

PRINCIPAL FEATURES OF THE RAILROAD  
RETIREMENT ACT OF 1974

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ABSTRACT

Public Law 93-445, enacted over President Ford's veto on October 16, 1974, provides for a complete restructuring of the railroad retirement system. Three major problems caused the system on the old basis to be faced with bankruptcy by the early 1980's and forced enactment of the law. These were (1) declining employment leading to a high ratio of beneficiaries to working employees; (2) concurrent social security benefits paid to railroad annuitants; (3) the approach used to increase benefits to keep up with inflation. This paper examines the second and third problems and describes the basic achievement of the new law, which was to create a two-tiered benefit structure. The manner in which concurrent social security benefits were phased out is described in detail. The paper also examines certain major changes made in the financing of the program.

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I. BACKGROUND

THE process that led to the Railroad Retirement Act of 1974 began in 1970 when a 15 per cent increase in benefits, corresponding to a similar increase under social security granted earlier in the year, was being considered. The Railroad Retirement Board's actuaries pointed out the severe strain such an increase would place upon the railroad retirement fund, noting that exhaustion of the fund was possible within twenty to twenty-five years. Congress responded to these warnings by enacting the increase on a temporary basis and by establishing the Commission on Railroad Retirement. The commission was to recommend measures necessary to provide adequate levels of railroad retirement benefits on an actuarially sound basis. By the time the commission's report appeared in 1972, the situation had been aggravated by additional 10 and 20 per cent increases ("temporary," but for all practical purposes permanent). Projections showed that the fund would disappear by 1980 or 1981.

The commission's report recommended in general terms (a) that the

\* Opinions expressed in this paper are those of the author and do not necessarily reflect the official views of the Railroad Retirement Board.

railroad retirement system be restructured into a "two-tier" system under which beneficiaries would receive a basic ("tier 1") benefit equivalent to what social security would pay if railroad employment were covered under the Social Security Act and a second tier of benefits based purely on railroad service and (b) that restrictions be placed on the earning of "dual benefits" (defined below) after the date of restructuring.

Congress then requested (Public Laws 92-460, enacted October 4, 1972, and 93-69, enacted July 10, 1973) that labor and management negotiate a solution to the problems of the railroad retirement system taking into account the recommendations of the commission. The negotiators eventually reached agreement on the provisions that were enacted into law.

In order to understand one of the major difficulties of the old law (referred to in the following as the "1937 act"), the workings of the system of coordination between railroad retirement and social security, known as the financial interchange, must be analyzed in some detail. The financial interchange operates to put the social security trust funds (old age and survivors, disability, and hospital insurance) in the position they would have had if railroad service had been covered under the Social Security Act. To meet this objective, the railroad retirement system transfers to social security the taxes which social security would have collected, and receives from social security the *additional* amount which social security would have paid out in benefits to railroad workers and their dependents, had railroad employment been covered under social security. The word "additional" in the preceding sentence is extremely important because a large percentage of railroad retirement beneficiaries receive concurrent social security benefits (called "dual benefits" in the following), derived from employment covered directly by social security, which must be deducted from the amount otherwise transferable. The following examples illustrate the financial interchange calculations and the effect of dual benefits on the financing of the railroad retirement system.

Consider an employee who retired in 1972 after spending his entire career in the railroad industry. He had no employment that was covered under social security and therefore does not receive a dual benefit. His railroad retirement benefit in 1972 was \$370 per month. The monthly benefit he would have received from social security had his employment been covered under that act is, say, \$220. The entire \$220 is transferred to the railroad retirement fund, leaving \$150 as the amount to be financed from the excess of railroad taxes over social security taxes.

Assume now that this same employee had engaged in just enough employment outside the railroad industry to be eligible for a dual benefit at retirement. The social security benefit computed on the basis of com-

bined railroad and nonrailroad earnings would be only slightly higher (\$240) than the \$220 computed on the basis of railroad earnings only. However, the benefit which social security paid this retiree in 1972 was its minimum benefit of \$84 monthly. Because of certain deductions made in the railroad retirement formula for receipt of a dual benefit, the employee's railroad retirement benefit is only \$350 per month instead of \$370. The amount transferred through the financial interchange is \$156 (\$240 minus the \$84 which social security actually paid the beneficiary), leaving \$194 (\$350 less \$156) as the amount to be financed by the railroad retirement taxes in excess of social security. These two cases are summarized in the accompanying tabulation.

	Case A	Case B
1. Railroad retirement benefit . . . . .	\$370	\$350
2. Dual benefit . . . . .		84
3. Social security benefit on combined earnings . . . . .	220	240
4. Total received by retiree, item 1 plus item 2 . . . . .	370	434
5. Amount transferred from social security to railroad retirement, item 3 minus item 2 . . . . .	220	156
6. Amount to be financed by excess of railroad retirement over social security taxes, item 1 minus item 5 . . . . .	150	194

Two conclusions can be drawn from examples of this type. The first is that the employee who has enough nonrailroad earnings to be covered under social security enjoys a significant advantage (\$64 per month in this case) over the employee who does not. This advantage may be considered a windfall to the employee arising from the existence of two independent yet interconnected social insurance systems. The basic cause of the windfall is the nature of the social security benefit formula, which pays much higher benefits, relative to earnings, to a low-paid worker than to a high-paid worker. In this example, combining the employee's nonrailroad earnings with his railroad earnings increases the social security benefit payable under a completely integrated system by only \$20 (from \$220 to \$240) but actually brings in to the employee a net amount of \$64 (the \$84 minimum benefit less the reduction in the railroad annuity).<sup>1</sup> The second conclusion is that the railroad retirement system has borne the brunt of financing the windfall—in this example, \$44 (\$194 — \$150) additional must be supplied by the railroad retirement system. The

<sup>1</sup> It is true that the employee has paid more taxes and therefore deserves a larger total benefit. The highly skewed nature of the social security formula, however, provides a disproportionate amount. Reference [3] discusses this point in detail.

situation is aggravated by an across-the-board percentage increase in the benefits of both systems.

In addition to the problem of dual benefits, the railroad retirement system suffered from the approach used to increase benefits in order to keep up with inflation. Future retirees have their benefit based partially on future earnings and therefore receive the advantage of higher wage levels in the benefit formula, whereas beneficiaries on the rolls do not. However, benefit formulas under the old act were amended in the same way for those already on the rolls as for those retiring in the future—leading to a double increase for the future retiree. A further problem was the lack of any provision requiring that total benefits after retirement not be more than an individual's take-home pay prior to retirement. If spouse's benefits are taken into account, an appreciable number of current retirees were awarded more in benefits (including dual benefits) under the former arrangement than they earned prior to retirement.

The following sections outline the provisions of the agreement between labor and management which Congress enacted in order to overcome these problems. The expression "date on which the annuity begins to accrue" means the annuity beginning date; the year of accrual is the year containing the annuity beginning date.

## II. THE 1974 LAW—ELIGIBILITY AND BENEFIT PROVISIONS

### *Employees*

An employee will be eligible for a regular railroad retirement benefit under the same conditions as under the pre-1974 law. That law contained a ten-year service requirement and provided full retirement benefits (*a*) at age 65 or (*b*) at age 60 for individuals with thirty years of service. Individuals who have attained age 62 and have at least ten but less than thirty years of service can retire on an actuarially reduced annuity. Occupational disability annuities are provided to individuals with a current connection who have attained age 60 or who have twenty years of service. Total disability annuities are payable at any age with only the basic ten-year service requirement. There is no age reduction for payment of a disability annuity. The only change under the new law is that payment of a supplemental annuity (described later) which previously required attainment of age 65 will now be available at age 60 for those whose regular railroad annuity began to accrue on or after July 1, 1974, and who have completed thirty years of service. The requirements of a current connection and twenty-five years of service for a supplemental annuity are continued.

