National Bureau of Economic Research

RETIREMENT AND DISABILITY RESEARCH CENTER
SEPTEMBER 2020

The Prevalence of COLA Adjustments in Public Sector Retirement Plans

FITZPATRICK, GODA

Key Findings and Policy Implications

This paper analyzes changes in the cost-of-living adjustment formulas, or COLAs, of state and local pension plans between 2005 and 2018. It also simulates the potential effect of COLA changes on labor supply and Social Security claiming. The authors compile COLA reform data from 49 pension systems in 30 states and covering over half of all non-federal public sector workers. These data are linked to the American Community Survey. The paper finds that:

- Each year during the 2005-2018 period, between 27 and 57 percent of public sector workers in the sample experienced a change in the COLA formula. The direction of change varied over time. In 2005 and 2006, before the Great Recession, 75 to 80 percent of COLA changes were increases. Many more negative than positive COLA changes occurred in 2007-2010 and 2013-2016. In 2013, for example, just 1 of the 19 COLA changes was positive. By 2017 and 2018, there was again an increase in the share of pension plan COLA changes that were positive.

- For a hypothetical full-career public sector worker, eliminating a 3 percent COLA reduces the discounted value of their retirement wealth by an estimated 35 percent. Apply elasticities from previous studies, this reduction translates to a delay in retirement of approximately 4.5 months.

About 14 percent of the U.S. workforce is comprised of state and local employees who are eligible for benefits from state or locally administered pension plans. Many of these plans have unfunded liabilities, but legal restrictions often prevent them from reducing benefits for current employees. They can, however, reduce future liabilities by changing the plan COLAs. The sheer number of workers affected by these changes – 60 million over the 14 years covered in our database – suggests that these changes, which have not been studied on a broad scale, could have significant changes on retirement and Social Security.

MARIA FITZPATRICK is an Associate Professor in the Department of Policy and Management, Associate Director of Data for Evidence-Based Policy at the Bronfenbrenner Center for Translational Research, and Research Associate at NBER.
GOPI SHAH GODA is a Senior Fellow and the Deputy Director at the Stanford Institute for Economic Policy Research (SIEPR) at Stanford University and a Faculty Research Fellow at NBER.
.

This research was supported by the U.S. Social Security Administration through grant # RDR18000003-02 to the National Bureau of Economic Research as part of the SSA Retirement and Disability Research Consortium. The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the Federal Government, or the NBER.