Post-retirement Pension Increases

BY HARRIET WEINSTEIN

Inflation erodes the purchasing power of pension benefits available to retirees in their retirement years. The significance of this declining real income with age is heightened by the rise in longevity over this century. The number of the aged will soon explode, as the "baby boomers" reach retirement age, and they will live longer. In 1900, the life expectancy of someone born in the United States was 49; today, it is 76. An awareness of the aging of the population has raised concerns regarding how retirement years will be financed. Retiree income comes from three main sources: Social Security; employer-provided pensions; and personal savings and investments. This article looks at the extent of post-retirement pension increases based on data obtained from the Bureau's Employee Benefit Survey (EBS).[1]

There are two types of employer-provided retirement plans: defined contribution and defined benefit plans. Defined contribution plans generally specify the level of employer contributions to the plan, but not the actual benefits that will be paid upon retirement. Because defined contribution plans generally pay a lump sum at retirement, there is no provision for adjusting benefits for inflation. In contrast, defined benefit plans obligate employers to pay retirees an annuity at retirement, based on a formula specified in the plan. The size of the benefit is typically based on salary and years of service. Some of these retiree benefits are protected from the loss of purchasing power over retirement years by automatic increases specified in the pension plan, discretionary adjustments (ad hoc), or both.

The EBS survey provides data on the prevalence of automatic post-retirement provisions, as well as ad hoc increases granted during the 5-year period prior to the survey.[2] Because the survey counts the number of current employees covered by the defined benefit plans and not the number of retirees, the survey cannot specify the proportion of annuitants actually receiving post-retirement pension increases.

Pension plan formulas calling for cost-of-living (COLA) increases are typically linked to changes in the BLS Consumer Price Index (CPI). Frequently, restrictions limit the size of the adjustment to a portion of the CPI change. Plans with COLAs most often provide annual adjustments.

Pension plan administrators consider several factors in deciding to grant ad hoc increases. These factors include general economic conditions (such as the rate of inflation), pension fund investment performance, and the firm's financial position. Ad hoc increases are not directly linked to a price index. Instead, retirees' current pensions are typically raised by a percent of the present benefit, which is commonly a uniform amount. For example, pension plan administrators may decide to provide a 3-percent increase to all those who are receiving an annuity. Other plans may call for larger pension increases for individuals who have been retired longer.

Post-retirement pension increases are more widespread during periods of high inflation. Table 1 shows the proportion of full-time workers participating in defined benefit plans that provided post-retirement increases, ad hoc increases in the prior 5 years, and COLA increases, as well as the CPI change in the corresponding period. For example, in 1983, the first year these data are available, 54 percent of full-time workers in medium and large firms participated in pension plans with post-retirement increases, compared to 10 percent in 1993; while the corresponding changes in the CPI during the previous 5 years, were 57 percent and 23 percent, respectively. While the prevalence of automatic increase provisions is relatively stable over time, COLA provisions are more likely to trigger an increase in benefits during periods of rapidly rising prices. Ad hoc increases, however, vary with changes in the general price level, as plan administrators recognize the need for benefit increases when there is a dramatic drop in purchasing power.

As shown in table 1, ad hoc increases are more common in private industry than in government, but the opposite is true for automatic increases. Overall, the availability of post-retirement increases is greater for State and local gov-

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ernment workers than those in private industry. Public sector pension plans frequently call for automatic benefit increases, typically (but not always) linked to changes in the CPI. In part, this reflects the absence of Social Security coverage to supplement retirement benefits for one-fourth of these government workers. In comparison, almost all workers in private industry are covered by Social Security. (Social Security benefits are adjusted annually to reflect increases in the cost-of-living.)

A study of defined benefit plans in medium and large firms in 1993 demonstrates that it is unlikely retirees received an increase in their pension benefit after retirement during this period of stable price changes. Plans for 90 percent of the full-time workers did not provide a post-retirement increase in the previous 5-year period. As shown in table 2, the prevalence of pension benefit increases varied little among major occupational groups, major industry groups, or union status.

