Volume Title: Investigations in the Economics of Aging

Volume Author/Editor: David A. Wise, editor

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-90313-3; 978-226-90313-2 (cloth)

Volume URL: http://www.nber.org/books/wise11-2

Conference Date: May 5-8, 2011

Publication Date: May 2012

Chapter Title: Comment on "How Well Are Social Security Recipients Protected from Inflation?"

Chapter Authors: Michael D. Hurd

Chapter URL: http://www.nber.org/chapters/c12434

Chapter pages in book: (p. 139 - 143)

Burdick, Clark, and Lynn Fisher. 2007. "Social Security Cost-of-Living Adjustments and the Consumer Price Index." *Social Security Bulletin* 67 (3): 73–88.

Cristia, Julian P. 2007. "The Empirical Relationship between Lifetime Earnings and Mortality." CBO Working Paper 2007-11. Washington, DC: Congressional Budget Office.

Di Nardi, Mariacristina, Eric French, and John Bailey Jones. 2009. "Why Do the Elderly Save? The Role of Medical Expenses." NBER Working Paper no. 15149. Cambridge, MA: National Bureau of Economic Research, July.

French, Eric, and John Bailey Jones. 2004. "On the Dynamics and Distribution of Health Care Costs." *Journal of Applied Econometrics* 19 (6): 705–21.

Hobijn, Bart, and David Lagakos. 2003. "Social Security and the Consumer Price Index for the Elderly." *Current Issues in Economics and Finance* 9 (5): 1–7.

List, Matthew Patrick. 2005. "Inflation and the Elderly." Unpublished Manuscript. Boston College, Chestnut Hill, MA.

National Commission on Fiscal Responsibility and Reform. 2010. "The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform." Washington, DC: National Commission on Fiscal Responsibility and Reform. http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf.

Stewart, Kenneth J. 2008. "The Experimental Consumer Price Index for Elderly Americans (CPI-E): 1982–2007." *Monthly Labor Review* 131 (4): 19–24.

Waldron, Hilary. 2007. "Trends in Mortality Differentials and Life Expectancy for Male Social Security-Covered Workers, by Socioeconomic Status." *Social Security Bulletin* 67 (3): 1–28.

Comment   Michael D. Hurd

In the mid-1980s Boskin and Hurd calculated a separate Laspeyres price index for the older population using weights that reflected the different consumption pattern by the older population (Boskin and Hurd 1985). Of particular interest was the higher budget share for health care (fraction of total spending for health care): in the population less than age sixty the budget share was 4.9 percent, whereas in the population age seventy-five or older it was 9.8 percent. A higher rate of inflation for health care services interacted with a greater weight on them would result in a higher inflation index for the older population. However, Hurd and Boskin found that "the inflation experience of the elderly from 1961–1981 was quite similar to the general population both cumulatively and year-by-year." Table 3C.1 gives their prices levels in 1961 and 1981 by age group, and, indeed, the cumulative price increases are almost identical across the age groups. One reason for this somewhat surprising outcome is that the rate of inflation for health

Table 3C.1   **Age-specific Laspeyres price indices**

	Age category			
	<55	60–64	70–74	75+
1961	90.5	90.4	90.5	90.5
1981	250.1	252.1	251.4	250.8

Source: Boskin and Hurd (1985).

Table 3C.2   **Budget shares for health care services (%) 2009**

	Age category			
	All	55–64	65–74	75+
Total	6.4	7.4	11.4	15.1
Health insurance	3.6	3.8	7.1	9.5
Medical services	1.5	2.0	1.9	2.6
Drugs	1.0	1.3	2.0	2.5
Medical supplies	0.2	0.3	0.4	0.5

Source: Bureau of Labor Statistics, Consumer Expenditure Survey.

care services was not systematically greater than the overall rate of inflation, and, in fact, for some years it was lower. For example, between 1976 and 1981 the Consumer Price Index-All Urban Consumers (CPI-U) increased by 70 percent, whereas the medical care inflation rate was just 59 percent.

