CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

BILL ANALYSIS

Senate Joint Resolution 4	**Senator Soto (As introduced 2/21/01)**
Position:	**Support**
Proponents:	**SACRS**
Opponents:	**None known**

SUMMARY

Senate Joint Resolution 4 requests that the President and the United States Congress enact legislation to limit the application of the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP) of the Social Security Act.

HISTORY

Originally, the Social Security system excluded state and local government employees from coverage. In 1954, however, state and local employees were given the opportunity to elect to participate in the Social Security system. Although many groups of public employees elected to participate in Social Security, California State Teachers' Retirement System (CalSTRS) members elected not to participate in the program in 1955.

Public Law (P.L.) 95-216—1977 reduces the Social Security benefit paid to a spouse by the amount of the spouse's government pension from work not covered by Social Security, effective 1982, if the spouse was not eligible for retirement as of 1982.

P.L. 98-21—1983 reduces Social Security benefits to workers who also receive a pension from work not covered by Social Security, and changes the reduction in the Social Security benefit paid to a spouse from 100 percent of that person's pension from work not covered by Social Security to 2/3 of such a pension.

Resolution Chapter 40, Statutes of 1999 (AJR 9—PER&SS) encourages the U.S. Congress and the President to exclude state and local employees from mandatory Social Security.

H.R. 1217/ S.717 (Jefferson/Mikulski), which was introduced in the 106th Congress, would have modified the reductions in Social Security benefits that are made to benefits paid to spouses and surviving spouses who are also receiving other government pensions, to the amount by which the total amount of the combined monthly Social Security benefit (before reduction) and monthly pension exceeded $1,200.

H.R. 860 (Frank), which was introduced in the 106th Congress, would have eliminated the reduction in Social Security benefits paid to individuals whose combined monthly income from Social Security benefits on their own earnings and other government pension payments was less than $2,000, with a graduated implementation of the reduction on amounts above $2,000.

H.R. 664 (Jefferson), which was introduced February 14, 2001, is a reintroduction of H.R. 1217 from the prior Congress.

AJR 3 (Leonard) requests that Congress repeal the GPO and the WEP on Social Security benefits.

CURRENT PRACTICE

Calculating Social Security Benefits. Social Security provides benefits to retired workers and, under certain circumstances, their spouses, ex-spouses, surviving spouses and surviving ex-spouses. Although CalSTRS members do not pay Social Security payroll taxes for CalSTRS-covered service and, therefore, do not earn Social Security benefits for such service, many CalSTRS members are eligible for Social Security benefits, due either to other employment that was covered by Social Security or by being married to a Social Security benefit recipient.

The Social Security benefits paid to a retired worker are based on the average monthly earnings, indexed for inflation, that were subject to Social Security payroll taxes during the 35 highest years of indexed earnings. The average indexed earnings is divided into three tiers. For individuals who first become eligible for the Social Security old-age benefit in 2001, the primary insurance amount (PIA), or full benefit, is the sum of

90 percent of the first $561 of the average indexed monthly earnings, plus
32 percent of the averaged indexed monthly earnings of the next $2,820, plus
15 percent of the average indexed monthly earnings above $3,381

For example, the PIA for a person whose average indexed monthly earnings was $4,000 would be

	90 percent of $561	$ 504.90
+	32 percent of $2,820	$ 902.40
+	15 percent of the remaining $619	$ 92.85
		$1,500.15

Spouses and eligible ex-spouses of retired workers also can receive a benefit based on the earnings of the retired worker. The full benefit paid to a spouse or eligible ex-spouse equals 50 percent of the PIA paid to the retired worker, if that amount is less than the benefit that would be paid based on the spouse's or ex-spouse's own covered earnings. In the example above, the spouse or eligible ex-spouse would receive about $750.

Finally, surviving spouses and eligible ex-spouses receive a benefit equal to the amount paid to the deceased workers, if that amount is greater than the benefit that would be paid based on the surviving spouse's or ex-spouse's own earnings.

