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SOCIAL SECURITY

Issues Regarding the Coverage of Public Employees

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Highlights

Highlights of GAO-08-248T, testimony before the Subcommittee on Social Security, Pensions, and Family Policy, Committee on Finance, U.S. Senate

Why GAO Did This Study

Social Security covers about 96 percent of all U.S. workers; the vast majority of the remaining 4 percent are public employees. Although these noncovered workers do not pay Social Security taxes on their government earnings, they may still be eligible for Social Security benefits through their spouses' or their own earnings from other covered employment. Social Security has provisions—the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP)—that attempt to take noncovered employment into account when calculating the Social Security benefits for public employees. However, these provisions have been difficult to administer and critics contend that the provisions themselves are often unfair.

The Committee asked GAO to discuss the issues regarding the coverage of public employees under Social Security, the provisions to take noncovered employment into account, and the proposals to modify those provisions.

What GAO Recommends

GAO has previously recommended that the Congress consider giving the Internal Revenue Service the authority to collect the information that the Social Security Administration needs on government pension income to administer the GPO and WEP provisions accurately and fairly. GAO continues to believe that this important issue warrants further consideration by the Congress.

To view the full product, including the scope and methodology, click on GAO-08-248T. For more information, contact Barbara Bovbjerg at (202) 512-7215 or bovbjergb@gao.gov.

SOCIAL SECURITY

Issues Regarding the Coverage of Public Employees

What GAO Found

There are no easy answers to the difficulties of equalizing Social Security's treatment of covered workers and noncovered public employees. About one-fourth of public employees—primarily state and local government workers—are not covered by Social Security and do not pay Social Security taxes on their government earnings. Nevertheless, these workers may still be eligible for Social Security benefits through their spouses' or their own earnings from other covered employment. To address concerns with how noncovered workers are treated compared with covered workers, Social Security has provisions in place to take noncovered employment into account and reduce Social Security benefits for public employees, as described in the table below.

Provisions Affecting the Calculation of Social Security Benefits for Public Employees

	When benefits are affected	How benefits are affected
The Government Pension Offset (GPO)	When a public employee's entitlement to Social Security is based on another person's (usually a spouse's) coverage.	Benefits are reduced by two-thirds of the amount of the government pension.
The Windfall Elimination Provision (WEP)	When a public employee's entitlement to Social Security is based on other covered employment, but the employee has had a lengthy career in noncovered employment.	Benefits are calculated using a modified formula to reduce the amount of benefits received.

Source: GAO analysis.

To be administered fairly and accurately, both these provisions require complete and accurate reporting of government pension income, which is not currently available. The resulting disparity in the application of the provisions is a continuing source of confusion and frustration for affected workers. Thus, various changes that would affect the GPO and WEP provisions have been proposed, such as:

- **Eliminate the GPO and WEP provisions.** This would simplify administration and avoid concerns about unfair treatment among public employees. However, any reductions in the GPO or the WEP would widen Social Security's financial gap and would raise concerns about unfair treatment of public employees compared with other workers.

- **Extend mandatory coverage.** If all newly hired state and local government employees who are not currently covered were to become covered, the need for the GPO and WEP could be phased out over time. In 2005, Social Security actuaries estimated that mandating coverage for these employees would reduce the 75-year actuarial deficit by about 11 percent. While mandatory coverage could enhance retirement benefits for the affected workers, it could also result in significant costs to the affected state and local governments.

As long as the GPO and the WEP remain in effect, it will be important to administer the provisions effectively and equitably based on accurate and complete information on both covered and noncovered employment.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the issues regarding Social Security coverage of public employees and the possible effects of reform. Social Security covers about 96 percent of all U.S. workers; the vast majority of the remaining 4 percent who are not covered are public employees. Moreover, 9 in 10 of the public employees not covered by Social Security are state and local government workers. Although these noncovered workers do not pay Social Security taxes on their government earnings, they may still be eligible for Social Security benefits through their spouses' or their own earnings from other covered employment. To address concerns with how noncovered workers are treated compared with covered workers, Social Security has provisions in place to take noncovered employment into account when calculating Social Security benefits for public employees, but the provisions have been difficult to administer. This situation poses difficult issues of fairness. It has also been a source of confusion and frustration for the workers these provisions affect. Thus, some have proposed eliminating these provisions. Alternatively, as part of Social Security reform, others have proposed extending mandatory coverage to all state and local government employees who are not currently covered; under mandatory coverage, the need for these provisions would be phased out over time.

