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United States General Accounting Office

GAO

Fact Sheet for the Chairman, Committee on the Budget, United States Senate

March 1986

RAILROAD RETIREMENT

Size, Nature, and Funding Sources

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

March 5, 1986

B-222204

The Honorable Pete V. Domenici
Chairman, Committee on
the Budget
United States Senate

Dear Mr. Chairman:

In accordance with your December 17, 1985, request, we are providing you with a fact sheet on the federal financial involvement in the railroad retirement and unemployment and sickness insurance programs.

In developing this document we relied primarily on Railroad Retirement Board accounting records, actuarial evaluations, and beneficiary data. We have discussed the facts in this document with Board officials and considered their comments in its preparation.

Since 1937, a number of laws have helped shape what is now referred to as the railroad retirement program. Over the years, the program has changed from one almost entirely funded by the rail industry to one that received almost half of its annual revenue from federal sources. During this time, the program has evolved from an industry-funded plan for retired workers to one containing both social security and private pension elements.

The following issues are highlighted in this fact sheet.

--Roughly half of the program's annual revenues are provided by the federal government--about 85 percent of these funds come from social security. These revenues help pay for social security equivalent benefits, which the federal government would have to pay anyway if railroad employees were covered by social security. These social security revenues will amount to about $2.4 billion in 1987.

--The dual benefit payments (generally called windfall benefits) to retirees entitled to both railroad retirement and social security will cost the federal government an estimated $375 million in 1987.

--The tax treatment of retirement benefits from the private pension component of railroad retirement differs from the taxation of normal private pension plan benefits in that tax revenues from railroad retirement benefits are returned to the railroad retirement trust fund rather than to general revenues. It is estimated that this will result in a $252 million loss to general revenues in 1987 and $138 million in additional losses through 1990.

--Certain rail private pension benefits, principally for early retirement, are more favorably taxed at the same rate as social security benefits rather than at the higher rate of other private pensions. It is estimated that this will result in a $42 million loss to general revenues in 1987 and an additional $129 million loss through 1990.

--Additional federal financial involvement could be required in the future if unemployment in the rail industry remains high--the unemployment and sickness program presently owes the retirement program $803 million.

--The unfunded liability of the railroad retirement trust fund--$33 billion according to December 1983 data (the latest available at the time we prepared this document)--is vulnerable to changes in the long-term health of the industry. Greatly reducing this liability in the near future seems unlikely.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this fact sheet until 30 days from its issue date. At that time we will send copies to other interested congressional committees and members; the Chairman, Railroad Retirement Board; the Director, Office of Management and Budget; and other interested parties and make copies available to others on request.

Should you need additional information on the contents of this document, please call me on 275-6193.