The employee benefit will consist of up to three components. The first

component is the tier 1 benefit as proposed by the Commission on Railroad Retirement; the employee will receive the amount he would have received from social security had his railroad employment been covered under the Social Security Act and had he met social security eligibility conditions. For purposes of determining this component, an individual aged 60 with thirty years of service is deemed to have attained age 65 and a disability annuitant is deemed to meet social security disability standards (without serving the five-month waiting period). The new law provides specifically that any dual benefit to which the employee is entitled will be deducted from the tier 1 benefit; however, the third component will restore the windfall element if the employee is dually vested, as explained below.

The tier 1 benefit will be designated *a*.

The second component is based on railroad service and consists of several subcomponents. The computation of this component involves several steps.

The first step is to compute a railroad retirement annuity under the 1937 act formula on the basis of the employee's pre-1975 railroad service and compensation. This benefit is calculated even though the employee may not have had ten years of service by December 31, 1974. The reduction in the pre-1975 formula for receipt of a supplemental annuity is not applied. The minor reduction for receipt of a dual benefit mentioned in the previous section is required if the employee is determined to be eligible for the third component, the windfall element. The result of this computation will be designated *b*.

The second step is to compute a so-called imputed social security benefit. This amount is equal to what social security would pay the employee on the basis of pre-1975 railroad service only, assuming the employee met all requirements for an unreduced benefit. As a result of this latter provision, the computation years used will be the same for all employees (the law in fact specifies eighteen) and the imputed social security benefit will not vary with age for employees with identical earnings histories. This amount will be designated *c*.

The first subcomponent of the second component is equal to  $b - c$ , with a minimum equal to 10 per cent of *c*. The logic behind subtracting *c* is that the employee will be entitled to a tier 1 benefit based on railroad as well as nonrailroad service, so that not subtracting it would result in crediting the pre-1975 railroad service twice. The "10 per cent of *c*" provision is a form of the overall minimum guarantee contained in the 1937 act, applied only to pre-1975 railroad service.

The second subcomponent (*d*) gives credit for years of service prior to

1975, but only if the employee engages in railroad service after 1974. The amount of post-1974 service is not specified, so any service would make the computation applicable. The benefit provided is \$1.50 for each of the first ten years of service prior to 1975, plus \$1.00 for each year of service prior to 1975 in excess of ten.

The third subcomponent (*e*) provides 0.5 per cent of average monthly compensation, plus \$4, all for each year of service after 1974. The average monthly compensation is based only on earnings after 1974 and excludes earnings over the monthly tax base (\$1,175 in 1975; adjusted upward in later years).

The second component (the tier 2 benefit) is therefore  $b - c + d + e$ .

The third component of the benefit formula (*f*) provides the windfall element. The following description of the windfall will show how labor and management agreed to phase out dual benefits. Only those employees dually vested are eligible to receive it. An employee is dually vested if he has ten years of railroad service before 1975 and is fully insured under social security for retirement (not death) using only social security earnings as of a certain date prior to 1975. Two categories of dually vested employees are recognized in requirements 1 and 2 below:

1. Specifies that the employee must have engaged in railroad service in 1974 or have a current connection on December 31, 1974, or the annuity beginning date or have twenty-five years of railroad service before 1975.
2. Includes employees who do not satisfy requirement 1 above but who have accumulated sufficient quarters of coverage under social security as of December 31 of their last year of railroad service for a fully insured status under the Social Security Act.

The intent is to distinguish between employees active in the railroad industry and those who left the industry several years ago. Active employees will be covered under requirement 1; the more stringent requirement 2 for inactive employees was designed to limit an otherwise prohibitive cost.

If an employee qualifies under requirement 1, his windfall will be computed as follows: A social security benefit using only earnings creditable under the Social Security Act will be computed. To this will be added a social security benefit based only on railroad earnings. From this sum is subtracted a social security benefit computed on the basis of combined railroad and social security earnings. The result is the windfall. Each social security benefit of the above computation uses only earnings through December 31, 1974, and each utilizes the number of benefit computation years appropriate to the employee's actual age (that is, in most cases, an age-62 computation point).

If the employee qualifies under requirement 2 but not under requirement 1, the only modification is to change "December 31, 1974" in the preceding sentence to "December 31 of the year in which the employee last engaged in railroad service." The typical inactive with less than twenty-five years of service will therefore receive a much smaller windfall than an active (if he qualifies for one at all).

An employee not entitled to a windfall maybe entitled to a lump sum at retirement. This amount, a refund of excess taxes, is computed by summing, for each year from 1951 through 1974, the product of the social security employee tax rate for the year times the excess of the employee's combined earnings for the year over (approximately) the maximum creditable for the year under the 1937 act.

The supplemental annuity amount ( $g$ ) is \$23 plus \$4 for each year of service in excess of twenty-five up to a maximum of \$43. Under the 1937 law, the rate was \$45 plus \$5 for each year of service in excess of twenty-five, up to a maximum of \$70; however, the reduction which existed in the regular annuity under the old law for receipt of a supplemental annuity has been eliminated. The net result of the supplemental annuity computation is the same under the two laws.

The total annuity is  $a + b - c + d + e + f + g$ . Component  $a$  will be increased automatically whenever social security benefits are increased. The component  $b - c$  and the \$4 per year of service portion of  $e$  will be increased by 65 per cent of the increase in the unadjusted consumer price index from September 30, 1976, through the earlier of September 30 preceding the year of accrual or September 30, 1980. The part of  $e$  based on compensation will be increased by the same percentage but will then be reduced by the excess of that part of  $e$  over what it would have been if the limit on taxable compensation in effect in September, 1976, had not been changed. (See Appendix, item 14, for a mathematical description of the increase.) Component  $f$  will be increased by the percentages of any cost-of-living increases under the Social Security Act between December 31, 1974, and the date on which the employee's annuity began to accrue. If Congress enacts a general social security benefit increase which negates a scheduled automatic cost-of-living increase, component  $f$  will be increased as it would have been under the scheduled increase.

Once the annuity has accrued, component  $b - c$  and component  $e$  will be increased on June 1 of each year from 1977 through 1980 by 32.5 per cent of the increase in the unadjusted consumer price index which is used, or would have been used had there not been a general benefit increase under the Social Security Act, in increasing social security benefits for those years. Unlike the provisions of the Social Security Act, this increase

will be provided even if the unadjusted consumer price index has risen less than 3 per cent. Component *d*, the windfall, and the supplemental annuity will not be increased after accrual.

The annuity at accrual, exclusive of the windfall and before any reduction for age or receipt of a social security benefit, is limited by a maximum based on final average monthly compensation. The maximum will vary between 90 and 100 per cent of the final average monthly compensation but cannot operate to reduce the annuity below \$1,200. Final average monthly compensation for a particular employee is obtained by dividing by 24 the total compensation received by the employee in his two calendar years of highest compensation, whether or not consecutive, during the ten-year period ending with December 31 of the year the annuity begins. For this purpose, wages and self-employment under the Social Security Act are included with railroad compensation. Because of the \$1,200 limitation, the maximum will not be effective in the near future.

The new law provides a grandfather clause guaranteeing that in cases where an employee's annuity begins to accrue before January, 1983, the total of the annuities (exclusive of the windfall and before reduction for receipt of social security benefits) payable to the employee and his spouse cannot be less than the total amount that would have been payable to the employee and his spouse under the old law in effect on December 31, 1974, on the basis of the maximum monthly compensation creditable at that time. The overall minimum guarantee is 100 per cent of the amount, or the amount in addition to that actually paid under social security, that would have been payable to the employee's family by social security on the basis of combined railroad and nonrailroad earnings. Under the 1937 act the guarantee was 110 per cent.

