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Social Security: The Windfall Elimination Provision (WEP)

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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 or "windfall" these workers would otherwise receive as a result of the interaction between the Social Security benefit formula and the workers' relatively short careers in Social Security-covered employment. Opponents contend that the provision is basically imprecise and can be unfair.

This report will be updated annually or upon legislative activity.

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Background

The Social Security benefit formula is designed so that workers with low average lifetime earnings in Social Security-covered employment receive a benefit that is a larger proportion of their earnings than do workers with high average lifetime earnings. The benefit formula does not distinguish, however, between workers who have low average earnings because they worked for many years at low wages in Social Security-covered employment and workers who have low average earnings because they worked briefly in Social Security-covered employment. The generous benefit that would be provided to workers who have split their careers between Social Security-covered and non-covered employment is sometimes referred to as a "windfall" that would exist in the absence of the windfall elimination provision (WEP). The WEP reduces the Social Security benefits of workers who also have pension benefits from employment not covered by Social Security.

A worker is eligible for Social Security after he or she works in Social Security-covered employment for 10 or more years (40 or more quarters). The worker's earning history is indexed to wage growth to bring earlier years of his or her earnings up to a comparable, current basis. Average indexed earnings are found by totaling the highest 35 years of indexed wages and then dividing by 35. Next, a monthly average, known as Average Indexed Monthly Earnings (AIME), is found by dividing the annual average by 12.

The Social Security benefit formula is designed to provide a progressive benefit. The benefit formula applies three progressive factors—90%, 32%, and 15%—to three different levels, or brackets, of AIME.[1] The result is known as the "primary insurance amount" (PIA) and is rounded down to the nearest 10 cents. For persons who reach age the age of 62, die, or become disabled in 2011, the PIA is determined in **Table 1** as follows:

Table 1. Social Security Benefit Formula in 2011

Factor	Average Indexed Monthly Earnings
90%	of the first $749, plus
32%	of AIME over $749 and through $4,517 plus
15%	of AIME over $4,517

The averaging provision in the benefit formula tends to cause workers with short careers in Social Security-covered employment to have low AIMEs, similar to persons who worked for low wages in covered employment throughout their careers. This is because years of zero covered earnings are entered as zeros into the formula that averages the worker's wage history over 35 years. For example, a person with 10 years in Social Security-covered employment would have an AIME that reflects 25 years of zero earnings.

Consequently, for a worker with a low AIME because she split her career between covered and non-covered employment, the benefit formula replaces more of covered earnings at the 90% rate

[1] 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.

than if this worker had spent his or her full 35-year career in covered employment at the same wage level. The higher replacement rate[2] for workers who have split their careers between Social Security-covered and non-covered jobs is sometimes referred to as a "windfall."[3]

A different Social Security benefit formula, referred to as the "windfall elimination provision," applies to many workers who are entitled to Social Security as well as 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).[4] Under these rules, the 90% factor in the first bracket of the formula is replaced by a factor of 40%. The effect is to lower the proportion of earnings in the first bracket that are converted to benefits. **Table 2** illustrates how the regular and WEP provisions work in 2011.

Table 2. Monthly PIA for a Worker With Average Indexed Monthly Earnings of $1,500 and Retiring in 2011

Regular Formula		Windfall Elimination Formula	
90% of first $749	$674.10	**40%** of first $749	$299.60
32% of earnings over $749 and through $4,517	$240.30	32% of earnings over $749 and through $4,517	$240.30
15% over $4,517	0.00	15% over $4,517	0.00
Total	$914.40	Total	$539.90

Under the WEP formula, the benefit for the worker is reduced by $374.50 ($914.40 - $539.90) per month relative to the regular benefit formula. Note that the WEP reduction is limited to the first bracket in the AIME formula (90% vs. 40% formula rates), while the 32% and 15% factors for the second and third brackets are the same as in the regular benefit formula. As a result, for AIME amounts that exceed the first threshold of $749, the amount of the WEP reduction remains a flat $374.50 per month. For example, if the worker had an AIME of $2,000 instead of $1,500, the WEP reduction would again be $374.50 per month.

