CALSTRS

HOW WILL YOU SPEND YOUR FUTURE?

DANA DILLON
CHAIR OF THE TEACHERS' RETIREMENT BOARD

OF THE
CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

HEARING ON

GPO AND WEP: POLICIES AFFECTING PENSIONS FROM WORK NOT COVERED BY SOCIAL SECURITY

BEFORE
THE SUBCOMMITTEE ON
SOCIAL SECURITY, PENSIONS, AND FAMILY POLICY
OF THE COMMITTEE ON FINANCE
U.S. SENATE

November 6, 2007

SUBMITTED FOR THE HEARING RECORD

California State Teachers' Retirement System, P.O. Box 15275, Sacramento, CA 95851-0275

Introduction

Thank you for providing this opportunity to express our concern about the Social Security Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO) on behalf of the 1,100 local school districts of the California public school system that educate California's children.

The California State Teachers' Retirement System (CalSTRS) provides retirement benefits to almost 800,000 active and retired public school teachers and their beneficiaries. California public school teachers are the largest single group of State and local government employees in the country who do not participate in the Social Security system.

Established by State law in 1913, CalSTRS began operation 22 years before Social Security was created. At the time Social Security was established, California's teachers and all other State and local government workers were barred by Federal law from participating in Social Security. Through sound management over nine decades, CalSTRS has developed into the second largest pension system in the United States with over $171 billion in assets. CalSTRS pays more than $6 billion a year in benefits to more than 200,000 retired and disabled public school teachers and their beneficiaries.

The California Teachers' Retirement Board, which governs CalSTRS, has previously expressed its strong concerns about the significant impact the WEP and the GPO have on public education in California. Many California educators have complained that the WEP and GPO create an unfair reduction of the Social Security benefits they have earned. In addition, the WEP and GPO adversely affect California's ability to recruit teachers into second careers from other professions as well as teachers from other states. Accordingly, in April 2007, the Board supported California Assembly Joint Resolution 5 requesting the President and U.S. Congress enact legislation that removes the burdensome effects of the WEP and GPO of the Social Security Act.

Absent full repeal of the WEP and GPO, CalSTRS supports efforts to eliminate the inequities, arbitrary effects, and particularly the harsh impact on lower and moderate income retirees that result from the application of the WEP and GPO. Benefits should not be determined by provisions that are arbitrary and unrelated to the very government pensions which subject those individuals to the offsets. There are discrepancies between the theoretical policy of the offset provisions and the actual consequences of the offsets. The offset formulas are arbitrary as there is little or no correlation between the offset formula and the public pension that triggers application of the offset.

WEP and GPO Hinders Efforts to Attract Qualified Teachers

CalSTRS members do not pay the Social Security payroll tax on their earnings from CalSTRS-covered service, and therefore are not entitled to Social Security benefits for such service. Nonetheless, many CalSTRS members have earned and become eligible for Social Security benefits either because they were employed in Social Security covered positions for some period of time or are the spouse, widow, or widower of individuals who were employed in such positions. When they receive their CalSTRS pensions, these teachers' Social Security benefits are reduced by the WEP formula or their spouse, widow, or widower's Social Security benefit is reduced or eliminated by the GPO.

The offsets create an impediment to people who might otherwise want to change careers to become public school teachers in California and hinder efforts by school districts to attract new people to the California classroom. The California Department of Education estimates that approximately one third of the current teachers will retire in the next ten years. All these teachers must be replaced. Although many enter the teaching profession at the beginning of their career, a significant number become teachers as a second career, often after lengthy work in the private sector covered by Social Security. Others work as educators in a state in which their earnings are covered by Social Security and later desire to teach in California. CalSTRS is very concerned that the WEP and GPO cause persons who otherwise would receive a full Social Security benefit to decide not to become public school teachers in California, because their Social Security benefits will be substantially adversely affected by their California service. California would be better able to recruit and retain future California educators if these professionals did not face reductions in their future Social Security benefits.

