THE SENIOR CITIZENS LEAGUE

WHITE PAPER

ON

GOVERNMENT MANIPULATION OF THE CONSUMER PRICE INDEX TO MINIMIZE SOCIAL SECURITY COLA ADJUSTMENTS

AND

PROPOSED LEGISLATION

MARCH 17, 2015

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EXECUTIVE SUMMARY

In 1972, Congress created a system whereby Social Security benefits would be increased annually by an automatic **Cost of Living Adjustment** ("COLA") to ensure that the purchasing power of those benefits is not eroded by inflation. COLA increases are based on the **Consumer Price Index for Urban Wage Earners** (CPI-W) issued by the **Bureau of Labor Statistics** ("BLS") in the U.S. Department of Labor.

In 2013 and 2014, COLA increases were, respectively, 1.5 and 1.7 percent. Recipients of Social Security believe that COLA has not kept up with the rate of increase of the price of goods and services which they use. Informal surveys of price increases bear out the extent of the problem. Increasingly, recipients of Social Security benefits are asking "How can this be?"

Congress is fully aware that revenue from past Social Security taxes not needed then for benefits were not put aside in so-called **Social Security Trust Funds**. In fact, Social Security taxes were treated as any other tax revenue, and spent by members of Congress on their favorite programs. As the number of persons receiving benefits increases, there is increasing incentive to find ways to spend less than promised for Social Security benefits. One way to reduce such spending without overly reducing benefits is by having the BLS manipulate the manner in which CPI is calculated.

Although the public has been told that the CPI measure used for the COLA adjustments would preserve the purchasing power of Social Security benefits, the very nature of CPI has changed greatly over the past three decades. The changes in CPI made by the BLS have been anything but transparent to the American people, and BLS always claims that changes made have been necessary to make the CPI measure "more accurate."

In truth, however, the very nature of CPI has changed. No longer a measurement of the money necessary to purchase the same "market basket" of goods and services, CPI is now based on an ever-changing "market basket," which assumes that when prices increase, Social Security recipients faced with price inflation will change their purchasing patterns. No longer able to buy high quality goods that they can no longer afford, they substitute lower quality goods that they can afford. If the price of steak increases due to inflation, BLS assumes people will buy hamburger or chicken. Economists term this maintaining a "constant level of satisfaction." The BLS has manipulated the CPI data set so that it no longer measures price inflation — allowing benefits to increase only enough to adjust to a lower standard of living.

CPI was reported for calendar year 2014 to be 1.7 percent. By one estimate, CPI would have been 5.2 percent using the methodology in place as of 1990, and 9.4 percent using the methodology in place as of 1980. And, in recent years, many in the Executive and Legislative branches are not satisfied by the magnitude of these manipulations, but are attempting to shift to another measurement, called Chained COLA, which reports CPI numbers even lower than CPI-W.

The American people are entitled to both transparency and honesty from their government, but the way that the CPI-W measurement has been manipulated over the past three decades provides neither transparency nor honesty.

Armed with these facts, The Senior Citizens League, representing almost 1 million Social Security recipients, is now on a mission to extract the truth from the government, to educate recipients of Social Security, and to obtain a fair and just Social Security COLA.

Board of Trustees
The Senior Citizens League
March 17, 2015

REPORT

I. Americans Accurately Perceive that Prices They Are Paying Are Escalating Faster Than Increases in the Social Security COLA.

For many years, the Social Security Administration ("SSA") has assured Social Security recipients that Social Security Cost of Living ("COLA") adjustments would "ensure that the purchasing power of Social Security … is not eroded by inflation."[1] However, few persons receiving Social Security believe that benefits have kept pace with inflation. Certainly recipients did not believe that the January 2014 Social Security COLA of 1.5 percent compensated them for price inflation that occurred during 2013,[2] and they are not much more satisfied with the adequacy of the January 2015 COLA of 1.7 percent to maintain their purchasing power this year.[3]

The Senior Citizens League ("TSCL") 2014 Annual Survey of Senior Costs reflects the practical experience of many, if not most, recipients. The TSCL survey is based on the costs of "33 key items" that "are typical of the costs seniors must bear." That survey reveals that, since 2000, the Social Security COLA has increased benefits just **41 percent** while typical expenses paid by Social Security recipients have jumped **84 percent**, more than twice as fast.[4]

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[1] SSA, "Cost-of-Living Adjustments," SSA Publication No. 05-10526 (Oct. 2012) http://www.ssa.gov/news/cola/2013/factsheet.htm.

[2] http://www.ssa.gov/news/press/factsheets/colafacts2014.html

[3] http://www.ssa.gov/news/press/factsheets/colafacts2015.html

[4] TSCL, Seniors Lose 31 Percent of Their Buying Power Since 2000; 2014 Annual Survey of Senior Costs Finds Expenses Have Increased More Than Twice as Fast as Social Security COLA (May 15, 2014) (emphasis added). http://seniorsleague.org/2014/seniors-lose-31-percent- of-their-buying-power-since-2000/

As people who receive Social Security benefits have come to focus increasingly on this problem, through the work of groups such as TSCL, many have come to question the accuracy of the index used as a measure of inflation. A survey was taken of Social Security recipients by TSCL at the end of 2014, and when asked — "Do you believe the **government is manipulating** the CPI to cut spending on cost of living adjustments (COLAs)?" — a remarkable **98 percent of respondents said "yes."**[5]

For many months, TSCL has been studying the adequacy of the COLA to preserve the purchasing power of Social Security benefits — and if COLA has failed to do so, whether that failure was inadvertent or the result of a deliberate government policy. This White Paper explains what the Social Security COLA was designed to achieve, how COLA was originally calculated, how the method by which it is calculated has changed, and what can be done to return the Social Security COLA to reflect price changes so that it can achieve the promises that have been made to Social Security recipients.

