



Inside the Social Security COLA Calculations

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Inside the Social Security COLA Calculations

Here's a primer on the inflation-adjustment machinery.

By **Gene Bond and Lloyd Lofton** | October 13, 2022

Every year, Social Security recipients get a cost-of-living adjustment, or COLA, to their benefits to help them keep up with inflation. The Social Security COLA for 2023 (<https://www.thinkadvisor.com/2022/10/13/social-security-cola-for-2023-is-8-7-percent/>), announced Thursday morning, will be 8.7%.

There are several different measures of inflation used to get a picture of what's happening in the economy.

It's important to note that when the news talks about inflation, they are using what's called the consumer price index, or CPI. The consumer price index data for September (<https://www.bls.gov/news.release/cpi.nr0.htm>), released Thursday morning, shows inflation ran at 8.2% over the past 12 months before a seasonal adjustment and was 0.4% from August to September on a seasonally adjusted basis.

However, the CPI isn't just a measure of the prices of goods.

The Consumer Price Index for Urban Wage Earners and Clerical Workers, or CPI-W (<https://www.ssa.gov/oact/STATS/cpiw.html>), is Social Security's annual inflationary benchmark to determine cost of living increases for Social Security recipients. This number rose 8.5% over the past 12 months and 0.1% for the month, prior to seasonal adjustment.

This CPI-W includes a long list of major and minor spending categories, each of which has its own respective percentage weightings.

These weightings allow the CPI-W to be expressed as a single figure, which can easily be compared to the previous month or year to determine if prices for a predetermined basket of goods and services have risen or fallen.

The Clients Affected

The Old-Age, Survivors, and Disability Insurance Program, or OASDI, covers three primary groups of people.

1. People Who Have Retired

- Workers, whether employed by someone else or who were self-employed, who paid payroll taxes.
- The spouses of retired workers who are eligible for Social Security retirement benefits, either because the workers' earnings were significantly higher than the spouses' earnings, or because the spouses did not work outside the home.
- Ex-spouses who were married for at least 10 years to workers, who are not currently married, and who either earned much less than their working spouses or who did not work outside the home.

- The children of workers who have filed for retirement benefits and who have one or more children under a certain age.

2. Survivors of People Who Retired and Later Died

- The spouses and children of people who were receiving retirement benefits and has died.
- An ex-spouse of a person who was receiving a retirement benefit and has died.

3. People With Disabilities

- People who qualify for Social Security Disability Insurance benefits.
- The children of recipients of SSDI benefits, if the children are under a specified age.

What the COLA Does

The Social Security COLA is like a pay raise. It helps Social Security recipients keep up with the effects of inflation on the prices of goods and services.

If buying the same amount of goods and services costs more this year than it cost last year, then, ideally, Social Security checks should increase by the same amount, so the recipients don't lose purchasing power.

When there is a Social Security COLA, the amount paid to all Social Security benefits recipients goes up.

In addition to increasing the benefit that current Social Security recipients receive, the COLA is also used as a basis for calculating the benefits that future recipients will receive, as well as the benefits that certain retirees who worked for the federal government receive.

So, whether your client has started receiving your Social Security benefit or not, the COLA will affect any Social Security benefits that your client will ever receive.

How Social Security Managers Calculate the COLA

The U.S. Bureau of Labor Statistics (BLS) released the September inflation data this morning.

Social Security managers compared the average CPI-W reading from the third quarter of the current year, which ended Sept. 30, with the average CPI-W reading from the third quarter of 2021.

The year-over-year percentage increase in CPI-W, rounded to the nearest tenth of a percent, determines how much Social Security checks will climb in 2023.

CPI-E vs. CPI-W

One problem with the Social Security COLA system is that it's based on the CPI-W.

The items included in the CPI-W are not the same items that most retirees buy.

Many economists and retirement income experts believe that the consumer price index for the elderly, or CPI-E (<https://www.thinkadvisor.com/2021/07/23/cpi-w-vs-cpi-e-how-should-social-security-colas-be-calculated/>), more accurately reflects changes in elderly people's spending. The CPI-E, which measures prices of a basket of items often purchased by people ages 62 and older, places a higher weight on medical care and shelter than two other commonly used inflation indexes do.

Some observers believe that CPI-W is good enough for COLA calculations because seniors, like other consumers, make substitutions.

