Chained Consumer Price Index

October 2019

Background

What a dollar can buy changes over time. The US Bureau of Labor Statistics has different ways to measure how the value of a dollar changes. These changes are known as inflation and deflation. The most traditional measure, the Consumer Price Index for All Urban Consumers (CPI-U) is commonly used to adjust for inflation or deflation. For example, Social Security beneficiaries receive a cost-of-living adjustment each year equal to the change in this traditional CPI-U.

In Idaho, statute and rule establish multiple uses for the traditional CPI-U. Income tax brackets are adjusted each year based on the index. Maximum cost-of-living adjustments for PERSI beneficiaries are equal to the traditional CPI-U.

The US Bureau of Labor Statistics claims that the traditional CPI-U overestimates inflation. To correct for biases that lead to overestimation, the bureau introduced a new index in 2002, the Chained Consumer Price Index for All Urban Consumers. The chained CPI-U uses monthly data on what consumers buy rather than changing the assumptions about what consumers buy only every two years. As a result, the chained CPI-U is more accurate and usually lower than the traditional CPI-U.

In 2017, Congress amended federal income tax law to use the chained CPI-U rather than the traditional CPI-U. A handful of states have done the same with their tax codes.

Scope

We will evaluate Idaho's use of various price indices, particularly the traditional CPI-U. We will also study the costs and benefits of switching to the chained CPI-U. Our evaluation will answer the following questions:

> Is Idaho using the most appropriate index when it adjusts for inflation?
>
> Are there dollar values in statute or rule that Idaho might find advantageous to automatically adjust?
>
> What practices do state agencies use to index contracts? What options exist to improve these practices?

Projected completion date: Fall 2019