BY THE COMPTROLLER GENERAL

Report To The Chairman, Committee On Government Operations, House Of Representatives

OF THE UNITED STATES

Keeping The Railroad Retirement Program On Track--Government And Railroads Should Clarify Roles And Responsibilities

The railroad retirement program has evolved from an industry-funded plan for retired workers to one which contains both social security and private pension elements. Funds to finance these elements consist of taxes paid by railroad workers and employers, transfers from social security trust funds, and general revenue appropriations from the Federal Government.

The Railroad Retirement Board predicts that it may not be able to pay total benefits by 1982. To ensure that railroad beneficiaries will receive, at least, the social security portion of the retirement benefits, the Congress should require that funds for that portion be used for that purpose only and that railroad employees and employers pay taxes for those benefits on the same basis as employers and employees under social security.

To help ensure that total benefits will be paid, the Congress should decide to what extent the Federal Government will fund windfall benefits for dual beneficiaries. The Congress also should consider whether certain groups, such as railroad beneficiaries' remarried widows and divorced spouses, which are not covered under railroad retirement, should be.

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HRD-81-27
MARCH 9, 1981

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-202007

The Honorable Jack Brooks
Chairman, Committee on Goverment
Operations
House of Representatives

Dear Mr. Chairman:

In response to your request, we have (1) obtained data on the cost of Federal assistance to the railroad retirement program, (2) reviewed the Federal role in providing financial assistance to the railroad retirement program, and (3) examined alternatives for funding and administering the program. This report discusses our findings and contains recommendations to the Congress for legislative action that would help clarify Federal and railroad funding responsibilities and ensure that railroad beneficiaries will receive the social security portion of their retirement benefits if sufficient funding is not available to pay all benefits.

At your request, we did not obtain official agency comments from the Railroad Retirement Board. We did discuss the matters covered in the report with agency officials during our review and included their comments, where appropriate. As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CHAIRMAN, HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

KEEPING THE RAILROAD RETIREMENT PROGRAM ON TRACK--GOVERNMENT AND RAILROADS SHOULD CLARIFY ROLES AND RESPONSIBILITIES

DIGEST

The railroad retirement program, the only federally administered pension plan for a private industry, pays benefits of over $4 billion a year to about 1 million recipients. To finance these benefits, the Railroad Retirement Account receives funds from employers' and employees' payroll taxes, the Social Security Administration, and general revenue appropriations. Officials of the Railroad Retirement Board, which administers the railroad retirement program, predict that the program may not be able to pay total benefits by May 1982 because of funding shortfalls.

GAO believes that the program's financial condition raises two issues that the Congress will have to address soon--(1) what the Federal role should be in providing financial assistance and (2) what funding alternatives are available? This report deals with these issues.

The railroad retirement program began in 1935 as a staff retirement plan exempt from social security coverage that provided benefits to retired railroad workers only. The program was funded by employers' and employees' payroll taxes with no Federal assistance until 1951.

FEDERAL ASSISTANCE EXPANDED COVERAGE AND PROVIDED A NEW SOURCE OF FINANCING

In 1951, the Congress established a financial interchange between the social security and the railroad retirement programs. The interchange requires that the Social Security Administration determine what it would have paid to railroad beneficiaries if they were covered by social security. If this amount exceeds the taxes received by railroad retirement for such benefits, social security must transfer the difference. If railroad retirement receives more in taxes than what is needed to pay railroad beneficiaries, the excess is transferred to social security. The interchange's purpose was to place the social security program in a position where it would neither gain nor lose by excluding the railroad industry from social security coverage.

From 1951 to 1979, social security transferred to the railroad retirement program for benefit payments $16.3 billion. The transfers resulted from (1) an increase in social security benefits, (2) a decline in railroad employment, and (3) a doubling in railroad beneficiaries. From 1980 to 2000, the Board estimates that social security will transfer about $23 billion more. These transfers have enabled the railroad retirement program to expand and add most of the beneficiary categories covered under social security. (See pp. 7 to 9.)

The Railroad Retirement Act of 1974 attempted to correct a funding defect under the financial interchange. Although the railroad industry had been exempted from social security coverage, individual railroad employees who also worked for nonrailroad employers covered by social security could receive benefits from both programs. The effect of such dual benefits was to reduce the social security interchange payments to the railroad retirement program. (See app. I.) To curb the financial drain, the act required that, unless earned by 1974, railroad workers could no longer receive dual benefits. The act retained dual benefits for those who had earned them and provided that their "windfall" benefits be funded from general revenues for 25 years (from 1976 to 2000). From fiscal years 1976 to 1980, the Congress provided the Account about $1.4 billion to pay windfall benefits. (See p. 10.) According to the Board, the cost of paying windfall benefits has exceeded appropriations by about $800 million.

Before 1974, railroad retirement's benefit formulas did not distinguish among the different types of benefits paid. The 1974 act separated benefits into three parts--social security equivalent, private pension, and windfall. It required railroad employer and employee payroll taxes and social security transfers to fund the equivalent benefits, the railroad industry to finance the private pension, and the Federal

Government to pay for windfall benefits. According to Board officials, the program has financial trouble, in part, because private pension and windfall benefit components are not being funded adequately. (See pp. 11 and 12.) GAO believes that, because the railroad retirement program has evolved from a staff retirement plan to a social security plus private pension plan, railroad beneficiaries should be assured of receiving, at least, their social security equivalent benefits. (See p. 14.)

CHANGES NEEDED TO INSURE RAILROAD RETIREMENT BENEFICIARIES RECEIVE SOCIAL SECURITY EQUIVALENT BENEFITS

If the Account is unable to pay full benefits in 1982, as predicted, railroad beneficiaries may not receive social security equivalent benefits even though such benefits are funded by social security transfers and employer and employee payroll taxes. This may occur because the railroad retirement program commingles in one account funds for social security equivalent benefits with inadequate funds for other benefits. (See p. 14.)

By making a distinction in 1974 between the social security equivalent and the private pension benefits, the Congress provided an opportunity to extend to railroad workers and beneficiaries the protection that those under social security have. To extend this protection, GAO believes that a separate account for social security funds should be established and used to pay only the social security equivalent portion of the railroad retirement benefits. This account, by itself, will not ensure that beneficiaries receive full railroad retirement benefits. However, GAO believes that such an account would better reflect the nature of the program--social security equivalent plus private pension--and would provide better accountability for each funding source, increasing the likelihood that all benefits will be fully funded. (See p. 15.)

In conjunction with establishing a separate social security equivalent account, railroad employers and employees should be required to pay taxes for the social security equivalent benefits based on annual maximum taxable earnings, as employees and employers do under social security, rather than on monthly maximum taxable earnings. GAO also suggests that the Congress consider the merits of Social Security's transferring funds on a more current basis rather than yearly as is done now. GAO believes this action would help insure that the Account receives on a timely basis the funds which a separate social security equivalent account will need to meet its obligations. (See p. 17.)

ALL BENEFICIARIES WHO WOULD HAVE BEEN ELIGIBLE UNDER SOCIAL SECURITY ARE NOT ELIGIBLE UNDER RAILROAD RETIREMENT

Remarried widows and divorced spouses do not receive benefits from railroad retirement although their counterparts do under social security. Some other beneficiary groups, such as retirees resuming work, children, and spouses of disabled workers, in most cases do receive as much as they would have under social security but not in the form of social security equivalent benefits. (See p. 21.)

Because of the differences in the program's eligibility requirements, railroad retirement receives annually from social security through the interchange funds for remarried widows and divorced spouses which it does not pay to them. For fiscal year 1978, for example, this amount was $4.2 million. (See p. 21.)

If it is the intent of the Congress that all persons who would have been covered under social security receive full social security equivalent coverage under railroad retirement, the railroad retirement program's eligibility criteria and benefit structure should be revised. (See p. 22.)

PAYING WINDFALL BENEFITS--WHAT IS THE FEDERAL GOVERNMENT'S RESPONSIBILITY?

Since the Congress agreed to pay windfall benefits in 1974, the estimated annual cost has doubled from the original estimate of $250 million. Board officials now estimate that $529 million annually will be needed from fiscal years 1981 to 2000. GAO believes that the issue which arises from mounting windfall costs involves how much of the windfall the Federal Government is willing to pay. In 1974, the Congress considered various alternative sources of windfall financing, but rejected them on the basis of public policy considerations. Another alternative, railroad financing of the windfall, was rejected because the Congress believed higher freight rates would have an adverse impact on inflation and the railroads' financial stability. The Congress may wish to determine if these factors are as valid today as they were believed to have been in 1974. (See p. 23.)

The Railroad Retirement Act of 1974 did not specify whether the Federal Government intended to fund gross or net windfall cost. Net cost involves windfall benefits computed on the basis of certain provisions which reduce retirees' private pensions when they receive separate social security benefits. The Board makes such reductions when paying windfall benefits. GAO's study indicates that these reductions in private pensions reduce railroad retirement's gross windfall costs by about 20 percent. (See p. 29.)

If the Congress intended to pay only the net windfall cost (the cost of windfall benefits less any offsets in private pension benefits), then the current estimate of $529 million per year for windfall costs to the Federal Government is overstated by $107 million. Based on this estimate, windfall cost to the Federal Government from fiscal years 1981 to 2000 would be about $2 billion less than the Board's latest estimate.

If the Federal Government funds only the net windfall cost, the railroad industry will have to either increase contributions or the private pension benefits will have to be reduced. (See p. 33.)

RECOMMENDATIONS TO THE CONGRESS

To ensure that railroad beneficiaries receive social security equivalent benefits and that railroad employers and employees assume the same tax responsibilities to support these benefits as those under social security, the Congress should enact legislation to:

--Establish a separate account for paying social security equivalent benefits and require that funds from social security transfers and employers' and employees' payroll taxes for social security equivalent benefits be placed in the account and be used only to pay the social security equivalent benefits.