Sincerely yours,

J.F. Delfico

Joseph F. Delfico
Associate Director

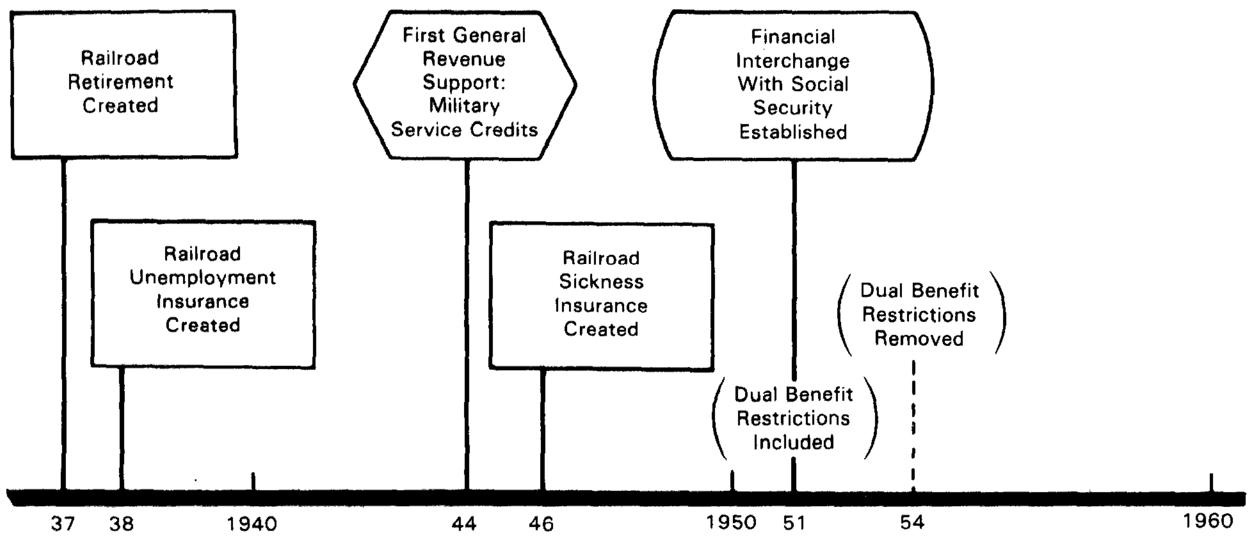
Contents

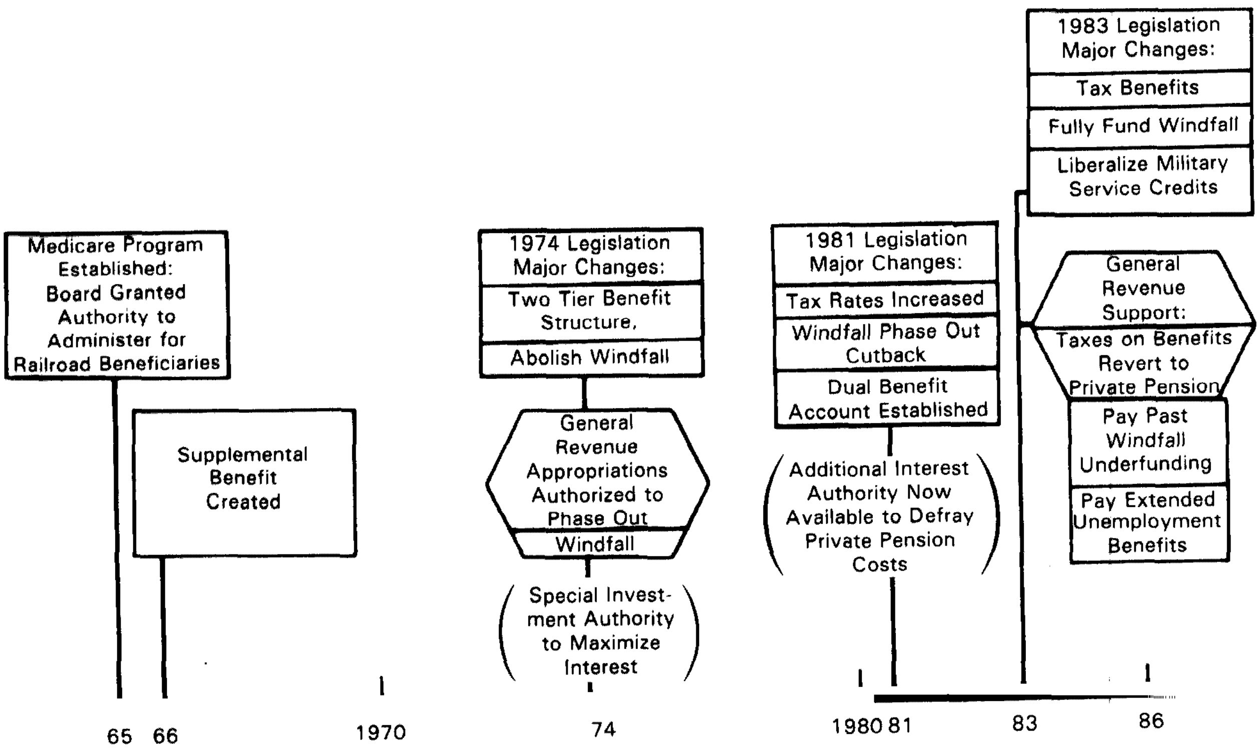
1. **WHAT ARE THE RAILROAD RETIREMENT PROGRAMS?**

Since its inception almost 50 years ago, the railroad retirement program administered by the Railroad Retirement Board has evolved from a staff pension program supported entirely by the railroads and their employees to a unique federally administered industry pension program relying in part on federal involvement.

The federal involvement, which started in 1937, included the creation of an unemployment and sickness program and has continued through today. Figure 1 shows legislative milestones in the railroad retirement programs.

