BURDICK. Thank you.

Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman, and thank you, Ms. Yarrington, for a good statement.

I was looking over the statement which is submitted for the record by Mr. Miller, the director of the Office of Management and Budget, and he has an interesting fact in there that I frankly didn't know of. I don't know whether you have had a chance to see his statement.[1]

Ms. YARRINGTON. No, sir. I picked up a copy on my way in but I haven't had an opportunity to read it.

Senator CHAFEE. On page 3 he says, "It is not correct to assume that all Social Security beneficiaries are elderly. Many are not. About 20 percent of those receiving Social Security benefits are younger people who receive benefits because of disability or because they are the surviving spouse or the minor children of covered workers."

I must say I hadn't thought of that. I had thought of all—I knew that——

Ms. YARRINGTON. Well, I can't imagine that a widow left with young children, who probably has a job that is something close to the minimum wage, not covered by health insurance, wouldn't benefit from a better COLA. As far as the disabled go, their medical expenses are by far above the average retiree on Social Security. Every study that has been done of the medical expenditures of disabled people shows that their Medicare expenses, when they finally become eligible for Medicare, are far above the average retiree.

Senator CHAFEE. I see, and do you think—of course, one of the factors that have to be calculated in here is the changes we have made in Medicare just recently, both the catastrophic and the prescription drugs.

Ms. YARRINGTON. The catastrophic.

Senator CHAFEE. The prescription drugs, well, both of those, and the changes they have made on the first day payment once a year——

Ms. YARRINGTON. Well, if you are hospitalized twice in one year, you are only going to have to make one first day payment. The number of people—what did we estimate?—roughly 4 percent of Medicare beneficiaries, I think it is, will profit from this legislation in the first year.

But look at the disabled. They don't become eligible for Medicare until they are in the 25th month of getting benefits. You have a 5-month waiting period, so we are talking about the 30th month after they became disabled. They are paying medical expenses all that time.

Senator CHAFEE. I see. Well, you have an excellent statement, and I thank you for it.

Thank you, Mr. Chairman.

Senator BURDICK. As you know, the BLS comparison of inflation rates under alternative CPIs points to rising costs in health care and housing as inflationary factors disproportionately impacting

[1] See appendix, p. 90.

the elderly. Are these results consistent with the reports from your members?

Ms. YARRINGTON. Are these results consistent with what?

Senator BURDICK. Reports from your members.

Ms. YARRINGTON. Reports from our members? Absolutely, sir, absolutely.

Senator BURDICK. In your testimony, you point out that legislation requiring a switch from CPI-W to CPI-U in COLA calculations for Federal income support is unnecessary. In the absence of a legislative mandate to this effect, do you think this change would be made?

Ms. YARRINGTON. Do I think that this current administration would take the initiative there? They have not shown any inclination to, sir. I can understand the Congress' hesitation to make a move in 1978 when we had a new index, but as the evidence has accumulated that the CPI-U is more representative, it would seem to me that an administration would take cognizance of that and try to move to a more broad-based index simply because it is more broad-based. But we haven't seen that, sir, and I would not want to speak for the administration as to what they might choose to do. This would seemingly be a good year, since the difference is so slight.

Senator BURDICK. Well, the thrust of my question was, do you think this change will be made?

Ms. YARRINGTON. Pardon, sir?

Senator BURDICK. The thrust of my question was, do you think we will see this change made?

Ms. YARRINGTON. Sir, you may not remember me, but you and I met many years ago when you had an office on the third floor of the Cannon Building.

Senator BURDICK. Oh?

Ms. YARRINGTON. You were in about room 318, 320, and your brother-in-law was across the hall from me, and I worked for Al Ullman. In that 30-some years I have seen a good many changes. I hope to see a lot more that are beneficial.

Senator BURDICK. Well, that was way back close to the Civil War period, wasn't it? [Laughter.]

Ms. YARRINGTON. That's right. We're warriors together, sir.

Senator BURDICK. Well, I'm glad to see you again.

Ms. YARRINGTON. I concluded my Hill career 2 years ago after 31 years, sir.

Senator BURDICK. Well, thank you very much.

Senator CHAFEE. Could I ask one quick question, Mr. Chairman?

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Could you envision a set of circumstances where a new CPI formula was developed for the elderly, in which it turned out that the increase granted under that new formula would be less than, say, under the current W formula?

Ms. YARRINGTON. Certainly, sir. That is precisely why we need the research that the chairman's legislation calls for. There may be spending patterns that show that the cost of living is not as high. If we ever got constraints on medical care, from Dr. Norwood's testimony it would appear that the COLAs would be very close, that the experimental COLA and the COLA in use would be very close

together. It is conceivable that they could even run smaller. The important thing is that we have an appropriate COLA, and that is what we would like to see.

Senator CHAFEE. Thank you very much.

The CHAIRMAN. Fairness is the basic issue, is it not?

Ms. YARRINGTON. Absolutely, sir, and that's why we like your legislation.

The CHAIRMAN. We also have prepared, written testimony from the National Council of Senior Citizens, and it will be made part of the record.

The hearing record will be kept open for 14 days to allow anyone else that may care to submit written testimony for the record to do so.

The committee stands adjourned.

[Whereupon, at 11:30 a.m., the committee adjourned, to reconvene at the call of the Chair.]

APPENDIX 1

AN ANALYSIS OF THE RATES OF INFLATION AFFECTING OLDER AMERICANS BASED ON AN EXPERIMENTAL REWEIGHTED CONSUMER PRICE INDEX

Bureau of Labor Statistics
U.S. Department of Labor
June 1988

The Older Americans Act Amendments of 1987 provided that the Department of Labor, through the Bureau of Labor Statistics, develop "a reweighted index of consumer prices which reflects the expenditures for consumption by older Americans 62 years of age and older." This report describes the construction of an experimental index and discusses issues that need to be addressed in developing a full scale index.

A price index measures the average change in prices over time for a fixed basket of goods and services for a defined population group. BLS currently publishes CPI's for two population groups: All Urban Consumers (CPI-U) representing the spending habits of 80 percent of the population of the United States; and Urban Wage Earners and Clerical Workers (CPI-W) representing the spending habits of 32 percent of the population.

The basic data for the experimental index were taken from the same sources as those underlying the official CPI. However, it must be noted that these sources may not be sufficient, without considerable expansion, to provide the information needed for developing an accurate measure of price change for the population group addressed in the legislation. The reasons are discussed in detail in later sections of this report.

POPULATION COVERAGE

The definition of the total population, age 62 and over, used for the experimental index was all urban noninstitutionalized consumer units which met one of three conditions:

(a) unattached individuals who were at least 62 years of age;

(b) members of families whose reference person (as defined in the Consumer Expenditure Surveys[1]) or spouse was at least 62 years of age; or

1. The Consumer Expenditure Survey defines the sampling frame based on Consumer Units. Consumer Units are defined as either: (1) all members of a particular household who are related by blood, marriage, adoption, or other legal arrangements; (2) a person living alone or sharing a household with others or living as a roomer in a private home or lodging house or in permanent living quarters in a hotel or motel, but who is financially independent; or (3) two or more persons living together who pool their income to make joint expenditure decisions. Financial independence is determined by the three major expense categories: housing, food, and other living expenses. To be considered financially independent, at least two of the three major expense categories have to be provided by the respondent.

(c) members of groups of unrelated individuals living together who pool their resources to meet their living expenses, whose reference person was at least 62 years of age.

Approximately 2,760 consumer units surveyed in the 1972-1973 CE Survey, or about 14 percent of the total sample used in constructing the CPI-U, met this definition. In the 1982-1984 CE Survey, 3,135 full-year equivalent consumer units met the definition, 19 percent of the total sample. The experimental index has roughly half the sample size of the CPI-W. Expenditure weights in the experimental index constructed from this small sample are likely to have a high variance.

Because the CE Surveys collect data about families or other people who pool their income and expenditures, the data used in the experimental index exclude some older consumers' expenditures and include some expenditures of family members who are under 62 years of age. Among the older consumers whose expenditures are excluded from the index are the institutionalized elderly population, estimated at 5.5 percent of the population over age 60, and those Americans age 62 and over who live in a consumer unit where the reference person and the reference spouse are under age 62. For example, older Americans living with their grown children are excluded from the experimental index population. On the other hand, expenditures of children or other related individuals living in consumer units where the reference person or spouse is 62 or over are included. However, the effect of these differences in population coverage is small, since about 82 percent of older Americans are included in the definition used.

Characteristics of the Age 62 and Over Population

In addition to age, some characteristics of the experimental index population differ significantly from those of the population represented by the CPI-U. Homeowners represent about 20 percent more of the experimental index population than in the CPI-U population. In the age 62 and over population individuals living alone account for 40 percent of the consumer units and 23 percent of that group's population, substantially higher than the 29 percent of consumer units and 11 percent of the population in the CPI-U.

In addition, the population age 62 and older is more likely to live in smaller cities in all geographic regions and in those larger cities experiencing lower rates of economic growth in the first half of the 1980's.

Older couples included in the experimental index population have money income that is 82 percent of the average for all CPI-U couples. Older 1-person consumer units, however, have an income level that is only 71 percent of that for 1-person consumer units in the CPI-U population.[2]

The most striking differences, however, are the differences between the 62 to 70 year olds and those consumer units where the reference person is 70 or older (table 1). While each group makes up 50 percent of the consumer units age 62 and over, the younger group is composed of more multi-person consumer units and fewer single person consumer units. Those in the younger group are more likely to own their homes, and are three times more likely to be working than are those age 70 or older.

The average income of the 62 to 70 age group is also significantly higher, both per consumer unit and per capita. The average cash income for all older couples is more than twice that of older individuals living alone.

When the older population is subdivided into those 62 to 70 years old, the differences between their income and that of the general population is much less, with income for couples at 93 percent, and single households at 82 percent of the CPI-U average. For those in consumer units age 70 years and older, however, the income gap between them and the CPI-U populations widens, with this group's income equal to only about two-thirds of average CPI-U income.

2. These income figures have not been adjusted to include certain tax preferences enjoyed by older Americans, for example: partial exemption from taxes on Social Security income and substantial exemption from capital gains tax in the sale of primary residences. These income figures also do not include the value of Medicare payments or other noncash income.

Table 1. Characteristics of the Experimental Index Population

	TOTAL CU's	-62 and Older- Mean income	CU's Age 62-70	CU's Age70 and over
Number of Consumer Units (in thousands)	17,166		8,576	8,590
Percent				
Homeowners	73.0	$14,615	78.0	68.1
Renters	27.0	8,080	22.1	31.9
Working	25.9	18,336	39.5	12.2
Not working [3]	15.3	9,465	16.9	13.6
Retired [4]	58.9	11,071	43.5	74.2
One person	40.4	7,041	31.1	49.7
Two or more persons	59.6	16,673	68.9	50.3
Male reference person	55.2	16,260	74.7	35.7
Female reference person	44.8	8,547	25.3	64.3
Mean income	$12,816		$15,645	$9,638

Source: 1982-84 CE Interview Survey

Expenditure Weights

The experimental Consumer Price Index was constructed as a weighted average of price changes at the item stratum level collected from the sample of urban areas used in calculating the official CPI, and weighted according to their importance in the spending patterns of the experimental index population. The weights for the experimental index were derived from the same survey sources (Consumer Expenditure Surveys of 1972-73 and 1982-84) as those for the official CPI. The 1972-73 weights were constructed using the same methodology as that employed for the CPI-U as of January 1983.

The CPI was most recently revised in January 1987 to reflect 1982-84 expenditure patterns. The experimental index also reflects the 1982-84 data, beginning with the index for January 1987. In updating the expenditure weights to the current time period, the CPI-U was used.

3. Not working is defined as not retired but reporting zero weeks of work. This group includes the unemployed and reference persons who do not qualify as retired such as widows or widowers who never were employed.
4. Retired is defined as zero weeks worked and the principal reason for not working is self reported as "retired".

