Cost-of-Living Adjustments

NASI 2017 Summer Academy for Interns
August 10, 2017

Kyle Burkhalter
Office of the Chief Actuary
Social Security Administration

Cost-of-Living Adjustments

- Since 1975, Social Security's general benefit increases have been based on increases in the cost of living, as measured by the Consumer Price Index (CPI)
- These Cost-of-Living Adjustments (COLAs) are effective with benefits payable for December
- Social Security benefits keep pace with inflation
- COLA cannot be less than zero
- Example: If initial PIA is $1,444.50 and it is increased by 0.3-percent COLA, the new PIA (truncated to the next lower dime) is $1,448.80

Consumer Price Index (CPI)

- Bureau of Labor Statistics produces monthly data on changes in prices paid for a representative basket of goods and services
- Social Security benefit COLAs are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W)
- COLA = percentage increase (if any) in the average CPI-W from Q3 of the last year with non-zero COLA to Q3 of current year
- 2016 (235.057) is 0.3% increase from 2014 (234.242)

COLA series, 1975-2016

Year	COLA	Year	COLA	Year	COLA	Year	COLA
1975	8.0	1986	1.3	1997	2.1	2008	5.8
1976	6.4	1987	4.2	1998	1.3	2009	0.0
1977	5.9	1988	4.0	1999	2.5	2010	0.0
1978	6.5	1989	4.7	2000	3.5	2011	3.6
1979	9.9	1990	5.4	2001	2.6	2012	1.7
1980	14.3	1991	3.7	2002	1.4	2013	1.5
1981	11.2	1992	3.0	2003	2.1	2014	1.7
1982	7.4	1993	2.6	2004	2.7	2015	0.0
1983	3.5	1994	2.8	2005	4.1	2016	0.3
1984	3.5	1995	2.6	2006	3.3		
1985	3.1	1996	2.9	2007	2.3		

Simple, right?

- Bureau of Labor Statistics produces monthly data on changes in prices paid for a representative basket of goods and services

- CPI-W (and CPI-U) based on experience of the relevant average household (spending habits survey of 7,000 families)

- Other indices, other approaches

Chained CPI (C-CPI-U)

- Based on idea that in an inflationary environment, consumers will choose less-expensive substitutes
- All indices correct for “lower-level substitution bias” (Red Delicious instead of Granny Smith) but not “higher-level substitution bias” (apples vs iPhones)
- CPI-W (and CPI-U) weights are adjusted every two years, but C-CPI-U is impacted the next month
- By age 85, benefits would be about **6.5% lower**
- OCACT estimates C-CPI-U would *reduce* the annual COLA by **0.3** percentage point, on average

CPI for the Elderly (CPI-E)

- Basket of goods and services for those age 62+
- Certain expenditure groups, such as medical care and housing, are given greater weight (10.8% in CPI-E vs. 5.3% in CPI-W)
- Medical care costs historically rise faster than inflation
- By age 85, benefits would be about **4.6% higher**
- OCACT estimates CPI-E would *increase* the annual COLA by **0.2** percentage point, on average

Other variations

- Proposals to reduce or increase annual COLA (as currently calculated) by a set amount
- Chained CPI-W, chained CPI-E
- Hold disabled (DI), lower earners harmless
- No COLA for high earners
- Different indices for different benefit amounts or earnings levels

So what?

- Changes to the COLA would have greater impact on long-range actuarial balance than you might think
- Switching from CPI-W to chained CPI-W starting December 2017 = **21%** of shortfall **eliminated**
- Switching from CPI-W to CPI-E starting December 2018 = **14% increase** in shortfall
- Reducing the annual COLA by 1 percentage point starting December 2017 = **66%** of shortfall **eliminated**
- Present law shortfall in long-range actuarial balance is **2.83** percent of payroll (2017 Trustees Report)

Resources

- 150+ provisions scored annually: https://www.ssa.gov/oact/solvency/provisions/index.html
- Cost-of-living adjustment provisions: https://www.ssa.gov/oact/solvency/provisions/cola.html
- Bureau of Labor Statistics – Consumer Price Index: https://www.bls.gov/cpi/home.htm