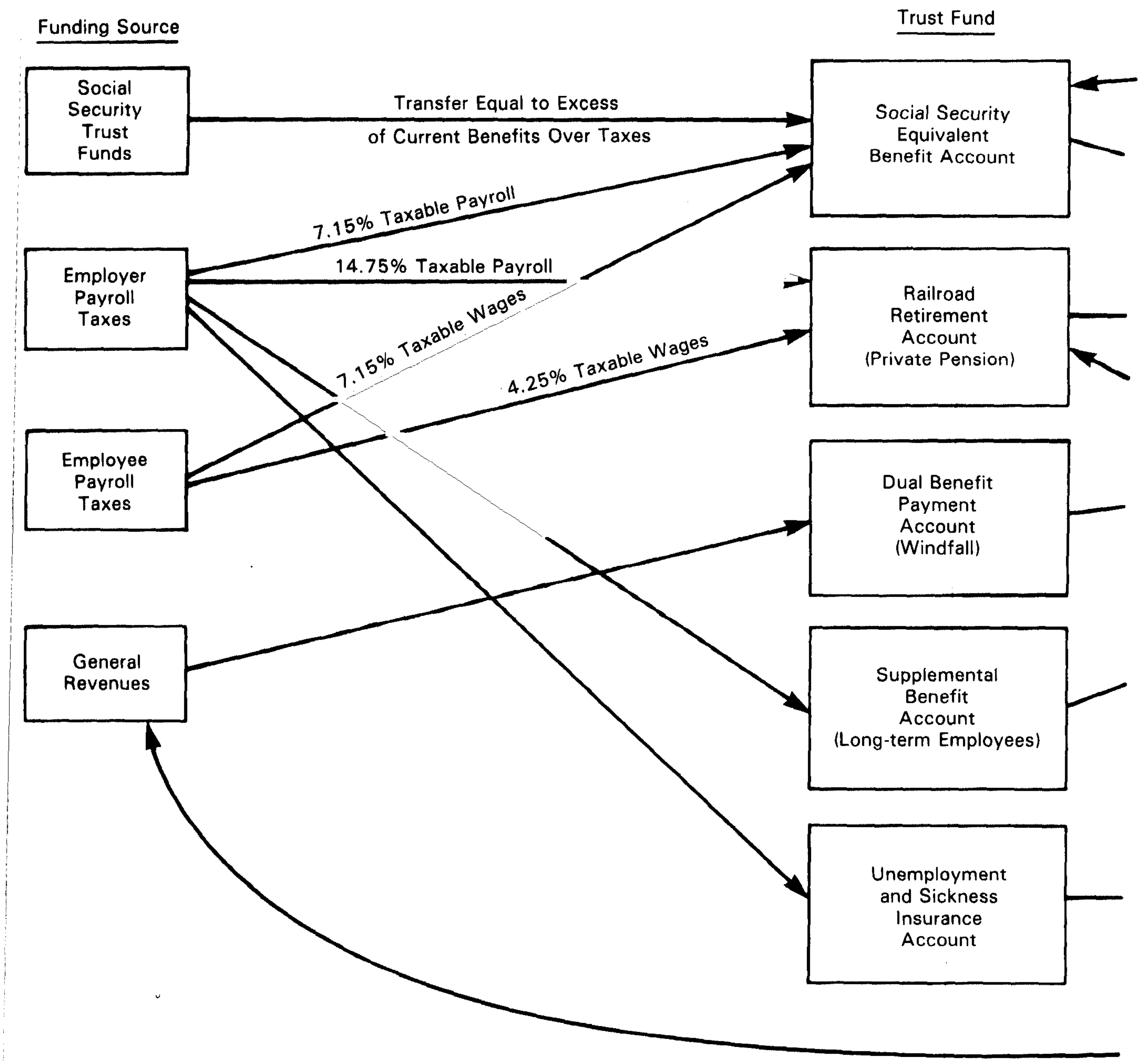
Figure 1:
Major Legislative Milestones
Involving Railroad Retirement Programs




Medicare Program Established: Board Granted Authority to Administer for Railroad Beneficiaries
Supplemental Benefit Created
1974 Legislation Major Changes:
Two Tier Benefit Structure,
Abolish Windfall
General Revenue Appropriations Authorized to Phase Out Windfall
Special Investment Authority to Maximize Interest
1981 Legislation Major Changes:
Tax Rates Increased
Windfall Phase Out Cutback
Dual Benefit Account Established
Additional Interest Authority Now Available to Defray Private Pension Costs
1983 Legislation Major Changes:
Tax Benefits
Fully Fund Windfall
Liberalize Military Service Credits
General Revenue Support:
Taxes on Benefits Revert to Private Pension
Pay Past Windfall Underfunding
Pay Extended Unemployment Benefits
65
66
1970
74
1980
81
83
86