In order to determine the weights of the various categories of expenditure needed to construct the experimental index, the expenditures of older consumer units were tabulated from the 1972-73 and 1982-84 CE Surveys. Expenditures by category, when expressed as a proportion of total expenditures, yields the relative importance of each category. (The terms "relative importance" and "weight" are used interchangeably in the following discussion.) Tables 2 and 3 show the relative importances of selected categories of expenditures aggregated from the more detailed levels used in construction of the index. In table 2, the relative importance is expressed in terms of 1972-73 expenditure quantities and December 1982 prices, to correspond to the month prior to the starting point of the experimental index. Table 3 is based on expenditure quantities for the 1982-84 CE survey and December 1986 prices, to correspond to the month prior to the 1987 CPI revision, which introduced the 1982-84 market basket into the official CPI in January 1987.

Table 2. Relative Importance of Selected Major Categories of Expenditures, December 1982[5]

	CPI-U	Experimental Index
All Items	100.00	100.00
Food and Beverages	20.07	18.98
Food at home	12.87	13.29
Food away from home	6.10	4.81
Alcoholic Beverages	1.11	.87
Housing	37.72	43.66
Rent	6.03	6.63
Owners'Equivalent Rent	13.49	17.51
Fuel Oil	1.34	2.09
Electricity	2.59	2.85
Natural Gas	2.07	2.63
Apparel and Upkeep	5.21	4.02
Transportation	21.79	16.47
Motor fuel	6.19	4.65
Medical Care	5.99	9.37
Entertainment	4.21	3.55
Other Goods and Services	5.01	3.95

Table 3. Relative Importance of Selected Major Categories of Expenditures, December 1986

	CPI-U	CPI-W	Experimental Index
All Items	100.00	100.00	100.00
Food and Beverages	17.66	19.45	15.62
Food at home	9.86	11.14	9.88
Food away from home	6.19	6.65	4.60
Alcoholic Beverages	1.55	1.65	1.14
Housing	42.48	39.95	48.47
Rent	6.03	6.87	4.43
Owners' Equivalent Rent	19.26	16.84	25.25
Fuel Oil	.30	.26	.49
Electricity	2.67	2.74	2.99
Natural Gas	1.23	1.29	1.68
Apparel and Upkeep	6.34	6.36	4.66
Transportation	17.45	19.41	14.24
Motor fuel	3.29	4.03	2.35
Medical Care	5.83	4.95	9.38
Entertainment	4.37	4.04	3.36
Other Goods and Services	5.93	5.84	4.27

5. CPI-W was not included in Table 2 since the rental equivalency approach to homeownership cost was not introduced until 1985 for the CPI-W and therefore, the CPI-W was not comparable to the CPI-U and the experimental index prior to that date.

The expenditure patterns of the three population groups shown in table 3 differed significantly. Further, expenditure patterns changed between 1972-73 and 1982-84 (tables 2 and 3). The differences in the relative importance of expenditure categories between the population groups and for the same population group over time resulted from differences in preferences, demographic characteristics, levels of income, and even from responses to price change. Some examples of differences between the population groups include: larger family size, with more children, in the younger population; and, in the older population, higher proportions of women and homeowners, different entertainment preferences, and a greater need for medical care.

Housing and medical care costs had considerably higher relative weight in the total expenditures of the older Americans than for the CPI-U or CPI-W populations. In addition, housing and medical care, along with apparel and upkeep, were the only major groups which increased in importance for older Americans between CPI revisions. The increase in medical care, while slight, is of particular interest, since this major group's relative importance declined for both of the other populations as the degree of employer provided health insurance increased.

Within the food and beverage category, the relative expenditures on alcoholic beverages and, especially, food away from home were significantly less for the experimental index. Within the food at home component the older population spent a higher proportion on bakery products, pork, fresh fruits, and fresh vegetables.

Within the housing major group, home rental expenses had less weight, and lodging while out of town more weight for the older population. The importance of expenditures for homeownership as measured by owners' equivalent rent was noticeably higher for the experimental index population, at nearly 26 percent, compared to 19 percent for the CPI-U population, an indication of the higher proportion of homeowners versus renters in the experimental index population. The higher weights for lodging while out of town and for long distance trips indicate that the experimental index population spends a greater percentage of their budget on travel. The older population also spends a higher proportion of their budget on heating oil and electricity than do the younger populations. The household services component of the housing major group also includes care of invalids in the home, which is understandably higher for the experimental index population.

The lower proportion of spending devoted to apparel and upkeep by the older population is almost entirely explained by the small number of children in this population group. The relative importance of expenditures for boys, girls, and infants' clothing is less than one-third that of the CPI-U population. On the other hand, relative importances of expenditures for women's apparel are about the same as that for the CPI-U and CPI-W populations.

Expenditures for every category of private transportation have a lower weight for the older population. Within public transportation, both airfares and other intercity transportation have a higher weight. Only intracity transportation, with its large commuting component, has a lower weight for the older population.

The relative importance for medical care expenditures for the experimental index population is at least one and a half times as large as that for either the CPI-U or the CPI-W population. Differences of this magnitude are found consistently for each item in the medical care category, including health insurance.[6]

The two remaining major groups, entertainment and other goods and services, are both characterized by small relative importances for the experimental index when compared with the CPI-U or CPI-W population. Within the entertainment major group, the relative importance of sporting goods and equipment is negligible for the older group. Entertainment services, particularly club membership fees, are also predominantly expenditures of the younger age groups. Within other goods and services, the smaller relative importance of the expenditures for education are offset only slightly by the experimental index's larger relative importance of expenditures for personal care.

Limitations of the Experimental Index

The experimental index has several limitations as an estimate of the inflation rate experienced by older Americans.

One major limitation is that the categories of items to be priced are selected using expenditure weights calculated from the CE surveys for the CPI-U population. As a result, the specific item classes selected for each stratum may not be representative of the experimental index population. Further, in the selection of items for pricing within an outlet, the items with larger market shares have a higher probability of selection than do items with smaller market shares. While the items selected for pricing are appropriate for the CPI-U, there is no certainty that they are equally appropriate for the older population. For example, surgeons selected for the CPI sample supply information on the relative proportions of procedures such

6. It should be noted that the expenditure weight for the medical care component of the Consumer Price Index is based only on out-of-pocket expenses for consumers. As a result, it includes only that portion of health insurance paid for by consumers (in addition to all directly paid medical care costs). Not included in the expenditure weight is the cost of health insurance borne by employers. Similarly, health care expenditures paid for by the federal government are also excluded. Medicare premiums, deducted from wage and salary income, as a part of Social Security (or FICA) deductions, are not included as medical care expenditures either. These deductions are a purchase of a claim to future medical care which all wage and salaried individuals are required to make, as a result they are treated as a tax and are excluded from the expenditure weights. Medicare Part B premiums, on the other hand, are paid only by those enrolled in the Medicare program who choose to participate. (Part B covers the cost of physicians' services.) These premiums purchase a claim to current period medical care, and so are considered to be medical care expenditures.

as appendectomies, hernia repairs, and cyst excisions that they perform for all of their patients. To the extent that these proportions differ from the proportions of each treatment type performed for older patients, the sample selected for the CPI-U may be an inappropriate reflection of the price experience of older consumers. Similarly, if the older population purchases certain brands or sizes of products that differ from the brands or sizes purchased by the general population, and if those brands or sizes have different price movements, the experimental index would be misstating the true price movements experienced by the older population. One way to obtain this detail about the variety of items and services purchased by older Americans is to ask the individual consumers themselves. Since the existing consumption surveys do not collect data with this degree of detail, a major survey redesign and expansion would be required.

In addition, the outlets for pricing are selected based on data reported in a survey representing all urban households, the Point-of-Purchase Survey. The outlets may not be representative of the places of purchase of the older population, however. The sample size of the current Point-of-Purchase Survey is not sufficient to determine whether older Americans typically shop in different types of stores or localities from the general population.

A final source of uncertainty about the appropriateness of using CPI-U prices in the index for older consumers concerns the availability of discount prices for the older population. For example, senior-citizen discount rates are used in the CPI in proportion to their use by all consumers. However, in constructing a CPI for the older population, senior-citizen discounts should be included in proportion to their use. To the extent that senior-citizen discounts generally take the form of a percentage discount from the regular price, this may not be a problem. But, if the discount is not a fixed percentage of the price, the current method introduces an error in the experimental index. When the discounts are only available during certain time periods, or on certain products, the within outlet sampling process would need to be enhanced so that the discount price is sampled in the same proportion that it represents of total purchases by the older population.

OTHER STUDIES ON PRICE INDEXES FOR THE OLDER POPULATION GROUP

Several individuals and organizations have conducted research on the differences in price change between the elderly and the population as a whole. As in the current study, all of these start with the assumption that, because the elderly have expenditure patterns different from the rest of the population, the inflation rates experienced by this group may be different. They then examine whether or not the differences persist over time.

Statistics Canada's Findings

In the most comprehensive study and the one most nearly comparable to the BLS study described in this report, Statistics Canada[7] has developed a consumer price index for the Canadian low-income senior-citizen population. Statistics Canada chose this group of senior citizens rather than senior citizens as a whole because even though the former group is declining in Canada while the latter group is increasing, the primary aim of the study was to demonstrate to what extent a low-income senior-citizens CPI would be similar to both the "official" Canadian CPI and a special index produced by Statistics Canada, the low-income CPI. In Canada, the "official" CPI is used to adjust Old Age Security payments, Guaranteed Income Supplements benefits, and other benefits under the Canada/Quebec Pension Plan. As in the United States, the use of the "official" CPI has been questioned by those who argue that since the expenditure patterns are different, the inflation rates must likewise be different.

Statistics Canada found, however, that even in a period when prices for shelter, which along with food comprise the two largest components of the low-income senior-citizen index, rose faster than all other items, the low-income senior-citizen index was lower than the "official" CPI. In their 1986 report, they stated that "(T)he reason why these particular conditions do not necessarily result in a higher index for a special group is because there are a large number of price and weight relationships in effect at any given time, and they usually tend to be offsetting. The reason they tend to be offsetting is because it is not likely that price increases would be consistently larger for the most important purchases by one group in the CPI population while at the same time they are consistently and substantially smaller for the most important purchases by the remainder of the CPI population."[8]

The results of their study, shown in Table 4, demonstrate that the movement of the low-income senior-citizen CPI was very similar to that of the "official" CPI; over the 1982-85 period, the low-income senior-citizen CPI was only 0.4 percent below the "official" CPI. Statistics Canada concluded that "the use of the 'Official' CPI as a measure of price-induced changes in the purchasing power of low-income senior-citizens is appropriate."

Table 4. Comparison of Canadian Consumer Price Index, for low-income senior-citizens and official CPI between March 1982 and December 1985, for ALL ITEMS (March 1982 = 100)

	Low-income senior-citizens CPI	Official CPI
March 1982	100.0	100.0
December 1982	105.1	105.9
December 1983	110.1	110.7
December 1984	114.5	114.9
December 1985	119.4	119.9

Source: Statistics Canada

7. K. Hannett and H. Scobie, "A CPI for Low-Income Senior-Citizens", Supplement to the January-March 1986 issue of Consumer Prices and Price Indexes, April 1986, P.5.

8. Ibid., p . 19.

United States' Research

No other research has been as comprehensive as that done by Statistics Canada. The results of some of the other research are summarized below:

Thomas Borzilleri[9] used summary level data from the 1972-73 Consumer Expenditure Survey in constructing his "older persons price index (OPI)." He derived indexes for the older population and the total population based on 15 categories of expenditures. During the time period studied, the OPI rose about 4 percent faster than his all persons index. The significance of this result would be greater had the analysis been performed at a more disaggregated level of detail.

Robert Michael[10] based his analysis on data from the 1960-61 Consumer Expenditure Survey. His analysis covered 1967 through June 1974. He examined the index differences both across age groups and within age groups. Like Borzilleri, he found differences in the rate of inflation experienced by different age groups. However, he also found the observed differences in inflation rates between the age groups were small relative to the differences within the age groups.

