Testimony
Before the Subcommittee on Social Security, Committee on Ways and Means, House of Representatives

SOCIAL SECURITY
Coverage of Public Employees and Implications for Reform

Statement of Barbara D. Bovbjerg, Director Education, Workforce, and Income Security
Social Security's provisions regarding public employees are rooted in the fact that about one-fourth of them do not pay Social Security taxes on the earnings from their government jobs, for various historical reasons. Even though noncovered employees may have many years of earnings on which they do not pay Social Security taxes, they can still be eligible for Social Security benefits based on their spouses' or their own earnings in covered employment.

To address the issues that arise with noncovered public employees, Social Security has two provisions—the Government Pension Offset (GPO), which affects spouse and survivor benefits, and the Windfall Elimination Provision (WEP), which affects retired worker benefits. Both provisions reduce Social Security benefits for those who receive noncovered pension benefits. Both provisions also depend on having complete and accurate information on receipt of such noncovered pension benefits. However, such information is not available for many state and local pension plans, even though it is for federal pension benefits. As a result, the GPO and the WEP are not applied consistently for all noncovered pension recipients. In addition to the administrative challenges, these provisions are viewed by some as confusing and unfair.

In recent years, various Social Security reform proposals that would affect public employees have been offered. Some proposals specifically address the GPO and the WEP and would either revise or eliminate them. Such actions, while they may reduce confusion among affected workers, would increase the long-range Social Security trust fund deficit and could create fairness issues for workers who have contributed to Social Security throughout their working lifetimes. Other proposals would make coverage mandatory for all state and local government employees. According to Social Security actuaries, mandatory coverage would reduce the 75-year actuarial deficit by 11 percent. It could also enhance inflation protection, pension portability, and dependent benefits for the affected beneficiaries, in many cases. However, to maintain the same level of spending for retirement, mandating coverage would increase costs for the state and local governments that sponsor the plans, and would likely reduce some pension benefits. Moreover, the GPO and the WEP would still be needed for many years to come even though they would become obsolete in the long run.
Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss how Social Security affects public employees and how reforms may change those effects. Social Security covers about 96 percent of all U.S. workers; the vast majority of the rest are state, local, and federal government employees. One option for Social Security reform is extending coverage to all state and local government employees who are not currently covered. While these noncovered workers do not pay Social Security taxes on their government earnings, they may still be eligible for Social Security benefits. This poses difficult issues of fairness, and Social Security has provisions that attempt to address those issues. Still, these provisions have been difficult to administer. They have also been a source of confusion and frustration for the workers they affect.

I hope I can help clarify and provide some perspective on the complex relationship between Social Security and public employees. Today, I will discuss Social Security’s coverage of public employees, Social Security’s current provisions affecting noncovered public employees, and proposals to modify those provisions or make coverage mandatory for all public employees. My testimony is based on a body of work we have published over the past several years.¹

In summary, Social Security does not cover about one-fourth of public employees, for various historical reasons. As a result, these employees do not pay Social Security taxes on earnings from their noncovered jobs. Nevertheless, they can still be eligible for Social Security benefits based on their spouses’ or their own earnings in covered employment. Currently, Social Security has two provisions to address the resulting fairness issues. The Government Pension Offset (GPO) affects spouse and survivor benefits, and the Windfall Elimination Provision (WEP) affects retired worker benefits. Both provisions reduce Social Security benefits for those who receive noncovered pension benefits. However, the Social Security Administration (SSA) cannot effectively and fairly apply these provisions because it does not have access to complete and accurate information on receipt of such noncovered pension benefits. Implementation of some of our recommendations has improved the availability and tracking of key information for federal retirees, which we estimate will save hundreds of

¹See the list of related GAO products at the end of this statement.
millions of dollars. However, Congressional action is still needed to improve access to information on state and local government pensions.

In recent years, various Social Security reform proposals that would affect public employees have been offered. Some proposals specifically address the GPO and the WEP and would either revise or eliminate them. While we have not analyzed these proposals, we believe it is important to consider both the costs and the fairness issues they raise. Still other proposals would make coverage mandatory for all state and local government employees. According to Social Security actuaries, doing so for all newly hired state and local government employees would reduce the 75-year actuarial deficit by about 11 percent. It could also enhance inflation protection, pension portability, and dependent benefits for the affected beneficiaries, in many cases. However, to provide for the same level of retirement income, it could increase costs for the state and local governments that would sponsor the plans. Moreover, the GPO and the WEP would continue to apply for many years to come, even though they would become obsolete in the long run.