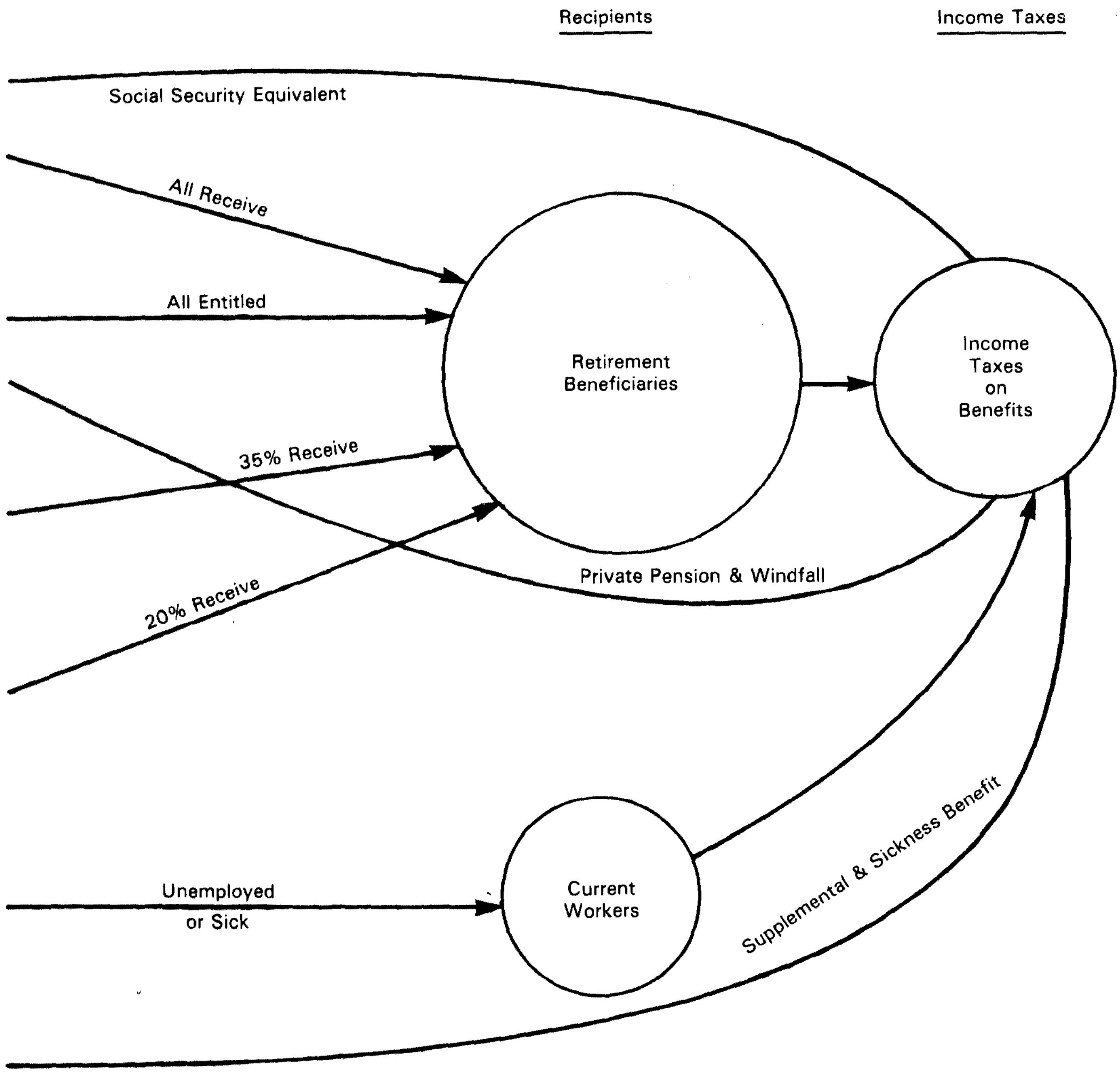
There are currently five trust funds paying benefits that are funded by four sources of revenue--taxes on both employers and employees, transfers from social security trust funds, and general revenue appropriations from the federal government. A beneficiary receives a single check from the Railroad Retirement Board which may include four different types of benefits--an amount equivalent to a social security benefit, an industry pension benefit, an industry supplemental benefit for those with long-term service, and a windfall benefit for those who are also entitled to benefits under social security.