### *Spouses*

The 1937 act provided that a spouse of an employee could be eligible for an annuity only if the employee had attained age 65. A spouse would then be eligible for a reduced annuity at age 62 or an unreduced annuity at age 65 or at any age if she had a child of the employee in her care. The new act provides that the spouse of an employee with thirty years of service will be eligible for an unreduced benefit when both she and the employee have attained age 60 if the employee's annuity began to accrue after June 30, 1974. No benefit is payable as a result of this liberalization until January, 1975. Additionally, a spouse of an employee with less than thirty years of service can receive an unreduced benefit when the employee has attained age 62 and the spouse either has attained age 65 or has a child in her care, or can receive a reduced spouse's annuity when



both the employee and the spouse have attained age 62. This liberalization applies only where the employee's annuity first accrued after 1974.

The spouse's benefit basically is equal to 50 per cent of the employee's tier 1 and tier 2 benefits. The tier 1 portion is reduced by the amount of any spouse's benefit received under the Social Security Act. If the employee has thirty years of service and both he and his spouse have attained age 60, the spouse will be deemed to have attained age 65 for purposes of computing the tier 1 benefit (before reduction for the dual benefit). The past-service part of the tier 2 benefit is reduced by the same "offset provisions" as under the 1937 act if the spouse is eligible for a windfall.

The spouse maximum provision of the 1937 law is retained and specifies that the sum of the first and second components (assuming no reduction for dual benefit in the first component) cannot exceed 110 per cent of the maximum possible wife's insurance benefit payable to *any* wife under social security. The spouse's benefit computed up to this point (before reduction for receipt of a social security wife's or husband's insurance benefit) is included along with the employee's annuity under the maximum based on final average monthly compensation mentioned in the previous section.

Cost-of-living increases in the various components of the spouse's annuity are provided and will be by the same percentages as the increases in the corresponding components of the employee's annuity.

If an employee has ten years of railroad service on December 31, 1974, and meets requirement 1 stated above in the section on employees, and if his spouse is permanently insured under the Social Security Act on that date, the spouse will be entitled to a windfall equal to the smaller of a social security benefit based on her earnings prior to January 1, 1975, or a social security spouse's benefit based on the employee's railroad earnings from 1937 through 1974. The spouse's windfall may not be less than 50 per cent of the employee's windfall.

A spouse's windfall is payable if the employee does not meet requirement 1 but did have ten years of railroad service prior to 1975 and the spouse was permanently insured under social security as of the end of the last year prior to 1975 in which the employee rendered railroad service. The windfall is determined in the same manner as in the previous case, except that only the spouse's earnings prior to the end of the last year in which the employee engaged in railroad service will be used. As above, the spouse will receive as a windfall a minimum of 50 per cent of the employee's windfall. The spouse's windfall is subject to the same cost-of-living adjustments before accrual as the employee's and is frozen at accrual (see the section on employees, above).

*Survivors*

Eligibility requirements for survivor annuities are identical with those contained in the previous law. Benefits are payable to aged and disabled widows, widowers, widowed mothers, children, and parents of employees who had a current connection with the railroad industry at the time of death. In the following discussion, only aged widows' benefits will be mentioned; the others follow the same general outline.

An aged widow's tier 1 benefit is equal to what she would have received from social security as a survivor had the employee's railroad earnings been covered under the Social Security Act. However, a widow retiring between ages 60 and 62 is deemed to be aged 62, lowering the age reduction that would have applied under social security. The tier 1 amount is reduced, but not below zero, by the amount of any social security benefit to which the widow is entitled on the basis of her own or another person's earnings record.

The second component of the widow's benefit is equal to 30 per cent of the first component (before the reduction for the dual benefit).

A windfall benefit is provided the widow if the employee had completed ten years of railroad service by December 31, 1974, and the widow was permanently insured under the Social Security Act on that date. The windfall is equal to (i) + (ii) - (iii), where (i) is a railroad retirement widow's benefit computed under the 1937 law but using only the employee's earnings prior to 1975 and disregarding the social security minimum guarantee provision; (ii) is a social security benefit using only the widow's social security earnings prior to 1975; and (iii) is an amount equal to 130 per cent of what social security would have paid as a widow's benefit on the basis of the employee's pre-1975 combined railroad and non-railroad earnings. The windfall is increased by the percentages of the automatic cost-of-living adjustments under social security occurring after 1974 and before the earlier of the employee's death or the date on which his annuity began to accrue. If the automatic adjustments are overridden by a general benefit increase, the adjustment which would have been made if there had been no general increase will be used.

Lump-sum death payments are also provided with respect to employees having ten years of service and a current connection at death. If the employee had completed ten years of service before 1975, the lump sum will be computed in accordance with the provisions of the 1937 law (10 times the "basic amount" defined in item 27 of the Appendix), but only combined railroad and nonrailroad earnings prior to 1975 will be used.

The amount will be computed as if the employee had died on January 1, 1975. If the deceased employee had not completed ten years of service prior to 1975, the amount payable is the amount social security would pay based on the employee's combined earnings; but no lump sum will be paid if there is a person eligible for a monthly survivor's annuity in the month of the employee's death.

The "residual lump sum" of the old law, intended to ensure that benefits payable with respect to an employee at least equal the railroad retirement taxes that he paid, is continued but will be based only on compensation before 1975. (Because the employee has been paying taxes at the social security rate since October, 1973, it was felt that this "refund of contributions" feature should be eliminated.)

### III. THE 1974 LAW—FINANCING AND MISCELLANEOUS PROVISIONS

#### *Financing*

A major change in the financing of the railroad retirement system was brought about by the 1974 act. In addition to the income from taxes and the financial interchange with social security (which remains unchanged), amounts are to be appropriated from general revenues to the railroad retirement account. The amounts appropriated are to be sufficient to fund, on a level annual payment basis over the years 1976–2000, the windfall benefit for new annuitants (defined in the preceding section) and for beneficiaries on the rolls. The yearly amount is to be reviewed every three years at the time of each actuarial valuation. The current estimate is \$250 million per year over the twenty-five-year period.

The 1974 act has also revised investment policy. The new law authorizes the Railroad Retirement Board to make mandatory requests to the Secretary of the Treasury as to the purchase of allowable investments and to determine which securities are to be redeemed and at what time. The estimated additional interest income expected to be realized over the years 1976–2000 as a result of this change in policy is to be utilized to reduce the appropriations from general revenues. As in the case of the appropriations to fund the windfall benefit, this determination will be reviewed every three years.

Although the supplemental annuity is now in the range \$23–\$43 instead of \$45–\$70 monthly, the new act provides that the supplemental tax rate will remain at the level necessary to fund the previous scale of benefits. Only that portion of the taxes collected which is necessary to fund the new scale of benefits will be appropriated to the railroad retire-

ment supplemental account; the remainder will go to the railroad retirement account.

#### *Miscellaneous Provisions*

The new act provides that liberalizations in social security eligibility requirements for old age, disability, spouse, and survivor benefits will automatically be reflected in railroad retirement eligibility requirements. However, reductions in social security requirements for categories not provided annuities under railroad retirement, such as divorced wives, will have no effect on railroad retirement entitlement. If the Social Security Act is amended to provide benefits to a class of beneficiaries not previously entitled to social security benefits, the new class will also be provided railroad retirement benefits. The amount will be that to which the beneficiary would be entitled under social security if all the employee's railroad earnings had been covered under social security.