Background

Social Security provides retirement, disability, and survivor benefits to insured workers and their dependents. Insured workers are eligible for reduced benefits at age 62 and full retirement benefits between age 65 and 67, depending on their year of birth. Social Security retirement benefits are based on the worker’s age and career earnings, are fully indexed for inflation after retirement, and replace a relatively higher proportion of wages for career low-wage earners. Social Security’s primary source of revenue is the Old Age, Survivors, and Disability Insurance (OASDI) portion of the payroll tax paid by employers and employees. The OASDI payroll tax is 6.2 percent of earnings each for employers and employees, up to an established maximum.

One of Social Security’s most fundamental principles is that benefits reflect the earnings on which workers have paid taxes. Social Security provides benefits that workers have earned to some degree because of their contributions and those of their employers. At the same time, Social Security helps ensure that its beneficiaries have adequate incomes and do not have to depend on welfare. Toward this end, Social Security’s benefit

\footnote{Beginning with those born in 1938, the age at which full benefits are payable will increase in gradual steps from age 65 to age 67.}
provisions redistribute income in a variety of ways—from those with higher lifetime earnings to those with lower ones, from those without dependents to those with dependents, from single earners and two-earner couples to one-earner couples, and from those who don’t live very long to those who do. These effects result from the program’s focus on helping ensure adequate incomes. Such effects depend to a great degree on the universal and compulsory nature of the program.

According to the Social Security Trustees’ 2005 intermediate, or best-estimate, assumptions, Social Security’s cash flow is expected to turn negative in 2017. In addition, all of the accumulated Treasury obligations held by the trust funds are expected to be exhausted by 2041. Social Security’s long-term financing shortfall stems primarily from the fact that people are living longer and having fewer children. As a result, the number of workers paying into the system for each beneficiary has been falling and is projected to decline from 3.3 today to about 2 by 2030. Reductions in promised benefits and/or increases in program revenues will be needed to restore the long-term solvency and sustainability of the program.

About one-fourth of public employees do not pay Social Security taxes on the earnings from their government jobs. Historically, Social Security did not require coverage of government employment because there was concern over the question of the federal government’s right to impose a tax on state governments, and some had their own retirement systems. However, virtually all other workers are now covered, including the remaining three-fourths of public employees.

The 1935 Social Security Act mandated coverage for most workers in commerce and industry, which at that time comprised about 60 percent of the workforce. Subsequently, the Congress extended mandatory Social Security coverage to most of the excluded groups, including state and local employees not covered by a public pension plan. The Congress also extended voluntary coverage to state and local employees covered by public pension plans. Since 1983, however, public employers have not been permitted to withdraw from the program once they are covered. Also in 1983, amendments to the Social Security Act extended mandatory coverage to newly hired federal workers and to all members of the Congress.

SSA estimates that in 2004 nearly 5 million state and local government employees, excluding students and election workers, are not covered by Social Security. In addition, about three-quarters of a million federal
employees hired before 1984 are also not covered. Seven states—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas—account for 71 percent of the noncovered payroll.

Most full-time public employees participate in defined benefit pension plans. Minimum retirement ages for full benefits vary. However, many state and local employees can retire with full benefits at age 55 with 30 years of service. Retirement benefits also vary, but they are usually based on a specified benefit rate for each year of service and the member's final average salary over a specified time period, usually 3 years. For example, plans with a 2 percent rate replace 60 percent of a member's final average salary after 30 years of service. In addition to retirement benefits, members generally have a survivor annuity option and disability benefits, and many receive some cost-of-living increases after retirement. In addition, in recent years, the number of defined contribution plans, such as 401(k) plans and the Thrift Savings Plan for federal employees, has been growing, and such plans are becoming a relatively more common way for employers to offer pension plans; public employers are no exception to this trend.

Even though noncovered employees may have many years of earnings on which they do not pay Social Security taxes, they can still be eligible for Social Security benefits based on their spouses’ or their own earnings in covered employment. SSA estimates that nearly all noncovered state and local employees become entitled to Social Security as workers, spouses, or dependents. However, their noncovered status complicates the program’s ability to target benefits in the ways it is intended to do.

