POSITION PAPER

The Windfall Elimination Provision

It's Time to Correct the Math

October 1, 2015

This paper explains how the formula used to calculate benefits under the Windfall Elimination Provision (WEP) works and describes proposals to modernize it; a separate paper will explain how the Government Pension Offset (GPO) works and outline proposals to improve it. WEP and GPO are similar in that they adjust Social Security benefits based on the presence of non-covered earnings. They differ in that they apply to different categories of beneficiaries: WEP adjusts worker benefits while GPO adjusts spousal and survivor benefits.

When Congress established the WEP formula as part of the Social Security Amendments of 1983, the Social Security Administration (SSA) lacked data on earnings in jobs not covered by Social Security that are necessary to make an exact benefit adjustment. Beginning in 2017, SSA will have 35 years of earnings data so that it can accurately calculate benefits for people who have worked both in employment covered by Social Security and in employment not covered by Social Security. Workers in covered employment contribute to Social Security through their payroll taxes, while workers in non-covered employment do not. The Social Security Advisory Board recommends that beginning in 2017, Congress change the current formula to one that uses actual earnings data in applying WEP. SSA should communicate this change to affected individuals, both in an outreach campaign and on its *mySSA* website.

The Social Security Act of 1935 established a retirement pension system financed by earmarked payroll taxes. The law initially exempted state and local government employees because of constitutional questions about whether the federal government could impose taxes on states for the employer portion of the Social Security tax. However, states without retirement systems of their own wanted some employees covered. Consequently, in the Social Security Amendments of 1950, Congress allowed states to enter into voluntary agreements with SSA for Social Security coverage. By the end of 1951, 30 states had executed such agreements with the federal government. Today, all 50 states, Puerto Rico, and the Virgin Islands, have such agreements, but some agreements do not cover all public employees; roughly 28 percent of state and local government workers remain non-covered by Social Security.[1]

WEP does not apply to workers who spend their entire career in non-covered employment. No Social Security is due, so no adjustment is necessary. However, problems arise when people work part of their careers in Social Security-covered employment and part in non-covered employment. In these cases, SSA determines an individual's retirement and disability benefit by averaging earnings over the highest 35 years of earnings in *covered* employment. Earnings from work in years not covered by Social Security are ignored. In addition, the Social Security benefit formula is progressive, in the sense that the ratio of benefits to earnings is higher for people with *low* lifetime earnings than for people with *high* lifetime earnings. The combination of these two facts creates a problem, as discussed below.

SSA's Benefit Calculation Under its Retirement and Disability Programs

Benefits are based on a person's primary insurance amount (PIA). SSA calculates the PIA by dividing the worker's average indexed monthly earnings (AIME) into three separate portions (divided at two specific bend points) and multiplies each portion by a specific percentage (called a PIA factor). The sum of the three portions is the PIA. The 2015 bend points and PIA factors are shown in the following table:

Average Indexed Monthly Earnings (AIME) for 2015*	PIA factor
Earnings up to $826 +	90%
Earning over $826 up to $4,980 +	32%
Earnings over $4,980	15%

* The dollar amounts in this column—$826 and $4,980 in 2015—are the "bend points."

1 Testimony Of Frederick Streckewald Assistant Deputy Commissioner Disability And Income Security Programs Hearing Before The House Ways And Means Subcommittee On Social Security June 9, 2005. http://www.ssa.gov/legislation/testimony_060905.html

The formula works as intended for people who have worked exclusively in jobs covered by Social Security. It does *not* work as it should for people who work part of their careers in jobs not covered by Social Security. The AIME of such part-career workers is lower than their actual average earnings; years spent in jobs not covered by Social Security are treated as years of zero earnings.

To see why this practice creates an issue, consider two workers, Ethan and Mia. Both worked for 35 years and both earned $44,000 every year. However, Ethan worked exclusively in Social Security-covered employment, while Mia worked 15 years in covered employment and 20 years for the state in non-covered employment.

Mia's AIME is less than half of Ethan's because SSA treats the 20 years Mia worked for the state (earning the same salary as Ethan) as years of zero earnings. Because the Social Security benefit formula gives low-income workers a benefit equal to a higher ratio of their earnings than it gives to high earners, Mia will receive a higher replacement rate of her covered earnings than does Ethan, even though they have similar career wage earnings.

