Using the Consumer Price Index as an Escalator in Labor Contracts

One of the most common indexes used to calculate cost of living adjustments (COLA) in collective bargaining agreements is the Consumer Price Index, or CPI. This index, published by the Bureau of Labor Statistics (BLS), measures the change in prices over time for a fixed basket of goods and services. The Bureau of Labor Statistics estimates the wages for over 2 million workers are tied to the CPI through collective bargaining agreements.

Variations in the Consumer Price Index

There are many variations in the CPI including the geographic region, population, and the time period covered. Two such variations include CPI-U and CPI-W. The first, CPI-U, reflects the spending of all urban consumers. This index includes the spending habits of almost all residents of urban and metropolitan areas representing approximately 87% of the U.S. population. This is the index that is used to annually update tax parameters.

The second index, CPI-W, reflects the spending of wage earners and clerical workers. This index is actually a subset of CPI-U covering approximately 32% of the U.S. population. The CPI-W index is used to calculate the annual benefit adjustment for Social Security.

A third index, the C-CPI-U or chained CPI, reflects consumer substitutions in response to changes in relative prices. This index is far less common than CPI-U or CPI-W.

In addition to the differences in populations, indexes are published for various geographic areas. The largest geographic area is covered by the U.S. City Average. Regional indexes are published for the Northeast, South, Midwest, and West. Indexes are also published for several metropolitan areas including Portland-Salem.

Summary

The Consumer Price Index is commonly used for Cost of Living adjustments in collective bargaining agreements.

Successful use of the Consumer Price Index for Cost of Living adjustments requires documentation of all variables used in the calculation.

The larger indexes, including the U.S. City Average and the four regional indexes are published monthly. Metropolitan area indexes are published less frequently depending on size. For example, larger metropolitan areas such as New York and Los Angeles are published monthly while smaller metropolitan areas including San Francisco and Seattle are only published every other month. Indexes for the smallest metropolitan areas, such as Portland-Salem, are only published twice a year.

Defining the Consumer Price Index variables for labor contracts

All of these variations must be considered when selecting a CPI to be used for COLA adjustments in a labor contract. For example, some feel the CPI-W is a better measure of inflation for labor contracts because it better reflects the buying habits of those covered under the agreement. While others may argue the CPI-U is superior because it represents a larger sample size. Whatever index is used, it needs to be clearly defined in the labor agreement. Merely stating “wages will increase by CPI” is not sufficient and leaves the contract open to varying interpretations.

Once the population coverage is defined, either CPI-U or CPI-W, the geographic area to be included must be determined. As with population, there are differing opinions on the appropriate geographic area. Some feel the index for the specific metropolitan area should be used because it reflects all of the factors specific to the area. However, the sample sizes for the metropolitan indexes are smaller resulting in more volatility. For this reason, the Bureau of Labor Statistics recommends using the U.S. City Average. There should also be a provision for potential changes to the index selected. For example, the Portland-Salem CPI was formerly Portland-Vancouver.

The CPI indexes are published on a seasonally adjusted and unadjusted basis. Seasonal adjustments are made for changes that occur at the same time and in about the same magnitude each year. Seasonally adjusted data is subject to revision for up to 5 years. Because this data is subject to revision, labor agreements should be based on the unadjusted CPI. This should also be defined in the labor agreement.

As mentioned previously, the CPI measures the change in price of a basket of goods. The index can be broken down into several subsets including food and beverages and housing. Price changes can be calculated for each of these individual subsets. However, when the CPI is used in labor agreements it generally includes all items. The series title should be defined as “all items.”

The index base period should also be identified. Currently the CPI is calculated on the 1982-84=100 base period.

The final variable that should be defined is the time period. Will the adjustment be based on the change in CPI from December to December or the annual average? Selection of the geographic region may limit the options available. For example, the Portland-Salem CPI is only published twice a year. The method and frequency of calculation should also be defined. Will wages covered under the contract be adjusted more frequently than once per year? What month will the adjustment be made? Is there a floor or ceiling to the annual adjustment? This should all be defined in the agreement.

In summary, clearly defining all of the factors used in the COLA calculation ensures all parties have the same understanding of how the calculation is made.