II. The Operation of the Social Security Cost of Living Adjustment.

The Social Security Administration issued its first benefit check to Ida May Fuller on January 31, 1940. From that beginning, and continuing for over three decades, the level of Social Security monthly benefits was set directly by Congress which increased benefits numerous times, primarily to keep pace with price inflation.

[5] TSCL, "Social Security Recipients Think Government Manipulates CPI Data" (Jan. 5, 2015) (emphasis added). http://seniorsleague.org/2015/social-security-recipients-think-government- manipulates-cpi-data-2/

In 1972, President Nixon signed a law[6] which implemented automatic annual cost of living adjustments. *Id.*, Section 202. The Social Security COLAs are based on the changes in the **Consumer Price Index for Urban Wage Earners and Clerical Workers ("CPI-W")**, an index of price inflation published by the Department of Labor's Bureau of Labor Statistics ("BLS") since 1971.[7]

The 1972 law provided for automatic COLA increase only if CPI-W increased at least 3 percent annually. That 3-percent trigger was eliminated in 1986, and now the COLA increase is triggered if the annual increase in CPI-W is at least one-tenth of one percent (*i.e.*, 0.1 percent).[8]

CPI-W seeks to measure changes in prices of common products used by those households in which at least one-half of household income comes from wage earners in clerical, craft, and sales among other occupations with at least one worker employed for 37 or more weeks. This definition covers about 32 percent of the U.S. population.[9]

In 1978, BLS initiated another price index — the **Consumer Price Index for All Urban Consumers ("CPI-U")** — in order to take into account prices paid by a greater share

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[6] Public Law 92-336, 86 Stat. 406 (July 1, 1972) http://www.gpo.gov/fdsys/pkg/STATUTE-86/pdf/STATUTE-86-Pg406.pdf.

[7] *See* 42 U.S.C. § 415(i). http://www.bls.gov/cpi/.

[8] If the CPI-W change is less than 0.05 percent, there is no COLA increase for that year.

[9] Social Security COLA increases, if any, go into effect on January 1 of each year. Since data for all four quarters of the prior calendar year are not available on January 1, the SSA determines COLA by comparing the average CPI-W for the third quarter of the prior year to the average CPI-W for the third quarter of the year just concluded. Thus, COLA is based only on a comparison between corresponding quarters, not between full years.

of the U.S. population. CPI-U focuses on all of the CPI-W population **plus** households of salaried workers, part-time workers, self-employed, unemployed, and retirees, which now account for 87 percent of the population.

CPI-W is used to calculate the Social Security COLA, but CPI-U is used to adjust Medicare benefits. Over the last nine years, CPI-U and CPI-W have trended together,[10] as shown in Table 1.

Table 1
Comparison of CPI-W and CPI-U, 2006-2014

Calendar Year	CPI-W	CPI-U
2006	2.4%	**2.5%**
2007	**4.3%**	4.1%
2008	-0.5%	**0.1%**
2009	**3.4%**	2.7%
2010	**1.7%**	1.5%
2011	**3.2%**	3.0%
2012	1.7%	1.7%
2013	1.5%	1.5%
2014	0.3%	**0.8%**
Compounded	19.11%	18.53%

(Note: where the indices are different, the higher index number for each year is bolded.)

The COLA increases to Social Security benefits over the past decade are set out in Table 2.

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[10] In 1978 and 1979, CPI-U and CPI-W each were conducted as independent surveys. Since 1980, "BLS economists track spending and prices by using the CPI-U sample of geographic areas, outlets, items, and prices. The CPI-W is then derived by adjusting the weights for various spending categories, reflecting that the spending habits of the wage earner population differ somewhat from the all urban consumer population." *See* Stephen Reed and Kenneth Stewart, Bureau of Labor Statistics, "Beyond the Numbers: Why does BLS provide both the CPI-W and CPI-U?" vol. 3, no. 5 (Feb. 2014), http://stats.bls.gov/opub/btn/volume-3/why-does-bls-provide-both-the-cpi-w-and-cpi-u.htm.

Table 2
Social Security COLA increases effective January 1, 2005-2015

January 1	SS COLA
2005	2.7%
2006	4.1%
2007	3.3%
2008	2.3%
2009	5.8%
2010	None[11]
2011	None
2012	3.6%
2013	1.7%
2014	1.5%
2015	1.7%

Efforts to obtain a more accurate CPI measure for Social Security have centered on a different measurement of CPI, known as **Consumer Price Index-Elderly ("CPI-E")**. Congress directed the Social Security Administration to develop this index in the Older Americans Act of 1987. CPI-E is designed to measure the specific consumption patterns of Americans 62 years and older. This data set still is considered "experimental." CPI-E has been increasing at a slightly higher rate than CPI-W. For example,

> [o]ver the 5-year period from December 1990 through December 1995, the experimental price index has risen **15.9 percent**. This compares to increases of **14.7** and **14.1** percent for the CPI-U and CPI-W, respectively.[12]

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[11] Note that there were no Social Security COLAs in 2010 or 2011 because the average CPI-W in the third quarter of 2009 did not exceed that for the third quarter of 2008, and the third quarter of 2010 did not exceed that for the third quarter of 2009.

[12] http://www.bls.gov/news.release/cpi.br12396.a06.htm (emphasis added).

The Social Security Administration has postulated moving to CPI-E in December 2016, and estimates that, if adopted, this "new computation will increase the annual COLA by about 0.2 percentage point, on average."[13] Legislation to move Social Security (as well as certain other federal benefits programs) to CPI-E was introduced in both houses in the 113th Congress.[14] However, Congress has shown little appetite to enact any such legislation.