Robert Hagemann[11] updated the earlier work of Michael. Hagemann made use of 1972-73 Consumer Expenditure data, and his results indicated that during the time period of the analysis, older Americans experienced a slightly higher rate

9. Thomas C. Borzilleri, "The Need for a Separate Consumer Price Index for Older Persons: A Review and New Evidence, The Gerontologist, June 1978.
10. Robert T. Michael, "Variations Across Households in the Rate of Inflation", Journal of Money, Credit and Banking, February, 1979.
11. Robert P. Hagemann, "The Variability of Inflation Rates Across Household Types," Journal of Money, Banking and Credit, November, 1982, Part 1.

of inflation than did the population as a whole (one-tenth of 1 percent more per year). However, within the older population, different subgroups experienced higher or lower rates and, overall, the variance within the age group was greater than the variance across the age groups.

In another study, Mary Kokoski[12] examined price changes for households by demographic characteristics representative of the urban population, including retired consumer units who were also renters. She found that a consumer price index constructed for those households would also have movements very similar to the official CPI-U.

Finally, the General Accounting Office[13] constructed several versions of a CPI for retirees and compared changes in them to changes in the official CPI. During the period examined, from the first quarter of 1978 through the first quarter of 1981, inflation as measured by the special retiree indexes did not differ significantly from inflation as measured by the official CPI. Lawrence Thompson, Chief Economist for the General Accounting Office, summarized their findings in testimony before the United States Senate Special Committee on Aging, and concluded that "such an index should not be used for purposes other than monitoring unless and until further developmental work has been undertaken."[14]

THE REWEIGHTED EXPERIMENTAL INDEX: WHAT DOES IT SHOW?

The experimental index was calculated for the period December 1982 through March 1988. The year 1983 was selected as the starting point for the index because the major change in the treatment of homeownership costs introduced in the CPI-U in that year made calculation of

12. Mary Kokoski, "Consumer Price Indices by Demographic Group", BLS Working Papers #167, April, 1987.
13. Charles Bowsher, "A CPI for Retirees Is Not Needed Now but Could Be in the Future", (GAO-GGD-82-41, June 1, 1982).
14. Lawrence Thompson, "Developing a Consumer Price Index for the Elderly", (GAO-T-GGD-87-22, June 29, 1987) p. 5.

indexes for earlier periods impractical. Over the 5-year period from December 1982 to December 1987, the experimental index rose 19.5 percent. This compares with increases of 18.2 percent for the CPI-U and 16.5 percent for the CPI-W.

Table 5. All Items percent change for alternative CPI definitions, 12 months ended in December, 1983-1987

	All Urban Consumers	Wage Earners and Clerical Workers	Experimental Index
1983	3.8	3.3	3.7
1984	3.9	3.5	4.1
1985	3.8	3.6	4.1
1986	1.1	0.6	1.8
1987	4.4	4.5	4.5
1982-1987	18.2	16.5	19.5

Examining the indexes in more detail, medical care costs registered the largest increase of the 7 major expenditure groups during the 1982-87 period for each of the three CPI's. The reweighted experimental index rose 37.2 percent, slightly less than the 37.4 percent increase in the CPI-U and the 37.8 percent rise in the CPI-W. The smallest advance in the five-year period among the major groups for all three indexes was the transportation component, which rose 10.5 percent in the experimental index and 9.7 and 9.5 percent in the CPI-U and CPI-W, respectively.

These differences occurred because the expenditure weights of the items that comprised the major groups varied among the three index populations. The expenditure weight that an item had in a particular population's index reflected the importance of that item as a proportion of total expenditures.[15] For example, within the

15. The expenditure weights are the product of estimates of mean expenditures per consumer unit meeting the index population definition, derived from the CE Surveys, and estimates of the number of consumer units comprising the index population. The weights are calculated at the item stratum level for each geographic market basket area priced in the CPI. Additional detail on the estimation process is contained in "Chapter 19, The Consumer Price Index", Handbook of Methods, Bureau of Labor Statistics, 1988.

transportation category the older population devoted a smaller share of spending to gasoline, automobile maintenance and repair, and auto insurance than did the general population. On the other hand, the older population spent a larger share on airline travel and intercity bus and train travel than did the general population.

Within the medical care component, the experimental index population devoted a smaller share of direct, out-of-pocket spending to hospital and related services than did the CPI-W population. The experimental index population, however, spent more of its medical care budget on prescription drugs and health insurance premiums than did the general population.

The food and beverage component of the experimental index (at 18.2 percent) rose more than the CPI-U's 17.6 percent and the CPI-W's 17.2 percent. Housing rose by the same amount in the CPI-U and the experimental index -- 18.7 percent -- whereas the CPI-W registered an increase of only 16.0 percent over the 5-year period.[16]

Similar to the relationship among the 3 indexes in other categories, the apparel and upkeep component of the CPI-U and the experimental index rose by close to the same amount -- 14.2 percent for the CPI-U and 14.3 percent for the experimental index; the CPI-W rose somewhat less -- 14.0 percent.

Entertainment rose more in the experimental index than in the two official indexes, but again, the increase in the CPI-U was closer to that of the experimental index. Other

16. During 1983 and 1984 the CPI-U shelter index, based on the flow-of-services approach to homeownership, rose more rapidly than the CPI-W index based on an asset approach to homeownership costs, as rents and homeowners' equivalent rents experienced higher rates of price change than did home prices and contract mortgage interest rates which are the major components of the asset approach to homeownership. Had the CPI-W utilized the flow-of-services approach to homeownership costs as early as 1983, the CPI-W housing index would have experienced price movement closer to that of the CPI-U.

goods and services, however, rose considerably less in the experimental index than in the official indexes -- 31.4 percent, compared to 36.2 for the CPI-U, and 35.5 for the CPI-W, probably because of the higher relative importance of the fast-rising cost of college tuition in the official indexes.

As indicated in this report, only the relative importance of the item stratum differed among the three indexes. The price movement of the item stratum indexes was based on prices collected for the CPI-U and CPI-W. But, the older population most likely purchased different types of items, and may have patronized different stores and other outlets when making purchases. They may also have had the advantage of special senior citizen's discounts (for example, for public transportation and entertainment). An index that takes account of these differences may show different trends.

Nevertheless, one thing is clear from this study: the experimental index, reweighted to incorporate the experience of older consumers, behaved more like the CPI-U than the CPI-W. This was not unexpected, of course, since the CPI-U includes the expenditure experience of all urban consumers, including those 62 years of age and over. The CPI-W, on the other hand, is limited to the expenditure experience of wage-earner and clerical-worker families and, therefore, specifically excludes the experience of families whose primary source of income is from retirement pensions. As a result, the relative importances of the items in the experimental index were closer to those of the CPI-U than the CPI-W. For example, in 1986 shelter represented 29.6 percent of the experimental index, 25.3 percent of the CPI-U and only 23.7 percent of the CPI-W; food at home comprised 9.9 percent of the both the CPI-U and the experimental index, but 11 percent of the CPI-W; and even in medical care the CPI-U's relative importance, while less than that of the experimental index's, was significantly higher than the CPI-W's.

Shelter, Energy and Medical Care

The inflationary experience of the last 5 years differed in many ways from that of the last decade or so, and there is no assurance that the results of this study would have been the same had the study covered the entire period -- or, indeed, whether the results will be similar in the years ahead. Shelter[17], energy and medical care stood out as significant sources of the inflationary experience of the past five years. Shelter and medical care had a big impact because their relative importances, especially in the experimental index, were so large. Energy was likewise significant because of its extreme volatility of price movement over the period. When these three components are factored out of the CPI's, there is virtually no difference among the indexes.

17. Shelter expenditures are composed of expenditures for rent, homeowners' equivalent rent, tenants and homeowners insurance, and maintenance and repairs. It differs from housing in that it does not include household furnishings and operations or fuel and other utilities.

Shelter accounted for nearly half of the difference observed among the three indexes. Shelter had about 15 percent more weight in the experimental index than in the CPI-U, and about 25 percent more than the CPI-W. During the 1982-88 time period shelter prices rose about nine percent more than all other items. Its effect can be seen in a comparison between tables 5 and 6. Table 6 shows the annual percent change for all items less shelter. From 1982 to 1987, the experimental index, the CPI-U and the CPI-W rose 16.3, 15.5, and 14.9 percent, respectively. As shown in the table, a substantial part of the difference between the 3 indexes ocurred in 1986.

Since 1968, shelter as estimated by rent has increased 122 percent, while all other items increased 162 percent. In the 15 years between 1968 and 1983, the rent index rose less than the index for all other items in 8 years. During the period that the experimental index was constructed, however, shelter rose at a slightly faster rate in all of the years except 1987. This suggests that a part of the difference observed among the three populations could be explained as a function of the time period selected for the analysis. Any different set of five years would have shown shelter having a substantially smaller effect on the differences among the three CPI's.

Table 6. All Items less shelter, percent change for alternative CPI definitions, 12 months ended in December, 1983-1987

	All Urban Consumers	Wage Earners and Clerical Workers	Experimental Index
1983	3.5	3.6	3.4
1984	3.7	3.5	3.8
1985	3.2	3.0	3.4
1986	0.1	-0.3	0.7
1987	4.2	4.4	4.0
1982-1987	15.5	14.9	16.3

Energy items, particularly fuel oil and motor fuels, experienced substantial deflation during the period 1982 through August 1986. Thus, the annual rates of price change were higher in the all items indexes excluding shelter and energy than for all items indexes excluding shelter for all three populations. However, as can be seen by comparing table 7 with the previous table, the differences among the rates of price change in the indexes for the three population groups was affected only slightly by the rate of change in energy prices.

Table 7. All Items less shelter and energy, percent change for alternative CPI definitions, 12 months ended in December, 1983-1987

	All Urban Consumers	Wage Earners and Clerical Workers	Experimental Index
1983	4.3	4.5	4.2
1984	4.2	4.2	4.3
1985	3.4	3.1	3.9
1986	3.5	3.3	4.2
1987	3.8	3.8	3.7
1982-1987	20.7	20.4	21.9

During the five years of the experimental index, the medical care index rose about twice as fast as the All Items Index.[18] The larger than average price increase, coupled with the significantly larger relative importance of medical care in the experimental index, resulted in this component having a greater effect on that index than on the two official indexes. When medical care is factored out of the all items less shelter and energy index (see table 8), the difference between the experimental index and either of the two official CPI's nearly disappears, with the CPI-U still slightly closer to the experimental index than is the CPI-W.

Table 8. All Items less shelter, energy, and medical care, percent change for alternative CPI definitions, 12 months ended in December, 1983-1987

	All Urban Consumers	Wage Earners and Clerical Workers	Experimental Index
1983	4.1	4.3	3.8
1984	4.0	4.0	4.0
1985	3.0	2.9	3.2
1986	3.0	2.9	3.4
1987	3.6	3.6	3.4
1982-1987	19.1	18.9	19.2

Thus, virtually all of the difference between the experimental index and the 2 official measures (during the 5-year period) can be explained by the differential effects of the shelter and medical care components. The shelter component accounted for about 40 percent of the difference between the CPI-U and the experimental index. Almost all of the remaining difference was accounted for by the medical component. The experimental index rose 3 percent more than the CPI-W index. Shelter accounted for one-half of that difference, and much of that stemmed from the difference in treatment of shelter costs in the CPI-W and the experimental index during 1983 and 1984. The medical care component accounted for most of the remaining difference. Thus, the medical care component was responsible for a large part of the differences between the experimental index and each of the official indexes, the CPI-U and CPI-W. This suggests that the most fruitful area of further research on a CPI for older Americans lies in examining the medical care expenditures of this population.

It is important to note that the foregoing analysis of the behavior of the experimental index does not attempt to evaluate the statistical significance of the differences observed among the three measures. For example, the fact that samples from which expenditure weights for the experimental index were calculated are substantially smaller than those used in either the CPI-U or CPI-W, means that the experimental index is subject to much larger sampling errors than either of the official indexes. This in turn increases the uncertainty of statements concerning the significance of observed differences among the indexes.