If beef prices rise sharply, seniors might switch to chicken.

Further, retirees' spending habits might protect them from inflation.

But the Senior Citizens League analyzes Social Security benefits' purchasing power by comparing Social Security COLAs with increases in the price of 37 goods and services typically used by retirees, and it says inflation has caused retirees' Social Security benefits to lose 40% of their buying power since 2000.

While prices rose in almost every spending category, benefits were most affected by sharp increases in costs for home heating, gasoline and food, and by a 14.5% increase in Medicare Part B premiums in January 2022.

The Medicare Part B premium will fall in 2023 (<https://www.thinkadvisor.com/2022/09/27/medicare-part-b-premium-to-fall-3-1-in-2023/>); however, that reduction is small relative to the increase in spending on other items.

Taxes

One byproduct of a large COLA increase for Social Security recipients in 2023 is a possible increase in tax liability.

According to the Senior Citizens League, 21% of Social Security recipients worried in 2021 that the large 5.9% COLA announced for 2022 would trigger an increase tax liability in 2022. Some survey participants feared that they would have to pay taxes on their Social Security benefits for the first time, after previously falling below the income thresholds where the benefits are subject to income taxes.

The Social Security 2021 average \$1,656 payment left recipients \$43.80 a month shy of keeping pace with actual price increases. If history repeats itself, and some clients end up with a tax liability due to the 2023 COLA, that could exacerbate the squeeze on their finances.

The Senior Citizens League's Spending Numbers

The Senior Citizens League found that, between 2000 and March 2022, COLAs increased Social Security benefits by a total of 64%.

The average Social Security benefit rose to \$1,656 per month, from \$816 per month.

Over that same period, the league says, typical senior expenses grew by 130%.

Because retiree costs are rising so much faster than the COLA, the typical retiree would need a Social Security benefit of \$1,876.70 per month, or \$539.80 per month more than the average benefit currently paid, *just to maintain the same level of buying power as in 2000.*

The league provided a table that shows how the cost of 10 items often purchased by older consumers changed between March 2021 and March 2022.

Fastest Growing Costs of Older Americans March 2021 – March 2022

Item	Cost in March 2021 Average cost \$ or numeric data*	Cost in March 2022 Average cost \$ or numeric data*	Percent increase since March 2021
1. Home heating oil (per gal.)	\$2.86	\$5.13	79%
2. Gasoline (all grades, per gal.)	\$2.86	\$4.33	51%
3. Used vehicles	153.873*	208.216*	35%
4. Propane gas (gal.)	\$2.30	\$2.98	30%
5. Eggs (per dz.)	\$1.63	\$2.05	26%
6. Bacon (per lb.)	\$5.85	\$7.20	23%
7. Oranges (per lb.)	\$1.27	\$1.48	16.5%
8. Coffee (per lb.)	\$4.67	\$5.41	16%
9. Medicare Part B premium (per mo.)	\$148.50	\$170.10	14.5%
10. Ground chuck (per lb.)	\$4.31	\$4.87	13%

*Source U.S. Bureau of Labor Statistics, data through March 2022. Where no average prices are available, numeric data are used.

This chart, created by The Senior Citizens League, shows how the cost of selected items increased between March 2021 and March 2022. (Image: The Senior Citizens League)

Retirees who have been retired since 2000 know all too well that Social Security benefits buy less today than when they first retired.

Consider this: A 40% drop in buying power means that for every \$100 of goods or services that retirees bought in 2000, today they would only be able to buy \$60 worth.

Or, in 2022, a retiree would have to spend \$140 to buy the same things they paid \$100 for in 2000.

Your Clients' Own CPI

Everybody's cost of living is different.

While there may be a lot of similarities between what one 65-year-old spends their money on when compared to all 65- year-olds, there will be differences.

For example, what your clients eat will affect how much those clients spend each week at the grocery store. If a client doesn't eat meat, it doesn't matter to that client how much the cost of meat increases.

If a client doesn't eat chicken, eggs, cereal or bread, and doesn't drink milk, those items won't have a direct effect on the client's budget.

Think back to what you bought when you went to the grocery store each week over the past five years.

There were some items you bought every week. There were some items that you only bought once or twice a month, or maybe less often.

As a financial advisor, we want to make sure the staples in our clients' lives don't become "luxuries."



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