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, about one-fourth of public employees are not covered by Social Security for various historical reasons. As a result, these employees do not pay Social Security taxes on earnings from their noncovered jobs. Nevertheless, these employees can still be eligible for Social Security benefits based on their spouses' or their own earnings from covered employment. Currently, Social Security has two provisions in place that attempt to ensure these workers' noncovered employment is taken into consideration when calculating their Social Security benefits: (1) the

[1] See the list of related GAO products at the end of this statement.

Government Pension Offset (GPO), which affects spouse and survivor benefits, and (2) the Windfall Elimination Provision (WEP), which 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 noncovered earnings and receipt of noncovered pensions. Implementation of some of our recommendations has improved the availability and tracking of key information for federal retirees, and we have estimated that this tracking will save hundreds of 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 reforms that would affect public employees have been proposed. 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. Other proposals would make Social Security coverage mandatory for all state and local government employees. In 2005, Social Security actuaries estimated that mandating coverage 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. Also, the GPO and the WEP would no longer apply to newly hired public employees and so could be phased out over time. However, mandatory coverage could increase retirement costs for state and local governments.

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 the worker's year of birth.[2] Social Security retirement benefits are based on the worker's age and career earnings, are fully indexed for price 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

[2]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.

employees. This Social Security tax is 6.2 percent of earnings up to an established maximum, paid by both employers and employees.

One of Social Security's most fundamental principles is that benefits reflect the earnings on which workers have paid Social Security taxes. Thus, Social Security provides benefits that workers have earned, in part, due to 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 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 live shorter lives to those who live longer. These effects result from the program's focus on helping ensure adequate incomes. Such effects depend, to a great extent, on the universal and compulsory nature of the program.

According to the Social Security trustees' 2007 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 2.2 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 Are Not Covered by Social Security

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 some government employers had their own retirement systems. In addition, there was concern over the question of the federal government's right to impose a tax on state governments. However, the remaining three-fourths of public employees are now covered by Social Security, as well as virtually all private sector workers.

The 1935 Social Security Act mandated coverage for most workers in commerce and industry; at that time, such workers comprised about 60 percent of the workforce. Subsequently, the Congress extended Social Security coverage to most of the excluded groups, including many state and local employees, military personnel, members of Congress, and federal civilian employees hired after January 1, 1984.

In 1950, Congress enacted legislation allowing voluntary coverage to state and local government employees not covered by public pension plans, and in 1955, extended voluntary coverage to those already covered by plans as well. Initially, public employers could opt in and out of the Social Security program under these provisions. Since 1983, however, public employers have not been permitted to withdraw from the program once they have opted in and their employees are covered. Also, in 1990, Congress made coverage mandatory for most state and local employees not covered by public pension plans. Nevertheless, the most recent data from SSA indicates that in 2005, about 6.8 million state and local government employees were still not covered by Social Security. Coverage varies widely across states. In some states, such as New York and Vermont, virtually all government employees are covered; in other states, such as Massachusetts and Ohio, less than 5 percent of government employees are covered. Seven states—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas—account for nearly 70 percent of the noncovered state and local government payroll.

In addition, SSA estimates that about half a million federal government employees are not covered. These are civilian employees hired before January 1, 1984, who continue to be covered under the Civil Service Retirement System.