--Require that railroad employers and employees pay taxes for the social security equivalent benefits based on annual rather than monthly maximum taxable earnings as employers and employees do under social security. (See p. 20.)

If it is the intent of the Congress that all persons who would have been covered under social security, except for the railroad retirement program, receive full social security equivalent coverage under railroad retirement, the Congress should pass legislation revising the railroad retirement eligibility criteria and benefit structure to ensure payment of such benefits. (See p. 24.)

The Congress should reevaluate the issue of how to finance windfall benefits, and as part of such an evaluation decide to what extent the Federal Government should fund windfall costs. (See p. 34.)

The Chairman, House Committee on Government Operations, asked GAO to make this review. As requested, the report does not contain official comments from the Board on matters discussed in this report.

Congressional hearings are being planned on some of the matters discussed in this report. In addition, a railroad labor and management group is required by Public Law 96-582 to submit its joint recommendations for dealing with the Account's financial problems by March 1981. At the conclusion of the hearings and after analysis of the labor-management report, GAO will be available to work with the appropriate committees in drafting necessary legislation.

Contents

		Page
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
	The railroad retirement program	1
	Objectives, scope, and methodology	3
2	RAILROAD RETIREMENT PROGRAM HAS CHANGED OVER THE YEARS--NEED TO REEXAMINE THE GOVERNMENT'S ROLE	6
	Railroad retirement program established separate from social security primarily to encourage retirement	6
	Program began expanding coverage	7
	Financial interchange expanded coverage further and provided a new source of financing through social security	8
	The Federal Government provides general revenue appropriations to correct funding defect under the interchange	9
	Current account structure blurs responsibility for funding benefits and weakens beneficiaries' protection	11
	Conclusion	12
3	RAILROAD BENEFICIARIES MAY NOT RECEIVE FULL SOCIAL SECURITY EQUIVALENT BENEFITS	14
	No or reduced benefits may be paid in the future	14
	The social security equivalent could be guaranteed with modification to the current structure	15
	Adequate funding needed to ensure beneficiaries receive full benefits	18
	Conclusion	19
	Recommendations to the Congress	19
4	RAILROAD RETIREMENT DOES NOT PAY FULL SOCIAL SECURITY EQUIVALENT BENEFITS TO ALL BENEFICIARIES WHO WOULD HAVE BEEN ELIGIBLE UNDER SOCIAL SECURITY	21
	Some do not receive social security equivalent benefits because of different eligibility requirements	21
	Benefits to remarried widows and divorced spouses	23

		Page
CHAPTER		
	Benefit structure should be realigned so that all social security equivalent benefits are paid	23
	Conclusion	24
	Recommendation to the Congress	24
5	WINDFALL BENEFITS--WHO SHOULD PAY AND WHAT WILL IT COST?	25
	The Congress' reasons for paying windfall benefits in 1974	25
	Our perception of financing windfall benefits	29
	Board's windfall estimates are overstated when reductions in private pensions are considered	31
	Conclusion	33
	Recommendation to the Congress	34
APPENDIX		
I	How paying dual benefits affected the railroad retirement program before 1974	35
II	Projection of amounts which the Railroad Retirement Account will receive from social security through the financial interchange	38
III	The effect of reducing windfall costs by amounts private pension benefits are reduced	39
IV	Our other reports on the Railroad Retirement Board	41

ABBREVIATIONS

GAO General Accounting Office

OMB Office of Management and Budget

CHAPTER 1

INTRODUCTION

The railroad retirement program is the only federally administered pension plan for a private industry. The Railroad Retirement Board, which administers the program under the Railroad Retirement Act, pays benefits of over $4 billion a year to about 1 million retired and disabled employees, spouses, and survivors. It also pays unemployment and sickness benefits to qualified railroad workers and participates in administering the Medicare program for persons covered by the Railroad Retirement Act. This report, requested by the Chairman, House Committee on Government Operations, reviews the evolution of the railroad retirement program and discusses the need for the Congress to improve the financing of and distribution of benefits from the Railroad Retirement Account.

THE RAILROAD RETIREMENT PROGRAM

The railroad retirement program is administered by the Board. The Board's three members are appointed by the President with the advice and consent of the Senate. One member is appointed upon recommendations made by representatives of railroad employees, another upon recommendations of railroad employers, and the third member, who is the chairman, represents the public interest.

The railroad retirement program began in 1935 as a staff retirement plan that provided benefits to retired railroad workers. It did not provide benefits for spouses and only provided small payments to survivors. Over the years, the program added most of the beneficiaries' categories included under social security--disabled workers, spouses, and surviving spouses, children, and parents.

The present benefit structure, established by the Railroad Retirement Act of 1974, is very complex and consists of four components. A beneficiary may receive benefits under one or more of the following components:

--Tier I - Benefits similar to what people receive under social security.

--Tier II - Special industry benefits (similar to a private pension).

--Supplemental - Special industry benefits for long service with a current connection with a railroad. 1/

--Windfall - Benefits to certain persons covered under both social security and railroad retirement.

Funding for each of the benefit categories comes from a different source. Table 1 shows the benefit categories, the type of benefit, and the source of funding.

Table 1

Railroad Retirement Program Benefit Structure (note a)

Benefit title	Type of benefit	Funded by
Tier I	Social security equivalent	Railroad employers' and employees' payroll taxes at social security rate and social security transfers
Tier II	Industry pension	Railroad employers' payroll taxes at 9.5-percent rate
Supplemental	Special industry pension for certain retirees with long service	Taxes from railroad employers based on a fixed rate times hours worked by employees
Windfall	Additional benefits for persons eligible under both the railroad retirement and social security programs	General revenue appropriations

a/Except for supplemental benefits, funds from the above-mentioned funding sources are combined to pay all beneficiaries.

Tier I benefits (social security equivalent)--are similar for the most part to social security benefits. In some cases, however, railroad retirement eligibility requirements differ from those provided under social security. For example, a railroad employee with 30 years of service can retire at age 60, whereas the minimum

1/To receive supplemental benefits, an employee must have at least 25 years of railroad service and a "current connection" which is 12 months of railroad service in the 30-month period of employment before his or her retirement or death.

age under social security is 62. Using the employee's combined railroad and nonrailroad earnings, railroad retirement computes tier I benefits, using the Social Security Act formulas. Since October 1973, both employers and employees pay tier I contributions equal to the social security rate. In 1980, both paid 6.13 percent of an employee's earnings on a monthly basis up to the $22,900 social security annual maximum. 1/

Tier II and supplemental benefits--represent the railroad industry pension (comparable to a private pension). The amount of railroad service is the basis for these benefits. However, only employees who have at least 25 years of railroad service and a current connection with a railroad can receive supplemental benefits. Only railroad employers pay contributions for tier II and supplemental benefits. For tier II, the employer pays 9.5 percent of the employee's taxable earnings. Employers pay $0.125 for each employee-hour worked as a contribution for supplemental benefits.

Windfall benefits--are paid only to persons who met certain eligibility requirements before 1975. Individuals cannot qualify for windfall benefits after 1974 because the law was changed to eliminate them. Before 1975, if employees, retired workers, spouses, and survivors were covered under both social security and railroad retirement and possessed certain other qualifications, they could receive benefits from both programs. Because of certain weighting factors used in computing benefits, these dual recipients receive what came to be called "windfall benefits." These beneficiaries receive a proportionately higher return for their taxes than if they were covered under only one retirement program because of the weighting factors found in the social security formulas. In most instances, these beneficiaries had low lifetime earnings covered by social security and higher lifetime earnings covered by railroad retirement. The social security formulas produce a proportionately higher benefit for low earnings and short-term workers. Before the Congress began authorizing appropriations from general revenues starting in 1976, the effect on the railroad retirement program was costly. (App. I explains how such dual payments affected the railroad retirement program.)

OBJECTIVES, SCOPE, AND METHODOLOGY

The Chairman, House Committee on Government Operations, requested this study. In accordance with his request and later discussions with his office, we (1) obtained data on the cost of Federal assistance to the railroad retirement program and the estimated cost of such assistance over the next 20 years, (2)

1/The 6.13 percent included 1.05 percent for Medicare hospital insurance.

reviewed the Federal role in providing financial assistance to the railroad retirement program, and (3) examined alternatives for funding and administering the program.

Our study tried to address the following:

--What is the estimated cost of continued Federal assistance to the railroad retirement program?

--What is the rationale for Federal assistance to the program?

--What alternatives exist to enable the program to deal with its pending financial crisis?

--What could be done to reduce, limit, or eliminate Federal financial assistance to the program while protecting current and future beneficiaries?

Although most of our work involved interviewing officials and reviewing records and data at the Board's headquarters in Chicago, we made an extensive legislative review of the program. As a result of this effort, in chapter 2, we described the railroad retirement program's transformation from an employee pension plan to a program containing both social security and private pension elements.

In considering alternatives for protecting workers' benefits in chapters 3 and 4, we reviewed the 1972 study of the Commission on Railroad Retirement. 1/ This study was used as the basis for restructuring the program in 1974. The purpose of such a restructuring, in part, was to better identify and separate the social insurance and private pension aspects of the program to help limit future costs. The Congress adopted the Commission's recommendation by enacting the Railroad Retirement Act of 1974. Based on the premise that separating the social security aspect of the program from the private pension could lead to better accountability and possibly limit future Federal costs, we sought ways to accomplish this separation.