Worker	Type of Employment	AIME*	Replacement rate
Ethan	35 years of SSA covered employment	$3,670	45%
Mia	15 years, SSA covered employment 20 years, non-covered employment	$1,580	62%

*based on identical incomes of $44,000 per year

For many years, SSA paid benefits to people such as Mia based on the enhanced replacement rate—in this example, Mia's 62 percent rather than Ethan's 45 percent. The 1983 Social Security Amendments changed that policy. These amendments made a number of changes designed to shore up Social Security's finances. They raised the age at which full benefits are paid, taxed benefits of higher income earners, and required all newly-hired nonprofit and federal employees to pay into Social Security; they also contained adjustments intended to equalize replacement rates for people like Ethan and Mia—the WEP.

The WEP provision reflected recommendations of the bipartisan National Commission on Social Security Reform (the 'Greenspan Commission'), which had said that people with some earnings from non-covered employment should receive the same replacement rates as paid to workers whose entire career was spent in covered employment.[2]

2 http://www.ssa.gov/history/reports/gspan5.html

The Commission described different methods of eliminating these "windfall" benefits:

1. One method was to modify the PIA formula for these workers by making the second percentage factor (32 percent) applicable to the first band of Average Indexed Monthly Earnings (instead of the 90 percent factor) while ensuring that the reduction in benefits would not be larger than the pension from non-covered employment.
2. Another method was to apply an unchanged benefit formula to earnings from the sum of covered and non-covered earnings to compute a replacement rate (the ratio of the computed benefit to previous earnings). That replacement rate would then be applied to the average earnings from *covered* employment.

Because the data needed to apply the second approach were unavailable, Congress adopted the structure of the first method described by the Commission. But the two houses of Congress disagreed on the rate that should be used to replace the 90 percent replacement rate used in the first leg of the benefit formula. The House proposed a 61 percent factor and the Senate, the 32 percent factor recommended by the Greenspan Commission. So, the Conference Committee settled on a 40 percent replacement factor for the first earnings band. The WEP formula applies to people who reached age 62 or became disabled in 1990 or later.[3] For the other two legs, the WEP formula is the same as the PIA formula, as shown in the following Table:

Average Indexed Monthly Earnings (AIME) for 2015*	PIA factor	WEP factor
Earnings up to $826 +	90%	40%
Earning over $826 up to $4,980 +	32%	32%
Earnings over $4,980	15%	15%

* The dollar amounts in this column—$826 and $4,980 in 2015—are called "bend points."

Here's How it Actually Works

Although Congress intended to treat comparably workers with non-covered earnings and workers who worked their entire careers in employment covered by Social Security, the formula is inexact. People subject to the WEP typically receive either higher or lower replacement rates than they would if all of their work were covered by Social Security. In the Ethan/Mia example above, Mia received a higher replacement rate than Ethan did. Under the WEP formula adopted in 1983, she receives a lower replacement rate. Thus, the WEP formula over-adjusts Mia's replacement rate.

3 Note the law includes some exceptions in applying WEP. See www.ssa.gov/pubs/EN-05-10045.pdf for a description of when WEP will not be applied.

Example of Over-Adjusting	Type of Employment	AIME*	Replacement rate after WEP
Ethan	35 years of SSA covered employment	$3,670	45%
Mia	15 years, SSA covered employment 20 years, non-covered employment	$1,580	36%

*based on identical incomes of $44,000 per year

Under different earnings assumptions, the WEP formula *under*-adjusts an individual's benefits. Had Ethan and Mia spent the same numbers of years in covered employment as in the previous examples, but earned an annual average of $100,000, Mia's replacement rate would have been higher than Ethan's (34 percent vs. 31 percent). In practice, the WEP PIA under-adjusts benefits more often than it over-adjusts benefits.

Example of Under-Adjusting	Type of Employment	AIME*	Replacement rate after WEP
Ethan	35 years of SSA covered employment	$8,333	31%
Mia	15 years, SSA covered employment 20 years, non-covered employment	$3,580	34%

*based on identical incomes of $100,000 per year

WEP is Difficult to Explain and to Administer

The WEP formula is complicated and hard to explain. When characterized as a benefit reduction, rather than a correction, it generates a negative reaction from for those facing the reduction. Affected employees and unions have charged that the WEP blindsides beneficiaries, who expected larger benefits than the formula allows, and larger than is indicated on the *Social Security Statement* mailed to employees and that is now found on-line at *mySSA*. Beneficiaries write numerous letters asserting that they are not receiving their full SSA benefit. Members of Congress have introduced numerous bills to repeal WEP.