Additionally, proposals have been made in Congress for some years to base the Social Security COLA adjustment on the BLS price index called **Chained CPI-U** or **C-CPI-U** (which is commonly referred to as "**Chained COLA**"). TSCL has been active in opposing a possible move to Chained COLA[15] which would result in even smaller Social Security COLA benefits than under the current CPI-W.[16] The Social Security Administration estimates that "this new computation will reduce the annual COLA by about 0.3 percentage point, on average."[17] Only one bill appears to have been introduced to move Social Security to Chained-CPI-U in the 113th

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[13] http://www.socialsecurity.gov/OACT/solvency/provisions/cola.html

[14] Bills have been introduced in Congress to base Social Security COLA on CPI-E, such as: "CPI-E Act of 2014" (H.R. 4202, Rep. Michael Honda); "Protecting and Preserving Social Security Act" (S. 308, Sen. Mark Begich) and H.R. 649 (Rep. Theodore Deutch) and "Strengthening Social Security Act of 2013" (S. 567, Sen. Tom Harkin) and H.R. 3118 (Rep. Linda Sanchez).

[15] For example, TSCL's Chained COLA Calculator has been popular. http://seniorsleague.org/chained-cola-calculator/

[16] *See, e.g.,* Julie Whittaker, "The Chained Consumer Price Index: What is it and would it be appropriate for cost-of-living adjustments?" Congressional Research Service (June 12, 2013).

[17] http://www.socialsecurity.gov/OACT/solvency/provisions/cola.html

Congress,[18] but the White House included Chained-CPI-U in its FY 2014 budget submission.[19] And House Social Security Subcommittee Chairman Sam Johnson expressed support for Chained-CPI-U during hearings held by his Subcommittee.[20] On the other hand, two resolutions were introduced to express a nonbinding sense of Congress that Chained-CPI-U not be used.[21]

Many Social Security Recipients do not believe that the current CPI-W reflects real world conditions. CPI-E would be a more accurate measure, but the only option actively being considered by Congress is Chained CPI-U, which would be worse. The question remains, is CPI-W such an inadequate index of price inflation? To analyze this question, we begin with a review of the Social Security Trust Funds.

III. Social Security "Trust Funds" Are Inadequate to Protect Social Security Recipients.

Despite the reassuring name, most Americans realize that there are no actual funds in the so-called Social Security Trust Funds — only IOUs from the federal government. The Social Security Administration describes Social Security Trust Funds, as follows:

> The Social Security trust funds are **financial accounts** in the U.S. Treasury. There are two separate Social Security trust funds, the Old-Age and Survivors

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[18] H.R. 3639 (Rep. Jim Bridenstine).

[19] S. Losey, "Republicans praise Obama's proposal to adopt 'chained CPI,'" *Federal Times*, Apr. 18, 2013.

[20] *See*, *e.g.*, Ways and Means Committee, Subcommittee on Social Security, Hearing on Chained CPI, April 18, 2013. http://waysandmeans.house.gov/news/documentsingle.aspx?DocumentID=328602

[21] *See, e.g.,* S. Con. Res. 15 (Senators Tom Harkin, Sheldon Whitehouse, Bernie Sanders); H. Con. Res. 34 (Rep. David Cicilline).

> Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits.
>
> Social Security taxes and other income are **deposited in** these accounts, and Social Security benefits are **paid from** them. The only purposes for which these trust funds can be used are to pay benefits and program administrative costs.
>
> The Social Security trust funds **hold money not needed** in the current year to pay benefits and administrative costs and, by law, **invest** it in special Treasury **bonds** that are guaranteed by the U.S. Government. A **market rate of interest is paid** to the trust funds on the bonds they hold, and when those bonds reach maturity or are needed to pay benefits, the Treasury redeems them.[22]

Although this description of the trust funds is not inaccurate, it is not fully revealing of the fact that, rather than preserving excess funds paid into the "Trust Funds" during years of plenty, the federal government spent every penny of these funds, replacing them with paper IOUs.

At the end of 2012, about **58 million people were receiving benefits** as part of Social Security's Old-Age, Survivors, and Disability Insurance ("OASDI") program. The OASDI program consists of two parts:

1. Old-Age and Survivors Insurance ("OASI"), paying benefits to:
    - 41 million retired workers and their dependants; and
    - 6 million survivors of deceased workers,
2. Disability Insurance ("DI") paying benefits to:
    - 11 million disabled workers and their dependents.

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[22] http://www.socialsecurity.gov/news/press/factsheets/WhatAreTheTrust.htm (emphasis added).

During 2012, the last year data were available, **163 million people had earnings** covered by Social Security, and paid payroll taxes.[23] The U.S. Census estimated that the population of the United States in 2012 was **315 million** people.[24] This means that almost one in five Americans was receiving OASDI benefits that year. With the greying of America, only 2.9 people were paying payroll taxes for each person receiving benefits in 2012, and the number has only gone down since then.[25]

With the maturation of the baby-boomer generation, many more OASDI beneficiaries are coming on line every year than the number of new workers paying into the program. The nation's 65-and-older population is projected to reach 83.7 million in the year 2050, almost double the 2012 level of 43.1 million.[26]

The number of Americans qualifying for disability benefits has skyrocketed in the past three decades.[27] Although OASI and DI trust funds are currently separate, greater spending on DI could mean less funds are available for retirees (OASI). There appears to be little chance that disability program cost will decrease, or that taxes will be increased.

The Social Security system is troubled and faces a troubled financial future. The most recent Social Security Trustees Annual Report (issued July 28, 2014) shows the following:

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[23] *See* 2014 Annual Report of the Trustees, p. 2, http://www.ssa.gov/oact/tr/2014/tr2014.pdf.

[24] http://quickfacts.census.gov/qfd/states/00000.html

[25] 2014 Annual Report of the Trustees, p. 57, Table IV.B2.