In chapter 5, we reviewed the windfall benefits appropriated by the Congress since 1976. Much of the information on the financing of windfall benefits comes from past congressional hearings and documents. Estimates of what future windfall costs will be

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1/"The Railroad Retirement System: Its Coming Crisis," report to the President and the Congress by the Commission on Railroad Retirement (June 30, 1972, House document 92-350).

and when the Account will run out of funds were developed by the Board's actuaries. For this study, we did not review the accuracy of these estimates although we plan to review the actuarial process later. In 1979, we reported to the Chairman, Senate Committee on Appropriations, on the Board's projection of windfall costs and discussed an alternative method. (See p. 41 for a list of our reports on the Board.)

As requested by the Chairman, House Committee on Government Operations, we did not obtain official comments from the Board on the matters discussed in this report. However, the matters covered were discussed with Board officials and their comments are incorporated where appropriate.

Congressional hearings are being planned on some of the matters addressed in this report. In addition, Public Law 96-582 requires representatives of railroad employees and carriers to submit joint recommendations for dealing with the financial problems of the railroad retirement system by March 1, 1981. Because of the pending hearings and joint railroad labor and management report, we believe that drafting legislative language to implement our recommendations would be premature at this time. We will be available, however, to work with the appropriate Commitees in drafting such lanaguage when appropriate.

CHAPTER 2

RAILROAD RETIREMENT PROGRAM HAS CHANGED OVER THE YEARS--

NEED TO REEXAMINE THE GOVERNMENT'S ROLE

The railroad retirement program has changed significantly since it began almost 50 years ago. Originally funded by railroad employers and employees, the program now receives Federal support from the Social Security Administration and annual appropriations from the Congress. From 1951 to 1978, social security provided railroad retirement about $14.9 billion from the social security trust funds. 1/ For fiscal year 1979, the amount was $1.4 billion. To pay windfall benefits, the Congress provided railroad retirement $1.4 billion from general revenues for fiscal years 1976 through 1980. Even with this support, the Railroad Retirement Account is in danger of not being able to pay full railroad retirement benefits.

In view of the evolution of the railroad retirement program, the pending Account shortfall, and increasing windfall costs, the Congress and the railroad industry--labor and management--should determine how best to meet the program's commitments to present and future retired railroad workers. Such effort, we believe, could provide a clearer delineation of the responsibilities of both the railroad industry and its workers and the Federal Government for funding future benefits.

RAILROAD RETIREMENT PROGRAM ESTABLISHED SEPARATE FROM SOCIAL SECURITY PRIMARILY TO ENCOURAGE RETIREMENT

Several factors influenced the Congress' decision to create a federally administered retirement program for railroad workers in 1935. In addition to providing some financial protection for retirees, the Congress believed that such a program would: (1) encourage older railroad workers to retire and thereby provide additional employment opportunities during the Depression, (2) enable railroad retirees to receive benefits sooner than under the social security program, and (3) contribute to efficiency and promote safety in interstate commerce.

The most significant factor appeared to be the Congress' desire to encourage the many elderly railroad workers to retire and provide jobs for unemployed workers during the Depression. Even before the Depression, the average age of railroad workers was higher than the

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1/The $14.9 billion is the excess of benefits over taxes received by railroad retirement plus an allowance for the effect of interest and administrative costs.

rest of the U.S. labor force. During the Depression, the average age of railroad workers increased dramatically because the seniority system was applied. The Railroad Retirement Act of 1935 required mandatory retirement for railroad workers at age 65 and permitted railroad employers to retire disabled workers who had 30 years of service on disability.

The Railroad Retirement Act enabled retired workers to receive benefits beginning in 1937 whereas under the Social Security Act of 1935, which passed a short time before the Railroad Retirement Act, benefits were not scheduled to be paid until 1942. 1/ The Congress exempted railroad employment from coverage under the Social Security Act of 1935.

The legislative history of the Railroad Retirement Act also suggests that some believed a pension plan for the railroad industry would promote efficiency and safety in interstate commerce. Since the 1850s, the Congress, with land grants and Federal charters, had generally treated the railroad industry as a single transportation system and workers as quasi-public servants. The Congress enacted much of the legislation affecting railroad workers because of its perceived effect on commerce. For example, establishing a standard 8-hour workday in 1916 was deemed necessary to promote safety and efficiency in interstate commerce.

PROGRAM BEGAN EXPANDING COVERAGE

At the outset, employers and employees financed the railroad retirement program solely by their contributions. Because the Congress exempted the railroad industry from the Social Security Act, social security provided no funds from its trust funds. From 1937 to 1946, railroad retirement provided benefits primarily to retired workers and small amounts for survivors and provided no benefits for spouses. A special survivors agreement, which employees had an option of selecting, accounted for only 4 percent of the total benefits disbursed between 1937 and 1946.

In 1946, the Congress added regular monthly benefits for the survivors of railroad employees. Social security had included survivors and dependents as beneficiaries since 1940. Railroad retirement's survivor benefits were similar to social security's but about 25 percent higher. In paying survivor benefits, railroad retirement began developing like the social security system which emphasized the social adequacy of benefits rather than basing them solely on career service.

1/Social security actually began paying benefits in 1940.

In 1950, social security liberalized its eligibility requirements to enable millions of new beneficiaries to receive immediate benefits. Also, social security provided a substantial increase in benefits. Whereas in the 1940s railroad retirees received benefits much higher than those under social security, the 1950 social security benefit increases narrowed the margin between these systems. To increase benefits and the number of beneficiaries, railroad labor and management believed that a change in financing the railroad retirement program was needed. As they believed that railroad employers and employees could not pay any higher tax contributions, they submitted legislation to establish a financial interchange between social security and railroad retirement. 1/

FINANCIAL INTERCHANGE EXPANDED COVERAGE FURTHER AND PROVIDED A NEW SOURCE OF FINANCING THROUGH SOCIAL SECURITY

In 1951, the Congress enacted legislation that provided for a financial interchange between social security and railroad retirement. The interchange required that the Social Security Administration determine what it would have paid to railroad beneficiaries if they were covered by social security. If this amount exceeds the taxes received by railroad retirement for such benefits, social security must transfer the difference. If the railroad retirement program receives more in taxes than what is needed to pay railroad beneficiaries, the excess is transferred to social security. In justifying the interchange the Congress reasoned that, in addition to the relatively high number of older workers in the railroad industry, the railroad retirement program had a high ratio of beneficiaries to tax-contributing workers. The Congress concluded that social security had gained by not having the railroad industry under its coverage. For these reasons, the Congress believed that the interchange placed social security in a position where it would neither gain nor lose by excluding the railroad industry from its coverage.

The Congress also passed a provision in 1951 which requires that social security, rather than railroad retirement, pay benefits to employees who retire with less than 10 years of railroad service. This provision and the financial interchange enabled railroad retirement to expand beneficiary coverage and receive revenue from social security.

The interchange agreement between social security and railroad retirement was made retroactive to 1937. Because railroad taxes collected had exceeded benefits paid between 1937 and 1951, railroad

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1/Representatives of employees' unions and railroad companies are permitted by law to submit draft bills to the Congress concerning the retirement program.

retirement owed social security the difference for the earlier years of the interchange. These payments were never transferred 1/ to social security, but were credited toward benefit payments that social security would provide the Account in later years. By fiscal year 1957, railroad retirement's credit balance with social security had been absorbed, and funds were due from social security to the railroad retirement program. For each fiscal year since, the transfer amounts under the interchange have been from social security to the Account because benefits payable exceeded railroad taxes collected. From fiscal years 1957 to 1978, social security transferred about $14.9 billion in benefit payments to railroad retirement. For fiscal year 1979, the amount was $1.4 billion.

The primary reasons for the gains to the railroad retirement program were:

--The substantial increases in social security benefits in the 1950s, 1960s, and early 1970s without corresponding tax increases.

--The decrease in average railroad employment from 1,476,000 in 1950 to 540,000 in 1976, while the number of beneficiaries rose from 484,000 to over 1 million.

As shown in appendix II, the Board estimates that social security will give about $23 billion to the Account over the next 20 years. However, railroad retirement believes that, by 2002, the flow of funds may change in social security's favor. It believes that the ratio of beneficiaries to workers (currently almost 2 to 1) will decline with a stabilized work force.

In addition, through the financial interchange the Board also receives funding for a portion of its administrative expenses from the social security trust funds, predicated on the estimated administrative expenses that social security would have incurred had railroad employment been covered by social security. The Board calculates these administrative expenses from unit cost factors supplied by social security and workload data developed from the sample cases used for the benefits and taxes. For fiscal year 1980, social security provided railroad retirement with $20 million (about 56 percent) of its administrative expenses for that period.

THE FEDERAL GOVERNMENT PROVIDES GENERAL REVENUE APPROPRIATIONS TO CORRECT FUNDING DEFECT UNDER THE INTERCHANGE

The Railroad Retirement Act of 1974 attempted to correct a funding defect under the financial interchange between social

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1/The Railroad Retirement Board did, however, make transfers to social security for the interest on the balance.

security and railroad retirement. Railroad retirement dual beneficiaries' benefits are computed as earned under each system separately (a dual system). The defect occurred because the interchange required that benefit computations for determining the amount of funds to be transferred be based on what social security would have paid if all workers' earnings were under social security (a single system). This resulted in Social Security providing reduced benefit amounts to railroad retirement which were less than what beneficiaries were entitled to receive.

When the Railroad Retirement Act of 1974 became law, the Federal Government began funding a portion of the railroad retirement program for the first time from general revenue appropriations to pay for certain windfall benefits for railroad workers who qualified for coverage under both railroad retirement and social security. Payment of these benefits adversely affected the railroad retirement program because they were in excess of what social security would pay to railroad retirement. Appendix I shows how such dual benefits reduced social security interchange payments to the railroad retirement program.