Use of CPI for Social Security Cost of Living Adjustments

The Senate Special Committee on Aging specified the population to be covered for this reweighting study: persons 62 years of age and older. While useful for study, this is not likely to be the most appropriate population definition, if the goal were to develop an index for use in indexing Social Security benefits.

18. In the late 1970's and early 1980's medical care costs rose about 20 percent faster than all items.

The first point that needs to be considered is that many persons receiving Social Security benefits are younger than 62 years of age. An estimated 6.7 million beneficiaries,[19] or about 25 percent of all Social Security beneficiaries, are younger people who receive benefits because they are surviving spouses and/or minor children of covered workers or because of disability. The expenditure experience of this group is not included in the weights for the experimental index for older Americans.

Further, a substantial number of persons 62 years of age and older do not receive Social Security benefits. According to data from the Social Security Administration, 42 percent of the population age 62 to 64, although eligible for retirement benefits, were not collecting them during the 1982-84 period.[20] This percentage drops sharply for those 65 years of age and over -- to 7 percent.[21] (These percentages showed relatively little change during the decade.) Although these older consumers are included in the population covered by the experimental reweighted index, they presumably should be excluded from an index designed to reflect the experience of Social Security pensioners.

An index designed specifically to measure price change for beneficiaries -- i.e., one that excludes older persons not receiving benefits, but includes younger persons receiving survival and disability benefits -- might well show price movements different from those of this study's experimental index. Nonetheless, BLS has developed simulations of alternative COLA's percentages under Social Security using the CPI-U and the experimental index. Because of the limitations of the reweighted index discussed in this report, however, these simulations should be analyzed with caution.

In addition, of course, it should be remembered that the period covered by this study, from 1983 to the present, has been a period of comparatively low inflation. The rates, shown in table 9, are in marked contrast to those from the late 1970's when double-digit rates of inflation were experienced.

19. Table 123. "Number and average primary insurance and monthly benefit amounts, by selected family groups, at end of 1986". Social Security Bulletin Annual Statistical Supplement, 1987.
20. Table 42. "Workers aged 62 or older eligible for retired-worker benefits: Estimated number and percent with benefits in current-pay status, by age and sex, 1956-87". Social Security Bulletin Annual Statistical Supplement, 1987.
21. Ibid.

Table 9. Annual Rates of Inflation, December to December, 1978-87, CPI-U

Year	12 Month Percent Change
1978	9.0
1979	13.3
1980	12.5
1981	8.9
1982	3.8
1983	3.8
1984	3.9
1985	3.8
1986	1.1
1987	4.4

As a result of this moderation, recent annual cost-of-living adjustments (COLA's) to Social Security benefit payments have been smaller than in prior years.

Adjustments to Social Security benefits currently are based upon the percentage change in the CPI-W (1967=100) measured from the average of the third quarter of one year to the average of the third quarter of the succeeding year. The following table presents simulations based upon the CPI-U and the experimental index as well as the CPI-W. (A COLA factor for 1983 has not been calculated because the experimental index is not available for the third quarter of 1982).

Table 10. Alternative COLA's based on the CPI-U and the Experimental Index, 1984-87

Year	CPI-W	CPI-U	Experimental Index
1984	3.5	4.3	4.3
1985	3.1	3.3	3.7
1986	1.3 [22]	1.6	2.3
1987	4.2	4.2	4.3

Although the official Social Security COLA based on the CPI-W yielded the lowest adjustment, the range among the indexes is not very large. The average annual COLA was 3.0 percent. Had the CPI-U been used, Social Security COLA's would have averaged 3.4 percent annually. Use of the experimental index -- with all its shortcomings -- would have yielded annual average increases of 3.7 percent.

RESEARCH NEEDS TO ADDRESS ISSUES

In identifying the research components needed in developing a price index for the older population, BLS has made several assumptions which would substantially affect the potential cost of both research and ongoing data collection. The first assumption is that a full-scale CPI for the older population should be of the same reliability as the current Urban Wage Earners and Clerical Workers Index which is used as the escalator for Social Security payments.

Secondly, BLS assumes that the definition of the older population includes all persons 62 and over residing in urban and rural nonfarm areas, and that all categories of expenditures will need to be addressed.[23]

Sample Sizes

Sample sizes would need to be determined for the three major surveys required to develop and maintain an index; namely, the Consumer Expenditure Survey, the Point-of-Purchase Survey, and the pricing survey. In addition, the definition of the population to be covered determines the level of effort needed to locate eligible units. To achieve reliability for an index for a subpopulation equal to that of the total population, it is a statistical necessity that the number of sample units interviewed for the subpopulation be equal to the number of sample units interviewed for the total population.

As an example, BLS prices about 100,000 items each month for the current indexes. Thus, for the older population index, BLS would need to develop surveys of sufficient size to potentially support monthly pricing of another 100,000 items related specifically to the older population.

Data Collection Methodologies

Conceptually, the solution to developing a CPI for older Americans requires the development of a series of household surveys for the older population which obtains detailed descriptions of items purchased by the older Americans and the identification of the outlets where they were purchased.

---

22. Under existing law, cost of living adjustments were to be made only when the annual change in the CPI-W was at least 3 percent. However, in 1986 Congress authorized a COLA based on the 1.3 percent increase in the benefit adjustment formula.

23. The definition would determine the data source, or sampling frame. The current definition of all persons age 62 and over would require using either the 1980 Census files maintained by the Census Bureau or a large area sampling approach such as that currently used by BLS for the CPI housing component. Since the older population is a relatively small proportion of the total population, significant oversampling would be necessary. The need for oversampling is a primary determinant of cost using this approach.

If an alternative definition of population were chosen, such as age 62 and over and retired, or recipients of Social Security payments only, alternative sampling frames such as the Social Security Master Beneficiary file would be a better source. Such frames would substantially reduce or eliminate the need for oversampling.

With this kind of information, the following issues could be addressed:

a. whether the nature of their purchases is different from the purchases of the general population;
b. whether the types of outlets frequented by older consumers are different;
c. whether the locations of outlets frequented are different;
d. whether the respondent is able to provide BLS with this kind of information, and
e. whether the information collected is sufficient to identify a specific item/outlet for the measurement of price change.

Further, evaluation criteria would need to be established to judge the reliability of the results of all tests.

To develop the questionnaires needed for data collection for the older population, BLS would use "cognitive" techniques in a laboratory setting for testing questionnaire design. This would address the problems of recall, understanding, and respondent burden that need to be overcome in order to provide the level of detail needed.

Once the questionnaires and procedures were refined, large scale field tests would be planned and carried out for both the older American population and, as a control group, the general population. A detailed description of the research requirements and possible research plan is provided in the appendix.

Given the potential level of resources and the uncertainties surrounding the need for specially selected samples, initial work on a CPI for older consumers should focus on research efforts. The purpose of the research would be to determine (1) whether the specific items purchased and outlets frequented by older consumers are sufficiently different from those of the population underlying the CPI-U that they will impact the measurement process of the older population's CPI in the long run, and (2) whether a methodology for identifying specific items and outlets for the older population can be developed. Even though the research described would require several years to complete, it could be structured so that incremental improvements could be made to the experimental index as the research is funded and results are obtained. In the near term, an estimate of the rate of price change affecting this segment of the population would be available and would provide a basis for comparing the rates of inflation of the older Americans with the rates obtained from the CPI-U and the CPI-W.

Based on the analysis of the 1983-1988 experimental index for older Americans, the initial research effort should focus on the medical care component of the CPI. This component has a substantially larger relative importance in the experimental index than in the CPI-U or CPI-W, and this component has shown significantly higher than average price increases over the past twenty years. A failure to measure

accurately price behavior of these services and commodities consumed by the older population would have a detrimental affect on the quality of the price index for the older population. The research would focus on selecting care providers and medical care items for pricing based on the experiences of older consumers.

After an improved sample has been implemented for the medical care component of the experimental index, other incremental improvements which address the limitations of the experimental index could be introduced. These would include the measurement of senior citizen price discounts to reflect their usage by older consumers, and enhancements in the surveys used to develop item and outlet samples.

A phased series of improvements to the experimental index may result in the process requiring a longer period of time. However, the interim indexes produced for the older population group would provide a more useful measure of the difference between the rate of price change between this group and the general population.

APPENDIX

The following outlines a research plan which addresses the issues that the Bureau of Labor Statistics (BLS) feels need to be considered in development of a reliable index for older Americans. It is clear that the research described is both costly and time consuming and has been laid out in accordance with the directive of Congress that BLS specify the steps needed to produce an accurate Consumer Price Index (CPI) for the elderly population.

After evaluating the performance of the experimental index for older Americans over the 1983-88 period, BLS suggests examination of those areas of consumer spending that account for the observed difference between the experimental measure and the official indexes. In this context, BLS would first suggest that efforts be focused on examining in detail the spending on medical care by the population age 62 and over. This suggestion is made because price changes for medical care are clearly one of the major factors that led to differences in behavior between the experimental index for older Americans and the official indexes. While detailed time and cost estimates would need to be developed if this course were to be pursued, it is now estimated that the resources required to support this effort would range from 1 to 2 million dollars per year on average for several years. After the research is completed, production of an index on a regular basis would entail substantial costs.

FIELD TEST DESIGNS FOR OLDER CONSUMER EXPENDITURE SURVEYS AND PRICING QUESTIONNAIRE

1. MEDICAL CARE EXPENDITURE TEST

A. Questionnaire

The questionnaire would be designed for a personal interview with a 3-month recall of medical expenditures. In addition, respondent would be asked to fill in a diary for a 1-month period, with interim visits by the interviewer. The interview questionnaire would develop a 3-month history of medical expenditures, types of illnesses, and descriptions and location of medical facilities used in the 3-month period. The 1-month diary would provide more detail on the smaller expenditures and test the feasibility of using the diary to collect all the information.

B. Hypotheses and Survey Design

The hypotheses are that recall is too difficult a method for obtaining item detail and that the diary format can provide sufficient information for item and outlet medical expenditures.

The test would be composed of several panels. One would be a control panel for all persons under the age of 62 and would be treated in the same way as the panels for age 62 and over. The second panel would be for persons 62 and over; the test would make use of both personal interview and diary formats. The third panel would be for persons 62 and over but would make use of the Diary format only.

One of the design criteria must be that the sample in a given area be of sufficient size to make it possible to identify the number of outlets needed for the pricing questionnaire.

The test would take one year to collect. Each panel would be comprised of the following samples:

1). Control panels: a> One with diary only
(800 usable interviews)
b> One with diary and personal interviews with 3-month recall
(800 usable interviews)

2). Research panels: a> One with diary only
(800 usable interviews)
b> One with diary and personal interview
(800 usable interviews)

Because of the need to screen a large number of cases in order to find the older population, about 12,000 cases would be needed, of which 7,400 would be screened and discarded and the remainder divided between the two control panels and the two test panels. The test would be conducted in about four sample areas such that 200 designated cases for the older population are defined per sample replicate type. This is needed to insure response levels of outlets per sample area similar to the response levels the current questionnaire obtains from the Point-of-Purchase Survey. The sample in the larger areas would be twice the size of the sample in the smaller areas.

2. APPAREL EXPENDITURE TEST

A. Questionnaire

The questionnaire would be in the Diary format and would obtain the detailed information on what was purchased as well as where and for whom it was purchased.

B. Hypotheses and Survey Design

One hypothesis is that the current methodology of recalling levels of expenditure for apparel items for the previous 3-months is not feasible when specific descriptions of the items bought are to be recalled. The second hypothesis is concurrent reporting of purchases and recording of the item descriptions in a diary format is more efficient.

The diary for the apparel test would take 6-months to complete with four visits by the interviewer to assure completeness and continued cooperation. The test would include use of additional visits and phone calls to measure effects of more frequent contact.

The test would be composed of two panels:

1). The control panel receiving the diary
(1,200 usable interview)
2). The research panel for those age 62 and over
(1,200 usable interviews)

Because of the need to screen the large number of units to locate the population 62 and over, 8,800 housing units need to be screened. The test would be conducted in four sample areas.