The situation today is quite different. The budget shares for health care are higher for everyone, but much higher for the older population, as shown in table 3C.2. In addition, the rate of inflation in health care services is persistently higher than the overall rate: between year 2000 and 2007 the CPI-U increased by 20 percent, whereas the medical care component increased by 35 percent. Thus there are good reasons to expect that the prior finding by Boskin and Hurd would no longer hold.

The BLS has calculated an experimental price index for the older population, the CPI-E.[1] Between 1997 and 2009 the CPI-U increased by 33.9 percent, whereas the CPI-E increased by 36.1 percent. Had Social Security benefits been indexed to the CPI-E over that period, benefits would have been about 6 percent higher than they actually were, at least partially protecting the older population from increases in health care spending, such as the increase in Part B premiums.

The chapter by Goda, Shoven, and Slavov has two main topics. What would be the consequences for Social Security benefits were the CPI-E to be used for indexing? By how much would Social Security benefits have to

---

1. See Stewart, referenced in chapter 3.

be increased with age so as to cover the increased costs of health care spending that are associated with age? According to their calculations, over the twenty-four years from 1983 to 2007 Social Security benefits would have increased by 8 percent more had the benefits been indexed to the CPI-E rather than to the CPI-U. While this difference is not as large as one might think due to the large increases in the medical component of the CPI over this time period,[2] it would have added a noticeable increase to the Social Security benefits of someone who claimed benefits in 1983 and survived to 2007. This result should rightfully enter the debate about the adequacy of Social Security benefits and potential reforms to the Social Security system.

The second and longest part of the chapter calculates the increases in Social Security benefits that would be required to fully cover age-related increases in health care spending over the period. Or said differently, by how much would Social Security benefits have to be increased to prevent health care spending from crowding-out non-health care spending? My reservations about this part of the chapter center around two issues. The first is that under the simplest life cycle model in old age total spending will decline with age, so that we would expect the level of spending on non-health care categories to decline with age. Further, the share of the budget devoted to non-health care categories will likely not be constant but will vary with the level of spending, as reflected in Engel-type curves.[3] Some goods are necessities, where the budget share will decline as total spending increases, and some are superior goods, where the budget share will increase. Whether the budget share would increase or decrease would depend on weighted spending responses of the various components.

My second reservation is based on the more realistic situation where tastes or production efficiencies change with age. As people age and health deteriorates, the marginal utility of spending on health care increases, so that quite naturally we would expect that spending on health care would increase with age. As a consequence, spending on other categories would decrease holding total spending constant. But, in addition, because of deteriorating health, declines in the marginal utility of spending on some non-health care categories are certainly plausible. For example, Börsch-Supan and Stahl (1991) speculated that the high German saving rate post-retirement comes from that fact that Germans are pretty well-protected from out-of-pocket spending on health care, and that declining health makes it hard to spend for non-health care. While it is difficult to generalize about total non-health care spending, it would seem that spending on at least some components is likely to decrease. Examples might be spending on private transportation,