Figure 2:
Flow of Funding, Benefit Payments, and
Taxation Under Railroad Retirement Programs



Windfall is the additional amount paid out to about 35 percent of all railroad retirement beneficiaries because they also worked outside the rail industry and became eligible to receive benefits under both railroad retirement and social security. Both the social security and railroad retirement benefit schedules favored retirees with lower career earnings. The windfall occurs because benefits were computed separately based on lifetime earnings split between the two programs.

Benefits are also available to current rail workers who are unemployed or sick. Figure 2 shows the flow of funding, benefit payments, and use of receipts from taxation of benefits.



2. WHO RECEIVES WHAT BENEFITS?

A. How Big Are the Benefit Programs?

	Paid in 1985	
	Dollars	Beneficiaries
Retirement	$ 6 billion	954,000
Unemployment and sickness	175 million	135,000

B. What Types of Benefits Are Paid?

Retirement	Average monthly award for retirees	Percent of beneficiaries entitled
Social security equivalent	$543	All
Private pension	317	All
Windfall	179	35
Supplemental (with at least 25 years of service)	42	20

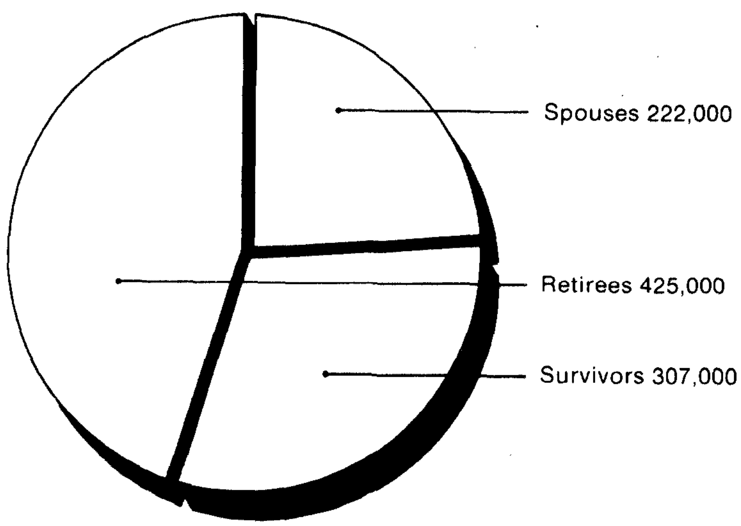
Unemployment and Sickness

Rail workers can currently receive up to a maximum of $25 a day for 26 weeks of unemployment or sickness.

C. Who Receives Benefits?

About three-fourths of those receiving retirement benefits are retirees and their spouses. The rest are survivors. (See figure 3.)

Figure 3:
Composition of Railroad Retirement Beneficiaries for 1985



D. What Are the Sources of Funding?

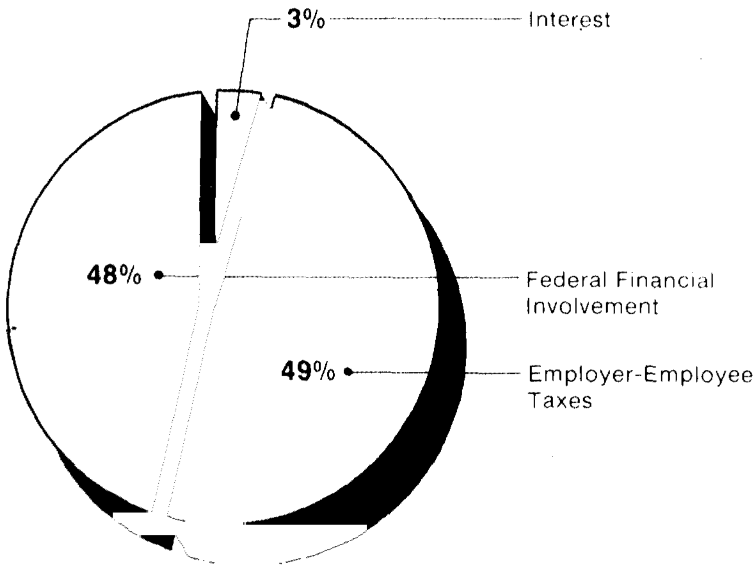
Railroad retirement and unemployment and sickness programs are financed primarily by payroll taxes on rail employers and employees but have had considerable federal financial involvement. (See figure 4.)