[26] http://www.census.gov/newsroom/press-releases/2014/cb14-tps59.html

[27] C. Joffe-Walt, "Unfit for Work: The startling rise of disability in America," National Public Radio. http://apps.npr.org/unfit-for-work/

- the projected asset reserves of the various OASI Trust Fund are anticipated to be inadequate within the next **10 years** (Trustees Report, p. 2);
- the reserves of the DI Trust Fund are expected to be depleted in **2016**, and continuing income is expected to cover only about 81 percent of costs at that time (*id.*, p. 3);
- the combined reserves of the OASDI Trust Funds are projected to increase until 2020. Beginning in **2020**, annual costs will exceed income, and reserves will begin to decline (*id.*); and
- the reserves of the OASDI Trust Fund, used to pay retired workers, will be depleted in **2033** (*id.*).

The Trustees' Report candidly admits that "Future changes in [CPI-W] will directly affect the OASDI program through the automatic cost-of-living benefit increases." *Id.*, p. 93. Despite the relatively large average annual CPI increases between 1966-73, 1973-79, and 1979-89 (4.6 percent, 8.5 percent, and 5.3 percent, respectively), the Trustees' Report projects three scenarios, all with reasonably low rates of inflation:

(i) low-cost, 2.0 percent;
(ii) intermediate, 2.7 percent[28]; and
(iii) high-cost, 3.4 percent. *Id.*

One of the beliefs underlying these assumptions is the "Federal Reserve Board's monetary policy … toward more vigilance in preventing high inflation." *Id.* Of course, if the Federal Reserve's recent loose monetary policy[29] itself leads to higher-than-expected inflation, the future insolvency predicted in the Trustees' Report could occur even sooner.

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[28] The intermediate assumption dropped 0.1 percentage point in the 2014 report after remaining at 2.8 percent for the 2004 though 2013 reports. *Id.*, p. 94.

[29] The Federal Reserve's Federal Open Market Committee Quantitative Easing III ended in October 2014. http://www.federalreserve.gov/newsevents/press/monetary/20141217a.htm

IV. The Federal Government Has Many Reasons to Understate Price Inflation.

Elected officials draw much of their power and their ability to convince voters and special interests to support them and fund their campaigns by how they spend taxpayer money. As entitlements like Social Security and Medicare increase, discretionary spending decreases. Thus, there is every reason for Congress to seek to minimize increases in Social Security benefits. And there are many other pressures on Congress to understate various official measures of price inflation (referred to as "CPI" here). Inflation affects federal spending in the following ways:

1. A CPI measure is used to adjust federal retirement benefits under: (i) the Civil Service Retirement System ("CSRS"), (ii) the Federal Employees Retirement System ("FERS"), and (iii) for military retirement.[30]

2. A CPI measure is used to reflect food-price inflation in the non-cash benefits provided under the Supplemental Nutrition Assistance Program ("SNAP"), formerly called the Food Stamp program), which provides lunches for 26.5 million children.

3. A CPI measure is used to adjust Medicare benefits.

4. If the government reported a higher inflation rate, consumers might alter their behavior in ways that would displease politicians. Consumers might choose to convert dollar holdings into foreign currencies or precious metals. Lenders may charge higher rates for loans as they build inflationary expectation into the interest rates they charge. The citizenry could

[30] *See* CRS Report, "Inflation-Indexing Elements in Federal Entitlement Programs" (Apr. 24, 2013) http://www.fas.org/sgp/crs/misc/R42000.pdf.

lose confidence in the Federal Reserve as it would reveal that its loose money policies have stolen the purchasing power of the people's money — best viewed as a hidden tax.

5. The CPI is used as a "deflator" in certain other data sets published by the federal government.

6. Furthermore, with over $18 trillion in debt, the United States government is the largest debtor in the world.[31] With budget outlays of $3.5 Trillion for Fiscal Year 2014,[32] the United States paid $411 billion in interest alone in Fiscal Year 2014, based on a current historically low average interest rate of 2.4 percent.[33] If this average interest rate were to increase significantly, this would further reduce federal discretionary spending. For example, if the average interest rate were to double, paying an average interest rate of 4.8 percent on its existing debt would drain another $411 billion from the federal government.[34] If investors knew that the actual rate of inflation was higher than reported, they could be expected to demand a higher interest rate on the debt they would purchase from the federal government.[35]

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[31] "The Debt to the Penny and Who Holds It," http://treasurydirect.gov/NP/debt/current.

[32] Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2014 to 2024," http://cbo.gov/publication/45653.

[33] Public Debt, Average Interest Rate, August 2014, http://treasurydirect.gov/govt/rates/pd/avg/2014/2014_08.htm.

[34] This 4.8 percent illustration is not unreasonable, for the reasons discussed *infra*.

[35] It is estimated that two-thirds of current borrowing by the federal government comes from the Federal Reserve. *See* Bureau of the Fiscal Service, Treasury Bulletin, http://www.fiscal.treasury.gov/fsreports/rpt/treasBulletin/current.htm.

Although inflation affects everyone, it affects different people differently, and governments differently than people. As John Maynard Keynes explained:

> By a continuing process of inflation, **governments can confiscate**, secretly and unobserved, an important part of the **wealth of their citizens**. By this method they not only confiscate, but they confiscate *arbitrarily*; and, while the process impoverishes many, it actually enriches some. [J.M. Keynes, The Economic Consequences of the Peace, Harcourt, Brace and Howe, Inc. (1920), pp. 235-36 (emphasis added).]

If price inflation caused by an increase in the money supply constitutes a form of wealth confiscation, the federal government which creates that inflation can mask its confiscation of wealth from the American people by under-reporting the rate of inflation. At the very least, the federal government has an insurmountable conflict of interest.

Only two, relatively insignificant, offsetting factors have been identified which may cause politicians to be concerned about understating inflation: (i) a measure of CPI is used by the IRS to adjust federal income tax marginal rates to avoid "bracket creep,"[36] and (ii) the maximum individual contribution to political candidates is adjusted each election cycle based on a measure of CPI.[37] On balance, the federal government has a significant incentive to understate the various CPI estimates.