---

2. The medical component of the CPI increased by about 250 percent, versus 107 percent for the CPI-U.

3. I say Engel-type curves because the budget constraint is not income within a time period but a within-period spending constraint determined by life cycle spending considerations.
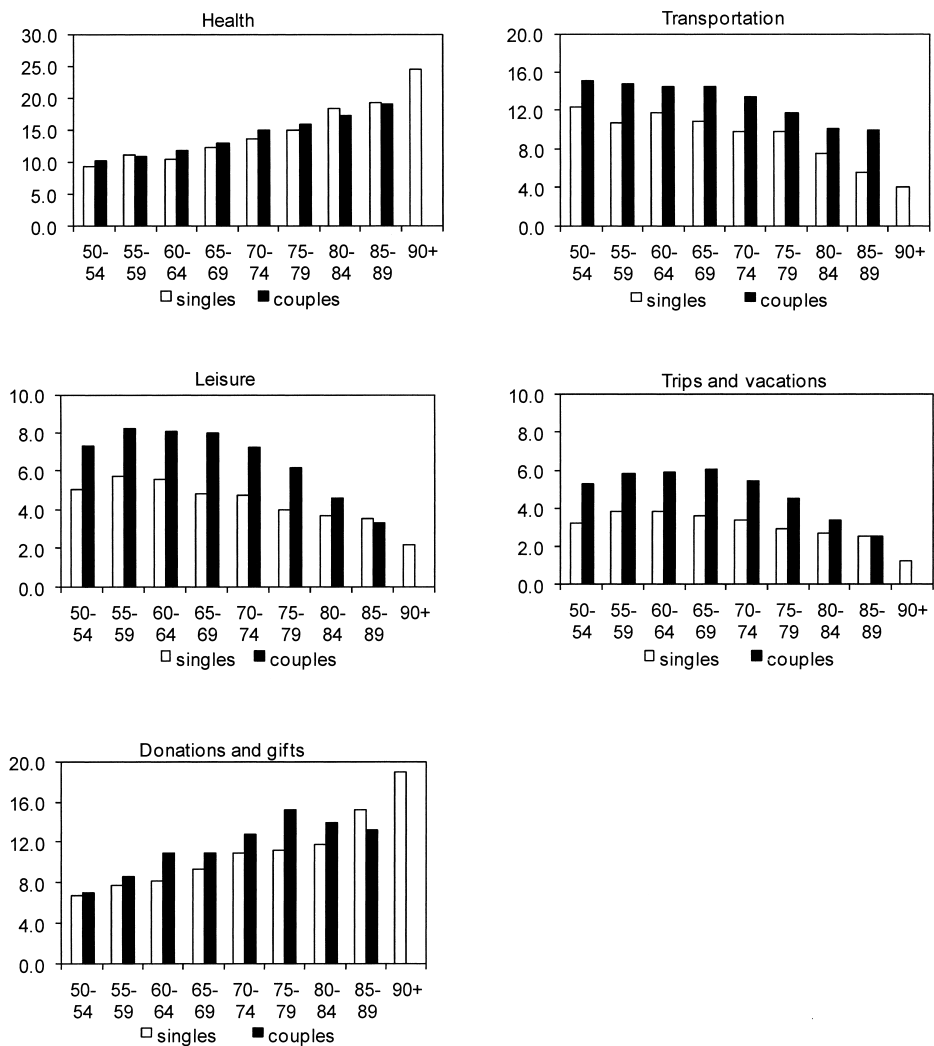
Fig. 3C.1   Budget shares
Source: Hurd and Rohwedder (2010).

where health limitations may reduce the quantity of driving, or spending on travel, where health makes travel more difficult. These and further examples are in figure 3C.1, which shows budget shares by age and marital status calculated from data from the Consumption and Activities Mail Survey. Accompanying the large increase in budget shares for health care are sharp declines for transportation (from about 12 percent to 4 percent for single persons), leisure (from about 8 percent to 3 percent for married persons), and trips and vacations (from about 6 percent to 2 percent for married persons).

The last category, donations and gifts, implies that the budget constraint is not forcing reductions in spending on transportation, leisure, and trips and vacations because donations and gifts are largely discretionary.

In our leading model of life cycle spending neither the level of spending nor the budget share of a category of spending should be constant with age. That basic model can be augmented from the observation that changes in health are likely to increase spending on health care and reduce spending on some other categories of spending because of changes in the marginal utility of consumption in those categories. These considerations lead to the conclusion that spending on non-health care will decline in level as people age, and likely also in budget shares. Thus a policy that aims to keep non-health care spending constant as people age would be odd indeed.

References

Börsch-Supan, Axel, and Konrad Stahl. 1991. "Life Cycle Savings and Consumption Constraints." *Journal of Population Economics* 4:233–55.

Boskin, Michael, and Michael D. Hurd. 1985. "Indexing Social Security Benefits: A Separate Price Index for the Elderly?" *Public Finance Quarterly* 13:436–49.

Hurd, Michael, and Susann Rohwedder. 2010. "Spending Patterns in the Older Population." In *The Aging Consumer: Perspectives from Psychology and Economics,* edited by Aimee Drolet, Norbert Schwarz, and Carolyn Yoon, 25–50. New York: Routledge.