Rail employers and employees pay the same payroll tax as persons covered by social security (7.15 percent of taxable wages), but employers pay an additional 14.75 percent and employees 4.25 percent of taxable wages to finance the private pension. Employers also presently pay a 22.5-cents-per-hour payroll tax to finance the private pension supplemental benefit payable to retirees with at least 25 years of service. Receipts from all of these payroll taxes are credited to the railroad retirement trust funds.

For the unemployment and sickness insurance program, only employers have been paying 8 percent of each employee's monthly wages up to $600.

Annual transfers from social security make up about 85 percent of the federal involvement. Presently, this represents the net amount social security would have paid out (excess of benefits over payroll taxes) had the rail industry been under social security. The annual transfer to railroad retirement does not constitute an additional federal expenditure because if that program did not exist, social security would pay the transferred amount directly to beneficiaries. Most of the remaining federal involvement comes from general revenues.

Figure 4:
Funding Sources (1981-83)



3. HOW DOES THE PROGRAM AFFECT GENERAL REVENUES AND SOCIAL SECURITY?

The retirement program (1) mirrors the social security program and receives annual transfers of funds from the social security trust funds, (2) receives general revenues to pay certain benefits, and (3) receives special treatment regarding taxation of benefits, tax revenues, investment authority, and certain administrative expenses.

A. What General Revenues Are Being Provided to Pay Benefits?

--Windfall benefits to persons entitled to railroad retirement and social security benefits will amount to an estimated $375 million in 1987 and will cost an estimated additional $3.3 billion through the year 2000. The windfall benefit offset, which reduces the amount of a beneficiary's private pension benefit by about 25 percent of the windfall amount received, results in savings to the private pension account at the expense of federal general revenues.

B. What Other Treatment or Allowances Affect General Revenues?

--Tax receipts from income taxes on the private pension benefits are returned to the railroad retirement trust funds rather than to general revenues as is the case with the tax receipts from other private pension benefits. This will result in an estimated $252 million loss to general revenues and an additional estimated loss of $138 million through 1990.

--Taxing certain rail private pension benefits, such as early retirement, at the lower rate applicable to social security benefits rather than the higher rate used for other private pensions will result in an estimated general revenue loss of $42 million in 1987 and additional estimated losses of $129 million through 1990.

--Investment authority originally intended to defray windfall costs allows the Railroad Retirement Board rather than the Department of the Treasury to manage Board investments and will result in about $30 million in additional interest earned by the Board in 1987 on its government securities at the expense of general revenues. These revenues are available to the private pension account to pay benefits.

--About $7 million of general revenues will be furnished to the civil service retirement and health insurance trust funds to cover certain Board administrative costs in 1987 which are attributable to administering the rail industry private pension.

C. What Program Aspects Involve Social Security Trust Funds?

--Annual financial transfer from social security trust funds supplements social security taxes paid by rail employers and employees and permits payment of an equivalent social security benefit to railroad retirees, spouses, and survivors. In 1987 about $2.4 billion will be provided by social security and an estimated $38 billion through the year 2000.

--Medicare trust fund pays for the cost of administering Part B of medicare for the rail industry at an estimated additional annual cost of $6 million.

