

# Ohio Retirement Study Council

# ISSUE BRIEF

Revised February 2024

## **Windfall Elimination Provision and Government Pension Offset**

*Under federal Social Security law, State and local government employees in Ohio may lose a portion or all of any Social Security benefit to which they are otherwise entitled.*

### **Reduction of Social Security Benefits to Governmental Employees**

99% of state and local government employees in Ohio contribute to a state retirement system, rather than Social Security, for their government service.<sup>1</sup> Because they do not contribute to Social Security, they are not entitled to a benefit from Social Security for that *government* service. But, those government employees or their spouses may have sufficient *private sector* service, for which contributions to Social Security were made, to qualify for a Social Security benefit. Even though they may qualify for Social Security resulting from that private sector service, two federal laws, the Windfall Elimination Provision and the Government Pension Offset, will in most cases cause that government employee to receive less, or none, of the Social Security benefit to which they are otherwise entitled. As a federal program governed by federal law, these Social Security reductions cannot be changed by the Ohio Legislature.

**The Windfall Elimination Provision (WEP) reduces the Social Security benefits that are based on a person's own earning record (page 3).**

**The Government Pension Offset (GPO) reduces, and may eliminate in full, Social Security benefits that are based on a spouse's earning record (page 4).**

### **Background: Social Security Non-Coverage of Ohio State and Local Employees**

When enacted in 1935, the Social Security Act did not provide coverage for state and local government employees.<sup>2</sup> There were two reasons for this. First, Social Security imposes a tax on employment (the Federal Insurance Contributions Act tax (FICA)),<sup>3</sup> and there was a concern about whether the federal government had authority to impose such a tax on state and local governments.<sup>4</sup> Second, numerous states and municipalities already had retirement systems, and Social Security coverage was seen as duplicative.

But, not all states had their own retirement systems. In 1950, Congress amended the Social Security Act to provide a mechanism for a state to *elect* Social Security coverage for the state’s government employees, effectively sidestepping the question of the authority of the federal government to tax states. Provided under Section 218 of the Act, and known as “Section 218 Agreements,” a state may voluntarily enter into an agreement under which the federal government agrees to cover the state’s employees under Social Security, and the state and its employees are subject to FICA taxes.<sup>5</sup> Once made, an agreement to cover a class or group of employees cannot be terminated or modified to exclude that class of employees in the future. With 99% of its state and local government employees not covered by Social Security, Ohio has maintained its exclusion from Social Security at a rate higher than any other state.<sup>6</sup>

Since Ohio’s state retirement system members and their employers have not contributed to Social Security, members do not receive Social Security benefits for employment covered under a state retirement system. However, retirement system members may have contributed for employment outside of government service. Or, a member may be eligible for spousal or survivor benefits by reason of a spouse’s employment in a position covered by Social Security. If a retirement system member receives a state retirement or disability benefit and is also eligible for a Social Security benefit because of the member’s own Social Security covered employment or a spouse’s employment, it is likely that the federal Windfall Elimination Provision or Government Pension Offset will reduce that Social Security benefit.

### **Progressive Tax Structure of Social Security and Inconsistency with Non-Social Security Employment**

The Windfall Elimination Provision and Government Pension Offset were enacted to resolve inconsistencies in Social Security law that result when a state or local government employee has access to both a state retirement pension and a Social Security benefit.

Before turning to these laws, one basic tenant of Social Security must be understood: Social Security is designed as a progressive tax system. Social Security benefits intentionally replace a greater share of low-wage workers’ earnings than for high-wage workers.<sup>7</sup> This is accomplished through the formula used to calculate benefits. Very generally, a two-step process determines these benefits. First, Social Security calculates the average lifetime earning of the worker, adjusted for inflation. Second, the average lifetime earnings are divided into three earning brackets. A different portion of each earning bracket is used to calculate the worker’s benefit, with a greater proportion used for the lower brackets.

Social Security calculates a benefit in 2023 as follows:

<b>2023 Social Security Benefit Calculation</b>	
Monthly Average Earnings	Percent Returned as Social Security Benefit
Up to \$1,115	90%
>\$1,115-\$6,721	32%
>\$6,721-\$160,200	15%

A 2022 study found that under the above formula a hypothetical low income worker retiring in 2022 (\$15,006 career average) would receive 77% of their pre-retirement salary as a benefit while the highest income worker (\$147,775 career average) would receive 27% of their pre-retirement salary as a benefit.<sup>8</sup>

The point being that Social Security benefits, by design, provide a higher rate or return for lower income individuals and a lower rate of return to higher income individuals.

### **Windfall Elimination Provision (WEP)**

According to the Social Security Administration, the Windfall Elimination Provision (WEP) was enacted to prevent federal and state employees from unfairly benefiting from the provisions aimed at low-income workers.<sup>9</sup> The federal government found that some employees worked both under a state retirement system and part-time for a period in a position covered by Social Security. The income from their main employment was unreported to Social Security, so to Social Security the person would appear to be low-income. In retirement, the former employee would receive a Social Security benefit that was proportionally larger than other Social Security recipients. WEP was enacted in 1983 to curtail this issue.

