

# Restructuring the Railroad Retirement System

by ALFRED M. SKOLNIK\*

*The Railroad Retirement Act of 1974 embodies some far-reaching changes mainly directed toward relieving the difficult financial situation of the nearly 40-year old railroad retirement system. The measure eliminates the dual payment of social security and railroad retirement benefits for future beneficiaries and provides that the cost of phasing out dual benefit rights already acquired will be met through general revenue appropriations. The system established under the Railroad Retirement Act of 1937 is restructured into two tiers of benefits—the first based on both railroad and nonrailroad employment and the second based on railroad service alone. Cost-of-living increases are provided in both tiers for persons on the rolls, as well as for future beneficiaries.*

ON OCTOBER 16, 1974, Congress passed the Railroad Retirement Act of 1974 (Public Law 93-445), overriding the President's veto. The legislation was based on proposals made jointly by railroad management and labor to restructure the railroad retirement system and to ease its financial difficulties. Railroad retirement benefits hereafter consist of two components: the first tier computed under the Social Security Act, counting all railroad employment as employment covered under the old-age, survivors, disability, and health insurance (OASDHI) program; and a second tier based on railroad service alone, computed under the new Railroad Retirement Act.

The financial difficulties of the railroad retirement system stem principally from two factors. The first is diminishing revenue prospects, arising out of a dwindling railroad labor force, in the face of ever-increasing benefit commitments. Since the end of World War II, the average number of workers in the industry has declined from 1,700,000 to fewer than 600,000, while the number of beneficiaries on the rolls has risen to more than 1 million. The second factor is the costs arising out of the payment of full railroad retirement benefits to individuals also entitled to OASDHI benefits—the so-called dual benefit cases.

Concern over the financial straits of the system led Congress in 1970 to establish a Commission on Railroad Retirement for the purpose of recommending measures necessary to putting the system on a sound actuarial basis. Public Law 93-445 in general reflects the principles underlying the Commission's 1972 recommendations for restructuring the railroad retirement program into a two-tier system. This restructuring is designed to bring about more nearly adequate coordination between the railroad retirement and social security programs and thus prevent the future excessive costs of dual benefits.

The new law also makes permanent the three increases in the level of railroad retirement benefits that Congress, commencing in 1970, put into effect on a temporary basis because additional income to cover the increases was not provided by the law. These temporary increases, which matched those provided for OASDHI, were 15 percent, 10 percent, and 20 percent, respectively, of then existing benefits and would have expired at the end of 1974.

P.L. 93-445 completely replaces the Railroad Retirement Act of 1937 as amended and provides that no benefits will be awarded under the 1937 Act on the basis of an application filed on or after the effective date of the new law on January 1, 1975.

## FUTURE RETIREES

For employees with 10 years or more of railroad service who retire after December 31, 1974, the regular annuity under the 1974 Act will consist of two components:

Tier 1—a basic social security level component equivalent to what would be paid under the Social Security Act on the basis of the employee's combined railroad and nonrailroad service, reduced by the amount of any monthly cash benefit under OASDHI, actually paid on the basis of nonrailroad work; and tier 2—a staff level component payable over and above the social security equivalent, on the basis of a formula applicable only to railroad service.

\* Division of Retirement and Survivor Studies, Office of Research and Statistics.

The tier 1 or social security level component paid to railroad employees is to be computed according to the OASDHI benefit formula and will be subject to any future increases in OASDHI benefits. For purposes of computing this amount, an annuitant at age 60 with 30 years of railroad service is deemed to have reached age 65; an individual entitled to a railroad retirement disability annuity is deemed to meet the eligibility requirements for disability benefits under the Social Security Act. The social security retirement test also applies in general to tier 1 benefits. The test does not apply, however, to that portion of the tier 1 benefit that would have been payable based solely on railroad earnings before 1975.

The tier 2 or staff level component has two subcomponents, one based on past service (service before the changeover date of January 1, 1975) and one based on future service after 1974. There are no changes in the computation of the monthly benefit based on past service, except that it is to be reduced by an imputed OASDHI benefit amount based exclusively on railroad service through December 31, 1974. This reduction is necessary to avoid duplication of benefits since the same railroad service is now creditable under tier 1.

