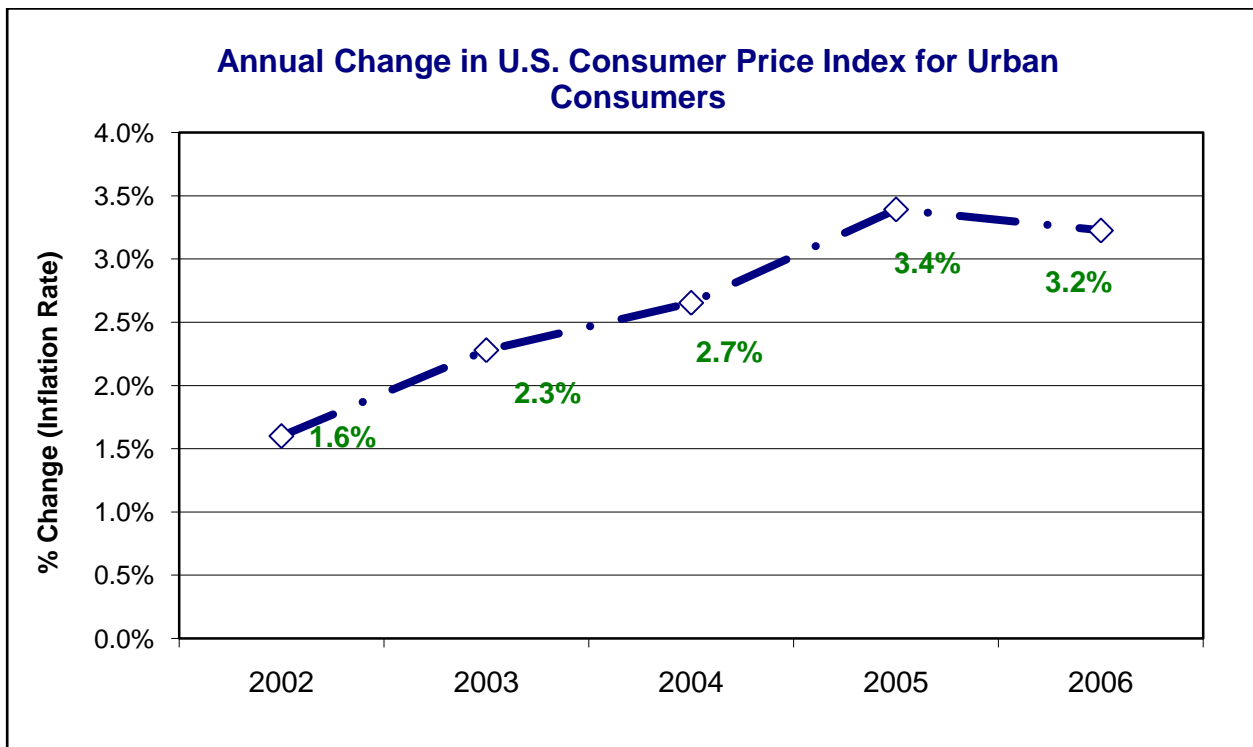


Using the U.S. Consumer Price Index as a COLA

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” was 196.8 in December 2005. 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 December 2005 CPI was less than the November 2005 CPI, the U.S. inflation rate was actually negative, -0.4 percent, between those two months. Overall, however, the 2005 national annual inflation rate was 3.4 percent (see graph), the highest rate since 2000.



Public concern about the inflation/deflation rate is rooted in two aspects of that statistic. First, it is an economic indicator, that is, what direction and how much it changes indicates whether 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 do not buy the same market basket of goods and services used to calculate the U.S. city 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 ($\10.00×1.047) as a result of the 4.7 percent increase in the CPI.

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