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SOCIAL SECURITY

Congress Should Consider Revising the Government Pension Offset "Loophole"

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss Social Security's Government Pension Offset (GPO) exemption. As you know, the GPO was enacted in 1977 to equalize the treatment of workers covered by Social Security and those with government pensions not covered by Social Security. In short, the GPO prevents workers from receiving a full Social Security spousal benefit on top of a pension earned from government employment not covered by Social Security.[1] However, the law provides an exemption from the GPO if an individual's last day of state/local government employment is in a position that is covered by both Social Security and their state/local pension system. In these cases, the GPO will not apply, and Social Security spousal benefits will not be reduced.

Last year, you asked us to (1) assess the extent to which individuals retiring from jobs not covered by Social Security may be transferring briefly to covered jobs in order to avoid the GPO, and (2) estimate the impact of such transfers on the Social Security Trust Fund. To complete our work, we first reviewed the GPO's legislative history and government reports documenting the purpose of the offset and the Social Security Administration's (SSA) policies and procedures for administering it. We also performed limited work with associations, researchers, and retirement system officials in 28 states.[2] Finally, we performed audit work in Texas and Georgia, two of the states where we identified use of the last-day exemption. On August 15, 2002, we reported to you on the results of our work.[3] Today I will discuss the findings of our review.

In summary, because no central data exists on use of the GPO exemption by individuals in approximately 2,300 state and local government retirement plans nationwide, we could not definitively confirm that this practice is occurring in states other than Texas and Georgia. In those two states, 4,819 individuals had performed work in Social Security-covered

[1]Currently the reduction in spousal benefits is two-thirds of the amount of their public pension.

[2]States were selected either because they were authorized to operate retirement systems with both covered and noncovered positions or because their state and local government plans had a mix of covered and noncovered positions, thus offering the greatest potential for use of the last-day exemption.

[3]See U.S. General Accounting Office, *Social Security Administration: Revision to the Government Pension Offset Exemption Should Be Considered*, GAO-02-950 (Washington, D.C.: Aug. 15, 2002).

positions for short periods to qualify for the GPO last-day exemption. In Texas, teachers typically worked a single day in nonteaching positions covered by Social Security, such as clerical or janitorial positions. In Georgia, teachers generally agreed to work for approximately 1 year in another teaching position in a school district covered by Social Security. Officials in both states indicated that use of the exemption would likely continue to grow as awareness increases and it becomes part of individuals' retirement planning. For the cases we identified, increased long-term benefit payments from the Social Security Trust Fund could be about \$450[4] million over the long term and would likely rise further if use of the exemption grows in the states we visited and spreads to others. SSA officials acknowledged that use of the exemption might be possible in other state and local government retirement plans that include both those positions covered by Social Security and those not.

The GPO "loophole" raises fairness and equity concerns for those receiving a Social Security pension and are currently subject to the spousal benefit offset. In the states we visited, individuals with a relatively minimal investment of work time and Social Security contributions can gain access to potentially many years of full Social Security spousal benefits. The last-day exemption could also have a more significant impact if the practice grows and begins to be adopted by other states and localities. Considering the potential for abuse, our report presented options for revising the GPO exemption, such as changing the last-day provision to a longer minimum time period or using a proportional approach based on the number of working years spent in covered and noncovered employment for determining the extent to which the GPO applies.

Background

The Social Security Act requires that most workers be covered by Social Security benefits. Workers contribute to the program via wage deductions. State and local government workers were originally excluded from Social Security.

Starting in the 1950s, state and local governments had the option of selecting Social Security coverage for their employees or retaining their

[4] This estimate was calculated by multiplying the number of last-day cases reported in Texas and Georgia (4,819) by SSA data on average annual offset amount (\$4,800) and the average life expectancy upon receipt of spousal benefits (19.4 years).

noncovered status. In 1983, state and local governments in the Social Security system were prohibited by law from opting out of it. Of the workers in the roughly 2,300 separate state and local retirement plans nationwide, about one-third are not covered by Social Security.