3. FOOD AND PERSONAL CARE TEST

A. Questionnaire

Three questionnaires to collect different components of food, food away from home, and personal care would be developed. The reference period would be expanded to 1-month versus the current 2 weeks.

B. Hypotheses and Survey Design

One hypothesis is that it is not feasible to collect accurate data on expenditures for all categories from one respondent. Another hypothesis is that a complete reporting of expenditures can be achieved by dividing into subpanels and asking each subpanel only for selected categories of expenditure.

The diary test for food etc. would take 6-months and involve four visits by the interviewer during 1-month to insure completeness and continued cooperation. The test would comprise a control panel and a research panel; each would have three subpanels for the different questionnaires.

The control panel would be comprised of 3,000 usable interviews and the research panel would be of the same magnitude. To identify the panel of the age 62 and over, 22,500 screenings would need to be made of which 12,400 would be discarded. The test would be conducted in about five sample areas.

4. PRICING

A. Questionnaire Design

For each of the relevant sections, modifications to the pricing questionnaires and procedures would need to be developed to address any special pricing rules for the purchases related to the older population, such as senior citizen discounts. Also, new procedures would have to be developed to use or adapt the reports provided in the expenditure surveys when item description and outlet locations are missing.

B. Hypothesis and Survey Design

The hypothesis is that all or most of the relevant detail needed for pricing can be obtained from the expenditure survey of the older population needs to be examined by attempting to locate the items and outlets reported by the older population. In addition, it is assumed that the responses will vary in completeness, and thus procedures need to be examined to ascertain the necessity and feasibility of the expenditure surveys.

For each of the research sections, a subsample of reported items and outlets would be selected and attempts to locate the item and outlet would be made. For each section about 500 outlets would be selected with about 2,000 individual items initiated to determine their availability.

Table A.1

Consumer Price Index, All Items, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	100.2	100.1	100.4	8601	112.3	111.1	112.9
8302	100.3	100.1	100.5	8602	112.0	110.7	112.7
8303	100.3	100.4	100.6	8603	111.5	110.1	112.3
8304	101.0	101.0	101.2	8604	111.3	109.8	112.3
8305	101.6	101.5	101.7	8605	111.6	110.1	112.6
8306	101.9	101.8	102.0	8606	112.2	110.6	113.1
8307	102.4	102.1	102.4	8607	112.2	110.6	113.3
8308	102.7	102.6	102.7	8608	112.4	110.8	113.6
8309	103.2	103.1	103.2	8609	112.9	111.3	114.1
8310	103.5	103.3	103.4	8610	113.0	111.3	114.2
8311	103.7	103.3	103.5	8611	113.1	111.4	114.2
8312	103.8	103.3	103.7	8612	113.2	111.5	114.4
8401	104.4	103.7	104.4	8701	113.9	112.2	115.2
8402	104.9	103.9	105.1	8702	114.3	112.8	115.7
8403	105.1	103.9	105.3	8703	114.9	113.3	116.1
8404	105.6	104.2	105.7	8704	115.5	113.9	116.7
8405	105.9	104.6	106.0	8705	115.9	114.2	117.1
8406	106.3	104.9	106.3	8706	116.3	114.7	117.7
8407	106.7	105.3	106.7	8707	116.6	115.0	117.9
8408	107.1	106.3	107.2	8708	117.2	115.6	118.6
8409	107.6	106.9	107.6	8709	117.8	116.1	119.0
8410	107.9	106.9	107.8	8710	118.1	116.4	119.3
8411	107.9	106.8	107.9	8711	118.2	116.6	119.5
8412	107.9	106.9	108.0	8712	118.2	116.5	119.5
8501	108.1	107.0	108.3	8801	118.5	116.8	120.0
8502	108.6	107.6	108.8	8802	118.9	117.0	120.3
8503	109.0	108.1	109.2	8803	119.4	117.4	120.9
8504	109.5	108.5	109.7				
8505	109.9	108.9	110.1				
8506	110.2	109.2	110.5				
8507	110.5	109.3	110.8				
8508	110.7	109.5	111.1				
8509	111.0	109.8	111.4				
8510	111.4	110.1	111.7				
8511	111.7	110.5	112.1				
8512	112.0	110.8	112.4				

Table A.2

Consumer Price Index, Food and Beverages, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	100.6	100.5	100.5	8601	110.3	110.0	110.7
8302	100.9	100.9	100.9	8602	110.2	110.0	110.7
8303	101.5	101.4	101.5	8603	110.3	110.0	110.8
8304	102.0	101.9	102.0	8604	110.6	110.3	111.1
8305	102.2	102.1	102.2	8605	110.9	110.5	111.4
8306	102.0	101.9	102.2	8606	111.0	110.6	111.4
8307	102.0	101.9	102.3	8607	111.9	111.6	112.5
8308	102.2	101.9	102.3	8608	112.7	112.5	113.4
8309	102.3	102.1	102.4	8609	112.9	112.7	113.5
8310	102.4	102.3	102.5	8610	113.1	112.8	113.7
8311	102.3	102.1	102.2	8611	113.4	113.1	113.9
8312	102.7	102.6	102.7	8612	113.6	113.3	114.1
8401	104.5	104.4	104.9	8701	114.9	114.5	115.5
8402	105.4	105.3	106.0	8702	115.3	114.9	116.0
8403	105.4	105.3	106.0	8703	115.3	114.9	115.9
8404	105.5	105.4	106.0	8704	115.6	115.3	116.2
8405	105.2	105.1	105.6	8705	116.1	115.8	116.9
8406	105.4	105.3	105.9	8706	116.6	116.3	117.5
8407	105.8	105.6	106.3	8707	116.5	116.2	117.2
8408	106.5	106.2	106.9	8708	116.6	116.3	117.2
8409	106.3	106.0	106.6	8709	117.0	116.7	117.6
8410	106.3	106.0	106.7	8710	117.1	116.8	117.7
8411	106.1	105.9	106.5	8711	117.1	116.8	117.5
8412	106.6	106.2	106.8	8712	117.6	117.2	118.2
8501	107.3	107.0	107.6	8801	118.5	118.1	119.2
8502	108.0	107.8	108.5	8802	118.6	118.2	119.2
8503	108.1	107.9	108.6	8803	119.4	118.4	119.4
8504	108.1	107.8	108.5				
8505	107.9	107.6	108.3				
8506	108.0	107.8	108.4				
8507	108.1	107.8	108.5				
8508	108.2	107.9	108.5				
8509	108.3	108.0	108.5				
8510	108.4	108.1	108.6				
8511	108.8	108.5	108.9				
8512	109.5	109.2	109.7				

Table A.3

Consumer Price Index, Housing, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	100.5	100.1	100.5	8601	112.8	110.5	112.8
8302	100.7	100.2	100.6	8602	112.7	110.4	112.6
8303	100.7	100.7	100.6	8603	112.8	110.5	112.6
8304	101.2	101.1	101.1	8604	113.1	110.8	113.0
8305	101.7	101.4	101.6	8605	113.3	111.0	113.1
8306	102.2	101.7	102.0	8606	114.2	111.8	113.8
8307	102.6	101.9	102.4	8607	114.3	111.9	113.9
8308	102.7	102.3	102.6	8608	114.6	112.2	114.1
8309	103.2	102.6	103.1	8609	115.0	112.6	114.5
8310	103.3	102.6	103.2	8610	114.8	112.2	114.3
8311	103.4	102.4	103.3	8611	114.4	111.8	114.0
8312	103.5	102.3	103.4	8612	114.5	112.0	114.1
8401	104.1	102.4	104.0	8701	115.0	112.5	114.8
8402	104.6	102.3	104.7	8702	115.4	112.8	115.2
8403	104.8	101.9	104.8	8703	115.8	113.2	115.7
8404	105.3	101.8	105.3	8704	116.2	113.6	116.1
8405	105.7	102.6	105.7	8705	116.6	114.0	116.6
8406	106.3	102.9	106.1	8706	117.4	114.7	117.3
8407	106.9	103.8	106.8	8707	117.8	115.0	117.7
8408	107.3	105.5	107.2	8708	118.5	115.9	118.5
8409	107.9	106.3	107.7	8709	118.7	116.0	118.6
8410	107.9	105.9	107.7	8710	118.6	115.9	118.6
8411	107.8	105.6	107.6	8711	118.6	115.8	118.6
8412	107.9	105.7	107.8	8712	118.7	116.0	118.7
8501	108.1	106.0	108.0	8801	119.3	116.5	119.5
8502	108.6	106.4	108.5	8802	119.7	116.9	119.9
8503	108.9	106.7	108.9	8803	120.1	117.2	120.5
8504	109.3	107.1	109.3				
8505	110.2	108.0	110.1				
8506	110.8	108.5	110.7				
8507	111.2	108.9	111.0				
8508	111.6	109.2	111.4				
8509	111.8	109.6	111.7				
8510	112.0	109.7	111.9				
8511	112.2	110.0	112.2				
8512	112.5	110.2	112.5				

Table A.4

Consumer Price Index, Apparel and Upkeep, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	98.7	98.5	98.5	8601	105.9	105.9	106.0
8302	99.2	99.0	99.0	8602	105.5	105.3	105.7
8303	100.5	100.6	100.3	8603	106.6	106.4	107.0
8304	101.0	101.0	100.9	8604	107.1	106.9	107.5
8305	101.3	101.2	101.2	8605	106.6	106.4	106.8
8306	101.0	100.9	101.1	8606	105.7	105.3	105.7
8307	100.7	100.6	100.7	8607	105.0	104.7	105.2
8308	101.9	101.8	102.2	8608	106.9	106.8	107.3
8309	103.5	103.3	104.0	8609	109.5	109.4	110.0
8310	103.6	103.6	104.0	8610	110.1	109.9	110.5
8311	103.6	103.5	103.9	8611	110.0	109.6	110.4
8312	102.9	102.7	103.2	8612	108.9	108.7	109.1
8401	101.4	101.2	101.5	8701	107.0	106.7	107.1
8402	101.3	101.3	101.4	8702	107.6	107.3	107.8
8403	102.6	102.6	103.3	8703	111.1	110.8	111.5
8404	102.9	102.7	103.5	8704	113.0	112.8	113.5
8405	102.7	102.5	103.3	8705	112.6	112.2	113.0
8406	101.9	101.7	102.5	8706	110.7	110.4	110.9
8407	101.5	101.2	101.7	8707	108.7	108.4	108.4
8408	103.3	103.1	103.7	8708	110.8	110.4	111.1
8409	105.5	105.4	106.0	8709	114.8	114.3	115.5
8410	106.3	106.2	106.7	8710	116.9	116.6	117.6
8411	106.0	105.9	106.3	8711	116.9	116.6	117.8
8412	105.0	104.8	105.3	8712	114.2	114.0	114.3
8501	103.2	102.9	103.4	8801	111.9	111.6	111.9
8502	104.3	104.0	104.3	8802	111.7	111.3	112.0
8503	106.1	105.9	106.4	8803	115.8	115.3	116.3
8504	106.4	106.3	106.9				
8505	106.1	105.9	106.5				
8506	105.7	105.7	106.0				
8507	104.8	104.7	104.8				
8508	106.1	106.0	106.2				
8509	108.3	108.2	108.7				
8510	109.0	109.0	109.5				
8511	109.1	109.0	109.6				
8512	107.9	107.9	108.4				

