Reforming the Social Security Windfall Elimination Provision and Government Pension Offset, while Maintaining the Original Intent of a Level Playing Field

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Good morning, Chairman Ferguson, Ranking Member Larson, and members of the subcommittee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I am Chief Economist at the Bipartisan Policy Center. I am also the Executive Director of the Retirement Income Institute with the Alliance for Lifetime Income, as well as a Policy Fellow with the Stanford Institute for Economic Policy Research (SIEPR) and Research Fellow with the Center for Financial Security at the University of Wisconsin. I am on the Board of Directors for the National Academy of Social Insurance (NASI), the FINRA Foundation, and a Member of the Puerto Rico Pension Reserve Trust, where I serve on both the Pension Benefits Council and the Pension Reserve Board. Previously I served in several positions at the Social Security Administration (SSA), including deputy commissioner of Social Security (acting) and chief economist. All opinions I express today are my own and do not necessarily reflect the views of any organization with which I am affiliated.

I'd like to begin by thanking Chairman Ferguson and Ranking Member Larson for their leadership in ensuring that important public policy issues involving Social Security get the attention and debate they deserve and that ideas and viewpoints from all sides are aired in a collegial, productive, and respectful manner. It is truly a privilege for me to be testifying before the subcommittee today.

My testimony focuses on three key issues. First, I will explain how the current-law Windfall Elimination Provision (WEP)[2] is overly complex and unfair. Second, I will discuss how reforming

[1] Biographical information is available here: https://bipartisanpolicy.org/person/jason-j-fichtner/ & a link to my CV and list of publications is available here: https://sites.google.com/site/jasonjfichtner/

[2] The Windfall Elimination Provision (WEP) reduces Social Security benefit payments to beneficiaries whose work histories include both Social Security–covered and non-covered employment, with the non-covered employment also providing pension coverage. The WEP reduces the share of preretirement earnings that Social Security benefits replace. For roughly the first $14,000 in average annual earnings (the first bend point of 90 percent in the benefit formula applies to the first $1,174 per month for 2024, or $14,088), the WEP reduces the replacement rate from 90 percent to as low as 40 percent, depending on the worker's years of coverage under Social Security. The reduction cannot exceed

the Social Security benefit formula would improve the simplicity and fairness of the WEP, while still maintaining the original public policy purpose. Though most of my testimony focuses on the WEP, the related Government Pension Offset (GPO)[3] has similar complexity and fairness problems that should be addressed in tandem. Third, absent legislative changes to the Social Security benefit formula, I will discuss other potential reforms that would assist SSA in the administration of the WEP and GPO.

From this discussion, I hope to provide the subcommittee with the following takeaways:

1) The original public policy intent of the WEP and GPO was to ensure fair treatment between workers whose only earnings are covered by Social Security and workers with earnings that are not covered by Social Security. It is important to maintain equity between covered and non-covered workers. But repealing the WEP and GPO would violate the principles of fairness and equity that these provisions were intended to protect.
2) Unfortunately, given data limitations at the time the WEP and GPO provisions were first established in law, these provisions create an overly complex structure rife with what economists call perverse incentives. This can sometimes result in higher replacement rates for people with *high* lifetime earnings than for those with *low* lifetime earnings. Further, the complexity and lack of transparency in the current WEP and GPO provisions can hinder people's ability to accurately plan for retirement and potentially cause undue hardship for retirees.
3) Much good could come from a relatively straightforward change that would make the Social Security benefit formula proportional or prorated. For workers with non-covered earnings, this formula would calculate a replacement rate using the current method of determining the primary insurance amount (PIA), taking into account *all* earnings—covered and non-covered. But the proportional formula would apply this replacement rate only to the years of covered earnings. This change would allow for the use of one benefit formula for all Social Security beneficiaries, would be simple to understand, and would be fairer than the current system, while maintaining the original intent of fairness and equity of the WEP and GPO provisions.
4) Finally, absent legislative changes to the Social Security benefit formula, Congress can legislate some administrative reporting changes that would better enable the Social Security Administration to administer the WEP and GPO.