The new act contains transitional provisions under which employees and spouses receiving benefits on January 1, 1975, who do not receive dual benefits will continue to receive exactly the same amount from the railroad retirement system as they did under the old law. The tier 2 benefit will be defined as the difference between the amount received under the old law and the tier 1 benefit. An employee or spouse receiving a dual benefit on the changeover date will have a windfall computed in accordance with the procedure described, but the windfall will be adjusted to make the total 1974 act annuity plus dual benefit equal to the 1937 act annuity plus dual benefit. In other words, the windfall element for employees and spouses receiving benefits will be the balancing item to ensure that total railroad retirement and social security benefits under the 1937 act equal total railroad retirement and social security benefits under the 1974 act. This definition is important in that it will help to establish the general revenue appropriation to be requested. The definition is also important from the point of view of the beneficiary, because it determines what portions of his annuity are subject to cost-of-living increases.

Supplemental annuities will continue to be paid to employees receiving benefits at changeover at the \$45-\$70 rate rather than at the \$23-\$43 rate.

Most survivors receiving benefits on January 1, 1975, will receive an increase in their annuities due to the "30 per cent of social security" component explained above. Any windfall to a widow or widower under the 1974 act must be in an amount such that the total annuity for

January, 1975, will be equal to that which would have been paid under the 1937 act.

The preceding description of the 1974 act has been by no means exhaustive. Many technicalities have been glossed over for the sake of simplicity, and some provisions of lesser significance have been omitted. The intent has been to provide a general understanding of the 1974 act, and especially of the way in which the dual benefit problem was handled.

#### IV. EFFECT ON THE ACTUARIAL CONDITION OF THE RAILROAD RETIREMENT SYSTEM

Although it would be possible to present a detailed cost analysis of the new act, all that will be done here is to mention that the actuarial deficiency has been reduced from 9.05 to 0.96 per cent of taxable payroll. The reduction in the deficit stems from the general revenue financing of the windfall, the phasing out of dual benefits, and the lower level of benefits that the new formula will produce after the grandfather clause period.

Many of the cost estimates which went to produce the 0.96 per cent of payroll figure and the general revenue appropriation estimate of \$250 million per year for 1976–2000 are based on few or no hard data. For example, the railroad retirement system did not, at the time these figures were produced, have any information at all on the social security earnings of inactive employees or on the social security earnings of spouses of active and inactive employees. It is hoped that by the time the next valuation is completed, such data (and other data) will be available and the position of the system will be known with a higher degree of confidence.

#### V. ACKNOWLEDGMENTS

The author wishes to express his appreciation to David Feinstein and Patricia Szewczyk for their assistance in the preparation of the Appendix table.

#### REFERENCES

1. COMMISSION ON RAILROAD RETIREMENT, *The Railroad Retirement System: Its Coming Crisis*. House Doc. No. 92-350, September, 1972.  
Pages 3–47 of the document present the major findings and recommendations of the commission.
2. COMMITTEE ON LABOR AND PUBLIC WELFARE, UNITED STATES SENATE. *Report on H.R. 15301*. Report No. 93-1163. Washington, D.C.: Government Printing Office, September, 1974.  
Pages 28–62 provide a section-by-section analysis of the bill that was finally enacted with only minor modifications.

3. COWEN, JAMES L. Testimony on H.R. 15301. See *Hearings before the House Committee on Interstate and Foreign Commerce*, Publication Serial No. 93-94, pp. 247-331, 336-54. Washington, D.C.: Government Printing Office.

Exhibit 1 of Mr. Cowen's prepared statement (pp. 265-69) explains the procedures used in making the financial interchange determinations. Exhibit 4, pp. 310-20, gives a detailed description of the dual benefit problem. Exhibit 5, pp. 321-23, describes the "double-dip" effect of the ad hoc procedure used for increasing railroad benefits under the previous law.

4. NIESSEN, ABRAHAM M. *Twelfth Actuarial Valuation of the Assets and Liabilities under the Railroad Retirement Acts as of December 31, 1971*. Chicago, Ill.: U.S. Railroad Retirement Board, Office of the Chief Actuary, December, 1973.

APPENDIX

OUTLINE OF THE PROVISIONS OF THE RAILROAD RETIREMENT ACT OF 1974\*

Item	Provision
<b>EMPLOYEE BENEFITS</b>	
1. Normal age annuity	Age 65 with 10 years of service.
2. Prenormal age annuity	Unreduced benefit for retirement at age 60 with 30 years of service if accrued on or after July 1, 1974 (reduced if male and retired prior to that date). Reduced by 1/180 for each month employee is under age 65 on accrual date for retirement at ages 62-64 with 10 but less than 30 years of service.
3. Total and permanent disability annuity	10-year service requirement.
4. Occupational disability annuity	20 years of service or attainment of age 60 with 10 years of service; current connection required.
5. Supplemental annuity	Age 60 with 30 years of service if retired on or after July 1, 1974, or age 65 with 25 years of service and retirement by closing date (generally closing date is last day of the month following the month employee becomes 65). Closing date extended in certain cases for employees with 23-24 years of service. Current connection required.
6. Work restrictions	Suspension of annuity for any month annuitant is employed by a railroad or by the last nonrailroad employer. For disabilities, loss of one month's annuity for each \$200 in excess of \$2,400 earned in a year. In addition, the tier 1 portion of the annuity based on railroad earnings after 1974 and all social security earnings is subject to social security work restrictions. All windfall dual benefits subject to social security restrictions.
7. Creditable service (continuity not required)	All service subsequent to December 31, 1936. Service prior to 1937 can be used if annuitant had employment relation on August 29, 1935, or 6 months of service after August 29, 1935, and before 1946. No limit on service except 30-year maximum if pre-1937 service used.
8. Creditable and taxable compensation	Maximum† monthly compensation: \$300—before July 1, 1954 \$350—July 1, 1954—May 31, 1959 \$400—June 1, 1959—October 31, 1963 \$450—November 1, 1963—December 31, 1965 \$550—1966-67 \$650—1968-71 \$750—1972 \$900—1973 \$1,100—1974 \$1,175—1975

\* See note at end of table.

† From October 1, 1965, to the present, amount is one-twelfth of annual social security maximum. Minimum of \$450 effective October-December, 1965.

APPENDIX—*Continued*

Item	Provision
EMPLOYEE BENEFITS— <i>Continued</i>	
9. Creditable military service and compensation	<p>Military service is creditable in war or national emergency period before or after 1937 if preceded by railroad service in the same year or year preceding entry into military service. Reduced for receipt of any other federal benefit based on the same service.</p> <p>Compensation: \$160 before 1968; \$260 after 1967 but before 1975; for each calendar year after 1974, compensation is the same as that credited under social security.</p>
10. Earnings base for tier 2 (average monthly compensation [AMC] using railroad earnings only)	<p>Pre-1975 AMC based on total creditable compensation for all creditable service before 1975; 1924–31 average used if available for service before 1937.</p> <p>Post-1974 AMC based on total creditable compensation for all creditable service after 1974.</p> <p>Compensation and service after 65th birthday used only if it raises the benefit amount.</p>
11. Basic annuity formula for all types of retirement cases	<p>Tier 1—social security component: Social security benefit based on combined earnings reduced by social security benefit payable based on wages only. (For purposes of computing this amount, an employee retiring at age 60 with 30 years of service is deemed aged 65.)</p> <p>Tier 2—railroad retirement component:</p> <ol style="list-style-type: none"> <li>(1) Railroad retirement annuity computed as of December 31, 1974, under the 1937 act reduced by an imputed social security benefit based on railroad retirement compensation through 1974 (18 computation years specified for social security computation). This is subject to a minimum of 10% of the imputed social security benefit.</li> <li>(2) \$1.50 per month for each of the first 10 years of service before 1975, plus \$1.00 per month for each year of service in excess of 10 before 1975. Paid only if employee has service after 1974.</li> <li>(3) 0.5% of AMC based on railroad retirement earnings after 1974 times years of railroad service after 1974, plus \$4.00 times years of railroad service after 1974.</li> </ol>
12. Eligibility conditions and computation of windfall benefit	<p>I. Eligibility conditions.</p> <ol style="list-style-type: none"> <li>A. Fully insured status under Social Security Act, effective December 31, 1974, and either (i) 25 years of railroad service before 1975 or (ii) 10 years of railroad service before 1975 with some railroad work in 1974 or a current connection on December 31, 1974, or at the time the annuity begins to accrue, or, if the above conditions were not met,</li> <li>B. Fully insured under the Social Security Act as of last year of railroad work prior to 1975 and 10 years of railroad service before 1975.</li> </ol>



