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Social Security: The Cost-of-Living Adjustment in January 2006

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Summary

To compensate for the effects of inflation, Social Security recipients receive a cost-of-living adjustment (COLA) in January of each year. The Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), updated monthly by the Department of Labor's Bureau of Labor Statistics (BLS), is the measure used to compute the change. The Social Security COLA is based on the percentage change in the average CPI-W for the third calendar quarter of the previous year to the third calendar quarter of the current year. The COLA becomes effective in December of the current year and is payable in January of the following year (Social Security checks always reflect the benefits due for the preceding month).

The 4.1% COLA payable in January 2006 was triggered by the rise in the CPI-W from the third quarter of 2004 to the third quarter of 2005. This COLA triggers identical percentage increases in Supplemental Security Income (SSI), veterans' pensions, and railroad retirement benefits, and causes other changes in the Social Security program. Although COLAs under the federal Civil Service Retirement System (CSRS) and the federal military retirement program are not triggered by the Social Security COLA, these programs use the same measuring period and formula for computing their COLAs. Their recipients also receive a 4.1% COLA in January 2006. This report is updated annually.

How the Social Security COLA Is Determined

An automatic Social Security benefit increase reflects the rise in the cost of living over roughly a one-year period. The CPI-W, updated monthly by the BLS, is the measure used to compute the change. The Social Security COLA is based on the percentage change in the average CPI-W for the third calendar quarter of the previous year to the third calendar quarter of the current year. The COLA becomes effective in December of the current year and is payable in January of the following year (Social Security checks always reflect the benefits due for the preceding month).

The January 2006 COLA

The January 2006 COLA became known on October 14, 2005, when the BLS announced the September 2005 CPI-W figure. With release of the September 2005 index, the two July-September sets of CPI-W figures needed to compute the COLA (one for 2004 and another for 2005) became available. **Table 1** shows how the January 2006 COLA is computed under procedures set forth in Section 215(i) of the Social Security Act.

Table 1. Computation of the Social Security COLA, January 2006

	CPI-W Index Points
July 2004	184.9
August 2004	185.0
September 2004	185.4
<i>Average for Third Quarter of 2004 (rounded to the nearest one-tenth of 1%):</i>	185.1
July 2005	191.0
August 2005	192.1
September 2005	195.0
<i>Average for Third Quarter of 2005 (rounded to the nearest one-tenth of 1%):</i>	192.7
Percentage increase from the third quarter average for 2004 to the third quarter average for 2005 (rounded to the nearest one-tenth of 1% as required by law):	$192.7 - 185.1 = 7.6$ $7.6 / 185.1 = 4.106\%$ COLA = 4.1%

Source: BLS data series for the CPI-W for 2004 and 2005.

Note: The reference base period for the CPI-W is 1982-1984, i.e., the period when the index equaled 100.

What Else Is Affected Besides Social Security Benefits?

Social Security COLAs trigger increases in other programs. SSI benefits, veterans' pension benefits, and railroad retirement "tier 1" benefits (equivalent to a Social Security benefit) are increased by the same percentage as the Social Security COLA. Railroad retirement "tier 2" benefits (equivalent to a private pension) are increased by 32.5% of the percentage increase applicable to "tier 1" COLAs. Although COLAs under the CSRS and the federal military retirement system are not triggered by the Social Security COLA, these programs use the same measuring period and formula for computing their COLAs.

Their recipients also receive a 4.1% COLA in January 2006.¹ The COLA also triggers other changes in the Social Security program including the following items indexed to the increase in national average wages:

- *Taxable Earnings Base.* The Social Security (or Old-Age, Survivors, and Disability Insurance — OASDI) taxable earnings base (the maximum amount of annual earnings subject to Social Security taxes) will increase to \$94,200 in 2006 (from \$90,000 in 2005).
- *Exempt Amounts Under the Social Security Earnings Test.* The exempt amount under the earnings test (the maximum annual amount a Social Security recipient can earn from work and still receive full benefits) will rise to \$12,480 in 2006 (up from \$12,000 in 2005) for persons who are below the full retirement age (FRA) and will not reach the FRA during 2006. For those born prior to 1937, the FRA is 65 years. Under the Senior Citizens' Freedom to Work Act (P.L. 106-182), effective January 1, 2000, the earnings test no longer applies to recipients beginning in the month they reach the FRA. During the calendar *year* in which a recipient will reach the FRA, an annual exempt amount still applies for months preceding the attainment of the FRA. For those born in 1941 and turning 65 at some point in 2006, the FRA is not reached until 65 years and eight months. According to law, the FRA will gradually increase to eventually reach 66 years for those born between 1943 and 1954, and 67 years for those born after 1959. The ages at which the earnings test applies will increase accordingly. Under the law, the exempt amount will be \$33,240 (\$2,770 per month) in 2006 (up from \$31,800, or \$2,650 per month, in 2005), and will continue to rise in proportion to the increase in national average wages.