Impact of WEP

While the intent of the WEP was to eliminate "windfall" benefits, often the actual effect is to reduce even modest Social Security benefits, which threatens the financial security of many State and local retirees. For example, many teachers earn Social Security coverage because of part-time jobs they had during their high school and college years or by working in private employment during the summer months after they became teachers. Such jobs will result in modest Social Security benefits, but these workers will be subject to the WEP just the same as workers who receive much higher Social Security benefits. The reverse is also true. Workers who receive very modest public pensions see their Social Security benefits reduced under the WEP the same as workers who receive more substantial public pensions.

Accordingly, a review of the manner in which the WEP operates in actual practice is justified. To accomplish this, we look at typical case examples and compare the benefits that are payable under various circumstances, including application of the WEP. Workers' retirement benefits change based on the years they worked in covered and non-covered employment rather than their total number of years worked or their salaries. To ensure that it is the impact of the covered/non-covered employment pattern that is being gauged, not years of service or salary, assume each of the four individuals has a total of 25 years of employment, some in the private sector and some in the public sector, and $4,000 final average salary.

Impact of WEP Depending on Employment Pattern

Employment	Diane	John	Mary	Jane
Years of Employment Covered Under Social Security	25	10	15	25
Years of Employment Covered Under Public System	0	15	10	5
Monthly Public Pension	$ 0	$1,360	$ 907	$ 453
Monthly Social Security Benefit without WEP	$1,668	$1,668	$1,668	$1,668
Monthly Social Security Benefit after WEP Applied	$1,668	$1,334	$1,334	$1,504
Monthly Combined Benefits	$1,668	$2,694	$2,241	$1,957
WEP Impact	$ 0	$ 334	$ 334	$ 164

From the table above the following analysis can be made:

- When the WEP is applied, the worker's Social Security benefit is reduced by the same dollar amount regardless of the number of years of covered employment unless the worker has 21 or more years that were covered. (With covered years between 21 and 29, benefits are reduced on a sliding scale when the WEP is applied.) Both Mary and John's monthly Social Security benefits are reduced by $334 with the application of the WEP. Even though Mary has 15 years of covered employment as compared to John's 10 years, her combined benefits under Social Security and the public system is $453 lower than John's combined benefits. This occurred because under the WEP no allowance is made for additional years of covered employment until the worker has 21 or more years that are covered under Social Security. At the same time, Mary's public pension is significantly lower than John's because Mary had fewer years of public employment and thus fewer years of service credit that could be used in the formula for determining benefits. Thus, two teachers with substantially different CalSTRS pensions could face the same reduction in Social Security benefits under the flat adjustment of the WEP offset.

- For two workers with identical work histories in Social Security covered jobs, the mere fact of additional public school teaching service by one of the workers in a non-covered job will trigger the WEP reduction in the Social Security benefits he or she has earned from the covered employment. The only difference between the employment careers for Diane and Jane is that Jane supplemented her earnings by working part-time in public employment. In both instances the worker had 25 years of Social Security-covered employment, but the WEP is applied to Jane's Social Security benefits because she will receive a public pension based on very minimal public service that was performed concurrently with the Social Security-covered employment.

Absent full repeal of the WEP, CalSTRS supports efforts to eliminate the inequities, arbitrary efforts, and particularly harsh impact on lower income retirees. Short of full repeal, the following options could constitute first steps to ameliorate the harmful impact of the WEP.

Alternatives to WEP

1. Adjust the reduction of the 90 percent factor in the first tier of the benefit formula when determining the Primary Insurance Amount to reflect the number of years the individual had actual employment on which the Social Security payroll tax was not paid rather than adjusting the reduction based on the years of employment covered under Social Security. In other words, reduce the income replacement factor used in the Social Security benefit formula based on the worker's actual years of non-covered employment. Because the maximum factor is used now for 30 or more years of covered employment and the minimum number of years needed to qualify for a benefit is 10 years, a sliding scale based on non-covered employment could be as follows:

Number of Non-Covered Years	Factor Used in Benefit Formula
5 out of 35 years	90% (same as current %)
10 out of 35 years	80% (increased from 65%)
15 out of 35 years	70% (increased from 40%)
20 out of 35 years	60% (increased from 40%)
25 out of 35 years	40% (same as current %)

   The current WEP implicitly assumes that in any year in which the worker had no Social Security covered earnings he or she had earnings from non-covered employment. This is not necessarily the case for CalSTRS members and many other government employees. For example, employees may take time off from work to raise a family and have no employment income during that time off. If the WEP were based on the number of years of actual employment that was not covered by Social Security rather than on the total number of years during which the Social Security payroll tax was not paid, it would more accurately reflect the worker's true employment history.