APPENDIX—Continued

Item

Provision

EMPLOYEE BENEFITS—Continued

II. Benefit computation.

- A. For employees satisfying condition I(A) above, benefit is social security benefit based on compensation only through 1974 plus social security benefit based on wages only through 1974, reduced by social security benefit based on combined wages and compensation through 1974.
- B. For employees satisfying condition I(B) above, benefit is the same as in II(A), except for the exclusion of all earnings after last pre-1975 year employee had railroad employment.

13. Supplemental annuity computation

For employees retired before 1975, the benefit is a minimum of \$45 increased by \$5 for each year of service over 25, with a maximum benefit of \$70. These employees have a reduction in their regular railroad retirement annuity.

For employees whose supplemental annuity begins to accrue after 1974, the benefit is a minimum of \$23 increased by \$4 for each year of service over 25, with a maximum benefit of \$43. These employees have no reduction in their regular railroad retirement annuity. Supplemental annuity will be reduced if employee receives a private pension from railroad employer based on employer contributions.

14. Cost-of-living increases

Tier 1: Subject to social security increases.

Tier 2: Employees retiring after 1977 (initial computation):

- (i) The portion of tier 2 based on service before 1975 (excluding \$1 and \$1.50 a year portion) is subject to an increase of 65% of the change in the cost of living from September, 1976, through the earlier of the September preceding the year of accrual or September, 1980.
- (ii) The portion of tier 2 based on years of service after 1974 times \$4 is increased by the same percentage as in item (i).
- (iii) The portion of tier 2 based on post-1974 AMC, limited by the 1980 railroad retirement maximum, is increased by the same percentage as in item (i). This amount is reduced by the difference between the amount based on AMC for service after 1974 limited by the 1980 railroad retirement maximum and the amount based on AMC for service after 1974 limited by the 1976 railroad retirement maximum. The reduction cannot make the increase negative.

Expressed mathematically, portions (ii) and (iii) combined are equal to  $I = 2.6YC + 0.005Y[0.65BC - (B - D)]$ , where  $I$  represents the increase,  $Y$  represents the years of service after 1974,  $C$  represents the change in the consumer price index as defined in item (i),  $B$  represents post-1974 AMC disregarding compensation in excess of 1980 taxable limit, and  $D$  represents the same as  $B$  above, replacing 1980 with 1976.

Employees who retire on or before June 1, 1980 are eligible for yearly increases in the tier 2 benefit (excluding the \$1 and \$1.50 a year portion) of 32.5% of the yearly rise in the cost of living. These increases occur on June 1 of the years 1977-80.

APPENDIX—Continued

Item

Provision

EMPLOYEE BENEFITS—Continued

The windfall dual benefit will be frozen at the 1974 level, except that social security cost-of-living increases effective between December 31, 1974, and the annuity beginning date will be included in the computation. The windfall will be increased as it would have been under an automatic cost-of-living adjustment and will not participate in general benefit increases enacted by Congress.

15. Tax rebate lump sum An individual who has at least 10 years of railroad service and is not eligible for the windfall will receive a lump sum at retirement computed by summing for each year from 1951 through 1974 the product of the social security tax rate for the year times the excess of the employee's combined earnings for the year over (approximately) the maximum creditable for the year under the 1937 act. Survivors of employee may receive refund if employee dies before receiving it.

SPOUSE'S BENEFITS

16. Eligibility Unreduced annuity: (1) Spouse aged 60 (or any age if she has a child in her care), employee aged 60 with 30 years of service and retired after June 30, 1974 (this provision becomes effective January 1, 1975), or (2) spouse aged 65 (or any age if she has a child in her care), employee aged 62 and retired after December 31, 1974, or employee aged 65 if retired before January 1, 1975.

If spouse is not entitled to an unreduced annuity, spouse may receive a reduced annuity at age 62 if (1) employee retired after December 31, 1974, and has attained age 62 or (2) employee retired before January 1, 1975, and has attained age 65.

17. Work restrictions Same as employee; in addition, spouse's annuity is not paid for any month employee annuity is not payable by virtue of work restrictions.

18. Annuity formula Tier 1—social security component:  
One-half of social security benefit based on employee's combined earnings. If employee receives unreduced 60/30 benefit, spouse is deemed to be age 65. If spouse is entitled to a social security benefit, tier 1 is reduced by the amount of the benefit but not below zero. If spouse is entitled to employee annuity, certain additional restrictions apply.

Tier 2—railroad retirement component:

One-half of employee's tier 2 benefit. If spouse is eligible for a windfall benefit based on spouse's own earnings, tier 2 is reduced in accordance with 1937 act. Spouse receives additional benefit if spouse is also an employee.

19. Eligibility conditions and computation of windfall benefit I. Eligibility conditions.  
A. Spouse is fully insured under Social Security Act effective December 31, 1974, and employee has either (i) 25 years of railroad service before 1975 or (ii) 10 years of railroad service before 1975 with some railroad work in 1974 or a current connection on December 31, 1974, or at the time annuity begins to accrue, or, if the above conditions for employee were not met.

APPENDIX—Continued

Item

Provision

SPOUSE'S BENEFITS—Continued

- B. Spouse is fully insured under Social Security Act as of December 31 of the last year of employee's railroad service, and employee has at least 10 years of railroad service before 1975.
- C. Spouse is not fully insured under Social Security Act, but employee is eligible for a windfall.
- II. Computation of windfall benefit.
  - A. For spouse satisfying condition I(A) above, the benefit is the smaller of (i) the social security benefit based on the spouse's social security earnings through 1974 or (ii) the social security spouse's benefit based on the employee's railroad retirement compensation through 1974. This is subject to a minimum of 50% of the employee's windfall.
  - B. For spouse satisfying condition I(B) above, benefit is the same as in II(A), except for the exclusion of all earnings of spouse after last pre-1975 year employee had railroad employment.
  - C. For spouse satisfying condition I(C) above, benefit is one-half of employee's windfall.

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- 20. Cost-of-living increases
- 21. Spouse maximum annuity
- 22. Maximum annuity (employee and spouse)

Subject to same percentage increases as employee benefit.

110% of maximum social security benefit payable to any spouse, before the windfall. Maximum applies to spouse's annuity alone; see item 22 for employee and spouse maximum.

100% of the final AMC up to an amount equal to 50% of railroad retirement maximum taxable compensation in the year in which the annuity begins to accrue, plus 80% of that part of the final AMC that exceeds 50% of the railroad retirement maximum taxable compensation. The final AMC is the average monthly compensation based on both wages and compensation received by the employee during his two highest calendar years of compensation in the 10 years ending with his retirement. Earnings used in computing the final AMC are subject to the railroad retirement maximum.

