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SOCIAL SECURITY

Issues Relating to
Noncoverage of Public
Employees

Statement of Barbara D. Bovbjerg, Director
Education, Workforce, and Income Security Issues



G A O

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Highlights of [GAO-03-710T](#), a testimony before the Subcommittee on Social Security, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

Social Security covers about 96 percent of all US workers; the vast majority of the rest are state, local, and federal government employees. 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, but critics contend these provisions are themselves often unfair. The Subcommittee asked GAO to discuss these provisions as well as the implications of mandatory coverage for public employees.

What GAO Recommends

GAO has previously recommended that the Internal Revenue Service (IRS) provide for complete and accurate reporting of noncovered pensions, but IRS has responded that it lacks the necessary authority from the Congress. GAO therefore takes this opportunity to bring the matter to the attention of the Congress for its 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.

www.gao.gov/cgi-bin/getrpt?GAO-03-710T.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Barbara D. Bovbjerg at (202) 512-7215 or bovbjergbj@gao.gov.

SOCIAL SECURITY

Issues Relating to Noncoverage of Public Employees

What GAO Found

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, GPO and 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, and a number of proposals have been offered to either revise or eliminate GPO and WEP. 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.

Making coverage mandatory has been proposed to help address the program's financing problems, and doing so could ultimately eliminate the need for the GPO and the WEP. According to Social Security actuaries, mandatory coverage would reduce the 75-year actuarial deficit by 10 percent. However, to provide for the same level of retirement income, mandating coverage would increase costs for the state and local governments that would sponsor the plans. Moreover, GPO and 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 Social Security provisions affecting public employees. Social Security covers about 96 percent of all U.S. workers; the vast majority of the rest are state, local, and federal government employees. 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. However, 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 provisions affecting noncovered public employees, and the potential implications of mandatory coverage of public employees. My testimony is based on a body of work we have published over the past several years.¹

In summary, 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 fairness 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, and 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, GPO and WEP are not applied consistently for all noncovered pension recipients. We have made recommendations to improve the availability and tracking of key information, and in the federal case, the implementation of our

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

recommendations has saved hundreds of millions of dollars. However, congressional action appears to be needed in this area with respect to state and local government pensions. At the same time, a number of proposals have been offered to either revise or eliminate GPO and WEP. While we have not analyzed such proposals, we believe it is important to consider both the costs and fairness issues they raise.

Aside from the issues surrounding GPO and WEP, another aspect of the relationship between Social Security and public employees is the question of mandatory coverage. Making coverage mandatory has been proposed to help address the program's financing problems. According to Social Security actuaries, doing so would reduce the 75-year actuarial deficit by 10 percent. Mandatory coverage 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, mandatory coverage could increase costs for the state and local governments that would sponsor the plans. Moreover, the GPO and 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.² 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

²Beginning with those born in 1938, the age at which full benefits are payable will increase in gradual steps from age 65 to age 67.

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 do not 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' 2003 intermediate, or best-estimate, assumptions, Social Security's cash flow is expected to turn negative in 2018. In addition, all of the accumulated Treasury obligations held by the trust funds are expected to be exhausted by 2042. Social Security's long-term financing shortfall stems primarily from the fact that people are living longer. 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 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 employees because they had their own retirement systems, and there was concern over the question of the federal government's right to impose a tax on state governments. 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, the Congress extended mandatory coverage to newly hired federal workers.

The Social Security Administration (SSA) estimates that 5.25 million state and local government employees, excluding students and election workers, are not covered by Social Security. SSA also estimates that

annual wages for these noncovered employees totaled about \$171 billion in 2002. In addition, 1 million federal employees hired before 1984 are also not covered. Seven states—California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas—account for more than 75 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, a 1994 U.S. Department of Labor survey found that all members have a survivor annuity option, 91 percent have disability benefits, and 62 percent 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 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 95 percent of noncovered state and local employees become entitled to Social Security as workers, spouses, or dependents. Their noncovered status complicates the program's ability to target benefits in the ways it is intended to do.

Provisions Seek Fairness but Pose Administrative Challenges

To address the fairness issues that arise with noncovered public employees, Social Security has two provisions—GPO, which addresses spouse and survivor benefits and WEP, which addresses 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. As a result, proposals have been offered to revise or eliminate both provisions.

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 their 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 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 WEP, the Congress was concerned that the design of the Social Security benefit formula provided unintended windfall benefits to workers who 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 GPO and 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, our prior work found that SSA lacks payment controls and is often unable to determine whether applicants should be subject to GPO or WEP because it has not developed any independent source of noncovered pension information.³ In that report, we estimated that failure to reduce benefits for federal, state, and local employees caused \$160 million to \$355 million in overpayments between 1978 and 1995. In response to our recommendation, SSA performed additional computer matches with the Office of Personnel Management to get noncovered

³See U.S. General Accounting Office, *Social Security: Better Payment Controls for Benefit Reduction Provisions Could Save Millions*, [GAO/HEHS-98-76](#) (Washington, D.C.: Apr. 30, 1998).

pension data for federal retirees in order to ensure that these provisions are applied. These computer matches detected payment errors; correcting these errors will generate hundreds of millions of dollars in savings, according to our estimates.⁴

Also, in that report, we recommended that SSA work with the Internal Revenue Service (IRS) to revise the reporting of pension information on IRS Form 1099R, so that SSA would be able to identify people receiving a pension from noncovered employment, especially in state and local governments. However, IRS does not believe it can make the recommended change without new legislative authority. Given that one of our recommendations was implemented but not the other, SSA now has better access to information for federal employees but not for state and local employees. As a result, SSA cannot apply GPO and WEP for state and local government employees to the same degree that it does for federal employees. To address issues such as these, the President's budget proposes "to increase Social Security payment accuracy by giving SSA the ability to independently verify whether beneficiaries have pension income from employment not covered by Social Security."