V. The Federal Government CPI-W Data Set Understates Price Inflation.

Social Security recipients know from personal experience that the Social Security COLA no longer allows them to maintain the same standard of living from year to year. They suspect that the annual COLA understates true price inflation, but they have not known

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[36] *See* 26 U.S.C. § 1(f).

[37] *See* 52 U.S.C. § 30116(c).

whether this was deliberate. This section discusses how, for almost 35 years, the federal government has actually changed the method by which CPI-W is calculated, thereby artificially reducing the index.

Unbeknownst to most Americans, the **federal government has made substantial changes in its CPI formula**, particularly since 1980, and most of these changes have had the effect of the index showing a lower and lower level of inflation. When there has been public explanation of these changes, it has been in the context of making the index "more accurate," and the reasons are discussed in ways that only academics could understand. Generally, the public has been unaware of these changes. Although this manipulation has been discussed occasionally in the economic and investment literature, it rarely has entered into mainstream public policy debate. TSCL appears to be the first Social Security advocacy group that has focused on this problem.

As discussed above, in simple terms, the Social Security Administration explains to the public the purpose of the Social Security COLA as follows:

> The purpose of the COLA is to ensure that the **purchasing power** of Social Security and Supplemental Security Income (SSI) benefits is **not eroded by inflation**.[38]

To maintain the same purchasing power, Social Security benefits would need to be increased as prices increase so recipients could maintain **a constant "standard of living."** That "standard of living" is measured in terms of **out-of-pocket expenses** incurred. Indeed, prior to 1945, CPI was known as the **"Cost of Living Index."** CPI measured the price of purchasing a

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[38] http://www.ssa.gov/cola/ (emphasis added).

"fixed-weight market basket of goods and services,"[39] and how the cost of that "market basket" changed over time. This is no longer the case.

Government economists began to develop alternate theories to gauge what they euphemistically called the "true cost of living," which took into account how consumers responded to price changes by changing what they purchased — changing the items in that "market basket." This generally assumed the **substitution of less-expensive goods for more-expensive goods**. No longer was CPI based on a fixed market basket of goods and services. Economists described consumer changes in spending as "maximizing the utility" of his money to maintain a "constant level of **satisfaction**."[40]

There are several illustrations as to how the government has changed the CPI measure. For example, if the price of steak becomes too high, the economists will assume that consumers out of necessity will switch to hamburger or chicken.[41] Based on the efforts of persons on fixed incomes to adapt to rising prices, BLS economists now change the items in

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[39] Of course, for many reasons, the items that were in that "market basket" may need to change. At one time there were no personal computers or cellular phones, while LP records and 8-track tapes are now no longer made. However, these types of necessary adjustments to the "market basket" of goods and services are distinguishable from the problem discussed in this paper.

[40] Common Misconceptions about the Consumer Price Index: Questions and Answers. http://www.bls.gov/cpi/cpiqa.htm It should be understood that the Social Security COLA was not designed to compensate retirees for growth in productivity in the economy, as wage earners would receive. Social Security COLA was only designed to protect retirees from the effect of price increases.

[41] The Boskin Commission Report, Toward a More Accurate Measure of the Cost of Living (Dec. 4, 1996), section IV, http://www.ssa.gov/history/reports/boskinrpt.html.

the "market basket." Without a fixed "market basket" to evaluate, the CPI index ceased to serve its basic function — preserving a constant "standard of living."

With Social Security and government retirees having been granted automatic COLA increases, a way had to be found to minimize the cost effect of those politically popular decisions without politicians being required to go on record to reduce benefits. With Congress unwilling to reduce Social Security benefits, **political pressure was put on bureaucrats at the Bureau of Labor Statistics by Congress** to manipulate the numbers to reduce the cost of the laws Congress had enacted.[42] Although the government always claims that its changes were made to make the index "more accurate," it is more than coincidence that these changes consistently have had the effect of lowering the stated rate of inflation.[43]

In 1997, the Congressional Budget office described the effect of these changes over just one seven-year period would be to reduce CPI significantly:

> Clearly, the combined effect of the BLS's changes on the CPI over the **1995-2000** period will be substantial. Taken together, the changes may reduce

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[42] According to one story, Speaker Newt Gingrich told BLS Commissioner Katherine Abraham, "If you could see your way clear to doing these things [minimizing CPI], we might have more money for BLS programs." John Williams, "Public Comment on Inflation Measurement and the Chained-CPI (C-CPI)," No. 515, *Shadow Government Statistics* (Apr. 8, 2013) ("Public Comment"), p. 4, http://www.shadowstats.com/article/no-438-public-comment-on-inflation-measurement.pdf. *See also* June 1997 BLS response to a letter from Congressman Jim Saxton, Chairman of the Joint Economic Committee, to Katharine Abraham, Commissioner of the Bureau of Labor Statistics (January 28, 1997). http://www.bls.gov/cpi/cpigm697.htm

[43] *See, e.g.,* 1999 Economic Report of the President ("A final reason for the slowing of reported price indexes has been methodological changes to both the CPI and the indexes used in the national income accounts.... In general, these changes have reduced the measured rate of inflation...."), http://fraser.stlouisfed.org/ docs/publications/ERP/1999/ERP_1999.pdf.

> measured inflation on the order of **0.7 percentage points** compared with what would have occurred if no changes in methodology had been made.[44]

Thus, BLS made a series of changes in the manner in which CPI is calculated that — perhaps depending on how you view government — either (i) were designed to, or (ii) had the effect of, reducing the CPI percentage changes. In either event, for recipients of Social Security, the result is the same.

