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Reforming the GPO and WEP In Social Security

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Social Security has a progressive benefit formula that generates a higher replacement rate for lower earners than higher earners; that is, monthly benefits represent a larger share of previous earnings for lower earners. The program also provides auxiliary benefits to some spouses without lowering the benefit of the worker with such a spouse. In the absence of special rules, workers or spouses with extended careers outside Social Security (for example, some federal, state, and local employees) would gain from these provisions even though the provisions were not intended to benefit those with public pensions provided outside Social Security. In both cases, Congress has enacted rules to limit the extent to which Social Security provides unwarranted subsidies to workers with pensions based on noncovered work.[1] Some advocates and policymakers, however, have expressed dissatisfaction with the workings of these rules and we propose a modification to address them.[2]

The government pension offset (GPO) reduces Social Security spousal or widow(er) benefits by $2 for every $3 received from a pension based on federal, state, or local government employment *not* covered under Social Security. Under Social Security, spouses of retired, disabled, or deceased workers are entitled to Social Security benefits on the basis of the worker's earnings history. To clarify the discussion, we refer to the primary worker as spouse A and the person benefiting from the spousal or widow(er) benefit as spouse B. As long as the retirement benefit that spouse B earns based on his or her own work record is smaller than the spousal or widow(er) benefit based on spouse A's work record, spouse B's total Social Security benefit is unaffected by having worked at covered jobs. In other words, a spouse working in employment covered by Social Security has his or her spousal and widow(er) benefit reduced dollar-for-dollar for any retirement benefits earned under Social Security, until the retirement benefit exceeds the benefit he or she would have received without working.

For example, consider a worker (spouse A) whose Social Security benefit is $1,500 per month. The worker's spouse (spouse B) would normally be entitled to a spousal benefit of $750 per month even if B never worked. If spouse B had worked, B's total Social Security benefit (including both the spousal benefit and B's own retirement benefit) remains $750 unless B's work is so extensive that B's own retirement benefit is higher than $750.[3]

Now consider an otherwise identical spouse B who worked in employment that was *not* covered by Social Security. Since any pension from such work is outside the Social Security system, the spousal benefit under Social Security would not be affected were it not for the government pension offset. Without the government pension offset, this spouse would therefore receive a total retirement benefit of more than $750: the full spousal benefit from Social Security plus any pension from the noncovered work. In other words, a spouse B who worked in employment covered by Social Security would receive $750, and an otherwise identical spouse B who worked in a job not covered by Social Security would receive more.

The government pension offset is intended to address this inequity. When it was initially introduced in

[1]For a discussion of the role of these provisions, *see* GAO (2003). For a discussion of the extent of coverage of state and local workers, see Munnell (2000).

[2]Recent proposals to modify the GPO include the Social Security Fairness Act of 2003 (S. 349, H.R. 594) and the Government Pension Offset Reform Act (S. 363).

[3]Unless her own retirement benefit exceeds the spousal benefit to which she is entitled even without working, spouse B would be a "dually entitled" beneficiary: Her total Social Security benefit would comprise both a retirement benefit and a (reduced) spousal benefit. For these dually entitled beneficiaries, the total Social Security benefit is no larger than what they would have received without working at all. In 1998, 62.7 percent of female beneficiaries aged 62 or over were either dually entitled (27.0 percent) or entitled only as a wife or widow (35.7 percent). *See Social Security Bulletin, Annual Statistical Supplement 1999*, Table 5.A.14. In other words, for the majority of current female beneficiaries under Social Security, the spousal benefit would be reduced dollar-for-dollar for any retirement benefit they earn on the basis of their own work history. The percentage of female beneficiaries whose benefit reflects solely their own work histories is expected to increase over time, reflecting the dramatic increase in female labor force participation.

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1977, the government pension offset reduced Social Security spousal benefits by $1 for each $1 received as a government pension for work not covered by Social Security. In 1983, however, legislation limited the offset to two-thirds of the pension from noncovered employment. The two-thirds factor is intended to reflect the portion of the pension from noncovered government employment that replicates the Social Security benefit (the other one-third would then replicate a private pension).[4]

The windfall elimination provision (WEP), by contrast, applies to workers who worked part of their careers in jobs not covered by Social Security and part of their careers in jobs covered by Social Security. For someone with less than 35 years of covered work, Social Security's benefit calculation treats the years of noncovered work as if the level of earnings in those years were zero. To understand the effect of counting those years as zeros, it is necessary to review two key steps in how Social Security benefits are calculated:

- A worker's earnings history is used to compute that worker's average indexed monthly earnings (AIME). The worker's covered earnings in each year up to age 60 are indexed for the growth in national average wages that has occurred since that year. Not all of the years in a worker's career are included in the AIME computation, however; instead only the highest earnings years up to a specific number of years are included. The number of years depends on the type of benefit being claimed; for retired workers it is 35. The AIME is then computed by averaging the indexed earnings for those years (including zeros if the worker actually worked fewer than 35 years) and dividing by 12.
- The AIME is used to compute the worker's primary insurance amount (PIA). The PIA formula is progressive: The PIA is larger as a share of earnings for lower earners than for higher earners. For workers who initially become eligible for retirement or disability benefits in 2003, the PIA is determined as 90 percent of the first $606 of the AIME, plus 32 percent of the AIME between $606 and $3,653, plus 15 percent of the AIME over $3,653. For example, for a worker with a calculated AIME of $1,000 becoming entitled to benefits in 2003, the PIA would have been $671, or 67 percent of the AIME. For a worker with an AIME of $6,000, the PIA would have been $1,872, or 31 percent of the AIME.

The effect of including years of zero earnings is to lower the AIME, resulting in a higher ratio of PIA to AIME. A similar effect arises for someone doing both covered and noncovered work in the same calendar year. Thus, from Social Security's perspective, these workers appear to have lower lifetime earnings, even though their actual lifetime earnings may be substantially higher (because of the time they spent in work outside Social Security). In the absence of the windfall elimination provision, Social Security's progressive benefit formula would provide relatively large benefits to those workers.

Under the windfall elimination provision, a modified formula is used to compute Social Security benefits for some of these workers. In particular, in computing the Primary Insurance Amount, the 90 percent factor is reduced to 40 percent for those who reach 62 or become disabled in 1990 or later and are subject to the windfall elimination provision.[5] The size of the benefit reduction is limited to one-half of the pension from noncovered work.[6]

As noted, there has been some dissatisfaction with the rules, which are seen as too harsh for some of the workers affected by them. Here we propose a modification of both rules. In both cases, we propose an alternative calculation, allowing workers to receive the larger of the benefit under current law and the benefit under this alternative.

The starting place for our proposal is to require that the alternative calculations be available only to workers who provide the Social Security Administration with a complete history of earnings in noncovered work.[7] This noncovered work generates the public pension that is the basis of benefit reduction under current law. This earnings information is crucial to computing an adjustment to reflect the benefit level that would have been provided if the same level of earnings had been covered by Social Security.

For a worker with a pension from noncovered work, the first step would be to construct a lifetime earnings history combining both covered and noncovered work. From this combined earnings history, it is then straightforward to calculate both the AIME and the PIA for this combined history. The PIA for the worker would be the AIME for covered work multiplied by the ratio of PIA to AIME based on the combined earnings history. This approach ensures that the worker's benefits enjoy the same level of progressivity as would have

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[4]The two-thirds factor is a rough approximation that is not necessarily accurate for all workers. A Congressional Research Service report concluded that "The government pension offset is basically imprecise, but in many cases this has little practical effect on considerations of equity. Those likely to be adversely affected by its inaccuracy are surviving spouses of high-paid workers, and those who may partially escape its intended effect are shorter-term, lower-paid workers." *See* Geoffrey Kollmann, "What Amount of a Civil Service Retirement System (CSRS) Pension is Equivalent to a Social Security Benefit," Congressional Research Service, July 2, 1990.

[5]Exceptions to the rule include workers who have 30 or more years of "substantial" earnings covered by Social Security; workers employed on December 31, 1983, by a nonprofit organization that was exempt from Social Security who became mandatorily covered under Social Security on that date; workers whose only pension is based on railroad employment; and workers whose only work under noncovered employment was before 1957.

[6]The reduction in Social Security benefits from the windfall elimination provision cannot exceed 50 percent of the pension attributable to noncovered earnings after 1956.

[7]This should also apply to lump sum payments given in lieu of retirement benefits.

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occurred if his or her entire career had been covered by Social Security.

The approach to auxiliary benefits is the same. The first step is to calculate a combined earnings history for spouse B. Then the allowed auxiliary benefits are the benefits that would be paid to spouse B given that combined earnings history.

Both of these approaches are straightforward if the required information is available, and both provide a level of benefits appropriate for the total earnings history. Since the earnings history may not be available, we would not require that this rule for benefits be applied, but simply leave it as an option for a worker who chooses to amass statements from previous employers about earnings from noncovered work. The Social Security Administration could audit the submissions of earnings histories for accuracy, with appropriate penalties or criminal charges for misrepresentation.[8]

The cost of this change would be small. It would increase the fairness of both offset provisions. Furthermore, it is vastly preferable to eliminating or substantially weakening these provisions, as some have proposed. Finally, mandating coverage for all new hires of state and local workers — as has been advocated by us (Diamond and Orszag, 2003) as well as others — would eventually make these complications disappear.

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[8]There is already a concern about overpayment of benefits because of inadequate information about pensions from noncovered work (GAO, 1998, 2003). This option does not necessarily create additional problems of auditing or confirmation for Social Security.