The Railroad Retirement Act, among other things, provided that after 1974 individuals could no longer earn separate full benefits from both programs that, in total, were greater than benefits they would have earned had all their earnings been credited to only one program. To protect the rights of individuals who had, as of December 31, 1974, earned benefit rights under both programs, the act authorized annual appropriations from general revenues for fiscal years 1976 through 2000 to the Board. These funds would enable railroad retirement to pay the windfall benefits to those currently receiving benefits and those who had earned benefits, but were not yet eligible to receive them.

From fiscal years 1976 to 1980, the Congress provided railroad retirement about $1.4 billion to cover projected windfall costs. Appropriations for each fiscal year were:

Fiscal year	Windfall appropriation
	(millions)
1976	$ 250
1977	250
1978	250
1979	313
1980	313
Total	$1,376

Since the original estimate that $250 million annually would be needed for 25 years to pay windfall benefits, the projected cost has gone up. In fact, the estimates have more than doubled. The Board now estimates that it needs $529 million annually from fiscal years 1981 to 2000. Chapter 5 discusses the impact of rising windfall costs, how current estimates may be overstated, and the need to decide how best to fund future windfall benefits.

Railroad retirement's benefit structure changed

The 1974 act also changed the railroad retirement program's benefit structure. It established two benefit levels--social security equivalent and private pension. Although the purpose of the 1974 change was to revise the benefit formulas, the different levels of benefits which resulted reflected a further change in the railroad retirement's structure by making a distinction between social security equivalent and private pension benefits. Separating the benefits, in effect, appeared to acknowledge the program's ties to social security and that beneficiaries are entitled to social security benefits which are financed by the social security system.

CURRENT ACCOUNT STRUCTURE BLURS RESPONSIBILITY FOR FUNDING BENEFITS AND WEAKENS BENEFICIARIES' PROTECTION

The railroad retirement program has evolved to where it is now probably the Nation's most complex pension program. The program needs restructuring to ensure that beneficiaries will receive promised benefits. The Account soon may be unable to pay beneficiaries all benefits due. If this happens, beneficiaries could receive less than social security equivalent benefits even though employers and employees pay social security equivalent taxes and social security transfers funds to railroad retirement for paying social security equivalent benefits. If the Account cannot pay full benefits, the responsibilities of the Federal Government and the railroad industry are unclear. This is due, in part, to inadequate funds from various sources being commingled in one account with funds for social security equivalent benefits. Restructuring the Account would help clarify the responsibilities of the Federal Government and the railroad industry and could help ensure that adequate funds will be forthcoming.

The Account currently commingles social security equivalent payroll taxes from employers and employees, general revenue appropriations from the Federal Government for paying windfall benefits, payroll taxes from employers for funding the industry's private pension benefits, and amounts transferred from social security for the financial interchange. With such commingling, payments of the social security equivalent benefits are endangered because other sources are not providing their adequate share of financing.

Board officials attribute, among other reasons, the following factors for the Account's financial problems. First, they said that the costs of paying windfall benefits have exceeded the amounts appropriated by the Congress to pay these costs. Second, they said that taxes collected from the railroad industry to pay the private pension are insufficient. Because of these shortfalls, the accountability or liability of the various funding sources can become blurred when the Account's funds are insufficient to pay benefits.

The issue of accountability may soon become even more urgent because the Account has a cash flow problem. The Board projects that its Account may not have enough money to pay all benefits in 1982 and thereafter. In a study of the legal issues which might arise in case of a cash shortage in funds, the Board stated that it appears there would be no liability on the part of the Federal Government if no funds were available to pay benefits other than that specifically provided by the Railroad Retirement Act and the Railroad Unemployment Insurance Act. These acts provide that beneficiaries should receive only those funds generated by the railroad retirement program. Therefore, because funds from some sources are inadequate and combined in the same account with other funds which may be adequate to cover the benefits to which they apply, a situation exists where beneficiaries might not receive their social security equivalent of the retirement benefits. This could occur even though employers and employees pay taxes at the social security rate and Social Security transfers funds to help pay these benefits.

The issue of who is liable for what raises a broader issue in view of the deteriorating financial condition of the program. It involves whether the public confidence in other federally funded programs would be undermined if the Federal Government does not ensure that railroad workers receive the social security equivalent benefits.

In addressing the Account's financial problem, we believe that the Congress could clearly define the Federal Government's role by taking actions which we suggest in chapters 3 and 4 and by resolving the issues discussed in chapter 5. Chapter 5 discusses the complexities which the Congress faces in providing windfall appropriations.

CONCLUSION

The purpose and structure of the railroad retirement program have been fundamentally changed since its beginning. When Social Security continuously increased benefits and liberalized its program, the railroad retirement program could not keep up without major changes in its financing methods because railroad employment was decreasing while the number of railroad beneficiaries was increasing.

The Federal Government has helped the program increase benefits and add more categories of beneficiaries by (1) allowing railroad retirement to interface with and receive support from social security and (2) providing general revenue appropriations to pay for dual benefits. Such assistance, and the need for additional revenues to meet future program liabilities, raise questions as to the Federal Government's role and responsibilities in supporting the railroad retirement program.

In view of the evolution of the railroad retirement program, the pending Account shortfall, and increasing windfall costs, the Federal Government and railroad industry should determine how best to meet the program's commitment to present and future beneficiaries.

The Federal Government, through Social Security, presently insures that the Account receives funds to help pay the equivalent of social security benefits. The Federal Government also funds the windfall benefits. Funding of the private portion of benefits is the railroad industry's responsibility. How the Federal Government can insure that workers receive the equivalent of social security protection and better define its and industry's funding responsibilities are discussed in the following chapters.

CHAPTER 3

RAILROAD BENEFICIARIES MAY NOT RECEIVE

FULL SOCIAL SECURITY EQUIVALENT BENEFITS

Because the Railroad Retirement Account may run short of funds in mid-1982, beneficiaries may not receive their full retirement benefits and could receive less than social security equivalent benefits. This could happen because over the years funding for private pension and windfall benefit components of the railroad retirement program has been inadequate.

For the Nation's work force as a whole, social security benefits are intended to provide all workers with a minimum level of protection when they retire. Industry or other private pensions are expected to supplement this protection. The railroad retirement program structure has evolved to where social security equivalent benefits could provide beneficiaries a basic level of protection, supplemented by the program's private pension benefits. Under the railroad retirement program, however, this minimum level of protection is not guaranteed and beneficiaries' receipt of social security equivalent benefits may be jeopardized because of the shortfalls in the Account. Designating specific funds, such as the social security equivalency transfers, for specific benefits could guarantee a basic level of protection for railroad workers.

NO OR REDUCED BENEFITS MAY BE PAID IN THE FUTURE

Railroad retirement, in a February 1980 "worst case" projection, predicted that the Account will have negative balances in April and May 1982. Then, because of the annual interchange with social security, a positive balance will be maintained until November 1982. The Railroad Retirement Board's February 1980 projection differed from less pessimistic, earlier projections because of higher inflation rates and higher railroad unemployment.

Because employees' and employers' payroll taxes are received on a monthly basis, the Board is considering, if there is a shortage of funds, paying a pro rata benefit based on the amount of funds in the Account on a given date. When new income comes into the Account, the shortfall in past payments would be paid before current obligations. For example, if on June 1, 1982, beneficiaries are paid 75 percent of their benefits, and on June 2, 1982, additional income is received by the Account, the June 1, 1982, beneficiaries would be totally reimbursed before beneficiaries who become eligible for benefits on June 2, 1982.

Although the Congress established the interchange to ensure that the Social Security Administration neither gains nor loses by the exclusion of railroad employment from its coverage, it is possible that railroad beneficiaries may lose and receive less than they would under social security if railroad retirement runs short of funds. At the end of fiscal year 1979, the average monthly benefit for most railroad beneficiaries was $524. This included the social security equivalent, the private pension, and any windfall benefits. The social security portion of the average benefit was $305. When the Account is out of funds, the incoming payroll taxes may not cover the social security portion of the benefits. Board officials said that if funds are not available to pay beneficiaries the amount due, eligible beneficiaries may receive less than the average social security equivalent benefit of $305, and retirees who become eligible during the financial crisis may not receive any benefits.

THE SOCIAL SECURITY EQUIVALENT COULD BE GUARANTEED WITH MODIFICATION TO THE CURRENT STRUCTURE

Railroad retirement has evolved from a program financed solely by railroad workers and employers for the benefit of retired railroad workers to a system which reflects social security, in part, and provides an add-on industry benefit based on wages and years of service. To pay social security equivalent benefits, the program presently receives the railroad employer and employee payroll taxes paid at the social security rate and funds from social security. Also, the 1974 Railroad Retirement Act provides for separation of the private pension from the social security equivalent benefits. Ensuring full social security equivalent benefits as a basic level of protection for beneficiaries would complete the program's evolution and it would then resemble those of other industries in this country--one that establishes social security equivalent benefits as a basic level, supplemented and complemented by industry benefits.

To ensure that beneficiaries will receive social security equivalent benefits, the Congress could establish a separate social security equivalent account within the railroad retirement program. This account would receive the railroad employer and employee payroll taxes paid at the social security rate and the interchange transfers from social security. From the account, the Board would pay the social security equivalent benefits.

A separate social security equivalent account is needed

Currently, the Board commingles funds for the social security equivalent, private pension, and windfall portions of the benefits. When the railroad industry's tax contributions and the Federal windfall appropriations do not fully support their parts of the benefits being paid, the social security equivalent benefits, which are being fully funded, are jeopardized. Even if the private pension and the windfall benefits were fully funded, we see no advantage for linking together in one account all the benefit components. A separate social security equivalent account would provide for a basic level of protection, and the railroad industry could supplement the social security portion in keeping with its ability to pay. The industry pension then would be solely and clearly financed by the railroad industry and could be adjusted or modified as agreed upon by railroad labor and management. This concept is not new.

