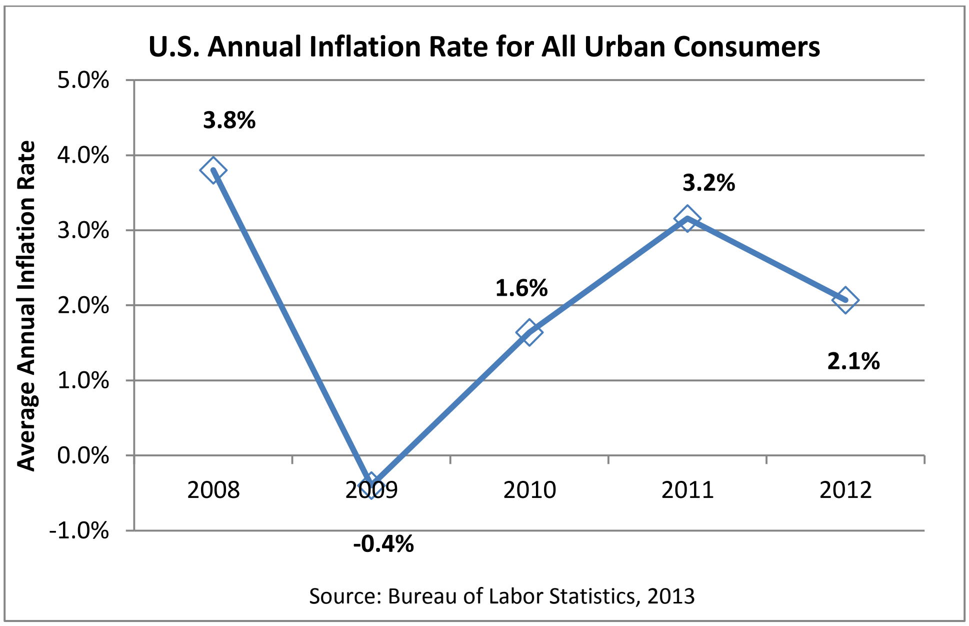
Using the U.S. Consumer Price Index as a COLA

The Bureau of Labor Statistics (BLS) of the U.S. Department of Labor calculates a consumer price index (CPI) each month. Actually, the BLS calculates several CPI values. The “CPI – For All Urban Consumers” averaged 229.6 in 2012. Many people may not recognize that number, however – they are more interested in and familiar with an economic measure derived from the CPI – the inflation/deflation rate. Because the average 2012 CPI was higher than the average 2011 CPI, the U.S. inflation rate was a positive, 2.1 percent, between those two years. Overall, the national average annual inflation rate was modest in 2012.



Public concern about the inflation/deflation rate is rooted in two aspects of that statistic. First, it is an economic indicator, that is, it suggests what direction and how much the economy is expanding or contracting – most economists prefer a steady, moderate increase in the CPI from one period to the next. The second aspect of the inflation rate that causes public interest is its annual use to adjust Social Security retirement payments – the so-called cost of living adjustment (COLA). Labor contracts are also often indexed to the inflation rate.

Consequently, every year a few of businesses in the state request the Nebraska inflation rate from DED. In fact, neither the BLS nor any state agency calculates a state CPI suitable for use in calculating a Nebraska COLA. So what can Nebraska businesses that want to base pay raises on changes in the cost of living do? The “BLS strongly recommends that users adopt the U.S. City Average CPI or one of the regional city averages [rather than one of the more volatile metropolitan averages] for use in escalator clauses.” However, if the employers and workers in a Nebraska business feel strongly that the year-to-year changes in the state’s cost of living differ significantly from national rates, they can negotiate adjustments to the national rates so they reflect the state's differences. (Note: The Nebraska inflation rate can vary from the national average largely for two reasons: (1) Nebraska consumers may not buy the same market basket of goods and services used to calculate the U.S. urban average CPI or (2) Nebraska prices for the market basket of goods and services do not increase/decrease at the same rate as national prices.) Thus, if the national inflation rate were 4.0 percent but the parties to a particular Nebraska labor contract agreed that state prices rose at only about ninety percent of the national rate, they could raise wages by only 3.6 percent rather than the entire 4.0 percent.

The BLS provides the following example of how to calculate the annual inflation rate on their Web site at: www.bls.gov/cpi/cpifact3.htm

> Escalation agreements using the CPI usually involve changing the base period payment by the percent change in the level of the CPI between the base period and a subsequent time period. This is calculated by first determining the index point change between the two periods and then the percent change. The following example illustrates the computation of percent change:

CPI for current period	136.0
Less CPI for previous period	129.9
Equals index point change	6.1
Divided by previous period CPI	129.9
Equals 0.047	
Result multiplied by 100	0.047 x 100
Equals percent change	4.7

To complete this example, if an employee's current wage rate were $10.00 per hour, it would increase to $10.47 ($10.00 x 1.047) as a result of the 4.7 percent increase in the CPI.

Last Updated: June 20, 2013

e-mail: michael.lundeen@nebraska.gov