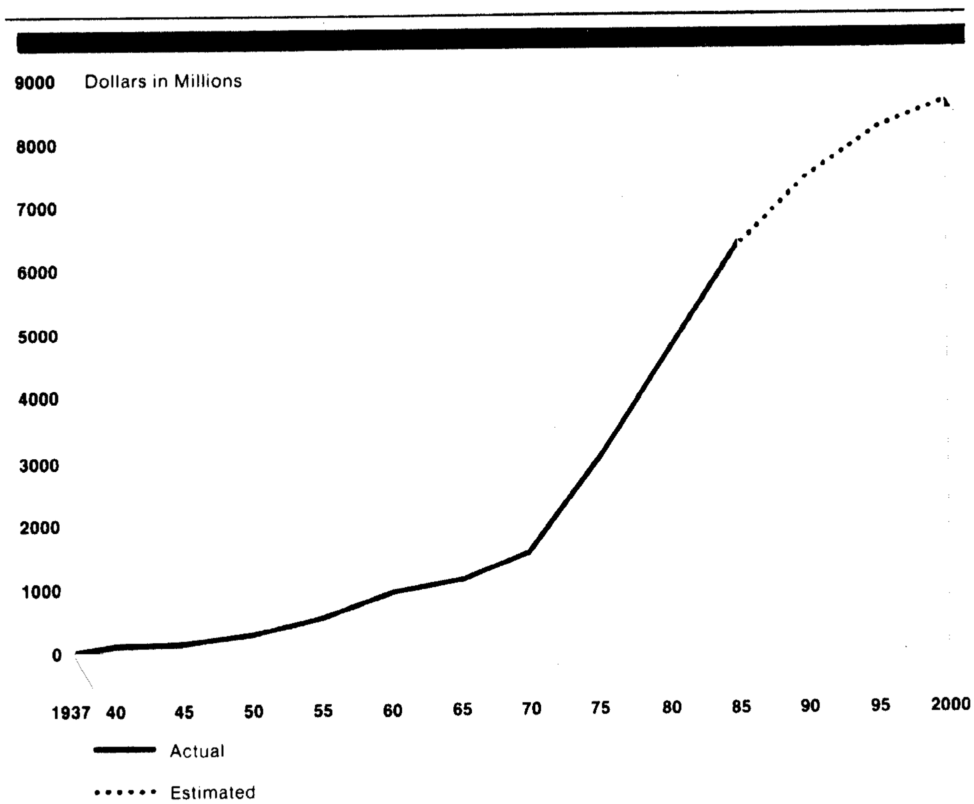
4. WHICH PROGRAM ELEMENTS COULD REQUIRE FUTURE FEDERAL INVOLVEMENT?

Future demographics and economic conditions will greatly affect the railroad retirement program. The 1983 legislation restored viability to the railroad retirement system, and current Board projections indicate that benefits can be paid beyond the year 2000 but lower than anticipated employment could again threaten the program's solvency.

A. What Is the Payout and Demographic Trend for the Retirement Program?

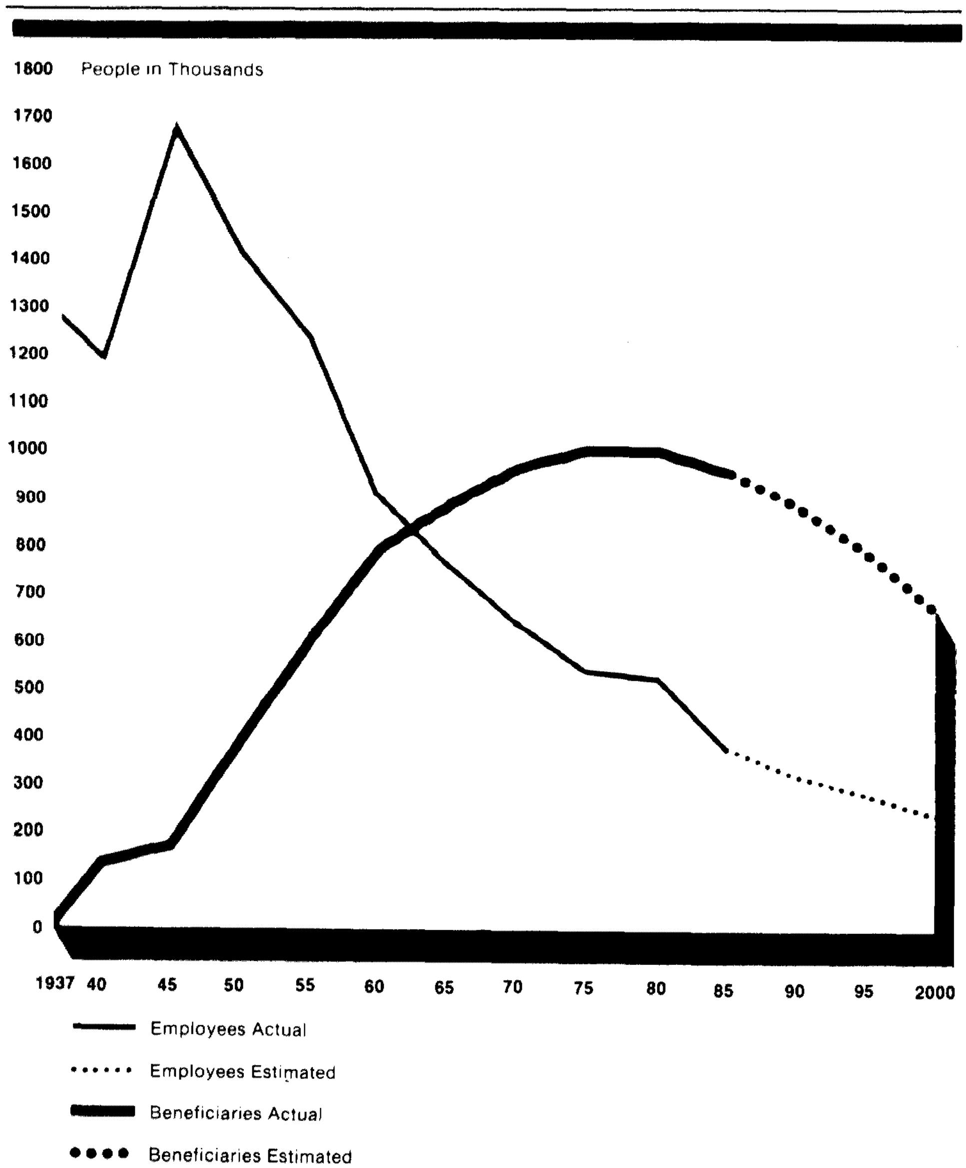
Although the number of beneficiaries on the rolls will decrease through the year 2000, total benefit payments will continue to increase because of higher average earnings of new retirees and inflation adjustments. Figure 5 shows the trend in benefit payments from 1937 through 1985 as well as estimated benefit payments through the year 2000.