These three benefits reflect an objective of providing a floor of benefits to people with lower earnings. The more money a worker earns, the lower the percentage of those earnings that is replaced by Social Security. For the lowest paid workers, Social Security replaces up to 90 percent of the average indexed monthly earnings. The percentage of earnings replaced declines as earnings increase. Similarly, if the spouse or surviving spouse has limited earnings, and therefore receives little or no Social Security benefits from his or her own earnings, the spouse or surviving spouse receives an additional amount based on the earnings of the worker.

<u>Social Security Benefits for CalSTRS Members</u>. As indicated earlier, CalSTRS members, and other government workers representing about 4 percent of the total national workforce, do not pay Social Security payroll taxes on earnings for their government service. If these workers receive a Social Security benefit, either due to other employment that was covered by Social Security, or by being a spouse or surviving spouse of a person covered by Social Security, the Social Security benefit paid to that government worker may be reduced. (CalSTRS, however, does not reduce the retirement benefit it pays to a person who receives a Social Security benefit.)

The reduction in Social Security benefits that are paid for a worker's own earnings is referred to as the WEP. Under the WEP, the percent of income replaced in the first tier is reduced from 90 percent of the first $561 to 40 percent of the first $561, for persons first eligible for a benefit in 2001. This means that a recipient's Social Security benefit can be reduced by up to $280.50 per month.

There are exceptions and limitations to the application of the WEP. First, the WEP does not apply if the member was eligible to retire from CalSTRS before 1986. In addition, if the recipient has more than 20 years of what are considered "substantial earnings" covered by Social Security (equal to $14,925 in 2001), the reduction is not as large. For example, if the recipient has 21 years of substantial earnings, the first tier percentage is 45 percent, and that percentage increases by five percentage points for each year of substantial earnings. After 30 years of substantial earnings, the WEP is not applied at all to a person who also receives a pension from work not covered by Social Security. In addition, the amount of the reduction in the Social Security benefit as a result of the WEP cannot exceed 50 percent of the governmental pension. For example, if the governmental pension was $500 per month, the reduction in the monthly Social Security benefit due to the WEP could not exceed $250.

Social Security benefits also are reduced for spouses, ex-spouses, surviving spouses and surviving ex-spouses who receive a pension, such as from CalSTRS, for work not covered by Social Security. This reduction is referred to as the GPO. Under the GPO, the Social Security benefit is reduced by two-thirds of the CalSTRS retirement allowance. If two-thirds of the CalSTRS allowance equals or exceeds the amount of the member's benefit from Social Security, the member will not receive a benefit from Social Security. (This does not affect the member's eligibility for Medicare benefits). Individuals are exempt from the GPO if they were eligible to retire from CalSTRS prior to December 1982 and met the Social Security spousal benefit requirements in effect in January 1977. Given the demographics of the CalSTRS population, and the size of the reduction under the GPO compared to the WEP, the GPO probably has a greater general impact on CalSTRS members than does the WEP.

DISCUSSION

Several legislative proposals have been introduced in the 107th Congress that would reduce these offsets. These proposals generally exempt people from the offsets if their Social Security benefit and governmental pension are less than a specified amount. Many organizations are urging Congress to enact legislation this year to reduce, if not eliminate the impact of the GPO and WEP on state and local government retirees, particularly those who have earned lower uncovered government pension benefits or partial benefits. SJR 4 is requesting that Congress and the President enact legislation to limit the application of both the GPO and WEP. The resolution does not specify how the application of these offsets would be reduced.

CalSTRS staff have been evaluating the impact of the offset provisions on CalSTRS members, whether there is sufficient basis for such reductions to take place and what, if any, modifications to the provisions would be appropriate. The preliminary assessment by CalSTRS staff is that reducing Social Security benefits for workers who receive a pension for work not covered by Social Security has an appropriate basis, given the nature of the Social Security benefit. At this time, however, it does not appear that the specific reductions applied are consistent with the policy objective of the reductions.

