RSC
Republican Study Committee
Rep. John Shadegg (R-AZ), Chairman
Neil Bradley, Executive Director
432 Cannon House Office Building
Washington, D.C. 20515
http://www.house.gov/burton/RSC/
(202) 226-9717

July 30, 2001

POLICY BRIEF…………………..H.R. 1140 — THE RAILROAD RETIREMENT AND SURVIVORS' IMPROVEMENT ACT

BACKGROUND: The Railroad Retirement system is comprised of two basic parts and is administered by the federal government in consultation with labor and management. The first part is equivalent to Social Security, financed by the same taxes collected for Social Security, but paid from a special account maintained by the Railroad Retirement Board. The second part is effectively a defined-benefit pension plan financed by contributions from employers, employees, and federal tax subsidies. The federal subsidies consist of the income tax collected on benefits received by retirees. Rather than considering the funds collected from the tax on benefits as general revenue (like taxes on all other private pension benefits), the funds are transferred back to the rail industry pension fund. **In fiscal year 2000, this general fund transfer is expected to provide the rail industry pension fund with a $265 million taxpayer subsidy.**

The legislation, introduced by Chairman Young, is the result of an agreement reached between railroad management and labor proposing changes to the current system.

BENEFITS FOR THE INDUSTRY: Under the proposed legislation, the railroad industry would reduce its contributions to the retirement fund. Proponents of the legislation consider this a "tax cut," however if we were making a comparison to the private sector these "taxes" would be considered the employer contribution. Specifically, the industry benefits from the following:

- Repeal of the 26.5 cents per hour employer contribution for the supplemental annuity for employees who performed rail service prior to October 1, 1981; and
- Reduction of the employer contribution from the current 16.1% to 14.75% in 2002, 14.2% in 2003, and in years thereafter an amount determined by a formula related to the average benefits accounts ratio. (The accounts benefits ratio is based on dividing the fair market value of the assets of the retirement system at the end of a fiscal year by the total benefits and administrative expenses paid during the same fiscal year. While such a calculation may indicate the ability of the retirement system to meet its obligations in the next few years, it is not comparable to the unfunded liability calculations required for private plans under ERISA.)

BENEFITS FOR EMPLOYEES & BENEFICIARIES: In addition to having the employee contribution calculated under the new average benefits accounts ratio in 2003, employees and beneficiaries receive numerous expanded benefits, including:

- Expanded benefits for current and new widow(er)s -- (Widow(er)s would now receive benefits initially equal to the benefit due the employee at the time the widow(er)'s annuity is awarded. Currently, the tier II (pension system) widow(er) benefit is roughly equal to 50% of the employee benefit);
- Full benefits for those retiring at age 60 with 30 years of service -- (Currently, the tier I (Social Security system) benefits are reduced if the employee retirees at age 60. This is similar to the reduction in Social Security benefits for those who retire before 65.);
- Reduces the vesting requirement from 10 to 5 years; and
- Removes the current cap on the payment of earned benefits.

COST TO THE TAXPAYER: Taxpayer subsidies to the Railroad Retirement System will actually increase as a result of this legislation. Since the bill increases benefits, more income taxes will be collected on the expanded benefits, which will in turn be credited to the retirement system rather than the general fund. Preliminary estimates indicate that the federal subsidy could increase by $300 million over the next ten years as a result of enactment of this bill.

THE RAILROAD RETIREMENT TRUST FUND: The bill creates an Investment Trust, whereby a seven member panel would invest in the equity market (bonds and stocks) funds transferred from the Railroad Retirement System accounts which are currently held at the Treasury Department. The seven-member Board of Trustees would be composed of three members representing labor, three representing management, and one member representing "the interests of the general public." Members would have to be appointed by a unanimous vote of the three members of the Railroad Retirement Board, who would be appointed by the President with the advice and consent of the Senate (one member each for labor and management with the Chair representing the general public). The bill would clarify that the Investment Trust would not be department or agency of the federal government and would be subject to certain fiduciary requirements. The Investment Trust would be required to submit an annual report to Congress.

AREAS OF CONCERN:

1) **The bill will raid the Medicare and possibly Social Security Trust Funds.** CBO has scored the bill as reducing the surplus by $15 billion FY 2002. Given current surplus projections and the expected August revisions, the bill will result in a raid on Medicare and possibly push us into Social Security. Proponents of the bill are hoping to avoid the raid on Medicare and Social Security by getting OMB to revise the way it scores the bill, however, this attempt to revise the scoring raises several concerns:
    - Arguing that the government simply exchanges assets (Treasury Notes for investments in the stock market) would imply that the Investment Board created under the bill is a government entity. The bill specifically states that the Board is NOT a government entity.
    - If, as the proponents argue, we should not score the bill as a cost because we are acquiring assets which will provide a return on investment, then shouldn't we revise how we score hundreds of other government expenditures? For example, government acquisition of land with mineral deposits or forests could be scored as an asset purchase since the minerals or timber are likely to generate revenue (i.e. a return on investment) for the government.

- How do you account for the fact that as a result of this “investment” you are paying down less debt and thereby increasing interest costs to the taxpayer?

2. **The bill violates President Bush’s principles for Social Security reform.** A government created and appointed entity will invest in private markets. It will preclude private, individually controlled accounts for railroaders – Tier I is Social Security for railroaders.

3. **The bill reduces employer and employee contributions and increases employee benefits, but increases the taxpayer subsidy.**

4. **The bill fails to move towards privatization**. Rather than transferring the Social Security-equivalent benefits to Social Security or creating a transition system to move new and younger workers into a private pension system, the bill simply provides for a mechanism whereby employees receive greater benefits with fewer employee and employer contributions.

5. **The bill fails to address the fact that if the Railroad Retirement system were governed by ERISA, it would have an unfunded liability of approximately $40 billion** (12/31/98) *(Source: U.S. Railroad Retirement Board Twenty-First Actuarial Valuation).* In fact, the benefit increases and contribution reductions under the bill will reduce the value of the fund by an estimated $6.7 billion over the next ten years. (Proponents argue this will be more than made up from the increased investment returns of the equity market.)

6. **Unlike the Thrift Savings Board, which administers a defined-contribution plan, the Investment Trustees under this bill would administer what is essentially a defined-benefit plan.** As Congress considers how Social Security should be converted into an investment based system it is important to note that the new Investment Trust established under this bill would be similar to a government board investing Social Security funds when those funds are connected to individual benefits rather than separate individual accounts. <u>This is the exact opposite direction of where most Members want to go with Social Security.</u>

The views expressed in this Policy Brief do not necessarily reflect the views of all Members of the Republican Study Committee.