WEP reduces the benefit earned through a government employee's *own employment*. The provision affects employees who are eligible to receive Social Security benefits, contributed to Social Security for less than 30 years of substantial earnings,<sup>10</sup> and are receiving pensions from their own employment for which Social Security taxes were not withheld. Under the provision, a modified benefit formula is used to calculate the amount of the retired or disabled employee's benefit.<sup>11</sup>

As discussed in the table above, in calculating a benefit, Social Security multiplies the first \$1,115 of average monthly earnings by 90%, earnings over \$1,115 but less than \$6,721 by 32%, and the remaining balance up to the maximum contribution rate of \$160,200 by 15%. Under the modified WEP formula, rather than using 90% of the first \$1,115 to calculate the benefit, a percentage based on the number of years of Social Security participation is used. For those who work 20 years or less, 40%, rather than 90%, is used. The percentage rises by 5% per year of participation until it reaches 90%, for 30 years of Social Security participation. The Social Security benefit is, therefore, lowered, but never totally eliminated, under WEP, and after 30 years of Social Security covered employment, the WEP does not apply. The 32% and 15% brackets are unaffected by WEP.

As an example, assume an employee participating in a state retirement system is eligible for a retirement benefit. This employee was also employed in a position covered by Social Security for 20 years and had averaged indexed monthly earnings of \$1,500. But for WEP, the employee would be eligible for a monthly Social Security benefit of \$1,126.70 (\$1,115 x 90% plus \$385 x 32%). However, because the employee receives a state pension, the provision reduces the benefit to \$569.20 (\$1,115 x 40% plus \$385 x 32%). The WEP causes a reduction of \$557.50.<sup>12</sup>

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According to the Congressional Research Service, 161,739 individuals were subject to WEP reductions in Ohio in December of 2022.<sup>13</sup> Ironically, while Social Security is designed as a progressive tax, the mechanics of WEP cause it to become regressive.<sup>14</sup> Because WEP only applies to the first bracket of the benefit formula, it causes a proportionally larger reduction in benefits for workers with lower average benefits amounts than for workers with higher average benefits. In the example above, if, instead of the person having indexed monthly earnings of \$1,500, the person had monthly earnings of \$5,000, the person would receive a benefit of \$1,689.20 rather than \$2,246.70. The WEP reduces both earners benefit by \$557.50. However, that \$557.50 constitutes a higher portion of the benefit to the lower income worker. That said, Social Security has found that those subject to WEP are less likely (3.5%) to have incomes below the poverty line than the general population (11.3%).

### **Government Pension Offset (GPO)**

The Government Pension Offset (GPO) reduces the Social Security benefit received by a Social Security contributor's spouse or survivor who is also receiving a federal or state retirement benefit. The offset reduces the benefit earned by reason of *another person's employment* in a position covered by Social Security.<sup>15</sup> GPO can be confusing as it applies only under specific circumstances.

### **Background: Spousal and Survivor Benefits**

"Dependent" payments (benefits for a spouse or surviving spouse) were established in the 1930s to compensate a spouse who stayed home to raise a family and were financially dependent on the working spouse. Generally speaking, under Social Security a spouse is eligible for an amount equal to 50% of a retired or disabled Social Security worker's benefit and, should that working spouse die, 100% of the deceased worker's benefit. However, Social Security has consistently required that a person's Social Security benefit be offset dollar-for-dollar by the amount of any *other* Social Security benefit to which the person is otherwise entitled, the so-called "dual entitlement provision."<sup>16</sup> As a result, if a person is eligible for both a spousal or survivor benefit and also a benefit based on their own earnings, the person will receive the highest benefit, not both.

### **GPO and State Retirement Systems**

As initially enacted, the Social Security Act applied the dual entitlement provision only to those eligible for two *Social Security* benefits; it did not apply to any outside federal or state pension benefits a spouse or surviving spouse might be eligible to receive. In 1977, however, Congress created the GPO to reduce or eliminate the Social Security benefit of a spouse or surviving spouse who also receives a retirement benefit from a government pension earned by reason of the spouse or surviving spouse's own employment. According to Social Security, the GPO ensures that benefits of government employees who don't pay Social Security taxes are calculated the same as workers in the private sector who pay Social Security taxes.<sup>17</sup>

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GPO causes a spousal or survivor Social Security benefit to be reduced by two-thirds of the amount of any federal or state retirement benefit for which the spouse or survivor is eligible. For example, assume that a husband worked in a position covered by one of the state's retirement systems and is receiving a \$3,000 per month benefit from the retirement system. His wife worked in a position covered by Social Security and receives a \$2,200 per month benefit. By reason of the wife's employment, the husband would normally be eligible for a \$2,200 survivor benefit from Social Security. The husband's state retirement system benefit *does not change*. However, the Social Security spousal benefit is reduced to \$200 per month. This is because the Social Security benefit is reduced by two-thirds of the retirement system benefit ( $\$3,000 \times 2/3 = \$2,000$  reduction to Social Security benefit). In this instance, the husband of the deceased Social Security worker receives a total benefit of \$3,200 (\$3,000 state retirement benefit plus \$200 Social Security survivor benefit). If a retirement system member takes a lump-sum benefit rather than a monthly benefit, Social Security will still calculate the reduction as if the member had elected to receive a monthly benefit.