Social Security benefits reflect two factors; (1) the amount of Social Security taxes paid by a worker and (2) a formula that pays a proportionately higher benefit to lower-paid workers. When the worker's entire career has been covered by Social Security, the wages used by Social Security to calculate the benefit properly reflects the wages earned by the worker during that worker's career. When the worker has employment that was not covered by Social Security, such as is the case with a CalSTRS member, the Social Security benefit formula understates the career earnings of the worker, and thereby overstates the Social Security benefit that should be paid, based on the objective of paying a relatively higher benefit to lower-paid workers. To compensate for the understatement of the worker's actual career earnings, the Social Security benefit formula is adjusted to reduce the benefit paid to workers who have been employed in jobs not covered by Social Security.

Similarly, spouses and surviving spouses of Social Security benefit recipients also receive Social Security benefits, but only to the extent that the benefit payable as a spouse or surviving spouse is greater than the benefit paid to the person as a result of his or her own employment. In other words, the spousal benefit is reduced by 100 percent of the person's own Social Security benefit. The Social Security benefits paid to spouses and surviving spouses are intended to provide a benefit to people who are or were financially dependent on their spouse because their own earnings were relatively low. As a result, the benefit paid to spouses and surviving spouses is paid only if the Social Security benefit the person earns from his or her own earnings would be less. CalSTRS members, however, do not receive a Social Security benefit from their CalSTRS-covered employment. Consequently, there may be no Social Security benefit to reduce the spousal benefit for such a person, even though, if the person had worked in employment covered by Social Security, the spousal benefit would have been completely offset. As a result, a CalSTRS member could receive a higher spousal benefit than would a similarly situated person who worked under Social Security, not because his or her own earnings were low and, therefore, he or she was financially dependent on the spouse, but because he or she did not pay the Social Security payroll taxes on earnings for the CalSTRS-covered service and therefore did not receive a Social Security benefit based on those earnings. The GPO is intended to compensate for that situation by reducing the benefit paid to a spouse or surviving spouse by 2/3 of the CalSTRS or similar pension.

As indicated earlier, although there appears to be a justification for reducing Social Security benefits to CalSTRS members and other similar government workers, the specific adjustments do not appear to be appropriate. For example, the WEP is intended to compensate for wages that were earned in employment not covered by Social Security, but the amount of the adjustment essentially bears no relation to the amount of such non-covered earnings. The only modification to the WEP, other than a relatively minor requirement that the WEP reduction not exceed 50 percent of the government pension, is that the WEP adjustment is reduced as the number of years of employment covered by Social Security increases. In other words, the amount of the reduction will be the same for two people who worked the same number of years in employment covered by Social Security, even if one person worked for only 5 years under CalSTRS and a second person worked for 20 years under CalSTRS, and therefore have a substantially different total earnings history.

Similarly, it does not appear that reducing the benefit paid to a spouse or a surviving spouse by 2/3 of the governmental pension properly adjusts for the distortion caused by the person working in employment not covered by Social Security. By reducing the benefit paid to the spouse and surviving spouse by 2/3 of the CalSTRS benefit, the CalSTRS benefit is used to approximate what the Social Security benefit would have been for the CalSTRS-covered employment, if the employment had been covered by Social Security. In effect, a 2/3 reduction implies that the earnings associated with CalSTRS-covered employment would result in a Social Security benefit equal to 2/3 of the CalSTRS benefit for that same earnings history. However, preliminary estimates by CalSTRS staff indicate that a typical CalSTRS career, if covered by Social Security, would result in a Social Security benefit that is only about 50 percent of the CalSTRS benefit. This suggests that the GPO results in an excessive reduction in Social Security benefits.

Based on this preliminary analysis of the offset provisions, it appears that changing the application of these two provisions would be appropriate.

FISCAL IMPACT

Benefit Program Costs – None

Administrative Costs – None

BOARD POSITION

Support. Current indications are that the WEP and GPO inappropriately reduce Social Security benefits to affected CalSTRS members, and should be modified.