In addition to paying retirement and disability benefits to covered workers, Social Security also generally pays benefits to spouses of retired, disabled, or deceased workers. If both spouses worked in positions covered by Social Security, each may not receive both the benefits earned as a worker and the full spousal benefit; rather the worker receives the higher amount of the two. In contrast, until 1977, workers receiving pensions from government positions not covered by Social Security could receive their full pension benefit and their full Social Security spousal benefits as if they were nonworking spouses. At that time, legislation was enacted creating the GPO,[5] which prevented workers from receiving a full spousal benefit on top of a pension earned from noncovered government employment.[6] However, the law provides an exemption from the GPO if an individual's last day of state/local employment is in a position that is covered by both Social Security and the state/local government's pension system.[7] In these cases, the GPO will not be applied to the Social Security spousal benefit.

Nationwide Extent of Transfers to Avoid the GPO Unknown, but Expected to Grow

While we could not definitively confirm the extent nationwide that individuals are transferring positions to avoid the GPO, we found that 4,819 individuals in Texas and Georgia had performed work in Social Security-covered positions for short periods to qualify for the GPO last-day exemption.[8] Use of the exemption may grow further as the practice becomes more rapidly institutionalized and the aging baby-boom generation begins to retire in larger numbers. SSA officials also acknowledged that use of the exemption might be possible in some of the

[5]Public Law 95-216, Section 334 (1977).

[6]Currently, the reduction in spousal benefits is two-thirds of the amount of their public pension.

[7]Exemption due to "The Last Day of Employment" Covered Under Social Security – State/Local or Military Service Pensions (SSA's Program Operations Manual System, GN 02608.102).

[8]Technically, individuals could have used this exemption since its passage in 1977. However, nearly all of the transfers we identified in Texas and Georgia occurred in the last several years.

approximately 2,300 state and local government retirement plans in other states where such plans contain Social Security-covered and noncovered positions.

Use of GPO Exemption in Texas is Growing

Officials in Texas reported that 4,795 individuals at 31 schools have used or plan to use last-day employment to take advantage of the GPO exemption. In 2002, one-fourth (or 3,521) of all Texas public education retirees took advantage of this exemption.

In most schools, teachers typically worked a single day in a nonteaching position covered by Social Security to use the exemption.

Nearly all positions were nonteaching jobs, including clerical, food service, or maintenance. Most of these employees were paid about $6 per hour. At this rate, the Social Security contributions deducted from their pay would total about $3 for the day. We estimate that the average annual spousal benefit resulting from these last-day transfers would be about $5,200.

School officials also reported that individuals are willing to travel to take these jobs—noting one teacher who traveled 800 miles to use the last-day provision. Some schools reported that they charge a processing fee, ranging from $100-$500, to hire these workers. These fees are a significant source of revenue—last year one school district collected over $283,000 in fees.

Our work shows that use of the exemption in Texas has increased since 1990, which was the earliest use reported to us.

In one school district, for example, officials reported that use of the exemption grew from one worker in 1996 to 1,050 in 2002. Another school district that began offering last-day employment in 2002 had received over 1,400 applications by June of that year from individuals seeking to use the exemption.

Use of the exemption is likely to grow further, according to trends in Texas teacher retirements and information from school officials.

There were about 14,000 teacher retirements in 2002, as opposed to 10,000 in 2000. At one university we visited, officials have scheduled workdays for imminent retirees, through 2005, to work in covered employment, an indication of the rapid institutionalization of this practice. The GPO exemption is also becoming part of teachers' regular retirement planning process as its availability and use is publicized by teaching associations and financial planners (via Web sites, newspapers, seminars, etc.) and by word-of-mouth. One association's Web site we identified lists the names and telephone numbers of school officials in counties covered by Social Security and how to contact those officials for such work. A financial planner's Web site we identified indicated that individuals who worked as little as 1 day under a Social Security-covered position to quality for the GPO exemption could earn $150,000 or more in benefits over their lifetime.

In Georgia, Workers Obtain GPO Exemption by Transferring Positions

In Georgia, officials in one district reported that 24 individuals have used or plan to use covered employment to take advantage of the GPO exemption. Officials told us that teachers generally agreed to work for approximately 1 year in another teaching position in a school district covered by Social Security to use the GPO exemption. These officials told us that they expect use of the exemption to increase as awareness of it grows.

According to Georgia officials, their need to address a teacher shortage outweighs the risk to individual schools of teachers leaving after 1 year. Officials in fast-growing school systems reported they needed to hire teachers even if they only intended to teach for 1 year. However, some schools reported that they have had teachers leave shortly after being hired. For example, in one district, a teacher signed a 1-year contract to teach but left after 61 days, a time sufficient to avoid the spousal benefit reduction. In some of the applications for school employment we reviewed, individuals explicitly indicated their desire to work in a county covered by Social Security in order to obtain full Social Security spousal benefits.