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50 percent of the amount of the pension received from non-covered employment. For more information on the WEP, see Social Security Administration, "Windfall Elimination Provision," January 2024. *https://www.ssa.gov/pubs/EN-05-10045.pdf*

[3] The Government Pension Offset (GPO) reduces Social Security benefits paid to spouses or survivors when the spouse or survivor earned a pension from a government job that was not covered by Social Security. The GPO reduction is equal to two-thirds of the amount of the pension payment from non-covered government work. For more information on the GPO, see Social Security Administration, "Government Pension Offset." *https://www.ssa.gov/pubs/EN-05-10007.pdf*

NON-COVERED WORKERS

Social Security retirement and disability benefits are funded via a payroll tax on covered earnings. The system is designed with a progressive benefit formula that provides a higher replacement rate for lower-income earners than for higher-income earners. The result is that monthly Social Security benefits represent a larger share of lifetime earnings for lower-income workers than higher-income workers. This does not mean that a lower-income worker's monthly benefit amount is higher in nominal dollars than a higher-income worker, but rather that the replacement rate is higher. For a simplified example, a lower-income worker whose final year of income before retirement was $25,000 and who receives $12,000 per year as a Social Security benefit ($500 per month) would have a replacement rate based on the final year of earnings of 48% ($12,000 / $25,000). Conversely, a higher-income earner whose final year of earnings was $100,000 and who receives $24,000 per year from Social Security ($2,000 per month) would have a replacement rate of 24% ($24,000 / $100,000).

For workers with entire careers in covered employment (employment subject to the Social Security payroll tax), lower lifetime wage earners receive a higher replacement rate than higher lifetime wage earners. But problems arise when workers have earnings from non-covered employment, such as those received through state and local governments in careers including public school teachers, police officers, or firefighters. Comparison of replacement rates can help illustrate how Social Security is a progressive system, but replacement rates are not necessarily a good tool for measuring benefit or program adequacy.[4]

The Social Security Act of 1935 initially exempted state and local government employers from mandatory participation. This exemption was because of constitutional questions as to whether the federal government could impose a payroll tax on state and local governments. Some state and local governments wanted their employees covered by Social Security, while others did not. Presently, all 50 states have agreements with the federal government to allow some state and local employees to be covered by Social Security. However, not all state and local public employees are covered.

According to SSA data, there were approximately 21.9 million state and local employees in 2021. Of those, roughly 5.9 million state and local workers—about 27%— do not pay Social Security taxes on the earnings from their state and local government employment.[5,6] If these

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[4] Though a full discussion on replacement rates is outside the scope of this testimony, for more information, see Jason J. Fichtner, "Addressing the Real 'Retirement Crisis' Through Sustainable Social Security Reform" (Testimony before the Senate Committee on Finance, Subcommittee Social Security, Pensions, and Family Policy, Mercatus Center at George Mason University, Arlington, VA, May 21, 2014), 3.

[5] Jeffrey R. Brown and Scott J. Weisbenner, "The Distributional Effects of the Social Security Windfall Elimination Provision," *Journal of Pension Economics and Finance* 12, no. 4 (2013): 415–34; and Patrick Purcell, "Trends in Noncovered Employment and Earnings Among Employees of State and Local Governments, 1994 to 2018," Briefing Paper No. 2021-01. Social Security Administration. August 2021.

[6] "The Windfall Elimination Provision: It's Time to Correct the Math" (Position Paper, Social Security Advisory Board, Washington, DC, October 1, 2015); Patrick Purcell, "Trends in Noncovered Employment and Earnings Among Employees of State and Local Governments, 1994 to 2018," Briefing Paper No. 2021-01. Social Security Administration. August 2021; and Zhe Li, "Social Security Coverage of State and Local Government Employees," Congressional Research Service, R46961. March 19, 2024.

workers have an entire career in state and local government that is not covered by Social Security, there is no problem with the WEP. However, many of these state and local government employees still qualify for some Social Security benefits, either because they have employment history in both covered and non-covered employment, or because they work simultaneously in multiple jobs that include both covered and non-covered employment. For example, a professor in the Commonwealth of Massachusetts (one of the states whose public workers are not necessarily covered under Social Security[7]) will spend the academic year teaching but may spend summers working for extra income in covered employment outside the university. A professor's career may also span multiple universities, with some of those years spent at a private university, such as Johns Hopkins, where I used to teach, where earnings are covered by Social Security. These employees could be affected by the WEP and receive Social Security benefits that are calculated in a way that results in an unfair benefit amount. About 2.1 million Social Security beneficiaries—or around 3%—were affected by the WEP as of December 2023, while approximately 746,000 beneficiaries, or less than 1%, were affected by the GPO.[8]

As explained by Brown and Weisbenner (2013):

