



Automatic Cost-of-Living Adjustment

Background

Social Security and Supplemental Security Income (SSI) benefits are adjusted annually to reflect the increase in the cost of living as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) prepared by the Bureau of Labor Statistics (BLS). The purpose of the annual cost-of-living adjustment (COLA) is to ensure that the purchasing power of Social Security and SSI benefits is not eroded by inflation.

As noted, the law provides that Social Security and SSI benefits will increase automatically to reflect the annual increase in the cost-of-living in the CPI-W. The average CPI-W for the third calendar quarter of the prior year is compared to the average CPI-W for the third calendar quarter of the current year, and the resulting percentage increase represents the percentage that will be used to adjust Social Security benefits beginning for December of the current year. SSI benefits are adjusted by the same percentage the following month (January).

History

The automatic COLA provision was enacted by Congress as part of the 1972 Social Security Amendments. Prior to enactment, increases in Social Security benefits had to be enacted by Congress on an *ad hoc* basis. At that time, inflation was relatively high, so the provision enacted in 1972 provided for an automatic COLA only if the increase in the CPI-W was at least 3 percent, the so-called “3-percent trigger”.

By the mid-1980’s, as inflation began to wane, it became apparent that because of the 3-percent trigger, it could be possible that there would not be an annual COLA. In 1986, Congress enacted legislation to eliminate the 3-percent trigger.

Annual COLA

Under present law, there will be an automatic COLA for Social Security and SSI benefits provided that there is an increase in the average of the CPI-W for the third calendar quarter of the prior year to the third calendar quarter of the current year of at least one-tenth of one percent (0.1%). If there is no increase in CPI-W, or the CPI-W decreases, there will not be an automatic COLA. However, in the case of a decrease in the CPI-W, Social Security and SSI benefits will remain the same; benefits will not decrease. Projections under the intermediate assumptions of the 2009 Social Security Trustees Report indicate that there will be no Social Security COLA effective December 2009 or SSI COLA effective January 2010.

If no automatic COLA occurs because of deflation, the starting point for the measuring period for a subsequent COLA would remain at the third calendar quarter for 2008.

Other Automatic Increases

There are a number of other automatic increases in the Social Security program. Two of these increases are based upon increases in the national average wage level, but are triggered only if there is an automatic Social Security benefit COLA. These increases are:

- The Contribution and Benefit base – the cap on the amount of wages and self-employment income subject to FICA tax (\$106,800 for 2009) and,
- Retirement Earnings Test (RET) exempt amounts –caps on the amount of earnings that a beneficiary can earn before a reduction in benefits will apply.

If there is no automatic COLA because the CPI-W did not increase over the prescribed measuring period, the contribution and benefit base and the RET exempt amounts are not be increased, even if there has been an increase in the national average wages.

Effect on Medicare Part B Premium

Unlike the Social Security COLA, the CPI-W plays no part in the computation of the Medicare Part B premium. The Medicare Part B premium is increased each year, if necessary, so that the Part B premium is sufficient to fund approximately 25 percent of the projected cost of the Part B program. Any such premium increase is effective in the same month that the Social Security COLA is payable.

The Social Security Act includes a provision that holds certain Social Security beneficiaries harmless for increases in the Medicare Part B premium. That is, any increase in the affected beneficiaries' Part B premiums is limited to ensure that their Social Security payments (after taking into account the increase in the Part B premium deduction and the COLA increase) do not decline from one year to the next. In a typical year, the hold harmless provision affects less than one million beneficiaries. However, in a scenario where Medicare Part B premiums increase but Social Security benefits do not, it is estimated that the hold-harmless provision will apply to about 34 million beneficiaries, nearly three-quarters of all Part B beneficiaries. For these beneficiaries, there would be no increase in their Part B premium so their Social Security payments would remain unchanged.

For the other one-quarter of Part B participants, the hold harmless provision would not apply and their premiums would be higher than otherwise—nearly four times greater than if there were no hold-harmless provision. There are three groups of beneficiaries to whom the hold-harmless provision would not apply¹:

- low-income beneficiaries whose Part B premiums are paid by the Medicaid program (currently 17% to 18% of Part B beneficiaries),
- high-income beneficiaries who are subject to income-related Part B premiums (about 5% of beneficiaries), and
- new enrollees (about 2% of beneficiaries).

¹ The applicable groups and percentages are from a Congressional Research Service report “*How Would Medicare Part B Premiums Be Affected If There Is No Social Security COLA?*” released May 4, 2009.