EBS data collected in the 1980s show that ad hoc pension increases were, on average, about one-third to one-half of the inflation rate. Detailed data were collected on ad hoc adjustment provisions, and pension increases were projected for various retirement periods and monthly pension amounts. Table 3 shows the projected increases after 10 years of retirement, for pensions that were initially $250 and $1,000 per month. For example, in pension plans granting one or more ad hoc increases from December 1977 to December 1982, annuities rose an average of 25 percent for persons retired for 10 years with a monthly pension of $250 in 1977, and 19 percent for those with a pension of $1,000 in 1977.

In general, even those receiving a post-retirement pension increase do not recover the full loss of purchasing power. While adjustments are more likely during periods of high inflation, the cumulative effect of several years of low inflation can also severely erode the value of pension benefits. Thus, despite post-retirement pension increases, retirees never recover the buying power of the benefit they receive at the onset of their retirement.

—ENDNOTES—

[1] The Employee Benefit Survey obtains information from establishments, excluding agriculture and the Federal government, on the incidence and characteristics of employer-provided benefits for those currently employed. Three surveys are conducted—one of establishments with 100 or more workers, which BLS refers to as "medium and large" establishments; another of small establishments with fewer than 100 employees; and a third of State and local governments.

[2] For detailed discussions of post-retirement increases see, Donald G. Schmitt, "Postretirement Increases Under Private Pension Plans," *Monthly Labor Review*, September 1984, pp. 25-30; and William J. Wiatrowski, "Factors Affecting Retirement Income," *Monthly Labor Review*, March 1993, pp. 25-35.

Table 1. Post-retirement pension increases from defined benefit pension plans and changes in the Consumer Price Index in previous 5 year period, selected years, 1983-94
(Percent of full-time participants in pension plan = 100)

Year	Post-retirement increases to retirees	Discretionary ad hoc increases to retirees in last 5 years	Automatic cost-of-living adjustments	Percent change in Consumer Price Index in previous 5 years
Medium and large establishments				
1983	54	51	3	57
1984	49	47	3	50
1985	43	41	4	37
1986	38	35	3	27
1988[1]	29	26	4	18
1989	28	22	7	19
1991	11	7	5	22
1993	10	6	4	23
Small private establishments				
1990	9	7	2	20
1992	8	4	4	25
State and local governments				
1987	75	33	51	18
1990	59	16	50	20
1992	59	10	52	25
1994	62	13	([2])	21

[1] In 1988, the sample size was expanded, particularly in the service industries. Corresponding data based on the old sample shows 33 percent with post-retirement increases available, 30 percent with ad hoc increases, and 4 percent with COLAs.

[2] 45 percent based on rise in CPI, 9 percent other automatic increases.

NOTE: The CPI changes were calculated by comparing the December to December BLS Consumer Price Index for Urban Wage Earners and Clerical Workers.

Table 2. Post-retirement pension increases from defined benefit pension plans, full-time participants, medium and large private establishments, 1993
(in percent)

	Total	Post-retirement increases available	Discretionary ad hoc increases to retirees in last 5 years	Automatic cost-of-living adjustments	No post-retirement increases
All employees	100	10	6	4	90
Occupational groups:					
Professional, technical, and related employees	100	10	6	4	90
Clerical and sales employees	100	8	4	4	92
Blue collar and service employees	100	11	7	4	89
Union status:					
Union	100	13	7	6	87
Non-union	100	9	6	3	92
Industry:					
Goods producing	100	12	11	1	88
Service producing	100	9	3	6	91
Manufacturing	100	11	10	1	89
Nonmanufacturing	100	9	3	6	91

NOTE: Sum of individual items may not equal 100 because of rounding.

Table 3. Projected pension increases under ad hoc post-retirement increases, after 10 years of retirement, selected 5-year periods, 1977-88.

Five year period (December 31 to December 31)	Percent change in Consumer Price Index	Percent change in average monthly pension of $250 at start of period	Percent change in average monthly pension of $1000 at start of period
1977-1982	57	25	19
1978-1983	52	23	17
1979-1984	41	22	18
1980-1985	31	27	22
1982-1987	18	15	12
1983-1988	19	10	8

NOTE: Increases were averaged by using the number of current full-time plan participants, not the actual number of retirees, as weights. CPI changes were calculated by comparing the BLS Consumer Price Index for Urban Wage Earners and Clerical Workers, December to December Index.