To address the fairness issues that arise with noncovered public employees, Social Security has two provisions—the Government Pension Offset, to address spouse and survivor benefits, and the Windfall Elimination Provision, to address retired worker benefits. Both provisions depend on having complete and accurate information that has proven difficult to get. Also, both provisions are a source of confusion and frustration for public employees and retirees.

Under the GPO provision, enacted in 1977, SSA must reduce Social Security benefits for those receiving noncovered government pensions when their entitlement to Social Security is based on another person’s (usually a spouse’s) Social Security coverage. Their Social Security benefits are to be reduced by two-thirds of the amount of their government pension. Under the WEP, enacted in 1983, SSA must use a
modified formula to calculate the Social Security benefits people earn when they have had a limited career in covered employment. This formula reduces the amount of payable benefits.

Regarding the GPO, spouse and survivor benefits were intended to provide some Social Security protection to spouses with limited working careers. The GPO provision reduces spouse and survivor benefits to persons who do not meet this limited working career criterion because they worked long enough in noncovered employment to earn their own pension.

Regarding the WEP, the Congress was concerned that the design of the Social Security benefit formula provided unintended windfall benefits to workers who had spent most of their careers in noncovered employment. The formula replaces a higher portion of preretirement Social Security covered earnings when people have low average lifetime earnings than it does when people have higher average lifetime earnings. People who work exclusively, or have lengthy careers, in noncovered employment appear on SSA’s earnings records as having no covered earnings or a low average of covered lifetime earnings. As a result, people with this type of earnings history benefit from the advantage given to people with low average lifetime earnings when in fact their total (covered plus noncovered) lifetime earnings were higher than they appear to be for purposes of calculating Social Security benefits.

Both the GPO and the WEP apply only to those beneficiaries who receive pensions from noncovered employment. To administer these provisions, SSA needs to know whether beneficiaries receive such noncovered pensions. However, SSA cannot apply these provisions effectively and fairly because it lacks this information, according to our past work. In response to our recommendation, SSA performed additional computer matches with the Office of Personnel Management to get noncovered pension data for federal retirees. These computer matches detected payment errors; we estimate that correcting these errors will generate hundreds of millions of dollars in savings. However, SSA still lacks the

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4SSA performed the first such match in 1999 and advised that it will be done on a recurring basis in the future. SSA identified about 14,600 people whose benefits should have been calculated using WEP's modified formula. We estimate that detecting these payment errors will generate $207.9 million in lifetime benefit reduction for this cohort. We further estimate each year's match will generate about $57 million in lifetime benefit reductions for each new cohort.
information it needs for state and local governments and therefore it cannot apply the GPO and the WEP for state and local government employees to the same degree that it does for federal employees. The resulting disparity in the application of these two provisions is yet another source of unfairness in the final outcome.

In our testimony before this committee in May 2003, we recommended that the Congress consider giving the Internal Revenue Service (IRS) the authority to collect the information that SSA needs on government pension income, which could perhaps be accomplished through a simple modification to a single form. Earlier versions of the Social Security Protection Act of 2004 contained such a provision, but this provision was not included when the final version of the bill, was approved and signed into law.

Some Reform Proposals Would Affect Public Employees

Some Proposals Focus on the GPO or the WEP

In recent years, various Social Security reform proposals that would affect public employees have been offered. Some proposals specifically address the GPO and the WEP and would either revise or eliminate them. Still other proposals would make coverage mandatory for all state and local government employees.

The GPO and the WEP have been a source of confusion and frustration for the more than 6 million workers and 1.1 million beneficiaries they affect. Critics of the measures contend that they are basically inaccurate and often unfair. For example, some opponents of the WEP argue that the formula adjustment is an arbitrary and inaccurate way to estimate the value of the windfall and causes a relatively larger benefit reduction for lower-paid workers. In the case of the GPO, critics contend that the two-thirds reduction is imprecise and could be based on a more rigorous formula. A variety of proposals have been offered to either revise or eliminate the GPO or the WEP. While we have not studied these proposals in detail, I would like to offer a few observations to keep in mind as you consider them.


First, repealing these provisions would be costly in an environment where the Social Security trust funds already face long-term solvency issues. According to the most recent estimates from SSA eliminating the GPO entirely would cost $32 billion over 10 years and cost 0.06 percent of taxable payroll, which would increase the long-range deficit by about 3 percent. Similarly, eliminating the WEP would cost nearly $30 billion and increase Social Security’s long-range deficit by 3 percent.