A "guarantee" in the WEP provision ensures that a worker's WEP reduction cannot exceed more than one half of the government pension based on the worker's non-covered work. This "guarantee" is designed to help protect workers with low non-covered pensions and also ensures that the WEP can never completely eliminate a worker's Social Security benefit. The WEP also exempts workers who have 30 or more years of "substantial" employment covered under Social Security, with lesser reductions for workers with 21 through 29 years of substantial covered employment, as shown in **Table 3**.[5]

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[2] A worker's replacement rate is the ratio of his or her Social Security benefit to pre-retirement income.

[3] The WEP is sometimes confused with the Government Pension Offset (GPO), which reduces Social Security *spousal* benefits of a worker who also has a government pension based on work that was not covered by Social Security. For more information on the GPO, please refer to CRS Report RL32453, *Social Security: The Government Pension Offset (GPO),* by Alison M. Shelton.

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

[5] For determining years of coverage after 1978 for individuals with pensions from non-covered employment, "substantial coverage" is defined as 25% of the "old law" (i.e., if the 1977 Social Security Amendments had not been (continued...)

Table 3. WEP Reduction Falls with Years of Substantial Coverage

	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%
Maximum dollar amount of monthly WEP reduction in 2010[a]	$380.5	$342.5	$304.4	$266.4	$228.3	$190.3	$152.2	$114.2	$76.1	$38.1	$0

Source: Social Security Administration, *How the Windfall Elimination Provision Can Affect Your Social Security Benefit*, Washington, DC, http://www.socialsecurity.gov/retire2/wep-chart.htm.

a. WEP reduction may be lower than the amount shown because the reduction is limited to one-half of the worker's pension from non-covered employment.

The WEP 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 the age of 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.

Who is Affected by the WEP?

According to the Social Security Administration (SSA), as of December 2010, about 1.3 million Social Security beneficiaries were affected by the WEP, as shown in **Table 4.** About 1.2 million persons affected by the WEP were retired workers (about 3.4% of retired workers). Of retired workers affected by the WEP, approximately 63% were men.[6]

(...continued)

enacted) Social Security maximum taxable wage base for each year in question. In 2011, the "old-law" taxable wage base is equal to $79,200, therefore 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.

6 Social Security Administration, Office of Research, Evaluation and Statistics, January 2010, unpublished table W01.

Table 4. Number of Beneficiaries in Current Payment Status with Benefits Affected by Windfall Elimination Provision (WEP), by State and Type of Benefit, December 2010

State	Total	Retired Workers	Disabled Workers	Spouses and Children
Total	1,282,786	1,174,743	17,136	90,907
Alabama	16,228	14,549	331	1,348
Alaska	6,735	6,344	90	301
Arizona	23,694	21,873	299	1,522
Arkansas	9,342	8,577	213	552
California	167,438	154,652	2,009	10,777
Colorado	38,430	35,814	510	2,106
Connecticut	12,513	11,815	180	518
Delaware	2,943	2,739	44	160
District of Columbia	7,104	6,721	132	251
Florida	73,098	67,214	851	5,033
Georgia	36,913	34,485	480	1,948
Hawaii	8,018	7,342	80	596
Idaho	5,625	5,153	75	397
Illinois	65,927	62,098	579	3,250
Indiana	12,850	11,829	235	786
Iowa	6,942	6,446	80	416
Kansas	7,466	6,949	103	414
Kentucky	16,600	15,279	328	993
Louisiana	25,322	22,764	565	1,993
Maine	11,739	10,984	156	599
Maryland	38,518	35,924	504	2,090
Massachusetts	45,128	42,572	658	1,898
Michigan	16,076	14,683	269	1,124
Minnesota	14,536	13,579	159	798
Mississippi	8,134	7,392	161	581
Missouri	27,099	25,478	394	1,227
Montana	4,731	4,343	67	321
Nebraska	4,556	4,254	43	259
Nevada	18,408	17,378	228	802
New Hampshire	5,810	5,395	122	293
New Jersey	18,639	17,095	344	1,200
New Mexico	10,817	9,661	187	969
New York	26,596	24,300	454	1,842