> If Social Security benefits were calculated as a simple linear function of lifetime earnings, it would be possible to calculate the retirement benefit for a worker with partial coverage by simply applying the standard benefit formula only to those earnings covered by Social Security. However, the Social Security benefit formula was explicitly designed to be nonlinear in order to offer a higher replacement rate (i.e., a higher ratio of Social Security benefits to average indexed monthly earnings over one's lifetime) for individuals with lower earnings. For workers with earnings that are not covered by the Social Security system, using only covered earnings in the standard benefit formula would result in a higher replacement rate on these covered earnings than they would receive if all of their earnings were covered. In order to adjust for this, the Windfall Elimination Provision (WEP) was enacted as part of the 1983 Social Security Amendments. This provision is meant to downward-adjust the Social Security benefits of affected workers in order to eliminate the "windfall" that arises when, for example, an individual with high lifetime earnings (based on both covered and uncovered earnings) would appear as if he or she were a low earner when evaluated solely based on covered earnings.[9]

In sum, while the WEP is intended to ensure that Social Security beneficiaries are treated fairly and that benefits are provided only for years in which people paid into the Social Security system, the result is that the replacement rate for some people with *high* lifetime combined

[7] "Frequently Asked Questions: GPO WEB FAQ," Social Security Fairness, accessed April 10, 2024. https://ssfairness.org/gpo-wep-faq/
[8] "Social Security: The Windfall Elimination Provision (WEP) and Government Pension Offset (GPO)" Congressional Research Service, Updated February 28, 2024.
[9] Brown and Weisbenner, "The Distributional Effects," 416.

earnings is higher than those with *low* lifetime earnings. The WEP mistakenly treats some high-income earners as if they were low-income earners. To see how this might come about, consider the following examples.

Table 1. Example of a Stylized Social Security Benefit

Average Annual Earnings Adjusted for Wage Growth	Average Indexed Monthly Earnings (AIME) for 2024	PIA 90% Bend Point	PIA 32% Bend Point	PIA 15% Bend Point	PIA	Replacement Rate
$24,000.00	$2,000.00	$1,056.60	$264.32	$0.00	$1,320.92	66%
$36,000.00	$3,000.00	$1,056.60	$584.32	$0.00	$1,640.92	55%
$100,000.00	$8,333.33	$1,056.60	$1,889.28	$188.30	$3,134.18	38%

Example of a Stylized Social Security Benefit

Note: For 2024, the first $1,174 of AIME is multiplied by 90 percent; AMIE between $1,174 and $7,078 by 32 percent; and the remaining AIME by 15 percent.

Source: Author calculations based on "Benefit Formula Bend Points," Social Security Administration, accessed April 10, 2024.

Table 1 shows that workers who turn age 62 in 2024 with 35 years of covered employment and who begin receiving Social Security retirement benefits at their full retirement age (FRA) would receive a monthly benefit of $1,321 if their average annual lifetime earnings were $24,000 (a 66% replacement rate); $1,641 if their average annual lifetime earnings were $36,000 (a 55% replacement rate); or $3,134 if their average annual lifetime earnings were $100,000 (a 38% replacement rate).

Now consider workers with the same average annual lifetime earnings but who have 20 years of non-covered employment and 15 years of covered employment. The Social Security program treats the years of non-covered employment as $0 years for purposes of calculating the average indexed monthly earnings (AIME). For the worker with average adjusted annual income of $24,000, 20 of the 35 years are considered $0. Hence, the resulting average annual earnings (adjusted for wage growth) is only $10,286 ($24,000 x 15 / 35). Table 2 shows the PIAs and replacement rates for these workers without the WEP adjustment.

Table 2. Example of a Stylized Social Security Benefit with 35 Years Employment: 15 Covered and 20 Non-Covered, No WEP Adjustment

Example of a Stylized Social Security Benefit With 35 Years Employment: 15 Covered & 20 Non-Covered No WEP Adjustment

Average Annual Earnings Adjusted for Wage Growth	Average Indexed Monthly Earnings (AIME) for 2024	PIA 90% Bend Point	PIA 32% Bend Point	PIA 15% Bend Point	PIA	Replacement Rate
$10,285.71	$857.14	$771.43	$0.37	$0.00	$771.79	90%
$15,428.57	$1,285.71	$1,056.60	$35.75	$0.00	$1,092.35	85%
$42,857.14	$3,571.43	$1,056.60	$767.18	$0.00	$1,823.78	51%

Note: For 2024, the first $1,174 of AIME is multiplied by 90 percent; AMIE between $1,174 and $7,078 by 32 percent; and the remaining AIME by 15 percent.

Source: Author calculations based on "Benefit Formula Bend Points," Social Security Administration, accessed April 10, 2024.