2. Establish a de minimis threshold for the benefit based on non-covered employment at which the offset would not be applied. Currently, the WEP is applied regardless of the benefit amount that is payable based on non-covered employment. By establishing a threshold for application of the WEP, workers who have significant Social Security-covered employment would receive a Social Security benefit that more closely reflects their employment career.

Impact of GPO

Social Security spousal benefits were intended to provide some protection to spouses or surviving spouses who had limited working careers. A spouse or surviving spouse can receive the equivalent of a Social Security benefit based on his or her own earnings record or the earnings record of a husband or wife, whichever provides a higher benefit, but cannot receive full benefits based on both earnings records.

The GPO was enacted to ensure that spousal and widow(er) benefits under Social Security would be paid only to individuals who are (or were) financially dependent on their husbands or wives. Those who work long enough in non-covered employment to earn a pension of their own do not meet Social Security's limited career criterion. For these individuals, the modified benefit formula used under the GPO reduces the amount of Social Security benefits payable by two thirds of the pension not covered by Social Security. It is not clear why the GPO reduction is set at two-thirds and seems to arbitrarily assume that the pension from non-covered employment is equal to two-thirds of the Social Security benefit payable without application of the GPO. Further, there is an inequity in some situations with application of the GPO. The comparison below shows the impact of the GPO will differ for two people with identical public pensions. Monthly benefits are used.

Impact of GPO

	Barbara	**Roberto**
Public Pension	$300	$300
Social Security before GPO Applied	$600	$900
Combined Benefit before GPO Applied	***$900***	***$1,200***
Government Pension Offset (2/3 of $300)	$200	$200
Social Security After GPO Applied	$400	$700
Combined Benefit After GPO Applied	***$700***	***$1,000***

From the table above the following analysis can be made:

- Barbara's Social Security benefit is $300 less than Roberto's benefit. However, both Barbara and Roberto's Social Security spousal benefit is reduced by $200 when the GPO is applied. The reduction is not consistent with financial dependence previously discussed because Barbara, who has a combined benefit of $900 before the offset, is subject to the same dollar reduction as Roberto whose combined benefit is $1,200 before the offset.

The Social Security spousal benefits was designed to provide Social Security benefits to surviving spouses based on economic need. Yet the effect of application of the GPO clouds that design. As in our example, such an effect is very common and most often it is women who suffer financially. Women, in general, tend to live longer than men which means they spend more years with declining financial resources than do men. A provision of the Social Security Act that was intended to be an equalizer has quite the opposite effect.

Given the demographics of CalSTRS' membership, which is 70 percent female, and the fact that the amount of the GPO is directly tied to the amount of the public pension benefit, it appears that the GPO currently has a greater impact on CalSTRS' membership than does the WEP. To the extent that more of CalSTRS' members embark on teaching as a second career, however, the impact of the WEP could increase.

Absent full repeal of the GPO, CalSTRS supports efforts to eliminate the inequities, arbitrary efforts, and particularly hard impact on lower income retirees. Short of full repeal, the following options could constitute first steps to ameliorate the harmful impact of the GPO.

Alternatives to GPO

1. Establish a de minimis threshold on the combined government pension and Social Security benefits at which the offset would not be applied.

2. Require the reduction in Social Security benefits under the GPO to be equal to the amount by which two-thirds of the combined Social Security benefits (before reduction) and monthly government pension exceeds $1,200, adjusted for inflation.

Conclusion

If full repeal of the WEP and GPO offsets proves too costly, CalSTRS believes that modifications of the offset provisions of the type we have described above would be appropriate first steps to ameliorate the harsh adverse effects on retirees with relatively modest benefits that arise from the current arbitrary formulas of the WEP and GPO offsets. We want to acknowledge our appreciation for the leadership of Senator Dianne Feinstein and members of the California delegation in the House in taking steps to address the problems raised by the WEP and GPO. CalSTRS is ready to work with the appropriate parties to further define a workable alternative to the existing criteria and to determine the best alternative to address the current inequities of WEP and GPO.