How do Public Pension Plans Measure up to Social Security on Inflation Protection?

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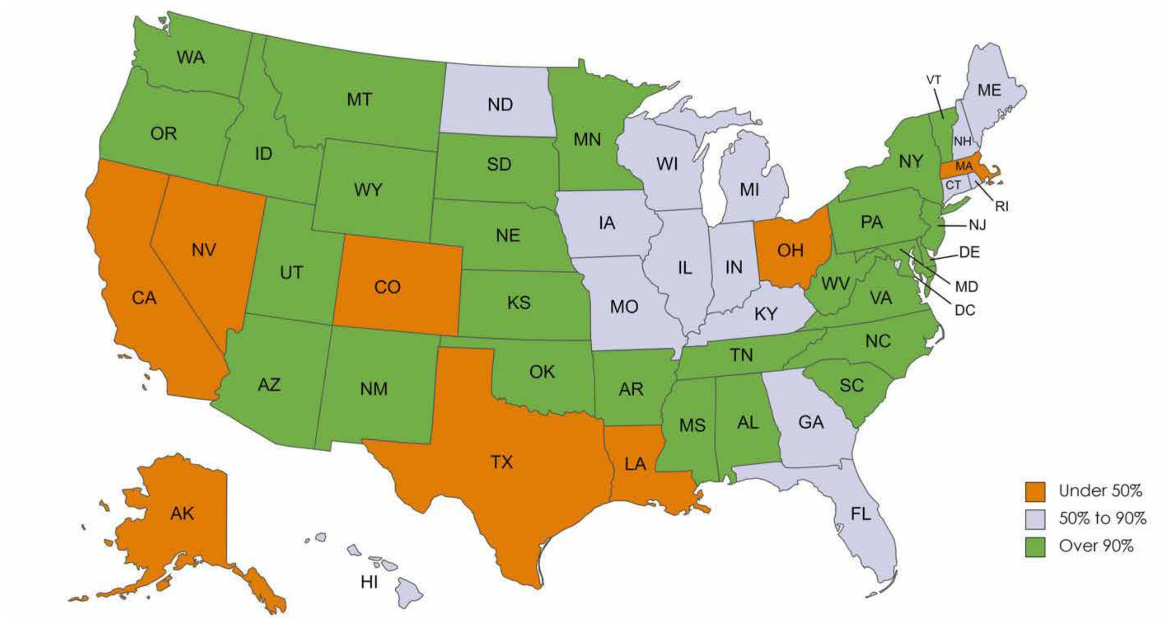
Despite concerns about how well Social Security is funded, the program has provided full annual cost-of-living adjustments (COLAs) to benefits based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), a measure of inflation, since 1975. This is basically a "one-for-one" adjustment. For example, the CPI-W showed an 8.7% inflationary increase for 2022 and Social Security benefits increased 8.7%. In years with negative CPI-W values, the COLA is 0.0%.

These COLAs are good news for private sector employees, 94% of whom are covered to some degree by Social Security. A smaller percentage of the 23 million public sector employees are covered by Social Security: 72%.[1] Even that percentage is not uniform across states.

While public employees' participation in Social Security is over 90% in more than half of states, in some large states the participation rate is much lower. For example, Texas and California are only at 46% and 45%, respectively.[2] Of the 6.5 million public employees who are not covered by Social Security, 2.4 million reside in those two states.

Participation in Social Security varies not only by state but also by industry.

Social Security Participation Rate of Public Employees, by State



Source: Segal Map created using CRS Report: Social Security Coverage of State and Local Government Employees, November 2021

Participation in Social Security varies not only by state but also by industry. At least 12 states exclude teachers from Social Security participation.[3] Public safety employees also often do not participate in Social Security.

Inflation's Impact on Benefits

Many public pension plans have COLAs, but they typically offer lower annual increases than Social Security. Other public plans offer no scheduled COLAs. Consequently, even short periods of high inflation can negatively affect public plan retirees' ways of life. The impact is more acute when there are sustained increases in inflation.

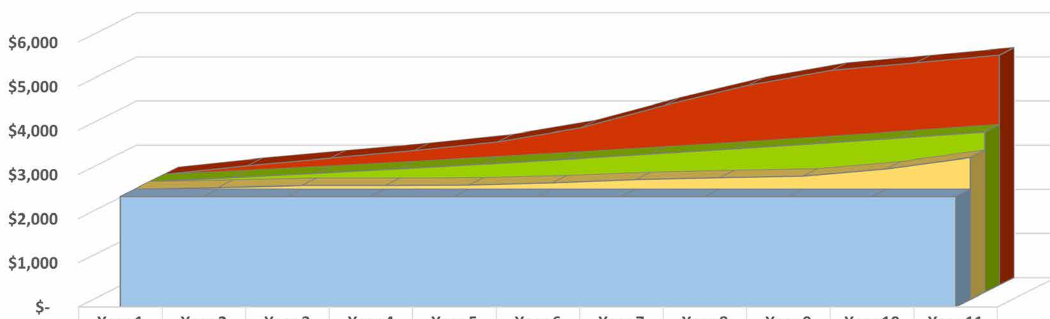
Social Security COLAs and Cumulative Increase for Two 10-Year Periods

Most Recent 10-Year Period				High-Inflationary Period from 1975–1984		
	Social Security COLA	Cumulative Increase			Social Security COLA	Cumulative Increase
2022	8.7%	128.6%		1984	3.5%	208.3%
2021	5.9%	118.3%		1983	3.5%	201.2%
2020	1.3%	111.7%		1982	7.4%	194.4%
2019	1.6%	110.3%		1981	11.2%	181.0%
2018	2.8%	108.6%		1980	14.3%	162.8%
2017	2.0%	105.6%		1979	9.9%	142.4%
2016	0.3%	103.5%		1978	6.5%	129.6%
2015	0.0%	103.2%		1977	5.9%	121.7%
2014	1.7%	103.2%		1976	6.4%	114.9%
2013	1.5%	101.5%		1975	8.0%	108.0%

Source: Social Security Administration Cost-Of-Living Adjustments

The average Social Security COLA increase from 2013 through 2022 was 2.6%. The average annual increase over all Social Security COLA years (1975–2022) was 3.8%. The first 10 years of COLAs averaged 7.7% (1975–1984). So, as with many things, timing is critical. The following graph illustrates this timing dependence for a starting monthly payment of $2500.