The BLS changes are highly intricate. Economist John Williams, Ph.D. explains some of the techniques used by BLS economists since the 1980's.[45]

> 1. "BLS introduced: **Geometric weighting** — a purely … mathematical gimmick that automatically reduces the weightings of goods rising in price, and vice versa — it has no demonstrated relationship to consumer substitution of goods based on price changes. It was explained as a surrogate for a substitution measure."
>
> 2. "BLS introduced: **More frequent re-weightings** of the CPI index from every ten years to every two years, which moved the CPI closer to a substitution-based index, but the change was not considered a change in methodology."
>
> 3. "BLS introduced: **Ongoing re-weightings of sales outlets** (discount/mass-merchandisers versus Main Street shops), also moving closer to a substitution-based index and creating other constant-standard-of-living issues."
>
> 4. "BLS expanded **quality adjustments** to include the concept of **'hedonic' quality adjustments** [also known as hedonic adjustment modeling], altering the pricing

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[44] "The Economic and Budget Outlook: An Update, A CBO Report (Sept. 1997), p. 66. *See particularly* Appendix B (Changes in Calculating the Consumer Price Indexes). http://www.cbo.gov/publication/10351 (emphasis added).

[45] John Williams, Public Comment, p. 5; *see also* June 1997 BLS response to a letter from Congressman Jim Saxton, Chairman of the Joint Economic Committee, to Katharine Abraham, Commissioner of the Bureau of Labor Statistics (Jan. 28, 1997). http://www.bls.gov/cpi/cpigm697.htm

of goods and services for nebulous quality changes that often were not viewed or recognized by consumers as desired improvements."

5. "[T]he government mandated the use of a gasoline formulation that purportedly would improve auto emissions. That added ten cents per gallon to gasoline costs, but that cost was excluded from CPI calculations. The person filling his or her gas tank, however, suffered the actual out-of-pocket expense." (Emphasis added.) BLS may have provided fancy sounding economic and mathematic terminology as camouflage for its manipulation, but the result has been to systematically reduce the level of benefits paid to seniors.

These and other incremental changes made by BLS have largely escaped public notice. The attached list of "Selected Authorities" demonstrates that discussion of this issue in technical publications dates back to the mid-1990's. However, it was not until Economist John Williams, Ph.D. began writing about the topic in 2004, that the government felt compelled to defend the integrity of its CPI index through several articles and publications. And, it was not until 2010 that articles such as "The CPI Is Broken. Here's Why" began to appear in the financial and investment press (*e.g.*, The Motley Fool, Daily Finance, The Financial Physician, Market Shadows, Forbes).[46] Still, only rarely has the story broken into the public policy press, such as a December 19, 2012 article in Daily Kos with the provocative title "Understating the CPI, or Starving Grandma 101."[47]

In one of its defenses to criticisms, the BLS published an article entitled "Addressing misconceptions about the Consumer Price Index."[48] This article denies that CPI would account

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[46] References to these articles appear in the Selected Authorities, *infra*.

[47] http://www.dailykos.com/story/2012/12/19/1172060/-Understating-the-CPI-101-or-Starving-Grandma

[48] John Greenlees & Robert McClelland, "Addressing misconceptions about the Consumer Price Index," Department of Labor Monthly Labor Review (Aug. 2008).

for substitution between steak and hamburger, but only for what it calls "close substitutes," such as shifting within the category of "nonfrozen non-carbonated juices and drinks." Apparently, BLS later clarified that denial on its website, revising its point to deny a somewhat different strawman argument: "[T]he BLS is not assuming that consumers substitute hamburgers for steak."[49] BLS denials are difficult to understand, since it is unquestioned that BLS accepts the view that it is "more accurate" to track consumer **changing consumption patterns** away from more expensive goods and services than to maintain a **fixed "market basket" of goods and services**. BLS prefers measurement of a **substitution-based "market basket."**

Should Chained COLA be adopted by Congress, matters will only get worse, since **Chained COLA is a fully substitution-based version of CPI**, artificially designed to reduce COLA adjustments for programs like Social Security. Both CPI-W and Chained COLA are dishonest and flawed measures; TSCL opposes use of either index.

VI. Further Manipulation of the CPI-W Data Set in 2015 Has Been Announced.

On October 22, 2014, the Bureau of Labor Statistics announced that it would be changing, yet again, its method of estimating CPI, effective with the release of the January 2015 CPI on February 26, 2015. This change is described as follows:

> The **new estimation system**, the **first major improvement** to the existing system in over 25 years, is a redesigned, state-of-the-art system with improved flexibility and review capabilities. In addition, this change eliminates paper in all steps of producing the CPI. The use of the **Constant Elasticity of**

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http://www.bls.gov/opub/mlr/2008/08/art1full.pdf

[49] http://www.bls.gov/cpi/cpiqa.htm.

> **Substitution** (CES) formula for initial and interim estimates of the C-CPI-U, and the new quarterly revision schedule for C-CPI-U indexes, are possible because of this new system. Also, as part of the redesign process, a small number of **minor methodology changes**, primarily affecting the imputation of price changes, were introduced. [Emphasis added.][50]

Considering all the changes that have been made to calculating CPI over the years, this press release indicates a major change indeed. BLS claimed "[t]he net impact of these changes on the All Items U.S. City Average level is expected to be minimal." *Id.* Only time will tell if the changes are small or great.

In the same press release, BLS announced that it would change the way in which Chained COLA was calculated. Revisions would be issued quarterly and a "**Constant Elasticity of Substitution (CES)** formula will replace the **geometric mean formula**" for the calculation of Chained COLA.[51] Economist John Williams describes this change as follows:

> Well, good-bye to the **geometric-weighting** sham; it automatically reduced the weighting of any inflation component going up in price, and increased the weighting of any component going down in price. It had no good theoretical basis for weighting components for the "substitution effect" (*i.e.,* hamburger versus more-expensive steak).
>
> And a not so happy hello to the greater sham of **constant elasticity of substitution**, which will allow the BLS to guess at final CPI weightings, using its mathematical models, instead of having to have actual information in hand, or being able to revise data later with the actual numbers in hand. The approach here simply is to minimize the reported headline inflation with a fully substitution-based CPI (as opposed to a fixed-weight CPI that measures the cost of living of maintaining a constant standard of living, as the CPI once was),

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[50] http://www.bls.gov/cpi/cpinewest.htm; see also BLS News Release, Consumer Price Index — September 2014 (Oct. 22, 2014) p. 5.