As can be seen, the $24,000-per-year worker is viewed by Social Security as a lower-wage, $10,000-per-year worker, and the non-WEP-adjusted monthly benefit amount would be $772.

This benefit amount is nominally less than the $1,321 that the $24,000-per-year worker with a full career of covered employment received, but the benefit now replaces 90% of the worker's covered earnings, as opposed to the 66% replacement rate received by the worker with only covered earnings. For the $100,000-per-year worker, the replacement rate is now 51% as opposed to 38%. In other words, this worker now receives a "windfall" in the form of a benefit that replaces a much higher proportion of *covered* earnings than it would otherwise.

To correct for this potential "windfall," the WEP adjusts the benefit formula. The first bend point is now reduced from 90% to as little as 40%.[10] Using the same stylized workers as before, but now applying the WEP adjustment, Table 3 shows the resulting PIAs and replacement rates.

[10] For more information on the WEP, see Social Security Administration, "Windfall Elimination Provision," January 2016.

Table 3. Example of a Stylized Social Security Benefit with 35 Years Employment: 15 Covered and 20 Non-Covered, with WEP Adjustment

Example of a Stylized Social Security Benefit With 35 Years Employment: 15 Covered & 20 Non-Covered With WEP Adjustment						
Average Annual Earnings Adjusted for Wage Growth	Average Indexed Monthly Earnings (AIME) for 2024	PIA 40% Bend Point	PIA 32% Bend Point	PIA 15% Bend Point	PIA	Replacement Rate
$10,285.71	$857.14	$342.86	$0.00	$0.00	$342.86	40%
$15,428.57	$1,285.71	$469.60	$35.75	$0.00	$505.35	39%
$42,857.14	$3,571.43	$469.60	$767.18	$0.00	$1,236.78	35%
Note: For 2024, the first $1,174 of AIME is multiplied by as little as 40 percent; AMIE between $1,174 and $7,078 by 32 percent; and the remaining AIME by 15 percent.						

Source: Author calculations based on "Benefit Formula Bend Points," Social Security Administration, accessed April 10, 2024.

Now the resulting replacement rates for these workers with split employment are more aligned with comparable workers (similar average annual lifetime earnings) whose entire careers were in covered employment. The "windfall" has been eliminated. However, the WEP formula is complicated and hard to explain to beneficiaries.[11] Further, the current Social Security Statement provides estimated monthly benefit amounts that are not adjusted for the WEP. While the Statement does include a note to all recipients that they could be subject to the WEP and that their benefits may be reduced if they have earnings from work not covered by Social Security, the complexity of the program and the benefit formula result in beneficiaries likely learning about the WEP only when they first receive a WEP-reduced Social Security benefit check. For people relying on the Social Security Statement as a retirement planning tool, the current non-WEP-adjusted information in the Statement could cause people to overestimate their financial readiness for retirement.

It is important to note at this point that eliminating the WEP will only return Social Security to its pre-WEP state and reinstate a windfall for those with both covered and non-covered employment. Hence, repeal is not advised. However, changing the benefit calculation to use a "proportional" or prorated formula would improve fairness in Social Security. It would also be easier for SSA to administer and beneficiaries to understand.

POLICY OPTIONS AND CONCLUSION

When the current formula for the WEP was established as part of the 1983 Amendments to the Social Security Act, SSA lacked the administrative records to accurately capture non-covered employment history. Hence, a proportional or prorated WEP wasn't possible. However, SSA now has 35 years of employment history including both covered and non-covered employment. Thus, we now have the information necessary to reform the WEP and move to a prorated formula.

[11] Brown and Weisbenner, "The Distributional Effects"; Social Security Advisory Board, "The Windfall Elimination Provision."

To see how a “proportional” or prorated benefit formula would look, consider Table 4 below, which includes the same stylized workers used in the previous illustrations.

Table 4. Example of a Stylized Social Security Benefit with 35 Years All Covered Employment with Proposed Prorated WEP Adjustment