Congress addressed the communication issue in the Social Security Protection Act of 2004. Section 419(c) of this law requires state and local government employers to disclose the effect of WEP to affected employees hired on or after January 1, 2005. Newly hired public employees must sign a statement affirming that they are aware of a possible reduction in their future Social Security benefit entitlement.[4]

4 https://www.socialsecurity.gov/forms/ssa-1945.pdf

SSA also responded to the communication issue. Beginning in 2007, it inserted a section describing the WEP into the *Statement*. However, communication problems remain. The *Statement* continues to provide Social Security benefit estimates based only on covered employment, with no estimates of the adjustment for WEP. Since the estimates are based only on the covered employment, these workers' *Statements* predict a higher replacement rate than they will actually receive. SSA has provided online benefit calculators to potentially affected workers to help them prepare their own estimates of WEP's effects. However, not all affected workers know that these tools exist or how to use them. In addition, SSA's communications about the WEP are something of a red flag, as they characterize the WEP as a benefit *reduction*, rather than a correction or adjustment.

A Chance to Get it Right

Beginning in 2017, SSA will have 35 years of data on earnings from both covered and non-covered employment. The availability of these data means that Congress can now apply the more accurate approach described in 1983 by the Greenspan Commission (method 2 described on page 4). The new formula could be applied to benefits of all retired worker and disabled worker beneficiaries newly eligible for benefits after December 2016. Under this approach, a replacement rate would be calculated using both covered and non-covered earnings. This replacement rate would be multiplied by the amount of covered earnings to compute the Social Security benefit. This computation is referred to as the "proportional formula." Mia's Social Security benefit would change under the proportional formula. Assume that Mia's replacement rate for earnings of $44,000 a year from *all* work—covered and non-covered—is 45 percent. Mia's benefits would be smaller than Ethan's, because less of her lifetime earnings than of Ethan's lifetime earnings would have come from employment covered by Social Security. But their replacement rates on *covered* earnings would be identical, which is a fair outcome.

Example of Proportional Formula	Type of Employment	AIME*/proportional calculated AIME	Replacement rate after WEP on covered earnings
Ethan	35 years of SSA covered employment	$3,670	45%
Mia	15 years, SSA covered employment 20 years, non-covered employment	$3,670	45%

*based on identical incomes of $44,000 per year

Current Legislative Efforts

Legislation introduced in Congress this year uses a proportional formula similar to that described above for beneficiaries with non-covered employment.[5] Co-sponsored by Representatives Kevin Brady (R-TX) and Richard Neal (D-MA), the bill's "Public Servant Fairness Formula" would apply to new beneficiaries who turn 62 beginning in 2017 who would have otherwise been subject to the WEP adjustment. For those turning 62 before 2017, the bill maintains the current law WEP formula with additional requirements to ensure pension receipt is reported.

The Board recommends implementation of the new proportional formula. Any recomputation of past benefits would impose serious workload burdens on SSA staff who are already hard pressed by increasing workloads and stagnant budgets. Furthermore, retrospective recomputations could reduce the benefits of current beneficiaries, many long retired and unable to recoup any benefit reduction by returning to work.

Conclusion

The Social Security Advisory Board urges simplicity. Congress should change the WEP so that replacement rates are based on total earnings, regardless of whether they are from covered or non-covered employment. The SSA should communicate the change to affected employees. In particular, SSA should re-calculate the benefit estimates in *mySSA* using the new formula. The process will appear to be and, in fact, *will be* more fair.

5 H.R. 711: Equal Treatment of Public Servants Act of 2015.

Social Security Advisory Board

In 1994, when Congress passed legislation establishing the Social Security Administration as an independent agency, it also created a 7-member bipartisan Advisory Board to advise the President, the Congress, and the Commissioner of Social Security on matters related to the Social Security and Supplemental Security Income (SSI) programs. Advisory Board members are appointed to six-year terms, made up as follows: three appointed by the President (no more than two from the same political party); and two each (no more than one from the same political party) by the Speaker of the House (in consultation with the Chairman and the Ranking Minority Member of the Committee on Ways and Means) and by the President pro tempore of the Senate (in consultation with the Chairman and Ranking Minority Member of the Committee on Finance). Presidential appointments are subject to Senate confirmation.

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