Introduction

Rising prices can erode the purchasing power of benefits provided through government assistance programs. To help protect program participants from the effects of rising prices, many government benefits are adjusted for inflation. Automatic benefit adjustments became prevalent in the early 1970s, when high inflation rates prompted Congress to take action. Since then, programs have used many adjustment methods involving different price indices, frequencies of adjustment, and lag periods between setting a new benefit level and implementing the change (see box, "Adjusting Government Program Benefits for Inflation").

Policymakers are continually challenged with how best to adjust government program benefits in response to rising prices while moderating increases in program costs. During periods of high inflation, concern centers on whether the adjustment methodology protects low-income households from steep reductions in the buying power of benefits. During periods of lean budgets, concern focuses on maintaining or reducing program expenditures. In the current period of rising food prices, the focus is on the frequency and method used to index food stamp benefits.

The Food Stamp Program (FSP)[1] is designed to provide low-income families with increased purchasing power to obtain foods that make up a low-cost, nutritionally adequate diet. Participating households receive benefits which, together with an expected contribution from their income, should enable them to purchase a diet that meets current dietary guidance. FSP benefits are adjusted annually for rising food prices, but there is a lag of nearly 4 months before the increase takes effect. Thus, even when benefits are adjusted at the beginning of the Federal fiscal year (FY)—October to September—program participants may already be experiencing a shortfall. Rising food prices in subsequent months of the fiscal year widen the shortfall. This effect is a particular concern in periods of high food-price inflation, such as in 2004, 2007, and 2008, and raises questions for policymakers about what can be done to reduce the effects of inflation.[2]

The FSP is a means-tested entitlement program. In most cases, a household is determined to be eligible for food stamps if its monthly gross income is less than 130 percent of the official poverty guidelines ($2,238 per month for a family with four members in FY 2008), its net income is less than 100 percent, and the value of its countable assets is less than specified limits. Benefits depend on net household income, which equals gross income less deductions.[3] An eligible household with zero net income receives the maximum benefit amount, which varies by household size. Households with positive net income receive benefits equal to the maximum benefit for their household size less 30 percent of net income. Households are expected to spend 30 percent of net income on food.

In FY 2008, the program's maximum monthly benefit was set at $162 for a single person, $542 for a four-person household, $975 for an eight-person household, and $122 for each additional member beyond eight (table 1). Nearly one of three food stamp households received the maximum benefit, and, together, these households collected 40 percent of the total benefits issued by the program. The average FSP household's benefit was about two-thirds of the maximum (USDA, FNS, 2007).

[1]In October 2008, the Food Stamp Program was renamed the Supplemental Nutrition Assistance Program (SNAP).

[2]Falling prices are also a possibility and a potential policy concern. With respect to food stamp benefits, food prices have, on occasion, fallen from one year to the next. For example, food price changes from 1992 to 1993 were negative, prompting congressional action to prevent a decrease in food stamp benefits that would have occurred with automatic adjustment.

[3]The deductions include a standard deduction, a 20-percent earnings deduction, a housing expense deduction subject to a cap for households without an elderly or disabled member, a child care deduction for households with members working or going to school, a medical care expense deduction for elderly or disabled household members, and a deduction for child support payments (http://www.fns.usda.gov/snap/applicant_recipients/eligibility.htm).

Adjusting Government Program Benefits for Inflation

The adjustment of benefits in response to inflation is common among Federal Government programs. Automatic adjustments became prevalent in the early 1970s when high inflation rates prompted a legislative response. Since that time, it is estimated that between one-third and one-half of Federal budget outlays are automatically escalated each year by the change in living costs (see CBO, 1981; and Boskin et al., 1997).

Social Security is the most important of the indexed Federal outlays, but indexing is also applied to Supplementary Security Income and military, civil service, and other Federal retirement programs. Food and agricultural programs as well as medical insurance payments are among current programs that are adjusted for inflation. The major indexed provisions are benefit levels, eligibility criteria, and ceilings or floors on payments and deductions. On the revenue side, social security taxes, individual income tax brackets, and personal exemptions are also indexed.