Example of a Stylized Social Security Benefit With 35 Years All Covered Employment With Proposed Pro-Rated WEP Adjustment									
Average Annual Earnings Adjusted for Wage Growth **(All Earnings)**	Average Indexed Monthly Earnings (AIME) for 2024	PIA 90% Bend Point	PIA 32% Bend Point	PIA 15% Bend Point	PIA **(All Earnings)**	Replacement Rate **(All Earnings)**	Average Annual Earnings Adjusted for Wage Growth **(Covered Earnings)**	Average Indexed Monthly Earnings (AIME) for 2024 **(Covered Earnings)**	**New PIA** (Replacement Rate for All Earnings x AMIE Covered Earnings)
$24,000.00	$2,000.00	$1,056.60	$264.32	$0.00	$1,320.92	66%	$24,000.00	$2,000.00	$1,320.92
$36,000.00	$3,000.00	$1,056.60	$584.32	$0.00	$1,640.92	55%	$36,000.00	$3,000.00	$1,640.92
$100,000.00	$8,333.33	$1,056.60	$1,889.28	$188.30	$3,134.18	38%	$100,000.00	$8,333.33	$3,134.18
Example of a Stylized Social Security Benefit With 35 Years Employment: 15 Covered & 20 Non-Covered With Proposed Pro-Rated WEP Adjustment									
$24,000.00	$2,000.00	$1,056.60	$264.32	$0.00	$1,320.92	66%	$10,285.71	$857.14	$566.11
$36,000.00	$3,000.00	$1,056.60	$584.32	$0.00	$1,640.92	55%	$15,428.57	$1,285.71	$703.25
$100,000.00	$8,333.33	$1,056.60	$1,889.28	$188.30	$3,134.18	38%	$42,857.14	$3,571.43	$1,343.22
Note: For 2024, the first $1,174 of AIME is multiplied by 90 percent; AMIE between $1,174 and $7,078 by 32 percent; and the remaining AIME by 15 percent.									

Source: Author calculations based on “Benefit Formula Bend Points,” Social Security Administration, accessed April 10, 2024.

Under the proposed new formula, the AIME is computed as it is currently but for all earnings, covered and non-covered combined. The combined-earnings PIA is then determined, which provides the replacement rate (PIA divided by AIME). Next, an AIME is computed for covered earnings only. Finally, the combined-earnings replacement rate is applied to the covered-earnings AIME, resulting in the final PIA.

For workers whose entire careers are in covered earnings, the resulting PIA is the same. However, for those with non-covered earnings, their PIA replaces the same proportion of their covered earnings as those with the same level of total earnings whose entire careers were spent in covered employment. In other words, the replacement rate on covered earnings is now the same and treats both workers with identical lifetime earnings history equally, thus restoring some fairness to the system while still maintaining the original intent of the WEP to avoid a “windfall” to those with non-covered earnings.

The simplicity and fairness of the proposed new formula is that it would apply to all workers—those with both covered earnings only and those with both covered and non-covered earnings—making it easy for SSA to administer and for beneficiaries to better plan for retirement. Additionally, under the proposed formula, the Social Security Statement could provide accurate monthly benefit projections to better enable people to plan for their financial security in retirement.

The original intent of the WEP still applies today; however, we now have the opportunity to get the formula right for the improvement of the Social Security program and its beneficiaries. The Bipartisan Policy Center has proposed a similar proportional policy reform option.[12]

[12] Commission on Retirement Security and Personal Savings, “Securing our Financial Future: Report of the Commission on Retirement Security and Personal Savings,” Bipartisan Policy Center, June 2016. https://bipartisanpolicy.org/download/?file=/wp-content/uploads/2019/03/BPC-Retirement-Security-Report.pdf

Beyond changes to the benefit formula itself, Congress could help SSA more accurately adjust benefits for workers with both covered and non-covered earnings. The Administration has exhausted its administrative options to address the issues I have outlined in this testimony, including by sending notices to workers that SSA suspects have non-covered earnings. However, because SSA still relies heavily on beneficiaries to self-report non-covered pension income, further efforts to improve data collection will require congressional action to ensure SSA is able to receive the data needed to accurately administer the program. SSA's Office of the Inspector General agrees.[13]

Congress can either: 1) mandate that each state provide SSA with a file of pension recipients and the portion of their pension that is based on non-covered work, which would address the legal issues SSA currently faces in getting voluntary agreements with the states; or 2) require the Internal Revenue Service to provide a checkbox on the Form 1099-R[14] to indicate that a person's pension is in whole or in part based on non-covered earnings and also legislate that the IRS be required to share that data with SSA. Note that option #2 would still require a great deal of manual work by SSA that could be avoided if the states are mandated to simply provide the data to SSA in the first place. Better data reporting would allow SSA to do a better job of informing workers who are subject to the WEP or GPO.

Thank you again for providing me with this opportunity to testify today.

[13] SSA OIG. Audit Report. "Government Pension Data for the Windfall Elimination Provision and Government Pension Offset Determinations." September 2023. https://oig.ssa.gov/assets/uploads/a-13-20-50970.pdf

[14] IRS Form 1099-R. "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc." https://www.irs.gov/pub/irs-pdf/f1099r.pdf