Most full-time public employees participate in defined benefit pension plans. Minimum retirement ages for full benefits vary, but 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 generally 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. State and local government workers also generally have a survivor annuity option and disability benefits, and many receive 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. There has been little movement toward adopting defined contribution plans as the primary pension plans for state and local workers, but such plans have become fairly universally available as supplemental voluntary tax-deferred savings plans.[3]

Current Provisions Seek Fairness but Pose Administrative Challenges

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. According to SSA, nearly all noncovered state and local employees become entitled to Social Security as spouses, dependents, or workers. However, their noncovered status for the bulk of their earnings 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, the Congress has enacted two provisions: (1) the Government Pension Offset (GPO) regarding spouse and survivor benefits, and (2) the Windfall Elimination Provision (WEP) regarding retired worker benefits. Both provisions apply only to those beneficiaries who receive pensions from noncovered employment. However, the provisions have been difficult to administer because they depend on having complete and accurate information on noncovered earnings and pensions—information that has proven difficult to get. Also, the 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. 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.

[3] See GAO, *State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs*, GAO-07-1156 (Washington, D.C.: Sept. 24, 2007).

Under the WEP, enacted in 1983, SSA must use a modified formula to reduce the Social Security benefits people receive when they have had a lengthy career in noncovered employment. 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, as the formula replaces a relatively higher proportion of wages for low earners than for high earners, and those with lengthy careers in noncovered employment appear on SSA's records as low earners.

Provisions Are Difficult to Administer

To administer the GPO and WEP, SSA needs to know whether beneficiaries receive pensions from noncovered employment. However, SSA cannot apply these provisions effectively and fairly because it lacks this information. In a report we issued in 1998, we recommended that SSA perform additional computer matches with the Office of Personnel Management to get noncovered pension data for federal retirees.[4] In response to our recommendation, SSA performed the first such match in 1999 and planned to continue to conduct the matches on a recurring basis. We estimated that correcting the errors identified through such matches will generate hundreds of millions of dollars in savings.[5] However, SSA still lacks the 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 extent it can for federal employees. The resulting disparity in the application of these two provisions is yet another source of unfairness in the calculation of Social Security benefits for public employees.

In our testimony before the Subcommittee on Social Security, House Committee on Ways and Means, in May 2003 and again in June 2005,[6] we recommended that the Congress consider giving the Internal Revenue

[4]See GAO, *Social Security: Better Payment Controls for Benefit Reduction Provisions Could Save Millions*, GAO/HEHS-98-76 (Washington, D.C.: Apr. 30, 1998).

[5] In its first match, 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.

[6] GAO, *Social Security: Issues Relating to Noncoverage of Public Employees*, GAO-03-710T (Washington, D.C.: May 1, 2003); and GAO, *Social Security: Coverage of Public Employees and Implications for Reform*, GAO-05-786T (Washington, D.C.: June 9, 2005).

Service (IRS) the authority to collect the information that SSA needs on government pension income, a task that 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.[7] As long as the GPO and WEP remain in effect, we continue to believe that the IRS should be given the authority to collect the information that SSA needs on government pension income to administer these provisions accurately and fairly.

Provisions Cause Confusion and Frustration

The GPO and the WEP have been a continuing source of confusion and frustration for the more than 7.3 million government workers affected. Critics of the measures contend that the provisions are basically inaccurate and often unfair. For example, critics of the GPO contend that the two-thirds reduction is imprecise and could be based on a more rigorous formula. According to a recent analysis conducted by the Congressional Research Service, the GPO formula slightly overestimates the reduction that some individuals (particularly higher earners) would otherwise receive if they worked in Social Security-covered employment, and greatly underestimates the reduction that others (particularly lower earners) would receive.[8] In the case of the WEP, opponents 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.

Some Social Security Proposals Would Affect Public Employees

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

[7] Pub. L. No. 108-203, Section 419(c), provides for disclosure to workers of the effect of GPO and WEP provisions.

[8] Laura Haltzel, *Analysis of How Well the Government Pension Offset (GPO) Replicates the Social Security Dual-Entitlement Rule* (Congressional Research Service, Washington, D.C.: July 5, 2007). See also Laura Haltzel, *Social Security: The Government Pension Offset (GPO)* (Congressional Research Service, Washington, D.C.: Updated March 9, 2007).