Figure 5:
Benefit Payments Under the
Railroad Retirement Act by Year



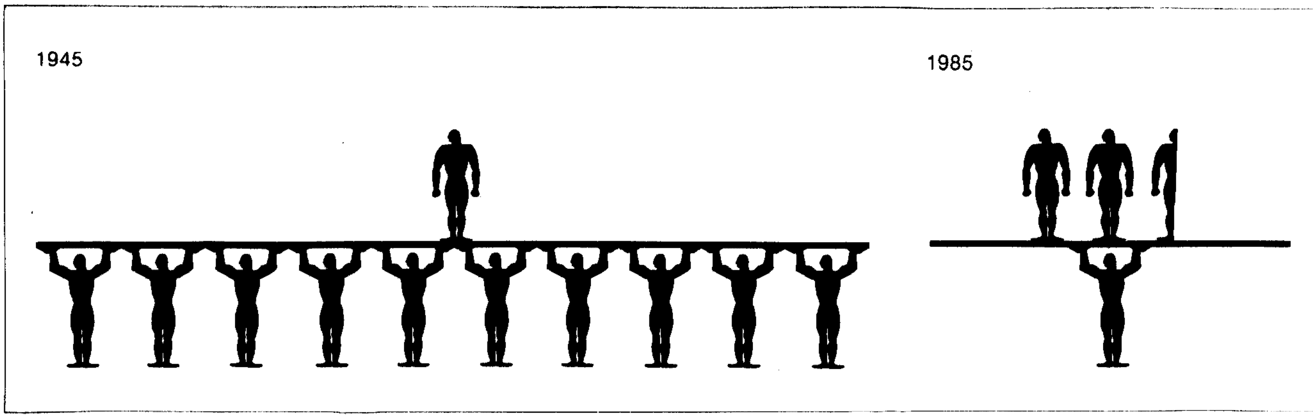
The number of railroad beneficiaries will continue to decrease but so will employment, which is critical to the program's future solvency. Figure 6 compares the historical trends in rail employment and railroad retirement beneficiaries since 1937 and projections by the Board through the year 2000.

Figure 6:
Railroad Employees and Beneficiaries
(1937-2000)



In 1945, there were 10 rail workers for every beneficiary. By 1985, there was 1 worker for every 2-1/2 beneficiaries. For the sake of comparison, social security's ratio in 1985 was now 3 workers for every 1 beneficiary. (See figure 7.)

Figure 7:
Ratio of Workers to Beneficiaries



B. Which Program Elements Are Not Fully Funded?

--The unemployment and sickness trust fund currently owes the retirement fund $803 million, and the fund's financial condition will continue to deteriorate if unemployment remains high.

--The retirement program's private pension funding is patterned after social security (current taxes pay current benefits) rather than other private pensions (future liabilities are insured and systematically fully funded), and a $33 billion unfunded liability developed as of December 1983.

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