Government Executive

The Incredible Shrinking COLA

By Tammy Flanagan

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Retirees have always had to be careful about their spending because they don't receive increases to their income in the same way as working, salaried employees do. As a practical matter for federal retirees, this means no promotions, step increases or across-the-board raises.

There are, however, cost of living adjustments for Social Security benefits, military retirement compensation and federal civilian retirement benefits under both the Civil Service Retirement System and the Federal Employees Retirement System. These COLAs are designed to maintain retirees' buying power in their golden years.

This week, the federal government announced that the COLA for federal retirees and Social Security recipients will be 1.5 percent in 2014. Cost-of-living adjustments for CSRS and FERS retirees are effective on Dec. 1 and will show up in the Jan. 1, 2014 retirement payment (covering December 2013). The COLAs are based on the percentage increase in the average Consumer Price Index for urban wage earners and clerical workers (known as the CPI-W), as determined by the Bureau of Labor Statistics.

The CPI-W group represents 32 percent of the total U.S. population and is a subset of the CPI for all urban consumers. The third quarter index (usually announced at the end of September) is compared to the third quarter index of the previous year to determine the amount of the retiree COLA. Due to the government shutdown, the announcement at the end of September was delayed until this week.

According to BLS, prices for the goods and services used to calculate the CPI are collected in 87 urban areas throughout the country and from about 23,000 retail and service establishments. Included in the data are prices for food, energy, commodities such as new and used cars, apparel, medical care, shelter and transportation.

The way the CPI is used in computing COLAs for federal benefits could be changing. Lawmakers and the Obama administration have been contemplating switching to what is known as "chained CPI." According to a 2003 Bureau of Labor Statistics report, the idea behind the chained CPI, which dates back to 1961, is to reflect consumer substitution in calculating the index. That involves tracking prices among specific products within a certain type of item (such as a leather watchband versus a stainless steel one or whole wheat bread versus white bread) and across different categories of items (such as theater tickets versus video rentals or beer versus wine). Evidence suggests that over time, the chained CPI would trend slightly lower than the standard CPI. Various groups that represent federal employees and retirees, such as the National Active and Retired Federal Employees Association, have lobbied against switching to the chained CPI.

For now, the standard CPI-W is the mechanism by which federal benefit COLAs are calculated. Let's look at how this plays out.

CSRS

Under CSRS, the first COLA received in retirement is prorated based on the number of months the retiree was retired before Dec. 1. To get 1/12 of the 2014 COLA, a non-disability CSRS retiree would have to retire no later than Nov. 3, 2013. For example, if the retiree's benefit was $5,000 per month, then the increase would be computed as 1/12 x 1.5% x $5,000, or $6.25 per month. If the retiree had retired on Jan. 3, 2013, he or she would be entitled to 11/12 of the COLA that is due on Dec. 1. To get the full 2014 COLA, the CSRS retirement date must be no later than Dec. 3, 2012. The full 1.5 percent COLA on a $5,000 CSRS retirement would add $75 per month in extra income for 2014.

FERS

Under FERS, there is no COLA until after age 62 for most retirees and a retiree must have turned 62 before Dec. 1 to receive the first adjustment. For FERS annuitants who are not eligible to receive a COLA during their first year (or more) on the annuity roll, the initial COLA they receive after becoming eligible is the full COLA without proration. If a retiree is already 62 in his or her first year of retirement, then the first COLA will be prorated as described above for CSRS.

There are exceptions to the delayed COLA for some groups: disability annuitants who are not receiving 60 percent of their average salary; military reserve technicians who are medically disqualified from service; employees who retired under special provisions for law enforcement officers, firefighters, or air traffic controllers; and survivor annuitants who are the spouses, former spouses and eligible dependent children of deceased employees and retired employee annuitants as well as the individuals receiving insurable interest survivor annuities of deceased retired employees. These retirees will receive their first COLA regardless of their age.

One more thing: The FERS COLA is sometimes referred to as a "diet COLA," because if the full COLA increase is 3 percent or higher, FERS retirees receive 1 percent less than the full increase. So if the full increase is between 2 percent and 3 percent, FERS retires will receive a 2 percent boost. If the increase is less than 2 percent, as it was this year, FERS retirees receive the same as CSRS retirees. With a 1.5 percent increase for 2014, a FERS basic retirement benefit of $2,500 a month would increase by $37.50 a month. Retirees with a CSRS component to their retirement (who transferred to FERS) will receive the immediate full COLA on the CSRS portion and the reduced and delayed COLA on the FERS portion.

Social Security

According to the Social Security Administration, Social Security COLAs are computed using the same formula as those used for CSRS and FERS retirees (but the full, rather than the "diet" COLA). The difference is that the first COLA under Social Security is not prorated or delayed, as it is for CSRS and FERS.

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