Transfers to Avoid the GPO May be Possible Nationwide

Use of the GPO exemption might be possible in other plans nationwide. SSA officials told us that some of the approximately 2,300 state and local government retirement plans—where such plans contain Social Security-covered and noncovered positions—may offer individuals the opportunity to use the GPO exemption. Officials representing state and local government retirement plans in other states across the country also told us that their plans allow covered and noncovered Social Security positions, making it possible for workers to avoid the GPO by transferring from one type of position to the other. For example:

- An official in a midwestern state whose plan covers all state government employees, told us that it is possible for law enforcement personnel (noncovered) to take a covered job in the state insurance bureau (covered) just before retiring.

- In a southern state with a statewide retirement plan for school employees, teachers and other school professionals (noncovered) can potentially transfer to a job in the school cafeteria (covered) to avoid the GPO.

- A retirement system official from a north central state reported hearing of a few cases where teachers had taken advantage of the exemption by transferring to jobs in other school districts covered by Social Security.

- Finally, in a western state with a statewide retirement plan, workers could move from one government agency (noncovered) to a position in another agency (covered).

Cost of Transfers to the Social Security Trust Fund is Growing, but Options Exist to Address Potential Abuse

The transfers to avoid the GPO we identified in Texas and Georgia could increase long-term benefit payments from the Social Security Trust Fund by about $450 million.[9] We calculated this figure by multiplying the number of last-day cases reported in Texas and Georgia (4,819) by SSA data on the average annual offset amount ($4,800) and the average retirees life expectancy upon receipt of spousal benefits (19.4 years). We believe that these estimated payments would likely increase as use of the exemption grows.

Our prior report identified two options for addressing potential abuses of the GPO exemption. The first option, as proposed in H.R. 743, is to change the last-day provision to a longer minimum time period. This option would require only small changes to administer and would be less burdensome than other methods for SSA to administer. Also, this option has precedent. Legislation in 1987 required federal employees transferring between two federal retirement systems, the Civil Service Retirement System (CSRS) and Federal Employees Retirement System (FERS), to remain in FERS for 5 years before they were exempt from the GPO. We found that most of the jobs in Texas last for about 1 day, so extending the time period might eliminate many of the exemption users in Texas.

[9]This estimate may over/under estimate costs due to the use of averages, the exclusion of inflation/cost-of-living/net present value adjustments, lost investment earnings by the Trust Funds, and other factors that may affect the receipt of spousal benefits.

The second option our report identified is to use a proportional approach to determine the extent to which the GPO applies. Under this option, employees who have spent a certain proportion of their working career in a position covered by Social Security could be exempt from the GPO. This option may represent a more calibrated approach to determining benefits for individuals who have made contributions to the Social Security system for an extended period of their working years. However, SSA has noted that using a proportional approach would take time to design and would be administratively burdensome to implement, given the lack of complete and reliable data on noncovered Social Security employment.

Conclusions

The GPO "loophole" raises fairness and equity concerns for those receiving a Social Security pension and currently subject to an offset of their spousal Social Security benefits. The exemption allows a select group of individuals with a relatively small investment of work time and only minimal Social Security contributions to gain access to potentially many years of full Social Security spousal benefits. The practice of providing full spousal benefits to individuals who receive government pensions but who made only nominal contributions to the Social Security system also runs counter to the nation's efforts to address the solvency and sustainability of the Social Security program.

Based on the number of people reported to be using the loophole in Texas and Georgia this year, the exemption could cost the Trust Fund hundreds of millions of dollars. While this currently represents a relatively small percentage of the Social Security Trust Fund, costs could increase significantly if the practice grows and begins to be adopted by other states and localities.

Considering the potential for abuse of the last-day exemption and the likelihood for its increased use, we believe timely action is needed. Accordingly, our August 2002 report includes a Matter for Congressional consideration that the last-day GPO exemption be revised to provide for a longer minimum time period. This action would provide an immediate "fix" to address possible abuses of the GPO exemption identified in our review.

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

GAO Contributions and Acknowledgments

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, Patrick DiBattista, Patricia M. Bundy, Jamila L. Jones, Daniel A. Schwimer, Anthony J. Wysocki, and Jill D. Yost.

Related GAO Products

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