No COLA, No Cry

You've probably heard by now that the 2016 cost of living (COLA) adjustment for Social Security benefits is zero—the third time this has happened in the last seven years. (2010 and 2011 were the other recent years.) In fact, Social Security benefit increases have stalled since the Great Recession; only once since 2008 have they risen by more than 2%.

For many retirees, this was surprising news. Anybody who has visited the grocery store lately knows that the price of food is rising. Every day, the papers tell us that housing costs are increasing and medical care costs are also rising.

You will undoubtedly see websites which blame the Obama Administration or Democrats generally for trying to balance the federal budget on the backs of people who have paid into the Social Security system, but in fact the annual COLA calculation is automatic and set by formula.

The formula is something called the Consumer Price Index for All Urban Wage Earners and Clerical Workers, known to economists as CPI-W, calculated by the government's Bureau of Labor Statistics in an effort to make the purchasing power of Social Security as close as possible to the same each year. The CPI-W was attached to Social Security payments in 1972 and has ever been replaced. There are many components, and indeed most of them rose in 2015. Food was calculated to be 1.6% more expensive than it was last year; shelter costs rose 3.2% and medical costs were up 2.4%. Ironically, the falling price of gasoline was the factor which drove the CPI-U back to zero; the index tells us that energy prices declined 18.4% this year.

Is this a fair way to calculate actual costs of living? Many believe it is not, for several reasons. First, the CPI-W is a weighted formula, based on the costs of urban workers, not retirees. Therefore, it presupposes, in the weightings, a very different lifestyle than most Social Security recipients are living. The price of gasoline, for example, is assumed to represent 20.1% of a retiree's total expenditures, which may be true for somebody who commutes to work every day in one of America's major cities, but doesn't reflect the normal lifestyle of a retiree. Medical care is assumed to be 5.1% of a retiree's annual expenditures. For a young office worker, that may be a slight overstatement. For a retiree over age 70, it is almost certainly a gross understatement.

Recreation is assumed to be 5.4% of expenditures, which again sounds about right for the office worker who brings home work on the weekends. But a retiree almost certainly spends more on travel and greens fees. (Amusingly, college tuition is assumed to be 1% of the average CPI-W person's expenditures.)

Is there a way to fix the formula so it more accurately reflects the actual costs of living in retirement? The Bureau of Labor Statistics actually calculates, each year, something called the Consumer Price Index for the Elderly. In that index, transportation costs are assumed to make up a more realistic 14% of yearly expenditures, and medical care counts double the CPI-W figure: 10.9% of assumed expenditures. Curiously, the index assumes that retirees spend less money on recreation (4.4%) and food away from home (4.6%, compared with 6.4% for that urban worker). The Social Security Administration has calculated that if it had been using the CPI-E COLA each year, rather than the CPI-W, the result would have been significantly higher Social Security benefits, more than 15% higher than today's payments.

So is it time to push for a switch? Alas, the proposals currently in Congress have nothing to do with the CPI-E. Our elected representatives want to switch the index tied to Social Security benefits to something called the "chain-weighted CPI," which annually comes up with lower COLA figures—and would, indeed, help balance the budget on the backs of seniors. Instead of complaining, should we celebrate the fact that the cost of living calculation wasn't negative for next year?

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