The Daily Dish

# COLAs and Social Security

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The Social Security Administration (SSA) recently announced the cost-of-living-adjustment (COLA) for Social Security (SS) benefits. As more fully discussed by Gordon Gray, at 8.7 percent this is the largest increase in 40 years. And, at least for Eakinomics, this raises three questions: (1) how did the COLA get calculated; (2) is this the right way to calculate the COLA; and (3) how does this affect the (in)solvency of the Social Security system?

First, what are the mechanics of the calculation? These are shown in the left panel of the table (below). The average of the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers (CPI-W) for the 3rd quarter of 2021 was 268.421, and 291.901 for the 3rd quarter of 2022. The percent increase in this average was 8.7 percent over the year, which is the cost-of-living adjustment that will be applied to benefits beginning in December.

| Year | July | August | September | Average | July | August | September | Average |
|---|---|---|---|---|---|---|---|---|
| **2021** | 267.789 | 268.387 | 269.086 | 268.421 | 273.003 | 273.567 | 274.310 | 273.627 |
| **2022** | 292.219 | 291.629 | 291.854 | 291.901 | 296.276 | 296.171 | 296.808 | 296.418 |
| | | | | 8.7% | | | | 8.3% |

Second, is this the "right" COLA calculation? Absolutely not. In the end, every individual has their own unique bundle of purchases of goods and services which, in principle, means that every person has their own CPI and their own, unique COLA adjustment. Putting aside the issue of how many COLAs fit on the head of a pin, the CPI-W is an outmoded choice that covers only 32 percent of Americans. The more common choice, the CPI-U that is reported each month, covers 87 percent of Americans. It would seem the logical choice for calculating COLAs.

The right panel of the table (above) shows the same calculation using the CPI-U, which yields a COLA of 8.3 percent. That, in a nutshell, is why the outmoded CPI-W remains the index of choice for SS – it typically yields a larger adjustment.

This feeds into the third point. COLAs do not affect the SS payroll tax at all. COLAs raise the amount of benefits paid (and probably by too much), thereby exacerbating the current cash-flow deficits in the SS system and accelerating the pace at which the SS Trust Funds are exhausted.

The COLA adjustment should be another reminder to Congress and the administration that the clock is ticking on reforms to put the SS financial house in order.