State	Total	Retired Workers	Disabled Workers	Spouses and Children
North Carolina	23,222	21,517	331	1,374
North Dakota	2,140	1,974	18	148
Ohio	92,301	85,858	1,069	5,374
Oklahoma	15,114	13,695	309	1,110
Oregon	12,672	11,729	164	779
Pennsylvania	29,641	27,124	531	1,986
Rhode Island	4,086	3,807	79	200
South Carolina	14,457	13,272	222	963
South Dakota	3,275	3,060	37	178
Tennessee	16,183	14,806	239	1,138
Texas	110,408	101,641	1,435	7,332
Utah	10,897	9,806	136	955
Vermont	2,148	1,988	22	138
Virginia.	40,334	37,030	436	2,868
Washington	24,358	22,030	301	2,027
West Virginia	5,328	4,719	132	477
Wisconsin	10,077	9,371	121	585
Wyoming	2,023	1,874	29	120
Outlying areas and foreign countries	70,147	53,761	595	15,791

Source: Social Security Administration, Office of Research, Evaluation and Statistics, January 2010, unpublished table B.

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. The 40% WEP formula factor was the result of a compromise between a House bill that would have substituted a 61% factor for the regular 90% factor and a Senate proposal that would have substituted a 32% factor for the 90% formula.[7]

The purpose of the 1983 law 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

[7] *Conference Report to Accompany H.R. 1900*, 98th Cong., March 24, 1983 (Washington: GPO, 1983), p. 120.

covered by Social Security. 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 because by definition they also receive government pensions from non-covered work. The guarantee provision ensures that the reduction in Social Security benefits cannot exceed half of the pension from non-covered work, which protects persons with small pensions 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.

The WEP's Impact on Low-Income Workers

The impact of the WEP on low-income workers has been the subject of debate. Jeffrey Brown and Scott Weisbenner (hereinafter referred to as "Brown and Weisbenner") point out two reasons why the WEP can be regressive. [8] First, because the WEP adjustment is confined to the first bracket of the benefit formula ($749 in 2011), it causes a proportionally larger reduction in benefits for workers with lower AIMEs and benefit amounts.[9] Second, a high earner is more likely than a low earner to cross the "substantial work" threshold for accumulating years of covered earnings (in 2011 this threshold is $19,800 of Social Security-covered earnings); therefore, high earners are more likely to benefit from the provision that phases out of the WEP for persons with between 21 and 30 years of covered employment.

Brown and Weisbenner found that the WEP does reduce benefits disproportionately for lower-earning households than for higher-earning households. For some high-income households, applying the WEP to covered earnings even provides a higher replacement rate than if the WEP

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8 Jeffrey R. Brown and Scott Weisbenner, *The Distributional Effects of the Social Security Windfall Elimination Provision*, NBER and the Social Security Administration, September 5, 2008, pp 8-13, http://www.nber.org/programs/ag/rrc/books&papers.html.

9 For example, a worker with an AIME of $4,000 would be entitled to a PIA of $1,714.40 before a WEP reduction of $374.50 per month, which would represent a reduction of 22% in this worker's benefit. By contrast, the worker shown in **Table 2** with an AIME of $1,500 would be entitled to a benefit of $914.40 before the WEP reduction of $374.50, representing a cut of 41% to this worker's benefit (CRS calculations).

were applied proportionately to all earnings, covered and non-covered. Brown and Weisbenner also found that the WEP can also lead to large changes in Social Security replacement rates based on small changes in covered earnings, particularly when a small increase in covered earnings carries a person over the threshold for an additional year of substantial covered earnings, leading to a modification in the WEP formula.

SSA estimated 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 aged 65 and older had incomes below the poverty line and 11.3% of the general population had incomes below the poverty line.[10] A potential conclusion is that persons who are subject to the WEP, who by definition also have pensions from non-covered employment, face a somewhat reduced risk of poverty compared with other Social Security beneficiaries.

[10] 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.