$2500 Monthly Annuity Payments Under Three COLA Scenarios

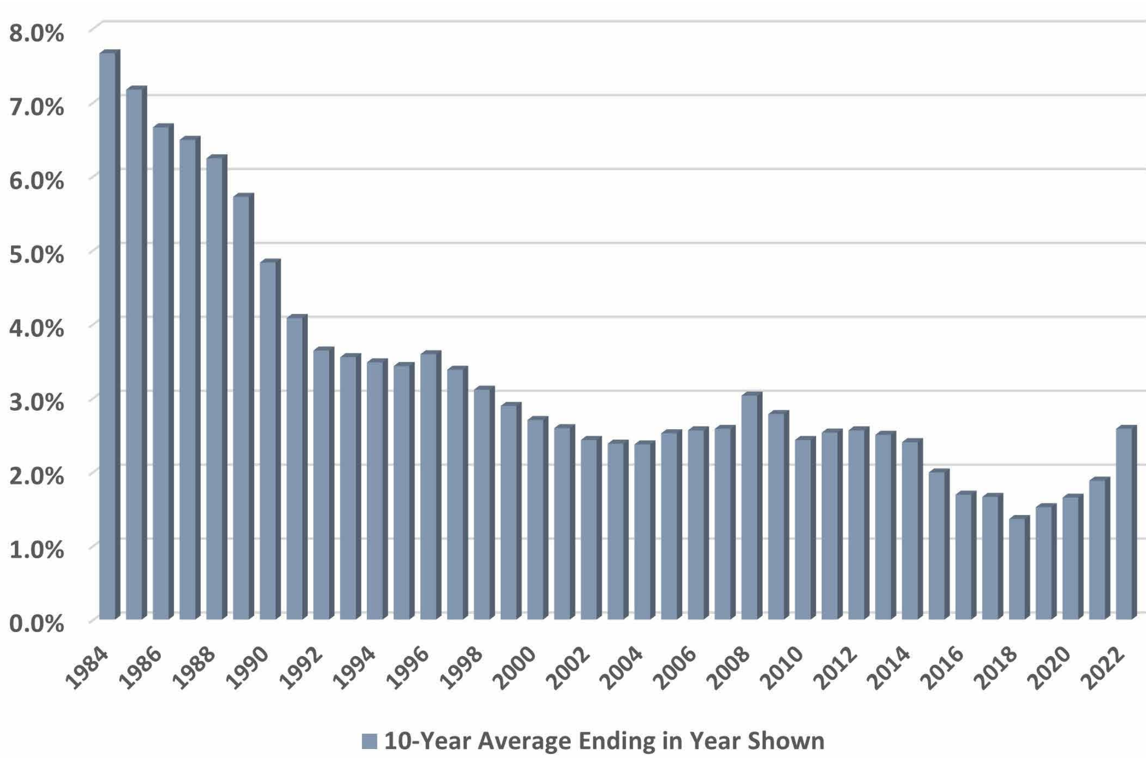


	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
No COLA	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500
SS COLA 2013-2022	$2,500	$2,538	$2,581	$2,581	$2,588	$2,640	$2,714	$2,757	$2,793	$2,958	$3,216
SS COLA 3.8% Average	$2,500	$2,595	$2,694	$2,796	$2,902	$3,012	$3,127	$3,246	$3,369	$3,497	$3,630
SS COLA 1975-1984	$2,500	$2,700	$2,873	$3,042	$3,240	$3,561	$4,070	$4,526	$4,861	$5,031	$5,207

Source: Social Security [Administration Cost-Of-Living Adjustments]

We are emerging from one of the lowest inflationary periods in recent history during which Social Security COLA increases averaged under 2.0% for multiple 10-year periods. That is now trending upward.

Average Social Security COLAs for 10-Year Periods Ending in 1984–2022



Source: Social Security [Administration Cost-Of-Living Adjustments]

Conclusion: How Do Public Plans Fare Against Inflation?

On average, public retirement plans whose members are ineligible for Social Security offer higher COLAs (2.5%) than plans that allow members to participate in Social Security (1.8%).[4] In both cases, these averages only sustain purchasing power for members in low inflationary environments. Yet, as already noted, some funds offer no scheduled COLAs. As inflation increases, members not participating in Social Security who receive a typical COLA or no COLA will lose net purchasing power and likely fall behind public sector employees who participate in Social Security. These plans may find retirees struggling to keep up with rising costs, especially during years of high inflation like we've seen recently. COLA concerns may vary state to state as well as across different industries.

Your actuarial consultant can help you learn more about your plan's COLA situation, including potential gaps and possible mitigations relative to inflation. ◆

Endnotes:

[1] CRS Report: Social Security Coverage of State and Local Government Employees, November 2021

[2] Ibid

[3] Social Security Intelligence, "Teacher's Retirement and Social Security" by Devin Carroll https://www.socialsecurityintelligence.com/teachers-retirement-and-social-security/ (accessed June 25, 2023.)

[4] NCPERS 2023 Public Retirement Systems Study: Trends in Fiscal, Operational, and Business Practices

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