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Social Security: The Windfall Elimination Provision (WEP)

Alison M. Shelton
Analyst in Income Security

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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

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). In general, a worker's monthly Social Security benefit is based on his or her 35 highest-paid years of earnings in Social Security-covered employment. The worker's earnings are indexed to wage growth to bring earlier years of his or her earnings up to a comparable, current basis. Average annual 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 so that workers with low average lifetime earnings, as represented by AIME, receive a benefit that is a larger proportion of their earnings than do workers with high average lifetime earnings. 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 62, die, or become disabled in 2009, the PIA is determined in **Table 1** as follows:

Table 1. Social Security Benefit Formula in 2010

Factor	Average Indexed Monthly Earnings
90%	of the first $761, plus
32%	of earnings over $761 and through $4,586 plus
15%	of earnings over $4,586

Years of zero covered earnings are entered as zeros into the formula that averages the worker's wage history over 35 years. Some workers have short careers in Social Security-covered employment—for example workers who have spent the majority of their careers in non-covered federal[2], state, or local government employment, or workers who have left the paid workforce for other reasons. These workers did not pay FICA taxes during their years of non-covered employment.

The averaging provision in the benefit formula tends to cause workers with short careers in covered employment to have low AIMEs, similar to persons who worked for low wages in covered employment throughout their careers. A worker's AIME will be lowered by any zero wage amounts that are entered into the 35-year averaging period, whether due to years of non-covered employment or years out of the workforce. Consequently, for a worker with a low AIME,

[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.

[2] Generally, employees of the federal government hired before 1984 are covered by the Civil Service Retirement System (CSRS) and are not covered by Social Security. Most federal workers first hired into federal service on or after January, 1984, participate in the Federal Employees' Retirement System (FERS), which includes Social Security coverage.

whether as a result of low career earnings or a short career in covered employment, the benefit formula replaces more of covered earnings at the 90% rate 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[3] for workers who have split their careers between Social Security-covered and non-covered jobs is sometimes referred to as a "windfall."[4]

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).[5] 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 2010.

Table 2. Monthly PIA for a Worker With Average Indexed Monthly Earnings of $1,500 and Retiring in 2010

Regular Formula		**Windfall Elimination Formula**	
90% of first $761	$684.90	**40%** of first $761	$304.40
32% of earnings over $761 and through $4,586	$236.48	32% of earnings over $761 and through $4,586	$236.48
15% over $4,586	0.00	15% over $4,586	0.00
Total	$921.38	Total	$540.88

Thus, under the windfall elimination formula the benefit for the worker is $380.50 ($921.38 – $540.88) less per month than under the regular formula. Note that the WEP reduction is limited to the first bracket in the AIME formula (90% vs. 40%), so that for AIME amounts that exceed the first threshold of $761 the amount of the WEP reduction remains a flat $380.50 per month. This is 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 $1,500, the windfall reduction would again be $380.50 per month.

A worker's WEP reduction cannot exceed more than one half of the pension based on the worker's non-covered work: this "guarantee" is designed to help protect workers with low pensions. Therefore, the WEP can never eliminate a person's Social Security benefit. The WEP also exempts workers who have 30 or more years of "substantial" employment covered under

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

[4] 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.

[5] 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.

Social Security, with lesser reductions for workers with 21 through 29 years of substantial covered employment, as shown in Table 3.[6]

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

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. 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.

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 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.

Who is Affected by the WEP?

According to the Social Security Administration (SSA), as of December 2009 about 1.2 million Social Security beneficiaries were affected by the WEP (about 3.3% of retired workers). Of these, approximately 64% were men.

6 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 enacted) Social Security maximum taxable wage base for each year in question. In 2010, 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.

Table 4. Number of Beneficiaries in Current Payment Status with Benefits Affected by Windfall Elimination Provision (WEP), by State and Type of Benefit, December 2009

State	Total	Retired Workers	Disabled Workers	Spouses and Children
Total	1,197,020	1,092,562	16,307	88,151
Alabama	15,557	13,892	306	1,359
Alaska	6,139	5,744	95	300
Arizona.	22,095	20,303	293	1,499
Arkansas	8,935	8,182	203	550
California.	153,504	141,292	1,894	10,318
Colorado	35,327	32,810	431	2,086
Connecticut	11,454	10,818	155	481
Delaware	2,747	2,547	41	159
District of Columbia	6,835	6,447	128	260
Florida	68,727	63,005	816	4,906
Georgia	34,230	31,848	467	1,915
Hawaii	7,575	6,908	81	586
Idaho	5,252	4,811	70	371
Illinois	61,403	57,748	548	3,107
Indiana	12,050	11,033	228	789
Iowa	6,680	6,180	75	425
Kansas	7,157	6,629	100	428
Kentucky	15,439	14,149	312	978
Louisiana	23,372	20,862	543	1,967
Maine	10,894	10,141	160	593
Maryland	36,458	33,886	459	2,113
Massachusetts	41,348	38,965	600	1,783
Michigan	14,998	13,640	263	1,095
Minnesota	13,901	12,924	162	815
Mississippi	7,750	7,010	153	587
Missouri	25,196	23,620	357	1,219
Montana	4,387	4,020	64	303
Nebraska	4,350	4,046	44	260
Nevada	16,558	15,581	221	756
New Hampshire	5,345	4,959	108	278
New Jersey	17,637	16,170	324	1,143
New Mexico	10,253	9,128	176	949
New York	25,199	22,997	440	1,762

State	Total	Retired Workers	Disabled Workers	Spouses and Children
North Carolina	21,837	20,127	326	1,384
North Dakota	2,072	1,900	18	154
Ohio	86,065	79,760	1,036	5,269
Oklahoma	14,547	13,093	309	1,145
Oregon	11,825	10,892	164	769
Pennsylvania	27,944	25,468	504	1,972
Rhode Island	3,787	3,513	79	195
South Carolina	13,657	12,483	202	972
South Dakota	3,077	2,868	37	172
Tennessee	15,351	13,995	227	1,129
Texas	102,033	93,655	1,389	6,989
Utah	10,365	9,292	123	950
Vermont	2,010	1,849	21	140
Virginia.	38,455	35,192	422	2,841
Washington	22,831	20,567	297	1,967
West Virginia	5,046	4,461	127	458
Wisconsin	9,542	8,859	101	582
Wyoming	1,922	1,776	28	118
Outlying areas and foreign countries	65,902	50,517	580	14,805

Source: Social Security Administration, Office of Research, Evaluation and Statistics, January 2010

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

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

other workers who appeared to have been low paid because they worked many years in jobs not 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. 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 ($761 in 2010), 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 2010 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 $1,721.38 before a WEP reduction of $380.50 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 $921.38 before the WEP reduction of $380.50, 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 age 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 to other Social Security beneficiaries.

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.[11] 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

[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.

[11] 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.

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.

Author Contact Information

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