Government assistance programs serving low-income households adjust eligibility thresholds based on poverty guidelines that are constructed annually by the U.S. Department of Health and Human Services. Those guidelines use the calendar year change in the Consumer Price Index-all urban consumers (CPI-U) to set poverty guidelines for the subsequent year. Since most of these programs operate on a fiscal year (FY) basis, which starts in October, the eligibility criteria depend on price change in the previous year. For example, the FY 2008 eligibility criteria for the Food Stamp Program (FSP) were based on the 2007 poverty guidelines, which reflect price change through calendar year 2006.

In addition to adjusting eligibility thresholds to account for inflation, many government assistance programs adjust benefits for inflation, with the adjustment methodology varying across programs by index, frequency, and lag period. Most programs use the CPI, but some choose other indices to account for the different rates of inflation that occur in various consumer goods and services targeted by the programs. The frequency of adjustment is annual for most programs, though some, including the Food Stamp Program, have used more frequent adjustments at some time in their history. The lag period for indexing depends on how the program is administered. FSP adjustments are discussed in detail throughout this report. Other programs that use inflation-adjustment methodologies include the following:

- *National School Lunch Program and School Breakfast Program:* School meal reimbursements are automatically adjusted for inflation with the CPI-U for food away from home. The May-to-May change in the price index is used to set the reimbursement rates for the upcoming school year, which officially starts in July.

- *Special Supplemental Nutrition Program for Women, Infants, and Children* (WIC): Starting in FY 2009, WIC will automatically adjust the monthly cash value of the fruit and vegetable voucher for inflation. The March-to-March change in the CPI-U for fresh fruits and vegetables will be used to adjust the cash value of the voucher for the upcoming fiscal year starting in October. The WIC quantity-based voucher for other program foods enables participants to purchase a specific quantity of food items. Inflation could affect the number of clients States can afford to serve given the federally legislated budget. Federal legislation can adjust the program budget for inflation when setting the next year's budget.

- *Social Security and Supplemental Security Income*: These programs base adjustments on the percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter (July-August-September) of one year to the third quarter of the next. The adjusted benefits start with the payment received in January.

Some Federal Government assistance programs do not automatically adjust benefits in response to inflation. In general, these are not entitlement programs. Instead, these programs provide States with Federal funds through block grants. States then determine how many clients to serve, who to serve, and how much cash assistance to provide, given program regulations. Funding can be adjusted for inflation through Federal legislation in the budget process. Examples of programs in this category include Temporary Assistance for Needy Families and the Low-Income Home Energy Assistance Program.

Table 1

Food Stamp Program (FSP) maximum benefit and estimated Thrifty Food Plan (TFP) cost by household size

Household size	FSP maximum benefit FY 2008	Estimated cost of TFP June 2008
	Dollars	
1	162	176
2	298	323
3	426	463
4	542	588
5	643	698
6	772	838
7	853	926
8	975	1,058

Source: USDA, Economic Research Service calculations (TFP costs) and USDA, Food and Nutrition Service, http://www.fns.usda.gov/snap/applicant_recipients/eligibility.htm (FSP benefit).

Since 1977, the level of the maximum benefit has been tied to the cost of USDA's Thrifty Food Plan (TFP). The TFP is a market basket of foods which, if prepared and consumed at home, would provide a complete, nutritious diet at minimal cost. Between 1997 and 2007, the FSP maximum benefit fell short of the cost of the TFP over most of the period. To examine how such shortfalls might have been mitigated, this study compares the shortfall in buying power under existing policy with simulated shortfalls from two alternative adjustment methods. Micro-simulation analysis is used to simulate the additional program costs under the alternative methods.

A goal of this study is to determine whether alternative methods of adjustment can reduce the loss in purchasing power of food stamp benefits when food prices rise. Meeting this goal requires measuring the monthly shortfall between the maximum FSP benefit and the cost of the TFP. The shortfall measure reveals that the maximum benefit is set using cost data that lag nearly 4 months behind the start of the fiscal year and that the benefit amount stays fixed for the entire fiscal year regardless of changes in the cost of the TFP.

This study does not focus on inflation adjustment issues addressed in the 2008 Farm Act. These include re-introduction of an inflationary adjustment for the standard deduction; removal of the cap on the maximum child care deduction; and an increase and indexation of the minimum benefit amount (Rosenbaum, 2007; USDA, ERS, 2008a). The maximum excess shelter cost deduction was already adjusted for inflation with the Consumer Price Index (CPI) for all items.