If the employee and spouse annuities (excluding the windfall) exceed the above amount, the spouse's tier 2 benefit is reduced first, then the employee's supplemental annuity is reduced, and finally the employee's tier 2 benefit is reduced. The tier 1 amounts may not be reduced. The maximum may not reduce total family benefits (excluding the windfall) below \$1,200 per month.

- 23. Minimum annuity

The new overall minimum guarantee for employees and spouses is 100% (rather than 110%) of the amount, or the additional amount, the family would receive under the Social Security Act if the employee's compensation after 1936 were credited as wages.

Employees and spouses retiring before January 1, 1983, will not receive less than they would have received under the 1937 Railroad Retirement Act as it stood on December 31, 1974 (excluding the windfall dual benefit), taking into account the maximum creditable compensation in effect on that date.

APPENDIX—Continued

Item	Provision
SURVIVOR AND DEATH BENEFITS	
24. Residual lump-sum death benefit	Payable when it appears no further benefits will derive from deceased employee except possibly to a widow, widower, or parent at a future date. In this case, survivor must waive the right to all future benefits. The amount payable is the sum of 4% of taxable compensation from January 1, 1937 to December 31, 1946; 7% from January 1, 1947 to December 31, 1958; 7½% from January 1, 1959 to December 31, 1961, and 8% from January 1, 1962 to December 31, 1965. From January 1, 1966 to December 31, 1974, the factor is 0.5% above the employee contribution rate exclusive of Medicare. Compensation after 1974 is not taken into account. The amount actually paid is reduced by the amount of benefits paid deriving from the deceased employee.
25. Employee requirement for survivor benefits	All benefits except residual lump sum require deceased employee to have 10 years of railroad service and a current connection. A current connection is generally defined as at least 12 months of railroad service in the 30 months preceding death or retirement. If employee does not meet above conditions, his earnings record is transferred to social security, which pays any survivor benefits.
26. Average monthly remuneration (AMR)	Combined railroad retirement and social security earnings divided by the number of months after 1936 or age 22 (if later) and up to retirement (including disability) or death; limited to years before 1975. The maximum creditable earnings in a month are the same as the maximum railroad retirement taxable earnings for that month.
27. Basic amount	52.4% of first \$75 of AMR, plus 12.8% of the remainder increased by 1% for each year before 1975 with earnings of \$200 or more.
28. Aged widow's and widower's eligibility	A widow or widower must be aged 60 and unremarried. A widower must have been receiving one-half his support from deceased employee at time of death or at time employee's annuity began to accrue. Age reduction is 19/40% for each month under 65, but widow aged 60–61 is deemed aged 62 in computing tier 1 (defined below).
29. Disabled widow's and widower's eligibility	A widow or widower must be aged 50, unremarried, and totally and permanently disabled, where disability occurs within 7 years of employee's death or, for a widow, within 7 years after widowed mother's status terminated. A widower must have been receiving one-half of his support from deceased employee at time of death or at time employee's annuity began to accrue. Age reduction is 28.5% plus 43/240% for each month from annuity beginning date to month widow attains age 60.
30. Widowed mother's eligibility	Unremarried widow of a deceased employee who is not entitled to larger amount as aged or disabled widow and who at the time of filing an application has in her care a minor or disabled child of the deceased employee.
31. Children's eligibility	A child of a deceased employee must be under 18 or under 22 and a full-time student. Dependent, unmarried children who were disabled before age 22 are also eligible regardless of age.
32. Parent's eligibility	A parent of a deceased employee who has attained age 60, received at least one-half of his support from the deceased employee, and has not remarried will be eligible for an annuity. No parent will be entitled in any case where employee died leaving a widow or widower or a child who is or might become eligible in the future.

APPENDIX—Continued

Item	Provision
	SURVIVOR AND DEATH BENEFITS—Continued
33. Work restrictions	Annuity not payable for any month in which survivor engages in railroad employment. Entire benefit subject to social security work restrictions.
34. Annuity computation for all eligible survivors	<p>Tier 1: Amount payable to survivor under Social Security Act based on the deceased employee's combined earnings after December 31, 1936 reduced by the amount of any social security benefit received. Additional restrictions exist for a widow who also receives an annuity as a railroad employee.</p> <p>Tier 2: 30% of tier 1 before deductions for work or entitlement to social security benefit or railroad retirement employee annuity. For aged widows and widowers, the total benefit (exclusive of windfall) may not be less than amount received as spouse in month prior to employee's death.</p>
35. Eligibility conditions and computation of windfall benefit for widows and widowers	<p>Eligibility: Widow or widower must have been fully insured under social security prior to 1975, and deceased employee must have had 10 years of railroad service prior to 1975.</p> <p>Computation: (i) + (ii) - (iii), where (i) is the amount survivor would have been eligible for under 1937 Railroad Retirement Act using basic amount formula (the overall minimum guarantee of the 1937 act and the spouse minimum mentioned in item 34 are disregarded for this purpose), (ii) is the social security benefit based on survivor's social security earnings through 1974, and (iii) is 130% of the social security benefit survivor would have received based on employee's combined earnings before 1975.</p>
36. Insurance lump sum	<p>Payable if employee leaves no survivor eligible for monthly benefits in the month of his death.</p> <p>Amount: (i) If employee had 10 years of service before January 1, 1975, the payment is 10 times the basic amount (see item 27). (ii) If employee had less than 10 years of service as of December 31, 1974, the amount will be the amount social security would have paid (currently \$255).</p>
37. Cost-of-living increases for survivors	Benefits exclusive of the windfall are subject to social security increases. The windfall is frozen as of the earlier of the employee's death or the employee's annuity beginning date. The windfall will be increased as it would have been under an automatic cost-of-living adjustment and will not participate in a general benefit increase enacted by Congress.
	COORDINATION WITH SOCIAL SECURITY
38. Combination of credits	All railroad retirement benefits are based in part on combined earnings. Transfer of railroad retirement credits to social security if employee had less than 10 years of service or, in the case of a survivor, if the employee lacked a current connection.
39. Financial interchange	Railroad retirement system pays to social security the taxes social security would have collected and receives the additional amount social security would have paid if railroad employment had been covered under social security.

APPENDIX—Continued

Item	Provision
FINANCING AND INVESTMENTS	
40. Supplemental annuity tax transfer	Taxes for the supplemental account will be collected on the basis of the \$45-\$70 scale previously in effect. The excess resulting from the new \$23-\$43 scale will be transferred to the regular account.
41. Contributions	Employees contribute at the prevailing social security rate. The present employer rate is the prevailing social security rate plus 9.5%.
42. Investments	Funds are permitted to be invested in special obligations, U.S. interest-bearing securities, and interest-bearing securities which are guaranteed by the U.S. or which are lawful investments for trust funds managed by the Treasury. The securities must have a fixed maturity date and interest at a rate equal to the average market yield, provided that this rate is at least 3%. The Board has the authority to make mandatory requests to the Secretary of the Treasury as to the purchase of such obligations. The Board shall determine when and which securities are to be redeemed for the purpose of paying benefits or for reinvestment. This authority was not given to the Board in the 1937 Railroad Retirement Act.
43. Financing of windfall	General revenue appropriations will finance all windfall payments after 1974. Level payments will be made on an annual basis for 25 years, the first being made in fiscal year 1976. This amount will be reduced by the excess interest the railroad retirement account will receive during fiscal years 1976-2000 because of the liberalized investment provisions. The annual appropriation will be re-evaluated every three years.
MISCELLANEOUS PROVISIONS	
44. Transitional provisions	Every individual who was entitled to a benefit under the 1935 or 1937 Railroad Retirement Act as of December 31, 1974 will be entitled to a benefit under the 1974 act. This amount will be at least as large as the benefit under the 1937 act and will be divided into tier 1 and tier 2 for purposes of computing cost-of-living increases.
45. Automatic benefit eligibility adjustments	Liberalizations in social security eligibility requirements will automatically be reflected in railroad retirement eligibility requirements, but reductions in social security requirements for categories not entitled to railroad retirement annuities under the 1937 act will not confer railroad retirement eligibility. If the Social Security Act is amended to provide benefits to a class not previously entitled under social security, the new class will also be provided railroad retirement benefits. The amount will be the social security benefit based on the employee's combined earnings.
46. Taxability of benefits	Only the employee supplemental annuity is subject to federal income tax.
47. Moratorium	An agreement between labor and management (not mentioned in the act) provides for a three-year moratorium on revisions.