The future service formula uses basically the two factors of career railroad earnings and a flat dollar amount per year of service. Under this formula, the future service portion of an employee's monthly annuity is an amount equal to 0.5 percent of the employee's average monthly taxable compensation after 1974, plus \$4 multiplied by the employee's years of service after 1974.

Both the past service and future service subcomponents are subject to a cost-of-living escalator. The law itself spells out the increases, providing for four fixed automatic cost-of-living adjustments during the 6-year period commencing January 1, 1975. Unlike the social security cost-of-living adjustment, the railroad adjustment provides for an increase in a particular year even if the increase in the consumer price index on which the adjustment is based is less than 3 percent—the minimum needed to trigger an increase in OASDHI benefits.

The first such adjustment, which is scheduled for January 1, 1978, will be an amount equal to

65 percent of the increase in the consumer price index between September 1976 and September 1977. Similar adjustments are to be made as of January 1 of each of the following 3 years, and each such adjustment is to apply to all employees (and their spouses) who retire after the effective date of the adjustment. To avoid what would be, in effect, duplicate benefit increases, however, the portion of the future service annuity based on 0.5 percent of average monthly compensation is subject to the 65-percent increase factor only after any increase in the average monthly compensation due to an increase in the tax base between 1976 and 1980 (or date of retirement, whichever is earlier) is excluded from the calculation.

The tier 2 formula also contains two transitional elements:

(1) A special credit for service before January 1, 1975. The monthly annuity will be increased by \$1.50 for each of the employee's first 10 years of railroad service before 1975 plus \$1 for each year before 1975 above 10. This increment will be provided only for employees who engage in railroad service after 1974 and is not subject to cost-of-living increases.

(2) An 8-year "grandfather" or savings clause applicable to all retirement benefits except the frozen portion of dual benefits, discussed later.

Taken together, these features assure that no employee retiring before 1983 will receive less in annuities than would have been payable under the 1937 Act on the basis of the maximum monthly compensation creditable at that time.

In addition to his regular annuity, a long-term railroad employee will continue to be eligible for a supplemental annuity if he has 25 years or more of railroad service and a "current connection" with the railroad industry (defined in both the old and new law as 12 months of railroad service out of the previous 30 months). Upon retirement such an employee will receive \$23 a month plus \$4 for each year of service above 25, up to a maximum of \$43 a month. These supplemental amounts are smaller than the range prevailing under the old law (\$45-\$70) but do not result in a lower total of regular and supplemental annuities, since the employee's receipt of a supplemental annuity under the 1974 law will no longer serve to reduce the amount of the regular annuity, as previously.

Under the new law, the maximum monthly

benefit payable to a railroad employee retiring in February 1975 is \$637. If a supplemental annuity is payable, the maximum amount is \$680.

## **CURRENT RETIREES**

Railroad employees who retired before January 1, 1975, and who are currently receiving railroad retirement annuities (including supplemental annuities) continue to draw the same amounts they were receiving before the changeover date. Their annuities, however, are similarly divided into social security level and staff level components, and are subject to future increases, including tier 1 increases based on the automatic cost-of-living adjustment under OASDHI.

The initial cost-of-living increase for tier 2 benefits becomes effective as of June 1, 1977, and will be an amount equal to 32.5 percent of the increase in the consumer price index between the first quarter of 1976 and the first quarter of 1977 (rounded to the nearest 1/10 of 1 percent). Similar adjustments will be made, effective June 1 of each of the following 3 years, that will be applicable to employees whose annuities began on or before the effective date of any particular adjustment.

## **SPOUSE ANNUITIES**

Spouse annuities, like employee annuities, consist of a social security level component plus a staff level component. The benefit amount under each component, as in the previous law, is in general equal to 50 percent of the employee's corresponding annuity (exclusive of the employee's supplemental annuity), subject to the same spouse maximum as that in the old law (110 percent of the maximum comparable OASDHI benefit). As of February 1975, the maximum spouse benefit was \$247.

