Social Security: The Windfall Elimination Provision (WEP)

Alison M. Shelton
Analyst in Income Security

May 11, 2009

Congressional Research Service
7-5700
www.crs.gov
98-35

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The windfall elimination provision (WEP) reduces the Social Security benefits of workers who also have pension benefits from employment not covered by Social Security. Its purpose is to remove an advantage these workers would otherwise receive because Social Security's benefit formula is weighted such that workers with low lifetime earnings receive a greater share of their covered earnings in benefits than workers with medium or high lifetime earnings. Opponents contend that the provision is basically imprecise and can be unfair. This report will be updated annually or upon legislative activity.

Contents

Tables

Contacts

Background

The Social Security benefit formula is designed so that workers with low average lifetime earnings receive a benefit that is a larger proportion of their earnings than do workers with high average lifetime earnings. Social Security monthly benefits are computed by applying a formula to an average of a person's earnings from work subject to the Social Security payroll tax. The formula applies three progressive factors—90%, 32%, and 15%—to three different levels, or brackets, of average indexed monthly earnings. (Both the annual earnings amounts over the worker's lifetime, and the bracket amounts, are indexed to national wage growth so that the Social Security benefit replaces the same proportion of wages for each generation.) The result is known as the "primary insurance amount," or PIA, and is rounded down to the nearest 10 cents. For persons who reach age 62, die or become disabled in 2009, the PIA is determined thus:

Factor	Average Indexed Monthly Earnings
90%	first $744, plus
32%	earnings over $744 and through $4,483, plus
15%	over $4,483

A different Social Security benefit formula, referred to as the "windfall elimination provision" (WEP), applies to many workers who also are entitled to a pension from work not covered by Social Security (e.g., individuals who work for certain state and local governments, or under the Federal Civil Service Retirement System).[1] Under these rules, the 90% factor in the first band of the formula is replaced by a factor of 40%. The effect is to lower the proportion of their earnings in the first bracket that are converted to benefits. The following table illustrates how the regular and WEP provisions work in 2009.

Table 1. Monthly PIA for a Worker With Average Indexed Monthly Earnings of $1,000

Regular Formula		Windfall Elimination Formula	
90% of first $744	$669.60	**40%** of first $744	$297.60
32% of earnings over $744 and through $4,483	81.92	32% of earnings over $744 and through $4,483	81.92
15% over $4,483	00.00	15% over $4,483	00.00
Total	751.52	Total	379.52

Thus, under the windfall elimination formula the benefit for the worker is $372.00 ($751.52-$379.52) less per month than under the regular formula. Note that once average indexed monthly earnings exceed the first level in the formula of $744, the amount of the reduction remains at a constant $372.00 per month because the 32% and 15% factors for the second and third levels are the same as in the regular formula. For example, if the worker had $2,000 of average indexed monthly earnings instead of $1,000, the windfall reduction still would be $372.00 per month. However, the constant benefit reduction amount of $372.00 represents a

[1] Social Security Act §215(a)(7). Federal service where Social Security taxes are withheld (Federal Employees' Retirement System or CSRS Offset) are not affected by the WEP.

smaller percentage when the dollar amounts of benefits is higher, so the percent reduction in benefits relative to the regular PIA formula varies with average indexed monthly earnings. For example, if we applied the WEP formula to a worker with an average indexed monthly earnings of $4,000, this worker would still see a dollar reduction of $372.00 per month. However, this worker would experience a 22% reduction in benefits under the WEP compared to the regular PIA formula, while the worker with a $1,000 in average indexed monthly earnings would experience a 49% reduction in benefits under the WEP compared to the regular PIA formula.

The provision includes a guarantee (designed to help protect workers with low pensions) that the reduction in benefits caused by the windfall elimination formula can never exceed more than half of the pension based on non-covered work. The provision also exempts workers who have 30 or more years of "substantial" employment covered under Social Security.[2] Also, lesser reductions apply to workers with 21 through 29 years of substantial covered employment, as follows:

	Years of Social Security Coverage										
	20	21	22	23	24	25	26	27	28	29	30
First factor in formula	40%	45%	50%	55%	60%	65%	70%	75%	80%	85%	90%

The provision also does not apply to: (1) an individual who on January 1, 1984 was an employee of a government or nonprofit organization and to whom Social Security coverage was mandatorily extended by the 1983 amendments to the Social Security Act (e.g., the President, Members of Congress in office on December 31, 1983); (2) benefits for survivors; (3) workers who reached age 62, became disabled, or were first eligible for a pension from non-covered employment, before 1986; (4) benefits from foreign Social Security systems that are based on a "totalization" agreement with the United States; and (5) people whose only non-covered employment that resulted in a pension was in military service before 1957 or is based on railroad employment.

According to the Social Security Administration (SSA), as of December 2008 about 1 million recipients were affected by the WEP (about 3.2% of retired workers). Of these, approximately 64% were men.

The impact of the WEP on low-income workers has been the subject of debate. SSA estimates that in 2000, 3.5% of recipients affected by the WEP had incomes below the poverty line. For comparison purposes, at that time 8.5% of all Social Security beneficiaries age 65 and older had incomes below the poverty line and 11.3% of the general population had incomes below the poverty line.[3]

---

[2] For determining years of coverage after 1978 for individuals with pensions from non-covered employment, the amount is 25% of the "old law" (i.e., if the 1977 Social Security Amendments had not been enacted) Social Security maximum taxable wage base for each year in question. In 2009, the "old-law" taxable wage base is equal to $79,200, and, thus, to earn credit for one year of "substantial" employment under the WEP, a worker would have to earn at least $19,800 in Social Security-covered employment.