For example, in 1972 the Commission on Railroad Retirement, whose purpose was to study the railroad retirement system and make recommendations to ensure adequate levels of benefits on an actuarially sound basis, acknowledged the desirability of separating social security equivalent and private pension benefits.

While some of the Commission's recommendations, such as separating the private pension from the social security equivalent benefits and limiting future eligibility for windfall benefits, were incorporated in the legislation proposed by railroad management and labor and became part of the Railroad Retirement Act of 1974, nothing was included in the act to ensure beneficiaries would always receive social security equivalent benefits.

In responding to our proposal for a separate account for the social security equivalent benefits, the Board members agreed that the concept appeared practicable. They felt that, apart from ensuring the social security equivalent benefit, separate accounts for each source of funding would provide the accountability and visibility that are needed to ensure that all benefit components are funded promptly and adequately. For example, they said that the appropriations for windfall benefits have been about $800 million less than needed to pay windfall benefits and that taxes from the railroad industry have been less than needed for paying private pension benefits. With separate accounts, they said it would be more likely that all the funds needed for paying such benefits would be provided because the benefits to be paid would be more clearly and directly attributed to the funding source.

Regarding the estimated $800 million shortfall in funds needed to pay windfall benefits, we show in chapter 5 that the act is unclear on how such estimates should be calculated and that current estimates may be overstated.

In conjunction with establishing a separate social security account, other actions are needed to provide railroad retirement with additional funds and to enable social security transfers of funds to be made on a timely basis. These actions, discussed in more detail below, involve requiring (1) railroad employers and employees to pay the social security tax rate on a yearly rather than monthly maximum earnings base and (2) social security to transfer interchange funds on a current basis.

Need to change tax earnings base from monthly to yearly

If railroad workers are to have the same basic protection as other workers covered by social security, they should be subject to the same tax structure. Presently, the railroad retirement maximum taxable earnings base is different from that used for determining social security payroll taxes.

Railroad workers and employers pay the same payroll tax rate as those under social security. The taxes for railroad workers and employers, however, are applied on monthly rather than yearly maximum taxable earnings. Even though the monthly limit is one-twelfth of the annual limit, the taxes collected for employees who earn more in 1 month and less in another month are less than would be collected using an annual tax base. For fiscal year 1978, the Board estimated that if the yearly rather than the monthly maximum taxable base had been used, it would have collected about $11 million more in taxes.

Consideration should be given to providing interchange funds on a more current basis

Social Security's present method of transferring the interchange funds only once a year after the end of the fiscal year in which the Board has already paid the benefits, has caused a serious cash flow problem and contributed to the Account's current financial condition. If a separate interchange account is established for social security equivalent benefits, providing interchange transfers on a more current basis would help to alleviate the cash flow problem.

Social Security now provides railroad retirement with funds to pay benefits about 9 months after the end of the fiscal year in which railroad retirement has already paid the benefits. The Board believes that the delay in receiving these interchange funds is unfair and that, in effect, it lends funds to social security. One Board member said that a separate account for the social security benefits would be meaningless unless the transfer of funds from social security was placed on a monthly basis. To change from a yearly to a monthly basis, social security would be required to provide a one-time payment to railroad retirement of about $1.5 billion to eliminate the time lag. The Board believes that this $1.5 billion would keep its Account financially stable for several more years under the system of commingling funds in the same account.

Although the $1.5 billion represents just slightly more than 1 percent of the $118 billion that social security is expected to pay in benefits in fiscal year 1981, we recognize that such a one-time payment may create a temporary financial hardship for the social security retirement trust fund. The trustees of the social security retirement and disability trust funds informed the Congress in June 1980 that the retirement trust fund was in financial trouble. At this time, we do not know what impact a one-time payment of $1.5 billion would have on the fund. Because social security would have to provide funds on a current basis if there were no railroad retirement program, such a one-time transfer warrrants consideration.

A bill, which was introduced on September 24, 1980, but not enacted, would have placed the financial interchange on a current basis. One way to alleviate the impact of a one-time payment and still allow social security to transfer funds on a current basis would be for social security to provide partial payments until the account is current.

ADEQUATE FUNDING NEEDED TO ENSURE BENEFICIARIES RECEIVE FULL BENEFITS

For beneficiaries to receive their other railroad retirement benefits in addition to the social security equivalent, other changes would have to be made to ensure adequate funding for the industry private pension and windfall benefits.

In our view, there are no easy choices in providing adequate financing for the private pension portion. The basic alternatives are increasing taxes, reducing benefits, finding additional revenue sources, or finding ways to reduce costs through administrative changes. Historically, railroad labor and management, through collective bargaining, propose legislation which deals with the administration and financing of the railroad retirement program. H.R. 5144, introduced in August 1979 and sponsored by railroad labor, contained provisions designed to improve railroad retirement's financial condition. One of the significant provisions would have revised benefit formulas and addressed any remaining deficit through a fluctuating employer tax based on the balance in the fund. Railroad management opposed certain aspects of labor's provisions. No action was taken on this bill. Another bill, proposed by the Office of Management and Budget, but never introduced in the Congress, had similar as well as other provisions directed toward the same objective of increasing railroad retirement revenues. We anticipate additional legislation will be proposed by railroad management and labor before the national rail contract, which specifies wage rates and fringe benefits, expires in April 1981. The Congress passed Public Law 96-582 in December 1980 requiring railroad management and labor to submit, by March 1981, recommendations to resolve the financial problems facing the retirement system.

While we do not advocate what the benefits should be, who should fund them, or how they should be funded, we believe that the Congress should consider requiring that any proposals which will affect the private pension benefits clearly show what the effect will be and how the industry will finance any additional revenues needed.

CONCLUSION

The railroad retirement program has been inadequately funded, and beneficiaries may receive no benefits or may receive less than their social security equivalent benefits as early as 1982. A primary reason for the overall inadequate funding is that funds from railroad employers and the Federal Government for other benefits--private pension and windfall--have not been adequate to cover benefits paid. Commingling all funds in one account blurs the accountability of each funding source for providing what is needed. Establishing a separate account for social security equivalent benefits would help ensure that beneficiaries will at least receive the equivalent of social security benefits. Windfall and private pension funds and benefit payments should be accounted for separately.

Guaranteeing railroad workers the equivalent of social security benefits will require several other changes. Payroll taxes should be on an annual rather than monthly maximum tax base and interchange transfers from social security would have to be made more current. We believe that equity justifies such a tax base change--it would place railroad workers and the industry in the same position as others that pay the social security payroll tax. Proposing that social security transfer the interchange funds on a current basis is not so readily justified, however, since to do so would require social security to provide a one-time payment of $1.5 billion. One way to alleviate the impact on the social security trust fund of such a one-time payment, and still allow social security to transfer funds on a current basis, would be for social security to provide partial payments until the account is current.

These changes would not only ensure that beneficiaries will receive the equivalent of social security benefits, but also that funds transferred by social security will not be used for windfall or private pension benefits. Adequate funding of private pension benefits and windfall benefits is necessary if beneficiaries are to receive their full retirement benefits.

RECOMMENDATIONS TO THE CONGRESS

To ensure that railroad beneficiaries receive social security equivalent benefits and that railroad employers and employees assume the same tax responsibilities to support these benefits as those under social security, the Congress should enact legislation to:

- --Establish a separate account for social security equivalent benefits and require that funds from social security transfers and employers' and employees' payroll taxes for social security equivalent benefits be placed in the account and be used only to pay the social security equivalent benefits.

- --Require that railroad employers and employees pay taxes for the social security equivalent benefits based on annual rather than monthly maximum taxable earnings as do employers and employees under social security.

We are not recommending that the Congress act to put the interchange transfers on a current basis because of the potential adverse impact on the social security trust fund at a time when that fund is also in financial trouble. We suggest, however, that as part of its evaluation of the financial condition of both funds, the Congress consider the merits of a more current interchange transfer.

CHAPTER 4

RAILROAD RETIREMENT DOES NOT PAY FULL SOCIAL SECURITY EQUIVALENT BENEFITS TO ALL BENEFICIARIES WHO WOULD HAVE BEEN ELIGIBLE UNDER SOCIAL SECURITY

In paying the social security equivalent benefits, the Railroad Retirement Board uses the eligibility requirements specified in its legislation rather than those of the Social Security Administration. As a result, railroad workers' remarried widows and divorced spouses receive no benefits from railroad retirement. Other beneficiary groups whose eligibility for benefits under railroad retirement differs from those under social security, nevertheless, in most cases, receive all the benefits they would have received if covered by social security because of railroad retirement's benefit provisions.

If the social security equivalent benefits are to provide a basic level of protection for beneficiaries, the railroad retirement program's eligibility criteria and benefit structure would have to be changed for railroad retirement to pay full social security equivalent benefits to all beneficiaries who would have been eligible under social security. Such a change also would insure that remarried widows and divorced spouses who would have received benefits if covered under social security but who do not under railroad retirement, receive benefits.

SOME DO NOT RECEIVE SOCIAL SECURITY EQUIVALENT BENEFITS BECAUSE OF DIFFERENT ELIGIBILITY REQUIREMENTS

Although the social security equivalent is a basic benefit component in the railroad retirement program, some beneficiaries do not receive it and some others only receive part of it. This happens because some of railroad retirement's eligibility requirements are different than social security's requirements. When social security transfers funds to railroad retirement under the financial interchange, it does so based on what it would have paid to the beneficiaries had they been covered under social security. Therefore, the transfer includes amounts social security would have paid to certain groups, such as remarried widows and divorced spouses. However, under the railroad retirement program, remarried widows and divorced spouses are not eligible for benefits and, therefore, they receive none from either railroad retirement or social security. For fiscal year 1978, the Board received from social security but did not pay $4.2 million for remarried widows and divorced spouses.