Table A.5

Consumer Price Index, Transportation, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	99.4	99.3	99.5	8601	109.9	109.7	110.1
8302	98.4	98.3	98.5	8602	108.3	108.1	108.6
8303	97.5	97.4	97.7	8603	105.0	104.7	105.5
8304	99.2	99.1	99.4	8604	102.9	102.4	103.4
8305	100.5	100.4	100.6	8605	103.7	103.3	104.3
8306	101.2	101.1	101.3	8606	104.7	104.2	105.3
8307	101.9	101.9	101.9	8607	103.4	102.9	104.2
8308	102.5	102.7	102.4	8608	102.2	101.5	103.1
8309	103.0	103.2	102.7	8609	102.4	101.8	103.4
8310	103.5	103.6	103.1	8610	102.7	102.0	103.5
8311	103.9	104.0	103.4	8611	103.2	102.7	104.2
8312	103.9	104.0	103.4	8612	103.4	102.7	104.5
8401	103.8	103.9	103.4	8701	104.6	104.0	105.8
8402	103.7	103.9	103.4	8702	105.1	104.6	106.3
8403	104.1	104.3	103.7	8703	105.3	104.9	106.5
8404	105.0	105.3	104.4	8704	106.2	105.9	107.3
8405	105.9	106.2	105.2	8705	106.7	106.5	107.7
8406	106.2	106.5	105.4	8706	107.4	107.2	108.4
8407	106.1	106.4	105.4	8707	108.1	108.0	109.0
8408	106.1	106.4	105.5	8708	108.6	108.5	109.6
8409	106.4	106.6	105.7	8709	108.7	108.6	109.7
8410	107.0	107.2	106.3	8710	109.2	109.1	110.0
8411	107.2	107.4	106.5	8711	109.9	109.8	110.8
8412	107.1	107.3	106.5	8712	109.7	109.5	110.5
8501	106.7	106.9	106.2	8801	109.2	109.0	110.1
8502	106.6	106.7	106.1	8802	108.9	108.6	109.7
8503	107.4	107.6	106.9	8803	108.6	108.4	109.5
8504	108.6	108.7	108.0				
8505	109.0	109.1	108.6				
8506	109.2	109.2	108.8				
8507	109.2	109.2	109.0				
8508	108.8	108.8	108.7				
8509	108.5	108.4	108.5				
8510	108.9	108.8	108.9				
8511	109.6	109.6	109.7				
8512	109.9	109.8	110.0				

Table A.6

Consumer Price Index, Medical Care, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	101.0	100.9	101.0	8601	121.5	121.7	121.6
8302	102.1	102.1	102.1	8602	122.7	122.8	122.9
8303	102.4	102.4	102.4	8603	123.7	123.9	123.9
8304	102.7	102.7	102.7	8604	124.4	124.5	124.6
8305	102.9	103.0	102.9	8605	124.9	125.0	125.1
8306	103.3	103.3	103.2	8606	125.5	125.6	125.8
8307	103.9	104.0	103.8	8607	126.3	126.4	126.7
8308	104.6	104.6	104.5	8608	127.1	127.2	127.5
8309	105.0	105.1	104.8	8609	127.8	127.8	128.1
8310	105.5	105.6	105.3	8610	128.5	128.6	128.9
8311	106.0	106.1	105.8	8611	129.2	129.1	129.6
8312	106.4	106.5	106.2	8612	129.8	129.9	130.3
8401	107.3	107.4	107.2	8701	130.7	130.7	131.0
8402	108.5	108.6	108.3	8702	131.5	131.5	131.8
8403	108.8	109.0	108.7	8703	132.2	132.3	132.5
8404	109.2	109.3	109.0	8704	132.8	133.1	133.0
8405	109.5	109.7	109.3	8705	133.3	133.6	133.4
8406	109.8	110.0	109.6	8706	134.1	134.3	134.0
8407	110.5	110.6	110.3	8707	134.9	135.1	134.8
8408	110.9	111.2	110.8	8708	135.4	135.7	135.3
8409	111.4	111.5	111.1	8709	135.9	136.4	135.8
8410	112.0	112.2	111.7	8710	136.5	137.0	136.4
8411	112.6	112.8	112.3	8711	137.0	137.4	136.9
8412	112.9	113.1	112.7	8712	137.4	137.8	137.2
8501	113.6	113.8	113.5	8801	138.7	139.0	138.5
8502	114.4	114.7	114.3	8802	139.8	140.3	139.5
8503	115.2	115.4	115.0	8803	140.7	141.0	140.4
8504	115.7	115.8	115.5				
8505	116.1	116.3	116.0				
8506	116.7	116.9	116.6				
8507	117.3	117.6	117.3				
8508	118.2	118.3	118.1				
8509	118.7	118.8	118.6				
8510	119.3	119.4	119.2				
8511	120.0	120.1	120.0				
8512	120.5	120.7	120.5				

Table A.7

Consumer Price Index, Entertainment, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	100.6	100.5	100.6	8601	112.8	112.3	114.6
8302	101.3	101.3	101.3	8602	113.3	112.7	115.2
8303	101.9	101.8	101.8	8603	113.3	112.7	115.4
8304	101.9	101.9	101.9	8604	113.5	112.9	115.6
8305	102.0	102.0	102.0	8605	113.7	113.1	115.8
8306	102.3	102.4	102.3	8606	114.1	113.5	116.2
8307	102.5	102.6	102.7	8607	114.3	113.8	116.5
8308	102.8	102.9	102.8	8608	114.4	113.8	116.7
8309	103.2	103.3	103.4	8609	114.7	114.2	117.1
8310	103.8	103.8	104.2	8610	115.3	114.6	117.7
8311	104.0	103.9	104.5	8611	115.6	115.0	118.2
8312	104.0	104.0	104.6	8612	115.6	115.1	118.1
8401	104.1	104.1	104.8	8701	116.0	115.5	118.4
8402	104.8	104.8	105.4	8702	116.2	115.7	118.6
8403	104.9	104.9	105.4	8703	116.6	116.1	119.0
8404	105.7	105.6	106.4	8704	117.2	116.7	119.6
8405	105.6	105.5	106.3	8705	117.5	117.1	119.9
8406	106.0	106.0	106.9	8706	117.6	117.2	120.1
8407	106.3	106.3	107.2	8707	118.1	117.7	120.8
8408	106.9	106.8	107.7	8708	118.3	117.8	120.7
8409	107.2	107.2	108.1	8709	118.8	118.3	121.2
8410	107.7	107.5	108.7	8710	119.7	119.0	122.0
8411	107.9	107.8	109.1	8711	120.1	119.4	122.3
8412	108.4	108.2	109.5	8712	120.2	119.7	122.5
8501	108.8	108.5	109.9	8801	120.9	120.2	123.4
8502	108.9	108.7	110.0	8802	121.1	120.4	123.7
8503	109.2	108.8	110.5	8803	121.8	121.0	124.4
8504	109.7	109.4	111.0				
8505	109.8	109.5	111.2				
8506	110.3	110.0	111.8				
8507	110.7	110.3	112.4				
8508	110.7	110.3	112.4				
8509	111.2	110.6	112.9				
8510	111.9	111.3	113.7				
8511	112.1	111.6	113.9				
8512	111.8	111.3	113.7				

Table A.8

Consumer Price Index, Other Goods and Services, by population definition, December 1982=100

year-month	CPI-U	CPI-W	Experimental Index	year-month	CPI-U	CPI-W	Experimental Index
8212	100.0	100.0	100.0				
8301	101.1	101.4	101.2	8601	122.6	122.3	119.9
8302	101.8	102.1	101.9	8602	123.0	122.7	120.4
8303	101.9	102.2	101.9	8603	123.3	123.0	120.8
8304	102.4	102.7	102.5	8604	123.5	123.2	121.1
8305	102.5	102.9	102.7	8605	123.6	123.4	121.3
8306	102.8	103.2	103.0	8606	123.8	123.5	121.5
8307	103.9	104.5	104.0	8607	124.6	124.6	122.3
8308	104.4	105.2	104.7	8608	125.2	125.1	122.7
8309	106.4	106.6	105.9	8609	127.6	126.8	123.9
8310	107.2	107.3	106.3	8610	128.1	127.3	124.3
8311	107.7	107.8	106.9	8611	128.2	127.5	124.5
8312	107.9	108.0	107.2	8612	128.4	127.6	124.8
8401	108.6	108.8	107.8	8701	129.4	128.8	125.8
8402	109.0	109.2	108.2	8702	130.0	129.4	126.4
8403	109.2	109.4	108.4	8703	130.2	129.6	126.8
8404	109.4	109.7	108.7	8704	130.5	129.9	127.1
8405	109.6	109.8	108.9	8705	130.8	130.2	127.5
8406	110.0	110.3	109.4	8706	131.1	130.7	127.9
8407	110.7	111.1	110.2	8707	132.0	131.6	128.7
8408	111.0	111.5	110.5	8708	132.5	132.1	129.3
8409	113.7	113.5	111.8	8709	135.2	134.5	130.5
8410	114.1	113.8	112.3	8710	135.7	135.0	130.9
8411	114.3	114.1	112.7	8711	135.9	135.2	131.1
8412	114.4	114.1	112.8	8712	136.2	135.5	131.4
8501	115.4	115.2	113.6	8801	137.5	136.9	132.7
8502	115.8	115.8	114.2	8802	138.4	137.9	133.8
8503	116.1	115.9	114.4	8803	138.8	138.3	134.3
8504	116.3	116.2	114.8				
8505	116.5	116.4	115.1				
8506	116.7	116.6	115.4				
8507	117.4	117.4	116.1				
8508	117.8	117.9	116.5				
8509	120.4	120.0	117.9				
8510	121.0	120.5	118.5				
8511	121.1	120.6	118.6				
8512	121.6	121.2	119.0				

Table A.9

Consumer Price Index for All Items less Shelter, and 12 month percentage changes, by population definition, end of year, 1982-87

year-month	ALL URBAN CONSUMERS Index	ALL URBAN CONSUMERS Twelve Month	URBAN WAGE EARNERS AND CLERICAL WORKERS Index	URBAN WAGE EARNERS AND CLERICAL WORKERS Twelve Month	EXPERIEMENTAL INDEX Index	EXPERIEMENTAL INDEX Twelve Month
8212	100.0		100.0		100.0	
8312	103.5	3.5	103.6	3.6	103.4	3.4
8412	107.3	3.7	107.2	3.5	107.3	3.8
8512	110.7	3.2	110.4	3.0	111.0	3.4
8612	110.8	0.1	110.1	-0.3	111.8	0.7
8712	115.5	4.2	114.9	4.4	116.3	4.0

Table A.10
Consumer Price Index for All Items less Shelter and Energy, and 12 month percentage changes, by population definition, end of year, 1982-87

year-month	ALL URBAN CONSUMERS Index	ALL URBAN CONSUMERS Twelve Month	URBAN WAGE EARNERS AND CLERICAL WORKERS Index	URBAN WAGE EARNERS AND CLERICAL WORKERS Twelve Month	EXPERIEMENTAL INDEX Index	EXPERIEMENTAL INDEX Twelve Month
8212	100.0		100.0		100.0	
8312	104.3	4.3	104.5	4.5	104.2	4.2
8412	108.7	4.2	108.9	4.2	108.7	4.3
8512	112.4	3.4	112.3	3.1	112.9	3.9
8612	116.3	3.5	116.0	3.3	117.6	4.2
8712	120.7	3.8	120.4	3.8	121.9	3.7

Table A.11
Consumer Price Index for All Items less Shelter, Energy, and Medical Care, and 12 month percentage changes, by population definition, end of year, 1982-87

year-month	ALL URBAN CONSUMERS Index	ALL URBAN CONSUMERS Twelve Month	URBAN WAGE EARNERS AND CLERICAL WORKERS Index	URBAN WAGE EARNERS AND CLERICAL WORKERS Twelve Month	EXPERIEMENTAL INDEX Index	EXPERIEMENTAL INDEX Twelve Month
8212	100.0		100.0		100.0	
8312	104.1	4.1	104.3	4.3	103.8	3.8
8412	108.3	4.0	108.5	4.0	108.0	4.0
8512	111.6	3.0	111.6	2.9	111.5	3.2
8612	115.0	3.0	114.8	2.9	115.3	3.4
8712	119.1	3.6	118.9	3.6	119.2	3.4

APPENDIX 2

United States Senate
SPECIAL COMMITTEE ON AGING
WASHINGTON, DC 20510-6400

October 26, 1988

Harry C. Ballantyne
Chief Actuary
Social Security Administration
900 Altmeyer Building
6401 Security Boulevard
Baltimore, Maryland 21235

Dear Mr. Ballantyne:

On behalf of myself and the other members of the Senate Special Committee on Aging, I would like to thank you for participating in the October 5th hearing, "Cost-of-Living Adjustments and the CPI." Your testimony provided the Committee with valuable information and helped make the hearing a success.

