Chapter 15

CONSUMER PRICE INDEX FOR THE ELDERLY

The law establishing the National Commission directs it to investigate the need for a special consumer price index for the elderly, and the effect which the use of such an index would be on Social Security benefits.

Current Provisions

Under an amendment passed in 1972, Social Security benefits are increased each June to take account of rises in the Consumer Price Index which occurred in the previous year. The intent of the law is to assure "...that the purchasing power of Social Security benefits will not be seriously eroded by inflationary changes in the economy."1/ The benefit increase is equal to the percentage rise in the average of the monthly Consumer Price Index for the first calendar quarter of the year over the average for the first quarter of the preceding year. However, no increase is provided if the rise is less than three percent.2/

The directive to the Commission grew out of Congressional concern that the current Consumer Price Index which was developed

1/ Committee on Ways and Means, The Social Security Amendments of 1971, H. Rept. No. 231, 92nd Congress, 1st Session, p.40.

2/ For example, the average of the monthly Consumer Price Indexes for urban wage earners and clerical workers for January, February and March 1979 was 207.0 and the average for the same three months in 1980 was 236.6. Dividing 236.6 by 207.0 shows that the rise in the Index was 14.3 percent. As a result, benefits for June 1980 were increased 14.3 percent.

to measure changes in the economy as a whole, understates the rise in the cost of living for older people. If this were true, Social Security beneficiaries would be receiving less than intended and a special computation of their living costs would be necessary. On the other hand, some critics of the Consumer Price Index say it overstates inflation because of the weight given to the costs of home purchase, and by implication, results in Social Security benefit increases higher than needed to keep up with the true rise in the cost of living for Social Security beneficiaries.

A special Consumer Price Index for the elderly would presumably take into account differences between the elderly and the rest of the population in the goods and services purchased, the geographic areas in which they live, and the types of stores they patronize. It is known that the aged tend to spend a higher proportion of their income on food to be consumed at home, on home heating and household operation, and on medical care. They are also much more likely to own mortgage-free homes. They tend to spend relatively less than other people on restaurant meals, transportation, clothing, home furnishings and recreation.

There are also differences in the rate at which the price of some goods and services change compared to an average for all items. During certain periods, prices have risen more rapidly for goods and services for which the aged spend a relatively high proportion of their income, and during other periods the reverse has been true.

A special problem is presented by measurement of changes in the costs of housing for the Consumer Price Index. Changes in housing costs reflect changes in the costs of both rented and owned dwellings, with a heavy weight assigned to changes in the cost of purchasing a new home, based on the frequency of home purchase during the survey period, 1972-74. Because the aged are not nearly as likely as the younger population to purchase a new home, the weight assigned to homeownership-cost changes would be substantially smaller in an index for the aged than in the Consumer Price Index.

The aged tend to be concentrated in areas with warm climates (to which the retired migrate) or in economically depressed areas (from which younger people migrate). The separate effect of these geographical differences on changes in the price of goods and services purchased by the elderly is not known.

Very little is known about the shopping patterns of the aged. It is known that they drive less, but whether this means that their shopping is concentrated in stores with pricing policies different from the general population is not clear.

To produce a special price index for the elderly, in the same manner as the Consumer Price Index was developed, would take extensive surveys to determine the items to be priced, the weights to be assigned to the price changes, and the outlets to be sampled. Because the aged have a different geographical distribution than the rest of the population, it also might be necessary for the Bureau of Labor Statistics to draw a special sample of cities.

In order to judge whether such an index is needed, the Commission reviewed an experimental index, constructed by adjusting the current Consumer Price Index for the factors discussed above, subject to the limitations of available knowledge.[3/] This experimental index, shown in Table 15-I for 1969-1979, differs relatively little from the Consumer Price Index now used to adjust Social Security benefits. The average annual rate of increase shown by the experimental index for the elderly was 7.1 percent from 1969 to 1979, compared with the 7.4 percent shown by the regular Consumer Price Index.

3/ Prepared for the Commission by Joseph J. Minarik of the Brookings Institution, Washington, D. C.

TABLE 1

EXPERIMENTAL SPECIAL PRICE INDEX FOR THE ELDERLY*

[1968=100]

		ANNUAL RATE OF CHANGE	
YEAR	SPECIAL INDEX	SPECIAL INDEX	CPI
1969	113.6	--	
1970	118.8	4.6	5.5
1971	123.2	3.6	3.4
1972	127.4	3.4	3.4
1973	140.0	10.0	8.8
1974	158.0	12.8	12.2
1975	168.9	6.9	7.0
1976	176.7	4.6	4.8
1977	186.1	5.3	6.8
1978	202.3	8.7	9.0
1979	225.0	11.2	13.3
Average		7.1	7.4

* Index values for December of the stated year; rates of change for December of the stated year over December of the preceding year. Percentage changes computed from unrounded data.