NOTE.—The technical terms used in the table are defined as follows: Compensation—earnings derived from covered railroad employment. Fully insured—insured for retirement at age 62 under social security; does not necessarily imply an insured status for disability benefits or for survivor benefits for death before age 62. Social security benefit (when used in describing the computation of the windfall)—a primary insurance amount computed by using the social security formula and the specified earnings; does not imply an actual benefit. Wages—earnings derived from employment covered under the Social Security Act (that is, “wages” excludes railroad earnings).

## DISCUSSION OF PRECEDING PAPER

A. M. NIESSEN

Mr. Solomon deserves our thanks for calling our attention to a most interesting piece of new pension legislation whose influence may conceivably extend far beyond the area of the railroad retirement system. Furthermore, since the new railroad retirement system is perhaps the most complicated and multiphased pension program in existence today, Mr. Solomon is to be congratulated for managing to give us such a readable description of it.

The paper was clearly intended as a factual summary of the 1974 Railroad Retirement Act (RRA) without any admixture of evaluation and/or critical analysis of its contents. This is understandable, since an analysis of this package of mixed fruit would be a formidable undertaking requiring a rather lengthy exposition all by itself. However, there may be room for the presentation of selected analytical or critical remarks by an observer who had the opportunity of watching the development of the 1974 RRA close at hand. This is what I will attempt in the discussion that follows.

The 1974 RRA is especially noteworthy because of the following:

1. Congress in effect took the position that any program sponsored jointly by railway labor and management should be approved without change. This was particularly true of the House committee in charge of railroad retirement legislation.
2. Even though the main purpose of the "restructuring" was to deal with the problem of the large actuarial deficiency, there was apparently no hesitation to burden the system with new and costly features.
3. The legislation has established a precedent for federal participation in the financing of pensions for nongovernment personnel.
4. There was a conflict between the social security system (OASDI) and the railroad retirement system in matters of jurisdiction and administration, and, as has happened so many times in the past, the conflict was resolved in favor of the railroad retirement system.

### *The Issue of Congressional Policy*

If the role of the federal government in the railroad retirement system had been limited solely to administration, it would have been entirely proper to leave the policymaking to railroad labor and management. However, it has been generally understood, and the provision for a subsidy in the 1974 RRA eminently confirms, that the existence of a

federal statute for the program implies a government guarantee that the benefits promised will indeed be paid. Under these circumstances, an essentially passive role on the part of Congress in the policymaking process cannot be justified. Except when certain provisions of the original bill, H.R. 15301, met with opposition from another powerful congressional committee, no change was made in the legislation. Otherwise, the industry negotiators were permitted to write their own ticket—as it has turned out, at the general public's expense.

While it is true that the railroad industry has special relations with the federal government by virtue of its interstate character and importance to the nation's security and economy, the fact remains that the railroad retirement system serves workers in private industry. It is therefore quite possible that groups in the private sector of our economy will try to follow the example set by the railroad industry and ask Congress to do for them what it has been doing for the railroad industry in the area of pensions. The passive role of Congress in railroad retirement matters is of rather long standing, but the legislative history of the 1974 RRA has given it added significance and greater weight.

#### *The Issue of Adding Liberalizations*

It seems incongruous that a pension plan in serious financial trouble should be burdened with new costly features. But this is exactly what has happened in the case of the 1974 railroad retirement legislation. Mr. Solomon tells us what these features were. What makes this action even more remarkable is that the "improvements" were made in dependent's and survivor's benefits, areas which so far have been receiving scant if any attention in private pension plans. We are told that the liberalizations were made possible by significant deliberalizations in employee benefits, but the latter are of the much-deferred variety, while the former were to take effect almost immediately. The truth of the matter is that in the area of dependent's and survivor's benefits there is probably not a single pension plan in the country which comes even close to the present railroad retirement system.

#### *The Issue of Subsidy*

From the beginning of the negotiations on the 1974 RRA, the parties included a subsidy in their plans for solving the financial difficulties of the railroad retirement system. The only question was how to go about it in order to gain acceptance by Congress. In view of the absence of any precedent for government participation in the financing of pension plans for workers in private industry (and that includes the general social security system), a decision was made to ask for additional money from



social security under a new interpretation of the provisions regarding the financial interchange between the two systems.<sup>1</sup> The main thesis advanced was that social security should be held financially responsible for the windfall created by the heavy weighting of low average earnings which is the principal reason for the existence of the so-called dual benefit problem.<sup>2</sup> However, as soon as the hearings on the legislation started, it became apparent that a subsidy (under a different name) from social security would not be approved because of the objections voiced by the Committee on Ways and Means, which has jurisdiction over social security matters. To make matters worse, it was not an appropriate time to impose additional costs on OASDI, which itself was found to be in a rather unsatisfactory actuarial condition. The sponsors of the railroad retirement legislation promptly changed their stance and came out with a request for a subsidy from general funds, plain and simple. As could have been expected, the highly accommodating congressional committees acceded to this request, and a provision for a subsidy over the next twenty-five years in the total amount (arithmetic total) of some \$7 billion was made a part of the bill as finally passed.

The events which in rapid succession followed the passage of the bill offer an outstanding illustration of the inordinate power wielded by energetic and entrenched special interest groups. The president vetoed the bill primarily because of the subsidy issue, but the following day the veto was overridden by both houses of Congress with but a single dissenting vote in the Senate. Thus a precedent was established for subsidizing pension plans for workers in private industry, and it is difficult to see why the same should not be done for OASDI. Conceivably, the precedent could be invoked also by any private pension plan that found itself in financial straits. All that is needed is an effective and strong lobby to get the request for a subsidy accepted. This gives an inkling of the tremendous potential significance of the 1974 RRA to the entire pension system in the United States.

### *Relations with Social Security*

On a de facto basis, the railroad retirement system has not been independent of social security since the introduction of survivor benefits in 1947, and certainly not since the establishment of the financial inter-

<sup>1</sup> In general terms, the purpose of the financial interchange is to turn over to the railroad retirement system the savings OASDI would have otherwise realized because of the exclusion of railroad employment from social security coverage.

<sup>2</sup> A critical analysis of this thesis may be found in A. M. Niessen's statement on H.R. 15301. See *Hearings before the House Committee on Interstate and Foreign Commerce* (Publication Serial No. 93-94 [Washington, D.C.: Government Printing Office, 1974]), pp. 398-401.

change in 1951. However, the appearance of independence has been maintained through the years by the formal exclusion of railroad employment from social security coverage and by the preservation of the status of the Railroad Retirement Board as an independent agency. So long as there was no formal separation of the railroad retirement benefits into social security and supplemental components, formal independence of the railroad retirement system could be defended. However, the 1974 RRA has changed that by introducing a visible and distinct social security benefit (tier 1) into the railroad retirement system. Logic would demand that the tier 1 component be treated with regular OASDI benefits and be subject to social security jurisdiction. This could have been accomplished either by direct social security administration of the tier 1 benefit or by administration of the tier 1 benefit by the Railroad Retirement Board as an agent of the Social Security Administration. But what was done was to take away from social security the prerogative of directly paying benefits based on nonrailroad earnings to any individual who will become entitled to railroad retirement benefits after 1974. This is in fact a further and totally unwarranted usurpation of the jurisdictional rights of the Social Security Administration.