[3] These are the most recent estimates available. Poverty rates were calculated by David Weaver of the Social Security Administration's Office of Retirement Policy using the March 2001 Current Population Survey (CPS). Poverty status is taken directly from the CPS and is thus subject to errors in the reporting of income. The sample size for the WEP poverty rate is relatively small (230 cases) and only includes persons for whom SSA administrative records could be matched.

Legislative History and Rationale

The Windfall Elimination Provision was enacted in 1983 as part of major amendments designed to shore up the financing of the Social Security program. Its purpose was to remove an unintended advantage that the regular Social Security benefit formula provided to persons who also had pensions from non-Social Security-covered employment. The regular formula was intended to help workers who spent their lifetimes in low paying jobs, by providing them with a benefit that replaces a higher proportion of their earnings than the benefit that is provided to workers with high earnings. However, the formula could not differentiate between those who worked in low-paid jobs throughout their careers and other workers who appeared to have been low paid because they worked many years in jobs not covered by Social Security. (The benefit formula is applied to Social Security-covered wages that are averaged over a 35 year career, and non-covered years of work are entered as "zero" into this formula. As a result, a short career in Social Security-covered work, when averaged over 35 years, appears to have artificially low wages.) Under the old law, workers who were employed for only a portion of their careers in jobs covered by Social Security—even highly paid ones—also received the advantage of the "weighted" formula. The windfall elimination formula is intended to remove this advantage for these workers.

Arguments for the Windfall Elimination Provision

Proponents of the measure say that it is a reasonable means to prevent payment of overgenerous and unintended benefits to certain workers who otherwise would profit from happenstance (i.e., the mechanics of the Social Security benefit formula). Furthermore, they maintain that the provision rarely causes hardship because by and large the people affected are reasonably well off as most of them also receive government pensions. The guarantee provision ensures that the reduction in Social Security benefits cannot exceed half of the pension from non-covered work. In addition, the impact of the WEP is reduced for workers who spend 21 to 29 years in Social Security-covered work, and is eliminated for persons who spend 30 years or more in Social Security-covered work.

Arguments Against the Windfall Elimination Provision

Some opponents believe the provision is unfair because it substantially reduces a benefit that workers may have included in their retirement plans. Others criticize how the provision works. They say the arbitrary 40% factor in the windfall elimination formula is an imprecise way to determine the actual windfall when applied to individual cases. Analysts point out two reasons why the WEP can be regressive. First, because the WEP adjustment is confined to the first bracket of the benefit formula ($744 in 2009), it causes a proportionally larger reduction in benefits for workers with lower AIME. Second, a high earner is more likely than a low earner to cross the "substantial work" threshold for accumulating years of covered earnings (in 2009 this threshold is $19,800 of Social-Security covered earnings); therefore, high earners are more likely to benefit from the phase-out of the WEP for persons with between 20 and 30 years of covered employment.[4]

[4] See, for example, Jeffrey R. Brown and Scott Weisbenner, *The Distributional Effects of the Social Security Windfall Elimination Provision*, National Bureau of Economic Research, Boston, MA, September 2008.

Recent Legislation

In the 111th Congress, Representative Howard Berman has introduced H.R. 235, the Social Security Fairness Act of 2009. S. 484, the companion bill to H.R. 235 in the Senate, was introduced by Senator Dianne Feinstein. H.R. 235 and S. 484 would repeal the WEP starting in January, 2010. The Social Security Administration (SSA), in an estimate from 2007, found that full repeal of the WEP would cost approximately $40.1 billion between 2008 and 2017. In the long run, SSA estimates that eliminating the WEP would cost 0.05% of taxable payroll (causing an increase in Social Security's long-range deficit of about 3%)

Representative Kevin Brady introduced H.R. 1221, the Public Servant Retirement Protection Act (PSRPA) of 2009.[5] Senator Kay Bailey Hutchison introduced a companion bill, S. 490, in the Senate. The PSRPA would eliminate the current-law WEP and substitute a new formula for those first entering non-Social Security-covered employment one year after the bill's enactment. Individuals who had worked in non-covered employment prior to this date would receive the higher of: (a) the current law benefit including the WEP; or (b) the benefit calculated by the new formula. Under the new formula, a PIA would be computed using both covered and non-covered wages, and then multiplied by the ratio of earnings worked in Social Security-covered employment to earnings in both covered and non-covered employment (where earnings are expressed as average monthly earnings, indexed to wage inflation). SSA's Office of the Actuary estimated in 2007 that a similar proposal would have cost $4.6 billion from 2008-2017 and in the long run would have cost 0.01% of taxable payroll (causing an increase in Social Security's long-term deficit of about 0.5%).

Representative Frank introduced H.R. 2145, the "Windfall Elimination Provision Relief Act of 2009," which would eliminate the WEP for persons whose combined monthly income from Social Security and a pension from non-covered employment falls below $2,500 in 2009 (adjusted for the changes in the national average wage index). The bill would phase in the WEP for those with combined monthly incomes of between $2,500 and $3,334. For those with combined monthly incomes (Social Security plus pension from non-covered employment) exceeding $3,334, the WEP would be fully applicable.

Representative Rohrabacher introduced H.R. 2286, the "Social Security Exemption Relief Act of 2009," which would allow an employee in a position that is not currently covered by Social Security to elect, irrevocably, to have his or her employment covered by Social Security and subject to Social Security taxes.

[5] For additional information on the PSRPA, please refer to CRS Report RL32477, *Social Security: The Public Servant Retirement Protection Act (H.R. 2772/S. 1647)*, by Laura Haltzel.

Author Contact Information

Alison M. Shelton
Analyst in Income Security
ashelton@crs.loc.gov, 7-9558