Second, in thinking about the fairness of the provisions and whether or not to repeal them, it is important to consider both the affected public employees and all other workers and beneficiaries who pay Social Security taxes. For example, SSA has described the GPO as a way to treat spouses with noncovered pensions in a fashion similar to how it treats dually entitled spouses, who qualify for Social Security benefits on both their own work records and their spouses’. In such cases, spouses may not receive both the benefits earned as a worker and the full spousal benefit; rather they receive the higher amount of the two. If the GPO were eliminated or reduced for spouses who had paid little or no Social Security taxes on their lifetime earnings, it might be reasonable to ask whether the same should be done for dually entitled spouses who have paid Social Security on all their earnings. Otherwise, such couples would be worse off than couples that were no longer subject to the GPO. And far more spouses are subject to the dual entitlement offset than to the GPO; as a result, the costs of eliminating the dual entitlement offset would be commensurately greater.

Making coverage mandatory for all state and local government employees has been proposed to help address the program’s financing problems. According to Social Security actuaries, doing so for all newly hired state and local government employees would reduce the 75-year actuarial deficit by about 11 percent. Covering all the remaining workers increases revenues relatively quickly and improves solvency for some time, since most of the newly covered workers would not receive benefits for many years. In the long run, however, benefit payments would increase as the newly covered workers started to collect benefits. Overall, this change would still represent a net gain for solvency, although it would be small.

\[\text{SSA uses a period of 75 years for evaluating the program’s long-term actuarial status to obtain the full range of financial commitments that will be incurred on behalf of current program participants.}\]
In addition to considering solvency effects, the inclusion of mandatory coverage in a comprehensive reform package would need to be grounded in other considerations. In recommending that mandatory coverage be included in the reform proposals, the 1994-1996 Social Security Advisory Council stated that mandatory coverage is basically “an issue of fairness.” Its report noted that “an effective Social Security program helps to reduce public costs for relief and assistance, which, in turn, means lower general taxes. There is an element of unfairness in a situation where practically all contribute to Social Security, while a few benefit both directly and indirectly but are excused from contributing to the program.”

Moreover, mandatory coverage could improve benefits for the affected beneficiaries, but it could also increase pension costs for the state and local governments that would sponsor the plans. The effects on public employees and employers would depend on how states and localities changed their noncovered pension plans to conform with mandatory coverage. For example, Social Security offers automatic inflation protection, full benefit portability, and dependent benefits, which are not available in many public pension plans. Creating new pension plans that kept all the existing benefit provisions but added these new ones would increase the cost of the total package. Under this scenario, costs could increase by as much as 11 percent of payroll, depending on the benefit packages of the new plans. Alternatively, states and localities that wanted to maintain level spending for retirement would likely need to reduce some pension benefits. Additionally, states and localities could require several years to design, legislate, and implement changes to current pension plans. Mandating Social Security coverage for state and local employees could also elicit a constitutional challenge. Finally, mandatory coverage would not immediately address the issues and concerns regarding the GPO and the WEP. If left unchanged, these provisions would continue to apply for many years to come for existing employees and beneficiaries. Still, in the long run, mandatory coverage would make these provisions obsolete.

In conclusion, there are no easy answers to the difficulties of equalizing Social Security’s treatment of covered and noncovered workers. Any reductions in the GPO or the WEP would ultimately come at the expense of other Social Security beneficiaries and taxpayers. Mandating universal coverage would promise eventual elimination of the GPO and the WEP but at potentially significant cost to affected state and local governments, and even so the GPO and the WEP would continue to apply for some years to come, unless they were repealed.
Whatever the decision, it will be important to administer the program effectively and equitably. The GPO and the WEP have proven difficult to administer because they depend on complete and accurate reporting of government pension income, which is not currently achieved. The resulting disparity in the application of these two provisions is yet another source of unfairness in the final outcome. We therefore take this opportunity to bring the matter back to your attention for further consideration.

To facilitate complete and accurate reporting of government pension income, the Congress should consider giving IRS the authority to collect this information, which could perhaps be accomplished through a simple modification to a single form.

Mr. Chairman, this concludes my statement, I would be happy to respond to any questions you or other members of the subcommittee may have.

For information regarding this testimony, please contact Barbara D. Bovbjerg, Director, Education, Workforce, and Income Security Issues, on (202) 512-7215. Individuals who made key contributions to this testimony include Daniel Bertoni, Ken Stockbridge, and Michael Collins.
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