Source: Joseph J. Minarik, the Brookings Institution

In three years early in the decade, the inflation rate of the special index was higher, and in one year it equaled the CPI. This is because inflation in those years was concentrated in food and energy, where the elderly spend more of their income. In the later years, the special index rose more slowly because inflation was concentrated in housing, where the elderly spend less than the younger population.

The importance of housing in these conclusions, and the controversy over the alleged tendency to overestimate inflation due to the treatment of housing in the Consumer Price Index, suggested an experimental computation. This compared inflation rates using the annual expenditure (in cash) on housing as the housing weight, and the price index for residential rent as the index for all housing expenditures, for both the elderly and the population at large.

As shown in Table 2, treating housing in this way eliminates most of the annual differences between the elderly and general inflation rates but does not reverse it. Averaged over the decade, the inflation rates are identical. The results suggest that if a special price index for the elderly were to be computed, it would probably be quite similar to the Consumer Price Index, whether the current or the most likely alternative treatment of housing were used.

TABLE 2

APPROXIMATE PRICE INDICES FOR ALL URBAN CONSUMERS AND THE ELDERLY, USING RENTAL EQUIVALENCE COST OF HOME OWNERSHIP*

[1968-100]

YEAR	INDEX FOR THE ELDERLY	ANNUAL RATE OF CHANGE	INDEX FOR ALL URBAN CONSUMERS	ANNUAL RATE OF CHANGE
1969	117.9	--	118.0	--
1970	124.4	5.6%	124.8	5.7%
1971	128.7	3.4	128.9	3.3
1972	132.8	3.1	132.9	3.1
1973	140.0	5.5	140.0	5.4
1974	155.0	10.7	154.6	10.5
1975	165.2	6.6	164.9	6.6
1976	175.3	6.1	175.1	6.2
1977	186.1	6.1	186.1	6.3
1978	203.2	9.2	202.4	8.8
1979	225.7	11.1	225.8	11.5
Average		6.7		6.7

*Index values for December of the stated year. Rates of change for December of the stated year over December of the preceding year. Percentage change computed from unrounded data

Source: Joseph J. Minarik, the Brookings Institution

A more detailed study is in progress at the Bureau of Labor Statistics.[4/] This new study attempts to analyze the differences in average price indexes across households with various characteristics. The study also uses three different measures of housing costs and two special indexes which omit housing costs or, alterntively, the costs of both housing and durable goods. The differences between households headed by a retired person compared to those headed by a non-retired person are of particular interest. The Commission encourages the Bureau of Labor Statistics to continue its efforts so that definitive research will be available to assist in deciding the need for a special index for the elderly.

In any case, the Commission is concerned about using an index for the retired or for the elderly to adjust benefits for all Social Security beneficiaries. Slightly more than one-third of these beneficiaries are less than 65 years of age and more than 30 percent are under age 62 (as of the end of 1979). The younger group includes the disabled and their dependents, and surviving dependents of deceased workers. Knowledge of their spending patterns and the effects of inflation on these groups compared to the population at large is scarce to nonexistent.

The Commission recommends that the Congress should authorize the necessary funds and personnel for the Bureau of Labor Statistics

4/ Hagemann, Robert P., Inflation and Household Characteristics: An Analysis of Group-Specific Price Index, Office of Prices and Living Conditions, Bureau of Labor Statistics, (forthcoming).

to undertake the field surveys and analyses needed to determine how a special index for the elderly might be calculated and whether and to what extent it would be appropriate for adjusting the level of Social Security benefits for price increases for all Social Security beneficiaries. When such an index has been developed and compared with the current Consumer Price Index, the Secretary of Labor should report to Congress on whether such an index should be used to calculate increases in Social Security benefits. In any case the Commission does not support separate indexes for every beneficiary group.[A/]

In the meantime, one change is necessary. The Bureau of Labor Statistics now produces two consumer price indexes--one for urban wage earners and clerical workers (the CPI-W) and a newer one, introduced in January 1978, for all urban consumers (the CPI-u). The index now used to adjust benefits, the CPI-W, excludes the retired from its sample. The CPI-U includes the retired, and is a more broadly based measure of inflation generally. Although there has been little difference in the rate of change between the two indexes,[5/] the Commission believes that the CPI-U is more appropriate in the long-run for adjusting Social Security benefits than an index based on the spending habits of workers only. The Commission therefore recommends the use of the CPI-U instead of the CPI-W, which is currently used to adjust Social Security benefits.

5/ From January 1978 (when the CPI-U was first produced) to September 1980, the CPI-W increased by 34.5 percent while the CPI-U rose by 34.6 percent.

A/ See dissenting statement on a special index for the elderly by Mr. Laxson, Mr. MacNaughton, and Mr. Rodgers.