As could have been expected, both the Social Security Administration and the Office of Management and Budget strongly objected to this jurisdictional arrangement, but, as has happened so many times in the past, the issue was resolved in favor of the railroad retirement system. It seems difficult to understand why the interest of the national system should give way before the alleged interests of a relatively small group. Here is another example of power politics in the legislative arena.

#### *Other Observations*

In spite of the criticism voiced above, I am ready to concede that the 1974 RRA was a step in the right direction. The principal points in its favor are the formal recognition of a two-tier benefit structure and the steps taken toward the eventual liquidation of the dual benefit problem. Also, the new statute is much better organized than the previous RRA, which, because of frequent patching, became rather unwieldy. However, because of the necessity for reconciling different interests and different views, the restructured program will be extremely difficult to administer and practically impossible to explain to its clientele.

In the area of financing we are told that there has been a great improvement. However, it should be noted that not all the cost reductions will be operative for some years to come, but the cost additions are in effect today. This raises the question whether in these times of price and wage inflation it is altogether appropriate to be guided by level cost figures. It

would seem that the only meaningful guidance can be obtained from projections covering a sufficiently long period of time. One would hope that the next actuarial valuation of the railroad retirement program will have such projections.

ROBERT J. MYERS:

Mr. Solomon has done an excellent service to the actuarial profession in describing in this paper the extensive revamping of the railroad retirement system that took place in 1974. This legislation differed from any of the previous railroad retirement system amendments (and from social security amendments, too), because the benefit and financing provisions were changed very drastically. This was essential in view of the serious financial straits of the railroad retirement system.

One of the most significant features of the new legislation is the financial support that is to be given to the railroad retirement system by an annual government subsidy over the next twenty-five years. This subsidy will amount in the aggregate to about \$285 million per year—\$250 million directly and another \$35 million from a revision in the investment procedures for the railroad retirement account.

This revised investment procedure is somewhat in the nature of a “heads I win, tails you lose” proposition. If interest rates are rising, the Railroad Retirement Board can redeem at par any past investments in United States government obligations bearing low interest rates, and then can reinvest in current higher-interest-rate securities. On the other hand, when interest rates are falling, the Railroad Retirement Board can retain its high-interest investments. During the first twenty-five years, the profit from this new investment procedure is offset against the general government subsidy.

Why was a government subsidy introduced into the railroad retirement system? The answer, simply enough, is that, despite cost-reducing changes made by eliminating windfall dual benefits for future service and restructuring the benefit formula for future service so that it would not get out of control when economic conditions changed, there still remained a substantial deficit. That deficit amounted to 3.64 per cent of taxable payroll on a level cost basis, and neither the railroad employers nor the railroad employees felt that they could increase their financial burdens, the current tax rates being 15.35 per cent for the employer and 5.85 per cent for the employee (the same for the latter as OASDI and HI combined). The employers did, however, agree that if any deficits in railroad retirement system financing occur hereafter, the necessary financing therefor will be provided by them and a further government subsidy will not be required.

Initially, the employers, with the concurrence and support of the unions, sought to obtain the necessary financing to overcome the deficiency from the OASDI system. Congress would not go along with this idea and believed that the only possible source was the General Fund of the Treasury.

Some people argued that the deficiency of the system was not the fault of the general taxpayer but rather that of employers and employees, because Congress had always adopted any benefit liberalizations to which both agreed, as well as some benefits on which there was disagreement between employers and employees. According to this belief, the financial soundness of the railroad retirement system should have been achieved either from additional financial support from one or both of the parties involved or from reduction in the benefit protection. It does seem anomalous that benefits were liberalized by the 1974 amendments at the same time that there remained a large deficiency, which, it was felt, would have to be financed by the general taxpayer. President Ford apparently shared this viewpoint when he vetoed the bill, but his veto was overridden by a tremendous margin.

In my opinion, the fact that there is now a government subsidy to the railroad retirement system is not necessarily a precedent for the same treatment for OASDI. After all, there is a difference between having the general body of taxpayers subsidize a small group and having them subsidize themselves in the aggregate.

I might point out that my new book *Social Security*, published in June, 1975, and a paper that I have prepared for the 1976 meeting of the International Congress of Actuaries go into certain aspects of this somewhat more fully.

Finally, it should be noted that some of the benefits for spouses of female workers described in the appendix to the paper include dependency requirements that are not applicable in the reverse situation for male workers. A recent Supreme Court decision has declared that there must be completely equal treatment of men and women as to OASDI benefits for the surviving spouse when dependent children are present. It seems likely that this equal treatment will be required in all cases, both under OASDI and under the railroad retirement system.

(AUTHOR'S REVIEW OF DISCUSSION)

NORMAN SOLOMON:\*

Mr. Niessen and Mr. Myers have brought up some highly pertinent points in their discussions. While I felt that consideration of these points

\* Opinions expressed in this discussion are these of the author and do not necessarily reflect the official views of the Railroad Retirement Board.

was beyond the scope of a factual report of the provisions of the new legislation, their remarks have added much to the value of the paper.

The provision for a federal subsidy to the railroad retirement system was easily the most controversial element of the Railroad Retirement Act of 1974. It would be improper for me, as an employee of the Railroad Retirement Board, to become involved in a discussion concerning the fairness of this provision. In order to balance the scale, however, a statement justifying the subsidy made by William H. Dempsey, chairman of the National Railway Labor Conference, during the hearings on H.R. 15301 is quoted below:

The railroad industry is perfectly prepared to fund the railroad retirement system in every respect in which it bears a reasonable resemblance to any other private industry pension plan, and what that means is that if somehow these figures go askew and we run into difficulty in the future because we have not put enough money in with relation to the benefits that are being provided, we will fund that, we will take care of it—that is our responsibility.

The single exception is this 3.64 percent cost of phasing out dual benefits because, in our view, dual benefits are an anomaly, and in the view of the Commission on Railroad Retirement, they are a quirk in the law. They don't exist in any other industry. They never would have been the product of collective bargaining. In those circumstances, we urge that this discrete element, this single feature of the railroad retirement system, is properly a Federal responsibility, but it is only in that respect that we seek Federal funding of this whole program.<sup>1</sup>

Even with the subsidy, it is questionable whether the legislation has achieved its goal of placing the system on an actuarially sound basis. Cost estimates made at the time of enactment of the new law placed the actuarial deficiency of the restructured system in the area of 1 per cent of payroll. A new actuarial valuation of the system is under way at the time of this writing. It seems likely that many of the assumptions that went into the 1 per cent figure will have to be replaced with much less optimistic assumptions. The most important of these are the interest rate, the employment level in the railroad industry, and the rate of retirement produced by allowing a full benefit for retirement at age 60 to employees with thirty years of service. (The last-mentioned assumption will definitely have to be revised upward in the light of current knowledge and by itself will add significantly to the cost of the system.) The result may open up again the whole issue of the adequacy of the financing of the system.

<sup>1</sup> *Hearings before the House Committee on Interstate and Foreign Commerce* (Publication Serial No. 93-94 [Washington, D.C.: Government Printing Office, 1974]), p. 210.