Due to time constraints, I was unable to ask a number of questions which I believe are needed to complete the record. I would therefore appreciate your providing a timely written response to the following questions.

1. In your testimony you indicated that in the long term the CPI-U will probably not increase at a rate significantly different from that of the CPI-W. If that is true, how do you explain that the difference over the past five years between these two indexes has been 1.7 percent?

2. Your testimony stated that there is no specific statutory authority to use a specific CPI for COLA calculations. Were you implying that the Administration could move to the CPI-U without a legislative mandate from Congress? Is the Administration seriously considering such a move?

3. Do you believe that beneficiaries have confidence in the currently used CPI as a measure of inflation?

We appreciate you taking the time to respond to these questions, and will, of course, forward you a hearing print as soon as it is available. If you have any questions regarding this request, please contact Christopher Jennings or Jennifer McCarthy of the Committee staff at 224-5364.

Finally, I would like to take this opportunity to let you know that on October 11, 1988, I offered an amendment to a pending tax technical corrections bill to require the use of the CPI-U in place of the CPI-W in federal COLA calculations. Although the amendment was accepted unanimously by the Senate, it unfortunately was later dropped in conference on the tax measure. I strongly believe this legislation is needed to help assure that elderly Americans and others are provided with the most accurate COLA possible, and I thus plan to renew my effort in this area in the 101st Congress.

Thank you for your cooperation and assistance with this request. We look forward to reviewing your responses.

Sincerely,

John Melcher

Chairman

DEPARTMENT OF HEALTH & HUMAN SERVICES

Social Security Administration

Refer to: S3NL

Baltimore MD 21235

DEC 5 1988

The Honorable John Melcher
Chairman, Special Committee on Aging
United States Senate
Washington, D.C. 20510-6400

Dear Mr. Chairman:

I am writing in response to your letter concerning cost-of-living adjustments, dated October 26, 1988. First, I would like to say that I enjoyed participating in the October 5 hearing and am happy to address your further inquiries.

You asked why we believe there will be little difference between the growth rates of the Consumer Price Index for all Urban Consumers (CPI-U) and the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) in the future when these two series grew at quite different rates over the past 5 years. Most of the difference in the growth in these indexes over the past 5 years has occurred because of differences in the way the housing cost component of each index was defined and weighted between 1983 and 1985. Both indexes have used the same housing cost component since January 1985.

Prior to 1983, both the CPI-U and the CPI-W included housing cost components that were heavily influenced by the current purchase prices of houses and the mortgage interest rates for recent purchases. In January 1983, the CPI-U was altered to reflect a new housing component based on "owners' equivalent rent." This new housing component is little influenced by current home purchase costs. However, the owners' equivalent rent concept was not used in the CPI-W until January 1985. Because owners' equivalent rent rose faster between January 1983 and January 1985 than did mortgage interest rates and purchase prices of homes, the CPI-U rose faster than the CPI-W.

Other smaller differences in the rates of increase in the CPI-U and the CPI-W since 1978 (the first year the CPI-U was produced), can be attributed to differences in the weight allocated to each major component in the two indexes. For example, the CPI-W gives greater weight to food and transportation, but less weight to housing and medical care, than does the CPI-U. These differences in the weighting in the two indexes are a result of the differences in the measured spending patterns of the two populations represented by each index.

Because we see no long-term, consistent tendency for any of the major components of the CPI indexes to rise faster than the others we do not expect the differently weighted indexes to experience significantly different growth rates in the long-term future.

Your second question relates to statutory authority to use the CPI-W as opposed to the CPI-U, for determining Social Security cost-of-living adjustments (COLA's). Section 215(i)(1)(D) of the Social Security Act specifies that the COLA be based on the "Consumer Price Index ... (as prepared by the Department of Labor)" with no clarification as to which specific index should be used. Back in 1972, when the automatic COLA provision was passed, there was only one CPI--the Consumer Price Index for Urban Wage Earners and Clerical Workers--and thus no further specification was necessary. In 1978, however, an additional index was created--the Consumer Price Index for all Urban Consumers. The old index--designated the CPI-W--and the new index--designated the CPI-U--have been published for each month beginning with January 1978.

Thus, a question was raised as to which of the two indexes should be used for the COLA determination. The Office of Management and Budget, after consultation with the Department of Health and Human Services (formerly the Department of Health, Education, and Welfare), decided that, in the absence of specific legislation providing for the use of the new CPI (the CPI-U), the CPI-W should be used in determining Social Security COLA's because it represented a continuation of the old CPI.

Your third question relates to whether Social Security beneficiaries have confidence in the currently used CPI as a measure of inflation. We believe that most beneficiaries are unaware that more than one consumer price index exists. The fact that both of the indexes prepared by the Department of Labor are expected to rise at essentially the same rate in the future suggests that it may not be important for the beneficiaries, in general, to be concerned about the distinction. However, public confidence in the accuracy of the price index(es) in general is of great importance. It is our belief that the design and monthly preparation of the indexes by the Bureau of Labor Statistics, in the Department of Labor, are done in a thoroughly competent and professional manner.

If we may be of any further assistance on this matter, please let me know.

Sincerely,

Harry C. Ballantyne

Harry C. Ballantyne
Chief Actuary

AARP

December 8, 1988

The Honorable John Melcher
United States Senate
Special Committee on Aging
Washington, D.C. 20515

Dear Senator Melcher:

As you requested in your follow up letter to the October 5 hearing on "Cost of Living Adjustments and the CPI", We have reviewed our correspondence files for examples of members of the American Association of Retired Persons (AARP) having difficulty keeping up with inflation in housing and medical costs. AARP receives numerous letters each month relating how Social Security cost-of-living adjustments (COLAs) do not cover the rising costs of housing and medical care.

Those that write concerning rising housing costs tend to be renters living in areas without rent control. For instance one Brooklyn, New York member writes:

> "As you are well aware, we are faced with a serious housing shortage which affects everyone, but mostly the people forced to live on small, fixed incomes from Social Security, pension, etc. These people, myself included, are unable to pay the astronomical rents being asked for the few available rental apartments. The coops and condominiums are entirely out of our reach because we don't have the kind of money they require. This situation has forced many out into the streets, and into shelters or other sub-human living situations."

Others write that their rent increases are higher than their COLAs every year. This year many have said their increases have been seven to ten percent. A 71 year old California member writes that he returned to work because his rent increased 7 percent and was assessed for retroactive maintenance and capital improvements.

Letters concerning the high cost of medical care focus on the combined costs of the increase of Medicare Part B premiums and private health insurance. Although hold-harmless legislation prevents Social Security beneficiaries from receiving lower benefit checks as a result of Part B premium increases, the increase in health insurance premiums often consumes any increases Social Security recipients may have.

One Spring Hill, Florida member writes that he had no benefit increase in 1988 and with the increase in his Blue Cross health insurance premiums he will have "about $4 or $5 less than last year a month." Another member writes that she represents "a proud class of people", and wonders how far she can go to maintain her dignity. She lost her health insurance when she became a widow after her husband's long illness.

In summary, many of our members have difficulty in keeping up with rising medical and housing costs and find their Social Security COLAs inadequate in meeting these expenses. If you have further questions, please contact Kathleen Scholl on my staff at 728-4705.

Sincerely,

John Rother

John Rother
Director Legislation,
Research and Public Policy

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

DEC 1 1988

Honorable John Melcher, Chairman
Special Committee on Aging
United States Senate
Washington, D. C. 20510-6400

Dear Mr. Chairman:

I appreciate your continued interest, as expressed in your October 26th letter, in the views of OMB on the issue of what price index should be used in government COLA calculations. I am happy to explain further the reasons why OMB did not recommend substituting the CPI-U for the CPI-W in calculating those COLAs in its written testimony, submitted to your Committee in October.

OMB last testified on this issue in 1980. Since then, there have been major revisions in both CPI-U and CPI-W. The treatment of homeownership costs was changed for CPI-U in 1983 and for CPI-W in 1985. In 1987, the "market basket" that is priced out to compute each index was revised for both CPI-U and CPI-W. We have not systematically analyzed the indexes since these revisions, and we did not have the time to review the issue before your hearing on October 15, to see how these changes may have altered what is the the best price index to use in government COLAs. Without a thorough study, we believe that it would be premature to conclude that what seemed to be the best choice eight years ago remains so today.

Both CPI-W and CPI-U are accurate broad-based measures of consumer prices that tend to change at the same rate. Over the last 12 months, the increase in CPI-U was 4.17 percent, while the increase in CPI-W was an almost identical 4.13 percent. Our best estimate is that the two indexes will change in the future at the same rate. In view of this, there does not seem to be any compelling reason to substitute CPI-U for CPI-W. It is true that, in the past, the two indexes have occasionally diverged. The most serious divergence occurred in 1983 and 1984 because of a temporary difference in the way the two indexes measured the costs of homeownership, but that difference has since been eliminated, and now both indexes measure homeownership costs in the same way.

In view of this, substituting CPI-U for CPI-W is unlikely to alter future COLA payments in any significant way, and there would seem to be no good reason for making a substitution at the present time. In addition, a change to the CPI-U could be viewed as disrupting the bipartisan National Commission on Social Security Reform agreement (enacted in the Social Security Amendments of 1983) that restored Social Security to solvency. The Commission unanimously recommended that Congress "not alter the fundamental structure of the Social Security program or undermine its fundamental principles."

Please let us know whenever we may be of assistance.

Sincerely,

Joseph R. Wright, Jr.
Director

APPENDIX 3

Executive Director
Lawrence T. Smedley
Washington, DC

National Council of Senior Citizens

President
Jacob Clayman
Silver Spring, MD

925 Fifteenth Street, N.W. • Washington, D.C. 20005 • (202) 347-8800

Statement of the

National Council of Senior Citizens

For Submission to the

Senate Special Committee on Aging

Hearing on

COLAs and the CPI

October 5, 1988

The National Council of Senior Citizens (NCSC) appreciates this opportunity to comment on proposed changes to the Consumer Price Index for Social Security purposes.

The Social Security cost-of-living adjustment (COLA) plays a critical role in the lives of millions of retirees, survivors and dependents. Increases in the COLA are responsible, almost singlehandedly, for improving the living standard of our nation's older citizens. Only with the improvement and regular indexation of Social Security benefits did poverty among the elderly begin to decline significantly. As recently as 1970, one-quarter of the elderly lived in poverty, double both the overall poverty rate and the current incidence of poverty among the aged. Today, annual adjustment of benefits prevents millions of persons from slipping further and further behind increasing costs.

Social Security comprises the single largest source of income for older Americans--38 percent overall. Aged households with total income below $10,000 annually (nearly half of all aged households) receive three-quarters of their income from Social Security. Viewed in this context, the annual COLA is of paramount importance for Social Security beneficiaries, particularly those with low incomes.

For this reason, NCSC supports both efforts to evaluate whether current measures for adjusting benefits are accurate and implementing changes where appropriate. We commend Senator Melcher for his leadership on this important issue.

Current practice calls for Social Security COLAs to rise with increases in the Consumer Price Index for wage earners and clerical workers, or CPI-W. This measure constitutes only about 32 percent of the national population and excludes retired persons from its expenditure weights. The Bureau of Labor Statistics (BLS) also conducts a broader measure, the CPI-U, that measures all urban consumer units and covers about 80 percent of the population.

Last year, the BLS conducted an experimental study to determine the effect of a CPI for the elderly and to compare this measure with the CPI-W and CPI-U. Significantly, the highest COLAs resulted from the experimental index (CPI-E); the lowest COLAs from the CPI-W, the one actually used. The CPI-U yielded an intermediate measure. For the years 1984 through 1987, the CPI-W resulted in an average annual COLA of 3.0 percent. The CPI-U would have averaged 3.4 percent annually, and the CPI-E would have increased an average of 3.7 percent.