[51] http://www.bls.gov/cpi/cpiccpi.htm (emphasis added).

> with weightings determined by BLS modeling instead of hard surveying....[52] [Emphasis added.]

Dr. Williams predicts that changes to Chained COLA indicate that the federal government intends to:

> usher in an era of the C-CPI-U as the new benchmark for determining the government's cost-of-living adjustment (COLA) measures and headline inflation, with a resulting further downside adjustment to official headline inflation being set in motion. The C-CPI-U would reduce COLA adjustments from what they would have been otherwise, a cost-cutting measure already agreed to in principle by the Congress and White House as a tool for reducing the federal deficit. [*Id.*]

To demonstrate the significance of the changes made in CPI-W since President Reagan was in office, Dr. Williams provides the following comparison for CPI-W from the third quarter of 2013 to the third quarter of 2014:

- **1.7 percent** — CPI-W reported by BLS, used for the Social Security COLA;
- **5.2 percent** — CPI-W based on the CPI reporting methodology in place as of 1990; and
- **9.4 percent** — CPI-W based on the CPI reporting methodology in place as of 1980.

Is it any wonder that Social Security recipients do not believe that the Social Security COLA fails to provide a constant standard of living? The Bureau of Labor Statistics knows that it has a credibility gap with the American people, and is trying to go on the offense to convince Americans to believe government numbers. In December 2014, the Commissioner of

[52] Shadow Government Statistics, Commentary No. 668 (Oct. 23, 2014), p. 4.

the Bureau of Labor Statistics felt it sufficiently important to release a statement entitled "Protecting the public's trust in federal statistics."[53]

> Why should people trust BLS and other federal statistical agencies? Today I want to celebrate a new publication that answers this question. The new Statistical Policy Directive Number 1 … lays out what federal statistical agencies do and don't do…. The directive makes a convincing case for why people can trust federal statistics. [*Id.*]

For the reasons contained in this White Paper, the government must be required to do more than issue platitudes to reassure us that its data sets like CPI-W are not corrupted — it should transparently explain how CPI-W has been manipulated over decades, and then lay out a plan to have the Social Security COLA return to serving its original, stated function — preserving a constant standard of living.

VII. A Strategy to Address Flaws in the Current CPI Measure.

It would be unrealistic to assume that Congress or the Bureau of Labor Statistics wants to acknowledge or address the problem addressed in this White Paper — that the CPI measure is being deliberately understated to help achieve a host of objectives of the federal government. In fact, Congress seems to be moving in the opposite direction, toward reducing Social Security outlays by moving to Chained COLA. However, one should never underestimate the degree to which the American people, particularly those who have paid taxes into Social Security for a lifetime, will react to gross deception, and to a deliberate victimization of millions of people. In fact, exposing the fraud that has been perpetrated on recipients of Social Security through the adoption of changes in the current CPI index might, at the very least, be

[53] Commissioner's Corner, Protecting the Public's Trust in Federal Statistics (December 12, 2014). http://blogs.bls.gov/blog/

effective in dissuading Congress from adding another layer of deception — Chained COLA. A strategy led by The Seniors Citizens League to expose government manipulation of the CPI measure includes these five prongs:

First, TSCL has authorized the release of this TSCL White Paper explaining how government has corrupted the CPI-W data set to understate the true rate of inflation.

Second, TSCL has launched an education campaign directed at TSCL members and prospects. Recipients of Social Security already know in their hearts and in their wallets that the Social Security COLA is understated, but they often do not know why. TSCL has a variety of educational vehicles (*e.g.,* letters, website, email, news articles) that will provide seniors with this vital information.

Third, initially, TSCL plans to invite other organizations to join its battle against an understated COLA, and plans to reach out to other organizations in the near future, as resources become available.

Fourth, TSCL has drafted legislation which could be introduced in Congress to require the Bureau of Labor Statistics to publish an additional data set, designed to replicate the CPI as it was calculated in 1980 before the manipulation began. This data set would be revised to include all of the factors built into what Dr. Williams terms the "Shadow Stats Alternative Consumer Inflation Measures"[54] which is based on the methodologies in place as of 1980. It is informative for Dr. Williams to publish such a data set privately, but it would be of great value

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[54] http://www.shadowstats.com/alternate_data/inflation-charts

to have this data set published officially, by the Bureau of Labor Statistics, so that "official" numbers can be shown to members of Congress.

Fifth, a Freedom of Information Act ("FOIA") request is being prepared to obtain records from the Bureau of Labor Statistics and the Social Security Administration, and perhaps other agencies, concerning specific information as to how the CPI methodology has changed over the years, away from a **fixed** "market basket" of goods toward a **substitutionary index** that no longer measures the price of maintaining a constant standard of living. This information could prove beyond a doubt that the government has made these changes deliberately. It is highly unlikely that BLS will be forthcoming as to how it has manipulated this data set, as this set is used for many purposes. If the FOIA request were denied, an administrative appeal could be filed, followed by litigation to compel disclosure.

Of course, publication of this TSCL White Paper is just the beginning. TSCL is planning to file Freedom of Information Act requests to uncover documents that will bring transparency to the largely concealed process by which BLS has changed the way CPI is measured. Congressional hearings should be sought, where government economists and statisticians and other experts in the field asked to provide expert testimony. Corrective legislation will likely be necessary. The process remedying this problem will be difficult, but Social Security recipients are not likely to be dissuaded by such factors.