Some other beneficiary groups (retirees resuming work who earn less than certain amounts, spouses of disabled workers, and children of retired or disabled workers) are not paid all the benefits transferred by social security for them. They do receive, however, in most cases, at least what they would have received under social security. This is because the Board pays portions of the social security equivalent benefits along with a private pension benefit to ensure certain benefit amounts for some families. This provision is called the "100 percent guaranty." The guaranty requires that the Board pay families whose members would be eligible for benefits under social security but who are not eligible under railroad retirement coverage, at least the same amount of benefits that would have been payable under social security. Consequently, children, and the spouses of disabled workers receive at least what they would have received under social security and so do retirees resuming work, except for the month in which they return to work. 1/

The following shows the beneficiary groups for which, and circumstances under which, the Board receives funds from Social Security which it does not pay as social security equivalent benefits because of differences in eligibility requirements.

--Retirees resuming work: Railroad retirement and social security programs pay full benefits to retirees who resume or continue to work after retirement if their earned income does not exceed specified amounts. If earned income exceeds the specified amounts, benefits are reduced. Under the railroad retirement program, however, a retiree and spouse cannot receive any retirement benefits for the month in which the employee returns to work for, and receives earnings from, a railroad or his or her last nonrailroad employer. Social Security has no such restriction and reduces benefits only when a retiree's earned income exceeds the specified amounts.

--Children of retired or disabled employees: The Board does not pay dependent children of retired or disabled employees but Social Security does.

--Spouses of disabled employees: Under the railroad retirement program requirements, spouses of disabled employees are eligible for benefits only when the employee reaches age 62 (except if the employee has 30 years of railroad service in which case the spouse is eligible when the disabled employee reaches age 60). Social Security provides

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1/Retirees resuming work for a railroad or his or her last nonrailroad employer do not receive benefits for the month in which they return to work.

benefits to spouses aged 62 or older of disabled employees regardless of the age of the employee.

--Remarried widows and divorced spouses: The Board pays no benefits for remarried widows and divorced spouses. Social Security pays benefits to divorced spouses if the marriage was for at least 10 years and pays remarried widows if remarriage occurs after age 60.

To establish the social security equivalent benefits as a basic level of protection, with private pensions as a supplement, certain actions must be taken to adjust railroad retirement's eligibility requirements. First, remarried widows and divorced spouses should receive benefits, and second, the benefit structure should be realigned so that all social security equivalent benefits are paid. These actions, in conjunction with those discussed in chapter 3, would tend to simplify the benefit determination process and ensure that railroad retirement beneficiaries are treated as if they were covered under social security.

BENEFITS TO REMARRIED WIDOWS AND DIVORCED SPOUSES

Remarried widows and divorced spouses receive no benefits because they are not covered under railroad retirement's eligibility requirements. Remarried widows became eligible for benefits under social security in 1977 and divorced spouses have been eligible since 1965. A Board official told us that, historically, the railroad retirement program expands its beneficiaries' coverage to match that of social security. However, in the case of remarried widows and divorced spouses, this has not yet been done. The Board would have to revise its eligibility requirements to allow that remarried widows and divorced spouses who would have received benefits under social security receive them under railroad retirement.

A bill, H.R. 7045 introduced in April 1980, but not enacted, contained provisions for remarried widows' and divorced spouses' benefits under the railroad retirement program. A Board official said it has not yet determined how many remarried widows and divorced spouses would receive benefits if the eligibility requirements were changed.

BENEFIT STRUCTURE SHOULD BE REALIGNED SO THAT ALL SOCIAL SECURITY EQUIVALENT BENEFITS ARE PAID

The benefit structure should be adjusted in such a way that the private pension complements the social security equivalent benefits. In doing so, the railroad retirement program should pay each beneficiary the benefit for which Social Security provides funds through the interchange. This would involve ensuring that not only remarried widows and divorced spouses, but retirees who return to work, children of retired or disabled workers, and spouses of disabled workers receive social security equivalent benefits, since funds for these benefits are provided by social security. This may require other adjustments in similar benefits currently paid as industry pension benefits. For example, under social security, a worker cannot retire at age 60 with 30 years of service and receive social security benefits. Railroad workers can retire at age 60 with 30 years of service and receive benefits from the railroad retirement program. If the Board retains this benefit, it should be considered an industry benefit and funds to finance it should come solely from the industry's private pension account.

The Board's members indicated that negotiations involving railroad labor and management and the Congress would be needed to adjust the present eligibility criteria, benefit formulas, and structure. We believe the relationship of how the private pension should fit with full social security benefits could be addressed at that time.

CONCLUSION

If it is the intent of the Congress that all persons who would have been covered under social security receive full social security equivalent coverage under railroad retirement, and it seems that the Congress was headed in that direction when the 1974 legislation established the tier I or social security equivalent benefits, then the railroad retirement program's eligibility criteria and benefit structure should be revised. Such revision would (1) insure that remarried widows and divorced spouses receive benefits as do their counterparts under social security and (2) enable other beneficiary groups, such as retirees resuming work, children, and spouses of disabled workers, to receive full social security equivalent benefits.

RECOMMENDATION TO THE CONGRESS

We recommend that if it is the intent of the Congress that all persons who would have been covered under social security, except for the railroad retirement program, receive full social security equivalent coverage under railroad retirement, the Congress should pass legislation revising the railroad retirement eligibility criteria and benefit structure to ensure payment of such benefits.

CHAPTER 5

WINDFALL BENEFITS--WHO SHOULD

PAY AND WHAT WILL IT COST?

Since the Congress agreed to pay windfall benefits in 1974, the estimated annual cost has doubled from $250 million to an estimated $529 million needed annually from fiscal years 1980 to 2000. In view of congressional concern about increasing windfall costs, the Congress may wish to reconsider tapping the alternative funding sources it considered and rejected in 1974--railroad employees and employers and social security--as well as the option to eliminate such benefits. However, most of the reasons the Congress gave for not selecting those alternatives are still valid today. One reason--the railroad industry's questionable ability to share the responsibility--could be reevaluated in light of events since 1974.

If the Congress decides that continued appropriations for windfall benefits are appropriate, the issue then becomes how much of the windfall costs does the Government want to finance. The Railroad Retirement Act contains certain offset provisions which reduce retirees' private pensions when they receive dual benefits. These offsets were imposed beginning in 1966, in part, to reduce the railroad retirement program's loss stemming from windfall benefits being paid. If the intent of the Congress is to cover only net windfall benefits, that is, after offsets to the private pension are considered, then the latest Railroad Retirement Board's estimate of $529 million needed annually from fiscal years 1981 to 2000 may be overstated by about $107 million per year.

THE CONGRESS' REASONS FOR PAYING WINDFALL BENEFITS IN 1974

When the Congress passed the Railroad Retirement Act of 1974 to fund that portion of a dual benefit which exceeds what social security would pay but to which the retiree is entitled, it concluded that general revenue appropriations were the fairest method of paying the phase out costs of windfall benefits. The Board at that time estimated that it would need $250 million a year in appropriations for 25 years to pay windfall benefits. Our legislative research indicates that the Congress believed that, because it did not restrict dual benefits in the 1951 amendments or later legislation, it was, therefore, the Federal Government's responsibility to correct this mistake. For example, the House Committee on Interstate and Foreign Commerce report 1/ states:

1/House Committee on Interstate and Foreign Commerce, (Rept. No. 93-1345, Aug. 29, 1974).

"The deficit caused by dual benefits occurred because of congressional action (1) liberalizing benefit eligibility under social security and (2) repealing restrictions on dual benefits. Following the precedent with respect to military service free wage credits, the Committee proposed that appropriations be made to cover the costs of phasing out dual benefits which had been provided by congressional actions."

The Senate Committee on Labor and Public Welfare reached a similar conclusion.

During the 1974 legislative discussions, the Congress considered other financing alternatives but rejected them. These were

--increasing tax rates for railroad employees and employers,

--eliminating windfall benefits of recipients, and

--requiring social security to provide additional funds.

Increasing taxes of employees and employers rejected as a source of funding

The Congress rejected increasing the payroll taxes of employees and employers. As to employees, both the House Committee on Ways and Means and the Senate Committee on Labor and Public Welfare concluded that additional taxes would be unfair. More specifically, the House Committee on Interstate and Foreign Commerce report 1/ states:

"Additional taxes on current and future employees would be unfair because current employees (except where vested rights were involved) would be required to pay for other people's benefits that they themselves could not receive."

The prevalent view in the Congress was that increasing taxes on employers (railroads) would have an inflationary impact on the economy. For example, the report of the House Committee on Interstate and Foreign Commerce states that:

"* * * in contrast to the alternatives suggested of raising additional revenues from the railway community, it does not create a situation which would favor generally increased prices. In this connection, the Committee would point out that increases in cost

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1/Ibid.

to railway employers require increases in railway shipping charges which are passed along at nearly all stages of production with a compounding effect on prices which may be many times the rate of increase in railway shipping costs.

"Imposition of additional taxes upon the carrier to finance the cost of phasing out dual benefits would add to the costs of the railroads, leading to justifiable applications for freight rate increases to cover these costs. In the Committee's view, such a course of action, though recommended by the Office of Management and Budget as an alternative method of financing these costs, would prove more inflationary in its effects than provisions of the bill as reported."

The Senate Committee on Labor and Public Welfare's report contains similar conclusions concerning the inflationary impact of increasing taxes for railroads to phase out windfall benefits. In addition, the Congress believed that the financial condition of the railroad industry made it necessary to relieve the industry of costs which would burden its ability to compete with other transportation modes.