Some Proposals Focus on the GPO or the WEP

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 current SSA estimates, eliminating the GPO entirely would cost $41.7 billion over 10 years and increase the long-range deficit by about 3 percent. Similarly, SSA estimates that eliminating the WEP would cost $40.1 billion, also increasing 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 manner similar to how it treats dually entitled spouses, who qualify for Social Security benefits on both their own and their spouses' work records. 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 who 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.

Mandatory Coverage Has Been Proposed

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' 2005 estimate, requiring all newly hired state and local government employees to begin paying into the system would reduce the 75-year actuarial deficit by about 11 percent.[9]

[9] 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.

Expanding coverage to currently noncovered 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, benefit payments would increase as the newly covered workers started to collect benefits; however, overall, this change would represent a small net gain for solvency.

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 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."

Another advantage of mandatory Social Security coverage is that it could improve benefits for the affected workers, but it could also increase pension costs for state and local governments. The effects on public employees and employers would depend on how states and localities changed their noncovered pension plans in response to mandatory coverage.

For example, by gaining coverage, workers would benefit from Social Security's automatic inflation protection, full benefit portability, and dependent benefits, which are not available in many public pension plans. Also, the GPO and the WEP would no longer apply and so could be phased out over time.

With mandatory coverage, the costs for state and local governments would likely increase, adding to the fiscal challenges that already lie ahead for many.[10] If states and localities provided pension benefits that are similar to the benefits provided employees already covered by Social Security, studies indicate that their retirement costs could increase by as much as 11 percent of payroll. Alternatively, states and localities that wanted to maintain level spending for retirement under mandatory coverage would

[10] See GAO, *State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade*, GAO-07-1080SP (Washington, D.C.: July 18, 2007).

likely need to reduce some pension benefits. Thus, while workers' benefits may be enhanced in some ways by gaining Social Security, their total contribution rate may increase, and the benefits they receive under their previously noncovered pension plans may be reduced.

Additionally, states and localities could require several years to design, legislate, and implement changes to current pension plans, and mandating Social Security coverage for state and local employees could elicit constitutional challenges. Also, mandatory coverage would not immediately address the issues and concerns regarding the GPO and the WEP, as these provisions would continue to apply to existing employees and beneficiaries for many years to come before eventually becoming obsolete. Finally, state and local governments would have to administer two different systems–one for existing noncovered employees and another for newly covered employees—until the provisions no longer applied to anyone or were repealed.

Conclusions

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 many years to come unless they were repealed.

As long as the GPO and the WEP remain in effect, it will be important to administer the provisions as effectively and equitably as possible. SSA has found it difficult to administer these provisions because they depend on complete and accurate reporting of government pension income, which is not currently available. The resulting disparity in the application of these two provisions is a continuing source of unfairness for Social Security beneficiaries, both covered and noncovered.

Matter for Congressional Consideration

GAO has previously recommended that the Congress consider giving IRS the authority to collect the information that SSA needs on government pension income to administer the GPO and WEP provisions accurately and fairly. GAO continues to believe that this important issue warrants further consideration by the Congress.

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

Contacts and Acknowledgments

For further information regarding this testimony, please contact Barbara D. Bovbjerg, Director, Education, Workforce, and Income Security Issues at (202) 512-7215 or bovbjergb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Michael Collins and Margie Shields.

Related GAO Products

State and Local Government Retiree Benefits: Current Status of Benefit Structures, Protections, and Fiscal Outlook for Funding Future Costs. GAO-07-1156. Washington, D.C.: September 24, 2007.

State and Local Governments: Persistent Fiscal Challenges Will Likely Emerge within the Next Decade. GAO-07-1080SP. Washington, D.C.: July 18, 2007.

Social Security: Coverage of Public Employees and Implications for Reform. GAO-05-786T. Washington, D.C.: June 9, 2005.

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