It is time to unearth the truth about artificial changes in the method by which the Social Security COLA is measured and for Congress to correct a great unfairness.

Appendix: The Bureau of Labor Statistics' CPI-U-RS Data Set

BLS acknowledges that "when a change is made in the way the CPI is calculated, the BLS does not revise previously published CPI data using the new method." This makes comparing present and past data as difficult as comparing apples to oranges. Allegedly to remedy this problem, BLS developed a little known research data series, CPI-U-RS — a "Research Series Using Current Methods" that is designed to be "methodologically consistent" and show changes in CPI-U over long periods of time using a consistent procedure. CPI-U-RS is calculated by taking the current methods, and calculating back as if the current methods had been in effect in the past. However, CPI-U-RS does not show what the CPI-U would be today had the old methods been kept in effect.

This CPI-U-RS data set shows that the reporting changes since 1980 have **reduced the reported level of annual CPI inflation by 5.1 percentage points** from the BLS' CPI estimates. In a sense, the very existence of this CPI-U-RS data set constitutes a backhanded admission that the BLS has "cooked the books" over the past 34 years.

Of course, BLS believes that its methodology for calculating CPI is "getting better," and so it is appropriate to apply current methodology to past time periods. BLS claims that it "has made numerous improvements to the CPI over the past quarter-century." BLS states that CPI-U-RS "incorporates most of the improvements made over that time span into the entire series." However, if one believes that changes in methodology have resulted in a data set which is "getting worse," then CPI-U-RS simply continues to mask the problem.

While marketed as being "consistent" and giving a more accurate representation of true cost-of-living increases, in reality CPI-U-RS actually distorts the true picture even more than CPI-U. BLS claims that "the measured rate of inflation would have been lower since 1978 if methods currently used in calculating the Consumer Price Index for All Urban Consumers had been in place from that year to the present."[55] **Indeed, "[o]ver the 21-year period of the study … the CPI-U-RS increased 141.2 percent, compared with 163.9 percent for the CPI-U. The figures represent an average annual increase of 4.28 percent for the CPI-U-RS and 4.73 percent for the CPI-U; the average annualized difference between the two measures is thus 0.45 percent."[56]**

For our purposes, what is needed is not a measure that carries current (manipulated) methods backwards, but a method that carries old (pre-manipulation) methods forwards.

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[55] BLS, Consumer Price Index research series using current methods, 1978-98, http://www.bls.gov/mlr/1999/06/art4full.pdf.

[56] *Id.*

Draft Legislation
114TH CONGRESS
1st SESSION

H.R. __________
HONESTY IN CPI REPORTING ACT

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 7 of Rule XII of the Rules of the House of Representatives, the following statement is submitted regarding the specific powers granted to Congress in the Constitution to enact the accompanying bill or joint resolution.

This bill is enacted pursuant to the power conferred by the United States Constitution upon each house of Congress by:

[to be written]

114TH CONGRESS
1ST SESSION

H.R. ________

IN THE HOUSE OF REPRESENTATIVES

Mr. __________ introduced the following bill;
which was referred to the Committee on ___________.

A BILL

To require the Bureau of Labor Statistics, Department of Labor, to report the Consumer Price Index (CPI-W) using methodology employed in 1980.

Be it enacted by the Senate and House of Representatives of the United States Congress assembled,

CONTENTS

SEC. 1. SHORT TITLE.

This Act may be cited as the "Honesty in Social Security COLA Act."

SEC. 2. FINDINGS.

(a) Beginning in 1975, Congress required Social Security retirements benefits to automatically increase annually in order to provide a Cost-of-Living Adjustment ("COLA"), based on increases in the Consumer Price Index (CPI-W), a data set issued by the U.S. Department of Labor Bureau of Labor Statistics.

(b) The Social Security Administration website correctly explains that "[t]he purpose of the COLA is to ensure that the purchasing power of Social Security and Supplemental Security Income (SSI) benefits is not eroded by inflation."

(c) The CPI-W data set published by the Bureau of Labor Statistics has come under criticism, as the BLS has made repeated changes in the methodology for calculation, of CPI-W, particularly since 1980, so that it no longer measures maintaining a constant standard of living by reflecting changes in price of a fixed market basket of goods and services, but rather reflects the consumer substitution of less-expensive products and services as prices rise.

(e) The Bureau of Labor Statistics publishes a research series data set designed to reflect the original fixed market basket of goods and services which factors out some, but not all, of the changes in methodology since 1980.

(f) Recipients of Social Security are entitled to have the government report a consistent data set measuring a constant standard of living based on a fixed market basket of goods and services.

(g) In addition to other data sets, BLS should regularly and routinely report the Consumer Price Index for Urban Wage Earners and Clerical Workers ("CPI-W") to the American people using the same methodology it used in 1980.

SEC. 3. REQUIRED REPORTING OF THE CONSUMER PRICE INDEX USING 1980 METHODOLOGY.

(a) Within four months after the enactment of this legislation, the U.S. Department of Labor's Bureau of Labor Statistics shall develop and publish on its website, a new Consumer Price Index data set, based on the Consumer Price Index for Urban Wage Earners and Clerical Workers ("CPI-W") data set, to be designated the CPI-W-1980, which utilizes the same methodology that was employed as of January 1, 1980 to create that index, based on a fixed market basket of goods and services, to the extent practicable.

(b) The CPI-W-1980 data set may adjust the CPI-W data set employed as of January 1, 1980 only as may be necessary to eliminate products and services that ceased to be generally available, and add products and services that have become generally available, where each of those modifications is reported and explained.

(b) BLS shall publish this new CPI-W-1980 data set to reflect annual price changes for each year from 1980 through the year before which this legislation is enacted, and on a monthly basis thereafter.

(c) The mandate in subsection (a) shall end if the Bureau of Labor Statistics ends reporting of CPI-W.

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