In addition to facing administrative challenges, GPO and WEP have also faced criticism regarding their design in the law. For example, GPO does not apply if an individual's last day of state/local employment is in a position that is covered by Social Security.⁵ This GPO "loophole" raises fairness and equity concerns.⁶ In the states we visited for a previous report, individuals with a relatively minimal investment of work time and Social Security contributions gained access to potentially many years of full Social Security spousal benefits. To address this issue, the House

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.

⁵Exemption 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).

⁶See 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).

recently passed legislation that provides for a longer minimum time period in covered employment.

At the same time, GPO and WEP have been a source of confusion and frustration for the roughly 6 million workers and nearly 1 million beneficiaries they affect. Critics of the measures contend that they are basically inaccurate and often unfair. For example, some opponents of 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. A variety of proposals have been offered to either revise or eliminate them. 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 SSA and the Congressional Budget Office (CBO), proposals to reduce the number of beneficiaries subject to GPO would cost \$5 billion or more over the next 10 years and increase Social Security's long-range deficit by up to 1 percent. Eliminating GPO entirely would cost \$21 billion over 10 years and increase the long-range deficit by about 3 percent. Similarly, a proposal that would reduce the number of beneficiaries subject to WEP would cost \$19 billion over 10 years, and eliminating WEP would 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 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 both on their own work records and their spouses'. In such cases, each spouse 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. If 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. Far more spouses are subject to the dual-entitlement offset than to GPO; as a result, the costs of eliminating the dual-entitlement offset would be commensurately greater.

Mandatory Coverage Has Been Proposed

Aside from the issues surrounding GPO and WEP, another aspect of the relationship between Social Security and public employees is the question of mandatory coverage. Making coverage mandatory has been proposed in the past to help address the program's financing problems. According to Social Security actuaries, doing so would reduce the 75-year actuarial deficit by 10 percent.⁷ Mandatory coverage could also enhance inflation-protection for the affected beneficiaries, improve portability, and add dependent benefits in many cases. However, to provide for the same level of retirement income, mandatory coverage could increase costs for the state and local governments that would sponsor the plans. Moreover, if coverage were extended primarily to new state and local employees, GPO and WEP would continue to apply for many years to come for existing employees and beneficiaries even though they would become obsolete in the long run.

While Social Security's solvency problems have triggered an analysis of the impact of mandatory coverage on program revenues and expenditures, the inclusion of such 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." The Advisory Council's 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."

The impact on public employers, employees, and pension plans would depend on how states and localities with noncovered employees would react to mandatory coverage. Many public pension plans currently offer a lower retirement age and higher retirement income benefit than Social Security. For example, many public employees, especially police and firefighters, retire before they are eligible for full Social Security benefits; new plans that include Social Security coverage might provide special supplemental benefits for those who retire before they could receive Social Security benefits. Social Security, on the other hand, offers

⁷SSA 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.

automatic inflation protection, full benefit portability, and dependent benefits, which are not available in many public pension plans. Costs could increase by as much as 11 percent of payroll for those states and localities, depending on the benefit package of the new plans that would include Social Security coverage. 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. Finally, mandating Social Security coverage for state and local employees could elicit a constitutional challenge.

Conclusions

There are no easy answers to the difficulties of equalizing Social Security's treatment of covered and noncovered workers. Any reductions in GPO or WEP would ultimately come at the expense of other Social Security beneficiaries and taxpayers. Mandating universal coverage would promise the eventual elimination of GPO and WEP but at potentially significant cost to affected state and local governments, and even so GPO and WEP would continue to apply for some years to come, unless they were repealed. Whatever the decision, it will be important to administer all elements of the Social Security program effectively and equitably.

GPO and 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 disparities in the application of these two provisions is yet another source of unfairness in the final outcome. We have made recommendations to the Internal Revenue Service to provide for complete and accurate reporting, but it has responded that it lacks the necessary authority from the Congress. We therefore take this opportunity to bring the matter to the Subcommittee's attention for consideration.

Matter for Congressional 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.

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 and Ken Stockbridge.

Related GAO Products

Social Security: Congress Should Consider Revising the Government Pension Offset “Loophole.” [GAO-03-498T](#). Washington, D.C.: February 27, 2003.

Social Security Administration: Revision to the Government Pension Offset Exemption Should Be Considered. [GAO-02-950](#). Washington, D.C.: August 15, 2002.

Social Security Reform: Experience of the Alternate Plans in Texas. [GAO/HEHS-99-31](#), Washington, D.C.: February 26, 1999.

Social Security: Implications of Extending Mandatory Coverage to State and Local Employees. [GAO/HEHS-98-196](#). Washington, D.C.: August 18, 1998.

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Federal Workforce: Effects of Public Pension Offset on Social Security Benefits of Federal Retirees. [GAO/GGD-88-73](#). Washington, D.C.: April 27, 1988.