On the other hand, the Office of Management and Budget did not agree about the adverse effects of tax increases. In its reports to the Committees, it acknowledged that the increased taxes might immediately be passed on to the consumer. However, it thought that the cost of the railroad retirement system should be a part of the industry's cost which its users should bear as is the case in other sectors of the economy and indeed other parts of the transportation industry. It believed that competition with other transportation modes would provide a better moderator of benefits and costs than a subsidy.

Eliminating windfall benefits rejected as an alternative

The Congress rejected eliminating windfall benefits as a way for dealing with the problem because it felt it would be unfair to beneficiaries. The Senate Committee on Labor and Public Welfare's report 1/ states:

"Cutting off the benefits to those already receiving or legally entitled to them would clearly be inequitable. These individuals have a right to receive those benefits the law has led them to rely upon or expect."

1/Senate Committee on Labor and Public Welfare, Report No. 93-1163, September 23, 1974.

In its report, the House Committee on Interstate and Foreign Commerce 1/ concludes:

> "Dual benefits were not equitable, but the equities of existing beneficiaries and employees with claims to them had to be preserved because these people merely secured benefits to which they were entitled under law."

Requiring Social Security to provide additional funds rejected as a source of funding

The Congress considered requiring the Social Security Administration to provide additional funds as a source of funding for windfall benefits, but rejected this alternative. Railroad management and labor had proposed legislation that would require the social security trust funds to pay the cost of phasing out windfall benefits. During the hearings before the House Committee on Interstate and Foreign Commerce, the chief railroad negotiator stated that, in part, the dual benefit problem arose from a defect in the social security law, and it was, therefore, appropriate that the expense of the correction should be incurred by the social security program. He said that railroad employees had been legally permitted, as no other workers could, to qualify for, in substance, two social security benefits--one as a component of their railroad retirement benefit and one as a regular social security benefit based on nonrailroad earnings. Although both were basically social security benefits, the costs of the windfall portion (the excess of the two separate benefits over the benefit based on combined earnings) had been charged to the railroad retirement program and played a major role in the projected financial crisis of the program. He said that because the windfall amount is part of the social security element of the railroad employee's benefit and arises by virtue of nonrailroad employment covered by the Social Security Act, windfalls should be paid from the social security trust funds.

Officials of the Department of Health and Human Services and Social Security testified against the provision. They argued that, under the financial interchange, the social security trust funds had not gained. Instead, more than $8 billion had been transferred to the Railroad Retirement Account, without which it would have been exhausted. They said the interchange provision was included in the Railroad Retirement Act of 1951 at the initiative of the railroad sector and was apparently considered to be an equitable provision for more than 20 years. They reasoned that to require that social security transfer two weighted benefits

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1/Ibid.

to the railroad retirement program would place the social security trust funds in a far worse position than they would have been in if railroad employment had been covered under social security. The officials noted that the argument that social security should pay the equivalent of two weighted benefits rather than one benefit based on combined earnings conflicted with the basic social security concept that no worker could come into the program twice and draw separate weighted benefits.

The Office of Management and Budget (OMB) opposed paying the windfall phaseout costs from the social security trust funds or from general revenues because it opposed treating the problems of the railroad retirement program as the responsibility of social security taxpayers or anyone else other than the employers and employees of the railroad industry. Instead, OMB recommended that some combination of benefit limitations and increased railroad taxes be used to solve the program's financial problems.

The House Committee on Ways and Means also opposed social security funding of the phaseout costs, and the Committee on Interstate and Foreign Commerce amended the bill to provide the general revenue appropriation instead.

OUR PERCEPTION OF FINANCING WINDFALL BENEFITS

Faced with escalating windfall costs in past years, the Congress, at the request of OMB, has held appropriations below the Board's estimates of amounts needed to pay windfall benefits. The following table compares the Board's projections of needed windfall amounts and requested appropriations with actual amounts which the Congress has provided from fiscal years 1976 to 1981.

Fiscal year	The Board's estimates (note a)	Requested appropriations	Actual appropriations
	(millions)		
1976	$250	$250	$250
1977	350	250	250
1978	356	250	250
1979	363	313	313
1980	363	313	313
1981	529	350	350

a/The amount shown in this column is railroad retirement's revised annual estimate of the amount needed each year, on a level basis, from the year of the estimate to the year 2000, to cover expected windfall benefit costs.

Although the Board's estimates of needed windfall appropriations have increased from $250 million for fiscal year 1976 to $529 million for fiscal year 1981, the budget requests for appropriations since fiscal year 1977 were less than the estimates. For fiscal years 1977 to 1980, the appropriations requested were less than the Board's estimates primarily because OMB was studying the windfall issue and had proposed legislation that would reduce such benefits. For example, the Board said it requested only $313 million for each of fiscal years 1979 and 1980 because OMB intended to propose legislation that would, for workers retiring after 1978, (1) no longer index initial windfall benefits for cost-of-living increases and (2) eliminate the applicability of a minimum benefit provision when calculating windfall amounts. Draft legislation was transmitted to the Congress but was never introduced. For fiscal year 1981, the Board's request for appropriations was less than it said it needed for windfall benefits because OMB proposed legislation placing a cap of $350 million on windfall appropriations.

Failure to resolve the windfall financing issue, we believe, will further jeopardize the railroad retirement program. We believe that the key element in this issue is whether the Federal Government is willing to fund solely the windfall costs or whether it will require an alternative source to pay all or part of the cost.

Most of the reasons the Congress gave in 1974 for not selecting alternative funding sources were based on public policy considerations which are still valid today. For example, the Congress believed that cutting windfall benefits was unfair to beneficiaries and raising employees' payroll taxes would be unfair to current workers. Taxing employers was rejected because of the railroad industry's financial instability and the potential impact of higher freight rates on inflation. This alternative, in particular, could be reexamined to determine if conditions have changed since 1974.

If the Congress decides that continued appropriations for windfall benefits are appropriate, the issue then becomes how much of the windfall costs does the Government want to finance. The Congress believed in 1974 that because the Congress never prohibited or restricted payment of dual benefits, the railroads should not have to pay windfall costs. Yet our study indicates that for railroad retirement benefit increases in 1966, 1968, and 1970, which were predicated on earlier social security increases, the Congress did provide for offsets in the private pension. This has reduced total windfall costs for the Account by about 20 percent.

Because the Congress did limit benefit increases to windfall recipients in 1966, 1968, and 1970, which has resulted in offsetting windfall payments by about 20 percent through reductions in private pension benefits, one could conclude that the Federal Government is responsible for only about 80 percent of the amounts projected by the Board. The rationale for such a conclusion is discussed in the following sections.

BOARD'S WINDFALL ESTIMATES ARE OVERSTATED WHEN REDUCTIONS IN PRIVATE PENSIONS ARE CONSIDERED

The Board's latest windfall estimate may exceed the actual cost of net windfall benefits because, in determining the amounts needed, railroad retirement does not consider reductions made in the beneficiaries private pension when they are receiving dual benefits. We estimate that, if reductions made in the private pension were included in the Board's estimate of $529 million per year, the projected windfall cost would be reduced by about $107 million per year (see app. III), or by about $2 billion from fiscal years 1981 to 2000.

The language contained in section 15(d) of the Railroad Retirement Act is silent as to whether the appropriated funds for windfall benefits are for gross windfall amounts paid to beneficiaries or actual windfall costs to the railroad retirement program. Board officials informed us that they interpret the act to mean that windfall appropriations should be for the total costs without consideration of reductions.

Reductions made in private pension portion of benefits

Earlier amendments to the Railroad Retirement Act in 1946 and 1951 required that railroad retirement reduce the private pension portion, in certain cases, when social security benefits were received. In later legislation, these offsets were repealed. However, when the Board increased benefits in 1966, 1968, and 1970, following social security's increases in 1965, 1967, and 1969, the Congress limited the railroad benefit increases of those beneficiaries who were also receiving social security benefits. For the 1968 and 1970 railroad benefit increases, retirees were limited to an increase of no more than $10 a month and survivors to an increase of no more than $5 a month. For most railroad beneficiaries who also receive social security benefits, these limitations constitute reductions in their private pension portion of the benefits. These limitations were not repealed; therefore, today many railroad retirees' and their dependents' private pension portion of the benefits are reduced when they receive social security benefits.

The Congress said, in its 1974 discussion of the act, that its failure to earlier impose reductions in other benefits received when persons received windfall benefits was a justification for the Government to begin paying windfall benefits. The Congress, however, cited other reasons for the Government's assuming windfall costs, such as the inflationary impact of having the railroad industry provide the funds. If the Congress' primary intent was to limit windfall appropriations to the net costs incurred by the railroad retirement program, the Board's latest estimate is overstated. Railroad labor and management do not believe that it is the industry's responsibility under the 1974 act to pay any portion of windfall costs.

Reductions are not reflected in railroad retirement's latest projection

The Railroad Retirement Act of 1974 specifies that the Board calculate and recommend the amount of windfall cost to be appropriated each fiscal year. It does not specify how the cost should be calculated. The Board estimates and requests the amount of windfall it will pay without regard to any reduction that will be made in industry benefits. The Board's 14th triennial valuation of the program revised its earlier estimates and projected that from $499 million to $529 million a year, depending upon the assumptions used, would be needed to finance windfall benefits from fiscal years 1981 to 2000. The Board's projection was based on

--a larger number and amount of windfall benefits than anticipated in 1976,

--use of economic assumptions which result in decreasing interest rates,

--lower mortality rates,

--shortfalls in 1979 and 1980 appropriations,

--increased widow windfalls resulting from 1976 amendments to the Railroad Retirement Act,

--increased projections for future spouse windfalls, and

--increased lost interest on shortfalls in 1977 and 1978 appropriations.

