InvestmentNews

Small Social Security cost-of-living adjustment likely for 2017

But increase would be seven times higher if pegged to Consumer Price Index for the elderly

By Mary Beth Franklin September 12, 2016

Although we are still a month away from an official announcement about the size of the annual cost-of-living adjustment (COLA) for Social Security benefits in 2017, the latest Social Security Trustees report projects a 0.2% increase in benefits next year.

That would boost the average Social Security retirement benefit of $1,341 per month by about $2.70 and increase the maximum benefit of $2,663 per month in 2016 by about $5.30 next year.

While that would be an improvement over this year when there was no inflation adjustment over 2015 benefit levels, a small COLA will do little to shield seniors' budgets from the specific type of inflation that they tend to experience compared to the general population.

The Social Security Act provides for an automatic increase in benefits if there is an increase in inflation as measured by the Consumer Price Index for Urban Wage Earners (CPI-W). The COLA for 2017 would be based on the increase in the third-quarter average CPI-W for 2016 over the third quarter of 2014 (the last year in which a COLA became effective). The government will announce the Social Security COLA for 2017 in October.

Several senior advocacy groups, including the National Committee to Preserve Social Security and Medicare and The Senior Citizens League, support using a different inflation measure — the Consumer Price Index for the Elderly (CPI-E) — as the basis for future increases in Social Security benefits. It would require congressional action to change the inflation-adjustment formula.

“The current COLA calculation method doesn't fairly take into account the spending patterns of older Americans,” said Jessie Gibbons, a senior policy analyst at The Senior Citizens League. Younger people tend to spend more money on gasoline and electronics — two categories that have experienced price declines in the past two years — while older consumers spend more on health care and housing, which are more heavily weighted in the CPI-E, she said.

Based on inflation data through July, the government's CPI-E would result in a Social Security COLA of 1.5% next year, more than seven times the 0.2% COLA estimated by the Social Security Trustees in their 2016 report. In addition, while there was no COLA for Social Security recipients this year, the CPI-E data would have increased benefits by 0.6% in 2016.

The difference in COLA measures are usually small, especially at first, but the higher benefits compound over time. For example, someone who retired last year with a monthly benefit of $1,200 would receive about $20,300 more in retirement income over a 25-year retirement using the CPI-E, according to The Senior Citizens League estimates. This year the disparity between the two indices appears to be the highest on record driven by a spike in health care costs and higher housing costs, Ms. Gibbons added.

But the Social Security COLA is only part of the story. The size of the inflation adjustment will also affect how much seniors pay for their Medicare Part B premiums next year. About 39 million people, representing 66% of Social Security beneficiaries, have Medicare Part B premiums deducted directly from their benefit checks.

By law, the majority of beneficiaries are protected by a “hold harmless” rule that says their Social Security benefits cannot decrease from one year to the next due to an increase in Medicare Part B premiums. In other words, the increase in their monthly Medicare Part B premiums, which pays for doctors' visits and outpatient series, cannot exceed the dollar amount increase in their Social Security benefits.

The standard monthly Part B premiums for new enrollees in 2016 is $121.80. But due to the 0% Social Security COLA in 2016, the majority of Medicare enrollees continued to pay the 2015 premium amount of $104.90 per month. However, some beneficiaries do not qualify for protection under the hold-harmless provision, including high-income enrollees and those who do not receive Social Security benefits.

While the majority of Medicare beneficiaries would still qualify for protection under the hold-harmless rule in 2017, most would see a small Medicare premium boost next year if there is an increase in Social Security benefits. The premium amounts will vary.

For example, consider a Medicare Part B enrollee who currently pays $104.90 per month for Medicare. If this individual were receiving a Social Security benefit of $1,500 per month, then a 0.2% COLA would increase the benefit by $3 per month, meaning the Medicare premium could go up by $3 to $107.90 per month. But if that individual received a Social Security benefit of $2,500 per month, then a 0.2% COLA would mean a benefit increase of $5 per month and that enrollee's Medicare premium would increase by $5 per month to $109.90 next year.