These differences may appear small, but even small increases, compounded over years of retirement can make a large difference in a retiree's purchasing power.

The experimental measure, however, must be viewed cautiously. The BLS has noted that the survey was limited in scope and cannot be considered as accurate as other indices. But the BLS did note that, "...one thing is clear from this study: the experimental index, reweighted to incorporate the experience of older consumers, behaved more like the CPI-U than the CPI-W."

NCSC supports legislation calling for the immediate use of the CPI-U for updating Social Security COLAs. It is evident that

this measure more closely matches the experience of older beneficiaries. There would seem to be no rational basis for continued use of the CPI-W.

The BLS experimental study noted several areas that would be appropriate for further study in developing a CPI specifically for use in adjusting Social Security benefits.

They appropriately noted that one-fourth of all Social Security beneficiaries are not elderly. As such, a CPI-E would not be a better measure for adjusting benefits for all Social Security beneficiaries.

The components most responsible for the differences in the experimental CPI-E were shelter and medical costs. The BLS recommended, and NCSC concurs, that additional study on medical expenditures is warranted. We also agree with the BLS that any new index should be as fully accurate and reliable as existing measures. Consequently, larger samples and more detailed study are needed before a new measure can be implemented. A new index must also be tested over an adequate duration of time. This additional study, as called for in Senator Melcher's legislation, should result in a more adequate information base from which to make future decisions, and is supported by NCSC.

Social Security beneficiaries rightfully expect that their payments will be adjusted to keep pace with inflation. If the promise of a COLA is to be meaningful, it must accurately reflect the true cost increases of beneficiaries. NCSC strongly supports measures to ensure that retirees, dependents and survivors are compensated adequately.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT

OF

JAMES C. MILLER III

DIRECTOR

OFFICE OF MANAGEMENT AND BUDGET

before the

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

OCTOBER 5, 1988

I welcome this opportunity to respond to the Chairman's question about the appropriate measure of inflation to use in making cost of living adjustments in Federal retirement programs. I am sorry that I am unable to appear before the Committee. As you are aware, I have resigned as Director of the Office of Management and Budget (OMB), effective October 15th, and am devoting my time and efforts to completing the Gramm-Rudman-Hollings Sequester Report due at the end of next week, insuring a smooth transition, and facilitating the production of the FY 1990 Budget, which must be presented to Congress on January 9th, an unusually early date.

Currently, the Bureau of Labor Statistics does not have a fully developed measure of the consumer prices paid by the elderly -- as opposed to the non-elderly, for example. Today, the CPI-W is used to make COLA adjustments for Social Security. The consumers whose purchases are reflected in this index are urban wage earners or clerical workers. The index does not include retired workers in its sample. The other leading measure of consumer prices compiled by the Bureau of Labor Statistics, CPI-U, does include retirees, but it also includes a broad range of other urban consumers whose expenditure patterns may differ from those of the elderly. The fact that neither index reflects purchases of the elderly alone is relevant only in so far as the purchases of the elderly differ from those of the non-elderly and the true index reflecting purchases by the elderly would differ from these two. (The true index could be either higher or lower, at least in theory.)

Despite differences in coverage, the two indexes -- CPI-W and CPI-U -- have been relatively consistent with one another. Indeed, it is the practice of OMB, in preparing our budget estimates, to assume that the proportionate increases in the two indexes will be identical in future years. Under our normal forecasting practices, it would make no difference to projected outlays if CPI-U replaced CPI-W in the COLA formula for Social Security, or anywhere else in the Budget.

Changes in Consumer Price Indexes, 1961-1987
(in percent, December to December)

Year	CPI-W	CPI-U
1978	9.0	9.0
1979	13.4	13.3
1980	12.6	12.5
1981	8.6	8.9
1982	3.8	3.8
1983	3.3	3.8
1984	3.5	3.9
1985	3.6	3.8
1986	0.6	1.1
1987	4.5	4.4

The CPI-U was introduced in 1978. As the table clearly shows, prior to 1983 there was little difference between the two price indexes, and there was no tendency for one to exceed the other. From December 1977 until December 1982, the average annual percentage change in both CPI-U and CPI-W was about 9.5 percent. Over this period it would have made essentially no difference which index had been used in the COLA formulas.

The main shortcoming in both CPI-U and CPI-W prior to 1983 and for CPI-W prior to 1985 was the treatment of home ownership costs. The cost of home ownership was calculated as the full amount that would be paid by home buyers during the period that they could be expected to own the home -- that is, the purchase price and the total amount of all mortgage interest payments for 15 years. These are large amounts, compared with the current incomes and expenditures of most households. They were treated as expenses only for those who actually bought houses -- about 3 percent of all households in a given year. For the other 60 percent that already owned a home and did not buy another one during the year, no home ownership costs were computed other than current outlays for property taxes, insurance, and repairs.

This procedure gave too much weight to changes in housing prices. During periods of inflation, these prices rise more rapidly than prices in general, because houses are an asset as well as a consumer good. Inflationary pressures during the late 1970s, for instance, caused problems primarily for those seeking to buy a house for the first time. Families that owned their homes before the inflation developed (that is, most families) enjoyed substantial real capital gains. For such families, the price increase reported in the CPI was an increase in wealth, not an increase in the cost of living. In fact, houses proved to be the best hedge against inflation available to most households.

The CPI also overemphasized changes in mortgage interest rates, which are notoriously volatile. During the early 1970s, the effect of these changes on the CPI was not particularly great. By the end of the 1970s, however, mortgage rates had risen dramatically. By 1979, the home ownership component amounted to 25 percent of the entire CPI -- far in excess of the share that owner-occupied housing actually represented in the typical household budget.

Thus, the old procedure was especially misleading for measuring the housing expenses of the elderly. Relatively few of them take out a mortgage when purchasing new housing. A frequent practice, when the elderly buy housing, is to pay cash using the equity built up in a previous home.

The CPI's measurement problem was widely recognized. Several independent analysts constructed alternative indexes that included the increase in the value of the home as an offset to the increase in its price. These measures showed a much smaller increase in the cost of owning a home during the 1970s.

The Bureau of Labor Statistics was aware of the measurement problem but was unable to correct it until 1983 for CPI-U and 1985 for CPI-W. The Bureau now measures homeowners' housing costs as the "rental equivalence," or the amount that would have to be paid if the owner actually rented the home from someone else. The rental equivalence measure is also used in the National Income and Product Accounts.

Alternative Measures of the Cost-of-Living

	CPI-U-X1, December over December	Fixed Weighted Price Index for Personal Consumption Expenditures, Fourth Quarter over Fourth Quarter
1968	3.8	4.0
1969	5.2	4.6
1970	4.7	4.6
1971	3.3	3.7
1972	3.4	3.6
1973	8.4	7.2
1974	11.0	10.3
1975	6.6	6.8
1976	5.0	5.0
1977	6.3	6.5
1978	8.0	7.5
1979	10.7	9.7
1980	10.7	10.6
1981	8.5	7.9
1982	5.1	4.8

The second table (above) depicts an alternative version of the CPI, called CPI-U-X1, which shows how the new definition of housing costs would have applied to the earlier period. The Commerce Department's fixed weighted price index for personal consumption expenditures is also shown. Both rose much less sharply in the late 1970s than did the two official CPI's. In the peak year of the inflation, the discrepancy was over two percentage points. Correcting the measurement of home ownership costs greatly improved the representativeness of both CPI-U and CPI-W. No shortcoming of this magnitude currently exists in either index.

The existing versions of CPI-U and CPI-W are excellent statistics. They accurately measure changes in the consumer prices facing the average citizen. They do not necessarily reflect, however, the particular consumption patterns of all subgroups in the population. If it is desired to compute a CPI that is more reflective of the spending patterns of the groups actually receiving government pensions, a number of difficult conceptual issues will have to be resolved.

First, it is not correct to assume that all Social Security beneficiaries are elderly. Many are not. About 20 percent of those receiving Social Security benefits are younger people who receive benefits because of disability or because they are the surviving spouse or the minor children of covered workers. Not only do some of the non-elderly receive Social Security, some of the elderly do not. Calculations of how the CPI varies based upon the age of the consumers in the sample survey cannot reveal how the index would change if only Social Security beneficiaries were surveyed.

A perfect adjustment for changes in living expenses would require a separate price index for each family receiving government benefits. Not all of the elderly have the same pattern of expenses and adopting a revised CPI based on the expenses of a typical elderly family may in fact provide less adequate inflation protection for many couples and individuals. Any revision could disadvantage those whose pattern of expenses is closer to the norm for the working population. The differences in the cost-of-living within any large group of the population far exceed the differences in <u>average</u> living costs between such groups.

Preparing a separate CPI for the purpose of replacing CPI-W in the Social Security COLA formula would be no simple undertaking. As the Bureau of Labor Statistics has carefully pointed out, the data needed to prepare such an index are not currently available. It would require new surveys of the same order of magnitude and which could cost as much as the exhaustive surveys now conducted in preparing CPI-U and CPI-W. A new sample of purchasers would be needed as well as a new survey of retail outlets. Before proceeding with such an expenditure, it would be well to know that it was really necessary.

The recent study by the Bureau of Labor Statistics, conducted at the Committee's request, presented an experimental estimate of a CPI for the population over age 62. The study recognized and thoroughly discussed a number of shortcomings in this experimental measure. In view of these limitations, it is not possible to conclude that the elderly have seen a more rapid increase in their living costs since 1982 than the rest of the population. The question is simply not answerable with existing data. At this time, it is not possible to calculate a CPI for the elderly, because the Bureau of Labor Statistics currently does not know which stores the elderly shop at, nor does it know exactly which goods they purchase and in what quantities within the large groupings of goods that go to make up the CPI. The significance of price discounts for elderly consumers cannot be assessed with existing data.

Even with these limitations, the experimental measure reported by the Bureau of Labor Statistics reveals some interesting information about recent inflation trends and the expenditure patterns of the overage 62 population. Essentially all of the difference between CPI-W and the experimental index can be accounted for by two subcomponents of the indexes: shelter and medical care. Housing differences have already been discussed. To summarize, housing expenses rose more in the experimental index essentially because it uses the current method of measuring home ownership costs for the entire period; CPI-W uses it only since January 1985. This discrepancy also accounts for most of the difference between CPI-U and CPI-W in the 1983-1984 period. This difference has been eliminated since 1985 and will not cause a divergence in the future.

The other reason for the difference between CPI-W and the experimental index is the higher share of medical expenditures in the budgets of the elderly. This factor may also be eliminated or at least reduced in future years. This year Congress passed, and the President signed, catastrophic health insurance legislation, which will cover, under Medicare, many of the expenditures which are now being made out-of-pocket by elderly Social Security beneficiaries. When this program is fully in place, many of the items that formerly would have been included in a survey of consumer expenditures will no longer be purchased directly by the elderly. One effect of this should be to reduce the share of medical expenditures in the budgets of elderly consumers.

I share the Committee's interest in ensuring that Social Security beneficiaries and other retirees are adequately protected against inflation. Social Security beneficiaries have in fact been well protected from inflation over the last decade and a half under the existing cost-of-living provisions in the program. A recent Congressional Budget Office study reports that families headed by individuals age 65 or older experienced the largest real income gains of any age group between 1970 and 1986. Poverty rates among the elderly have been cut in half over this period. The current Consumer Price Indexes prepared by the Bureau of Labor Statistics have been carefully developed, and are the best available measures in this country, and indeed in the world. Inasmuch as the problem with home ownership costs has now been corrected in both the CPI-W and the CPI-U, the two indexes can be expected to move closely together in the future. Thus, it would appear that any reasonable alternative measure of the cost of living for Social Security beneficiaries is likely to rise in the future at nearly the same rate as either of the established indexes.

In view of this, I do not believe any changes are needed at the present time in the method used to adjust Social Security benefits for changes in the cost-of-living.

○