Although not triggered by COLAs, other changes are tied to the increase in national average wages. In 2006, the amount of earnings needed for a Social Security “quarter-of-coverage” is \$970 (up from \$920 in 2005). The annual coverage thresholds for domestic workers and election workers each increase by \$100 in 2006, to \$1,500 and \$1,300, respectively. The monthly substantial gainful activity amount for the non-blind disabled is \$860 (up from \$830 in 2005), and the amount for the blind disabled is \$1,450 (up from \$1,380 in 2005).

Tables 2 and 3 show the history of increases in Social Security benefits and the taxable earnings base. **Table 4** shows the effect of the January 2006 COLA on monthly benefit levels.

¹ For retirees under the Federal Employees' Retirement System (FERS), a different formula is applied and the resulting increases may differ.

Table 2. History of Social Security Benefit Increases

Date increase was paid	Amount of increase (shown as a percentage)
January 2006	4.1%
January 2005	2.7
January 2004	2.1
January 2003	1.4
January 2002	2.6
January 2001	3.5
January 2000	2.5 ^a
January 1999	1.3
January 1998	2.1
January 1997	2.9
January 1996	2.6
January 1995	2.8
January 1994	2.6
January 1993	3.0
January 1992	3.7
January 1991	5.4
January 1990	4.7
January 1989	4.0
January 1988	4.2
January 1987	1.3
January 1986	3.1
January 1985	3.5
January 1984	3.5
July 1982	7.4
July 1981	11.2
July 1980	14.3
July 1979	9.9
July 1978	6.5
July 1977	5.9
July 1976	6.4
July 1975 ^b	8.0
April/July 1974 ^c	11.0
October 1972	20.0
February 1971	10.0
February 1970	15.0

Date increase was paid	Amount of increase (shown as a percentage)
March 1968	13.0
February 1965	7.0
February 1959	7.0
October 1954	13.0
October 1952	12.5
October 1950	77.0

Source: Social Security Administration.

- a. Originally computed as 2.4%, the COLA payable in Jan. 2000 was corrected to 2.5% under P.L. 106-554.
- b. Automatic COLAs began.
- c. Increase came in two steps.

Table 3. Social Security and Medicare Hospital Insurance Taxable Earnings Bases Since the Beginning of the Programs

Year Effective	Taxable Earnings Base	
	OASDI	HI
2006	\$94,200	All earnings
2005	90,000	All earnings
2004	87,900	All earnings
2003	87,000	All earnings
2002	84,900	All earnings
2001	80,400	All earnings
2000	76,200	All earnings
1999	72,600	All earnings
1998	68,400	All earnings
1997	65,400	All earnings
1996	62,700	All earnings
1995	61,200	All earnings
1994 ^a	60,600	All earnings
1993	57,600	\$135,000
1992	55,500	130,200
1991 ^a	53,400	125,000
1990	51,300	51,300
1989	48,000	48,000
1988	45,000	45,000
1987	43,800	43,800
1986	42,000	42,000
1985	39,600	39,600
1984	37,800	37,800
1983	35,700	35,700
1982	32,400	32,400
1981	29,700	29,700
1980	25,900	25,900

Year Effective	Taxable Earnings Base	
	OASDI	HI
1979	22,900	22,900
1978	17,700	17,700
1977	16,500	16,500
1976	15,300	15,300
1975	14,100	14,100
1974	13,200	13,200
1973	10,800	10,800
1972	9,000	9,000
1968-1971	7,800	7,800
1966-1967 ^b	6,600	6,600
1959-1965	4,800	—
1955-1958	4,200	—
1951-1954	3,600	—
1937-1950	3,000	—

Source: Social Security Administration.

a. The HI taxable earnings base was eliminated by the Omnibus Budget Reconciliation Act of 1993. In 1991, it was raised to \$125,000 as a revenue-raising measure in the Omnibus Budget Reconciliation Act of 1990.

b. 1966 was first year in which the HI tax was levied.

Table 4. Impact of January 2006 COLA on Monthly Benefit Levels

	Before 4.1% COLA	After 4.1% COLA
Average Social Security monthly benefit levels:		
All retired workers	\$963	\$1,002
Aged couple, both receiving benefits	\$1,583	\$1,648
Widowed mother and two children	\$1,992	\$2,074
Aged widow(er) alone	\$929	\$967
All disabled workers	\$902	\$939
Disabled worker, spouse, and one or more children	\$1,509	\$1,571
SSI federal monthly payment standard:		
Individual	\$579	\$603
Couple	\$869	\$904

Source: Social Security Administration, Oct. 14, 2005.