GPO reductions are not symmetrical. In the above example, if the husband predeceased the wife and the wife became eligible for a \$3,000 state retirement system survivor benefit based on her *spouse's employment in a non-Social Security position*, her Social Security worker's benefit *would not change*. In this instance, the Social Security benefit is not reduced so the woman receives a total of \$5,200 per month (\$2,200 Social Security benefit and \$3,000 state retirement survivor benefit). To put it simply, Social Security does not object to a Social Security worker receiving the entirety of their benefit based off their *own work* and also receiving a benefit from *a state retirement system*. But Social Security very much objects to providing a *spousal or survivor* Social Security benefit to a person already receiving a benefit from a state retirement system.

In December 2017, Social Security found that 96,563 Ohioans were subject to GPO, with 60,447 of those being fully offset (that is, the entire benefit was eliminated).<sup>18</sup> While there have been attempts to repeal GPO, it is important to note that the two-thirds reduction under GPO is less than the reduction under the dollar-for-dollar dual entitlement provision.

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<sup>1</sup>Government Accountability Office, "Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees" (GAO-10-938, September 29, 2010), Appendix II, 40-41.

<sup>2</sup>42 U.S.C. 301 et seq. "The Social Security Act of 1935," Pub. L. No. 74-271, 49 Stat.620.

<sup>3</sup>FICA imposes a 6.2% tax for Old Age, Survivor, and Disability Insurance and 1.45% Medicare tax on employees and an equivalent amount on employers.

<sup>4</sup>Barbara D. Bovdjerg, United States General Accounting Office, "Social Security: Issues Relating to Noncoverage of Public Employees," GAO-03-710T (May 1, 2003).

This concern on taxation of the states dropped away in the 1980s as all government employees hired after March 31, 1986, are required to participate in Medicare and pay the 1.45% Medicare FICA tax. In 1984, new federal employees were included in Social Security (previously hired employees participated in the Civil Service Retirement System).

<sup>5</sup>42 U.S.C. 418. “Determining Worker Status,” *Federal-State Reference Guide, IRS Publication 963*, revised 2020.

<sup>6</sup>Government Accountability Office, “Social Security Administration: Management Oversight Needed to Ensure Accurate Treatment of State and Local Government Employees” (GAO-10-938, September 29, 2010), Appendix II, 40-41.

<sup>7</sup>42 U.S.C. 415(a)(1). The average lifetime benefit is known in Social Security as the Average Indexed Monthly Earnings (AIME).

<sup>8</sup>Office of the Chief Actuary, Social Security Administration, “Replacement Rates for Hypothetical Retired Workers” (June 2022), available online at: <https://www.ssa.gov/oact/NOTES/ran9/an2022-9.pdf>, page 7-8.

<sup>9</sup>Social Security Administration, Windfall Elimination Provision (2023), available online at: <https://www.ssa.gov/pubs/EN-05-10045.pdf>

<sup>10</sup>“Substantial Earnings” is an indexed amount the employee must have earned each year to receive a full year of Social Security credit. For 2023, substantial earnings were \$29,700.

<sup>11</sup>42 U.S.C. 415(a)(7).

<sup>12</sup>Social Security also provides a “guarantee” that the WEP reduction in most cases won’t exceed 50% of your pension amount. Social Security Administration, Windfall Elimination Provision (2023), available online at: <https://www.ssa.gov/pubs/EN-05-10045.pdf>

<sup>13</sup>Congressional Research Service, “Social Security: The Windfall Elimination Provision (WEP)” (Updated February 2023). Available online at: <https://crsreports.congress.gov/product/pdf/RS/98-35>, page 6.

<sup>14</sup>Jeffrey R. Brown and Scott Weisbenner, “The Distributional Effects of the Social Security Windfall Elimination Provision,” *Journal of Pension Economics and Finance*, vol. 12, iss. 04 (October 2013), 415-434.

<sup>15</sup>Social Security Administration, “Government Pension Offset.” Available online at: <https://www.ssa.gov/pubs/EN-05-10007.pdf>. Social Security Amendments of 1977, Pub. Law 95-216 91, Stat. 1509 (42 U.S.C. 402, subsection (k) (5)).

<sup>16</sup>Social Security generally does not permit an individual to receive two Social Security benefits; a survivor will receive only the larger of the benefits. 42 U.S.C. 402(k)(1), (2), (3), and (4) contain restrictions, with very few exceptions, on any individual receiving simultaneously an old-age insurance benefit and a survivor or disability benefit.

<sup>17</sup>Social Security Administration, “Government Pension Offset.” Available online at: <https://www.ssa.gov/pubs/EN-05-10007.pdf>

<sup>18</sup>Congressional Research Service, “Social Security: The Government Pension Offset (GPO)” (Updated June 14, 2018), available online at: <https://crsreports.congress.gov/product/pdf/RL/RL32453/31>, page 9.

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