The estimate of $499 million assumed no inflation after 1980. When the Board assumed continuous inflation until the year 2000, the estimate increased to $529 million. However, in its estimates, the Board did not consider the reduction in the private pension when windfall benefits are paid.

CONCLUSION

The Federal Government, in the Railroad Retirement Act of 1974, agreed to provide annual appropriations to finance the phaseout cost of windfall benefits. At that time, the Congress believed that windfall appropriations would be about $250 million annually for 25 years. However, estimates, as well as annual appropriations, have risen steadily since 1974. The Board now projects that it will need $529 million annually from fiscal years 1981 to 2000 to pay windfall benefits. In view of congressional concern about mounting windfall cost, the Congress may wish to consider alternative funding sources it considered and rejected in 1974.

Two of the alternatives for resolving the windfall issue, which the Congress considered and rejected, involve decisions that are largely matters of public policy. These alternatives are (1) eliminating windfall benefits and (2) requiring Social Security to provide additional funds. The Congress rejected increasing railroad employees' taxes because it believed it unfair to require current workers to finance a benefit they would never receive. Requiring increased taxes for railroad employers was also rejected, in part, because of congressional concerns that the resulting increased freight rates would have an adverse impact on inflation and the railroads' financial stability. This alternative could be reexamined to determine if conditions have changed since 1974.

Apart from reviewing alternative funding sources, the Congress should consider another aspect of the windfall issue. The Board does not consider a significant factor when estimating its windfall costs. We found that, when retirees and dependents receive windfall benefits, in most cases, their private pension portion of the benefits is reduced. These reductions decreased the railroad retirement program's loss from windfall benefits being paid. If the annual Federal appropriation were predicated on only the amount that the Board pays out as a result of windfall benefits (windfall cost less the private pension offset), the Board's estimate of $529 million needed from fiscal years 1981 to 2000 is overstated by $107 million a year, or about $2 billion for the 20-year period.

If the Congress decides that continued appropriations for funding windfall benefits are in the Nation's best interest, the Congress could still require that requests for appropriations be reduced by the extent reductions in the private pension reduce the Board's windfall costs. However, if the Federal Government funds only net windfall costs, the railroad industry will have to either increase contributions or private pension benefits will have to be reduced.

RECOMMENDATION TO THE CONGRESS

In view of events since 1974, we recommend that the Congress reevaluate the issue of how to finance windfall benefits, and that as part of such evaluation it decide to what extent the Federal Government should fund windfall costs.

HOW PAYING DUAL BENEFITS AFFECTED THE RAILROAD RETIREMENT PROGRAM BEFORE 1974

The problem of dual social security and railroad windfall benefits and its effect on the Railroad Retirement Account can be traced to the 1951 establishment of the financial interchange arrangement between the railroad retirement and social security program. As discussed in chapter 2, the financial interchange requires that the Social Security Administration determine what it would have paid to railroad beneficiaries, if railroad workers were covered by social security. If this amount exceeds the taxes received by the Board from railroad employers and employees for such benefits, Social Security must transfer the difference. If such taxes collected are more than what is needed to pay railroad beneficiaries, the excess is transferred to Social Security. Although financing was coordinated, benefits, for the most part, were not. Individuals eligible under the provisions of each program received benefits calculated under the provisions of each program, without adequate consideration of whether the financial interchange adequately funded the benefits. Originally, payments to dual beneficiaries were not expected to cause a financial problem.

Payment of dual benefits, however, reduced the social security payments to the railroad retirement program from the financial interchange. When a railroad beneficiary received a separate social security benefit, Social Security reduced its payments to the Board to avoid paying duplicate benefits on the same earnings. Therefore, the Board had to pay a greater portion of the railroad retirement benefits.

The following hypothetical example illustrates the loss of funds to the Account from the financial interchange when an employee was entitled to dual benefits. Assume that retirees A and B had the same amount of retirement service and earnings and are entitled to a monthly benefit of $370, but retiree B also had enough social security coverage to qualify for social security benefits. Based on their service and earnings, retirees A's and B's benefits are as follows:

	Retiree A Railroad service only	Retiree B Railroad service and social security earnings
Benefits:		
Railroad retirement	$370	a/$350
Social security	-	84
Total benefit due	$370	$434

a/Although both retirees had identical amounts of railroad service, retiree B's railroad benefit was reduced $20 because regulations require a reduction in railroad benefits when social security benefits are also being paid. (The offset amount varies.)

The next table shows the transfer of social security payments to the Account for both retirees. Under the financial interchange, and using our hypothetical example, Social Security would pay the Board $220 of retiree A's $370 total benefit, but only $156 of retiree B's benefit, a difference of $64. The $220 is the benefit which retiree A would receive if all his services had been covered under Social Security. (In this example, the other $150 would be paid by railroad retirement program for the special industry tier II or supplemental benefits.) The purpose of the financial interchange is to place the social security trust funds in the same position as if railroad employment were under social security. For retiree B, Social Security would pay the Board a lesser amount because of dual benefits. To compute this payment, Social Security combined both railroad and nonrailroad earnings to derive an amount of $240. Note that retiree B's benefit of $240 is higher than retiree A's because of combined social security and railroad earnings. Social Security would then deduct $84, the actual social security benefit it pays to retiree B, from the $240 which he would have received if all earnings were covered under Social Security. Through the financial interchange, Social Security would pay the Board $220 for retiree A and $156 for retiree B.

	Retiree A Railroad service only	Retiree B Railroad service and social security earnings
Financial interchange social security benefit owed railroad retirement	$220	$240
Social security benefit paid retiree by the Social Security Administration	-	-84
Amount transferred from social security to railroad retirement	$220	$156

The next table shows the net loss to the Board from the financial interchange because retiree B is receiving a social security benefit. Social security's payment to the Board of $156 and the $20 reduction in benefits that occurred because the beneficiary also receives social security provide the Board with $176 to pay retiree B's benefit. If all of retiree B's earnings had been solely under railroad retirement, social security would provide the Board with a $240 payment. Therefore, the net loss to railroad retirement in this example is $64 which is the difference between $240 and $176.

	Retiree A Railroad service only	Retiree B Railroad service and social security earnings
Social security total payment to railroad retirement	$220	$156
Savings to railroad retirement when dual benefit was paid	-	20
Total amount available to railroad retirement	$220	$176
If all of retiree B's earnings had been solely under railroad retirement		$240
Total social security payment and reduction		$176
Loss to railroad retirement because of dual benefit		$ 64

PROJECTION OF AMOUNTS WHICH THE RAILROAD RETIREMENT ACCOUNT WILL RECEIVE FROM SOCIAL SECURITY THROUGH THE FINANCIAL INTERCHANGE

The table below shows the amounts the Board projects will accrue to the Account from the Old-Age, Survivors, and Disability Insurance trust funds from 1980 through 2000. The amounts do not include interest to the time the transfers are made or allowance for administrative expenses.

The amounts payable to the Account are expected to decline largely because the ratio of beneficiaries to active employees (currently almost 2 to 1) is expected to decline. By the year 2002, the Board estimates that amounts will be accruing to the Old-Age, Survivors, and Disability Insurance trust funds and will continue that way in later years.

Calendar year	Amount accruing to the Account
	(millions)
1980	$ 1,434
1981	1,405
1982	1,444
1983	1,468
1984	1,492
1985	1,426
1986	1,452
1987	1,469
1988	1,480
1989	1,476
1990	1,238
1991	1,185
1992	1,114
1993	1,023
1994	925
1995	824
1996	713
1997	588
1998	447
1999	310
2000	172
Total	$23,085

THE EFFECT OF REDUCING WINDFALL COSTS BY AMOUNTS PRIVATE PENSION BENEFITS ARE REDUCED

Based on information obtained from the Board, it appears that the private pension portion of the benefits are reduced about 23 percent when windfall benefits are paid. The table below demonstrates the impact of reductions on projected windfall costs. To compute the projected windfall costs, we applied the 23-percent reduction factor to 88 percent of railroad retirement's estimated windfall costs. (Survivors' benefits are not reduced when they receive windfall benefits. We estimate that the cost of paying survivors constitutes about 12 percent of the estimated windfall costs.)

Calculation of amount of windfall costs offset by reductions in private pension benefits

	(millions)
Railroad retirement windfall cost estimate	$529
Less 12 percent for survivors benefits not subject to offset (529 x .12)	-63
Total estimated windfall benefits subject to offset	$466
Estimated offsets to private pension for windfall recipients	x .23
Total estimated windfall offsets to private pension benefits	$107

Calculation of estimated net windfall cost to railroad retirement

	(millions)
Railroad retirement windfall cost estimate	$529
Less estimated windfall offsets to private pension benefits	-107
Estimated net windfall cost	$422

The estimated annual windfall offset to private pension benefits of $107 million is 20 percent of the Board's estimated annual windfall cost. Using the $107 million difference in projected windfall cost by including offsets, we project that the Board's latest estimate will exceed its net cost by about $2 billion from fiscal years 1981 to 2000.

OUR OTHER REPORTS ON THE RAILROAD RETIREMENT BOARD

Report title or subject	Reference number	Issue date
Comments On 10 Bills To Increase Railroad Retirement Benefits	HRD-79-23	12/18/78
Railroad Retirement Board's Calculations Of Annual Appropriations Necessary To Phase Out Dual Railroad Retirement And Social Security Benefits	HRD-79-33	1/11/79
"Railroad Retirement Program--How Does It Compare To Other Selected Retirement Programs?"	HRD-79-4	6/8/79
Serious Physical Security Deficiencies At Railroad Retirement Board's Chicago Headquarters And Steps Taken By The Board To Correct Same	HRD-78-162	8/29/79

☆ U. S. GOVERNMENT PRINTING OFFICE : 1981 341-843/570

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