The social security level component is reduced if the spouse is entitled to an OASDHI benefit based on either the employee's earnings or her own earnings. The spouse, however, receives an additional tier 2 benefit amount, if she had

"vested rights" to benefits under the Railroad Retirement Act and the Social Security Act as of the changeover date. This additional amount compensates with respect to benefit rights accrued before 1975, for the reduction in the tier 1 component of the spouse's annuity because of entitlement to an OASDHI benefit. Spouse annuities being paid at the time the 1974 Act became effective are to be continued at the same rates but divided, like employee annuities, into two tiers in accordance with the provisions of the new Act and adjusted for future cost-of-living increases.

## **Maximum and Minimums**

Combined employee and spouse annuities are subject to a maximum that, in general, for the employee with maximum earnings, is the greater of \$1,200 a month or 90 percent of the employee's maximum taxable earnings in the year of retirement.

The 1974 Act contains, in addition to this maximum, two minimum provisions applicable to employee and spouse annuities. The first of these minimums guarantees that employees and spouses retiring before 1983 will not receive less than they would have received under the previous law, on the basis of the maximum creditable compensation in effect on December 31, 1974. The second minimum provision involves a deliberalization of the so-called social security minimum guaranty contained in the 1937 Act. In general, it assures that the total monthly benefits to a retired employee and his spouse will not be less than 100 percent of the amount that would have been payable to the employee's family under the Social Security Act on the basis of his combined railroad and nonrailroad earnings. Under the old law, the guaranty was 110 percent.

## **SURVIVOR ANNUITIES**

Under the new law, a survivor, like an employee and a spouse, is entitled to a tier 1 benefit computed on the basis of the deceased employee's combined railroad and nonrailroad earnings. This

benefit, like an OASDHI survivor benefit, is subject to reduction if the survivor becomes entitled to a OASDHI benefit based on his or her own earnings. It is also subject to reduction by the amount of the tier 1 component of any employee annuity to which the survivor may be entitled.

The tier 2 amount for a survivor annuity is equal to 30 percent of the tier 1 amount before any reduction because of receipt of a benefit based on the survivor's own earnings. Thus the tier 2 benefit for survivors will automatically rise whenever a cost-of-living or other adjustment is made in tier 1 benefits. An additional tier 2 benefit amount may be payable to a widow or widower who has "vested rights" to benefits under both the Railroad Retirement Act and the Social Security Act as of the changeover date.

For survivors on the rolls, the new law also provides an increase in the social security minimum guaranty from 110 percent to 130 percent of the OASDHI benefit that would have been payable had the employee's railroad service been covered under the Social Security Act. This minimum affects widows, mainly. As of February 1975, total family survivor benefits under the guaranty may not exceed \$780 (\$438, for a widow alone filing at age 65).

Lump-sum death payments are continued under the new law, but the amounts are to be computed as under the old law and frozen as of the changeover date with a maximum of \$1,161. The residual lump-sum benefit—guaranteed to assure that in no case will the benefits paid on account of the employee's railroad service be less than the taxes he paid for railroad retirement purposes—is continued with the restriction that its amount be based only on railroad compensation before January 1, 1975.

## DUAL BENEFITS

The dual-benefit problem arises from the fact that up to now railroad employees and their spouses, unlike survivors, could receive separate benefits under both the railroad retirement and social security systems. This factor has worked to the financial disadvantage of the railroad retirement system. Whenever an individual receiv-

ing railroad retirement benefits also qualified for social security benefits, the amount paid by the social security system to the railroad system under the financial interchange<sup>1</sup> on account of that individual was reduced by the total of the OASDHI benefits actually received.

This reimbursement "lost" to the railroad retirement system is estimated to have amounted to more than \$4 billion over the years. A principal factor contributing to the loss is the method by which benefits are computed under the Social Security Act. That Act grants large benefits for comparatively short service and low wages and includes, as well, a "new start" and 5-year drop-out provision. As a result, the sum of two separate benefits—one based on railroad service alone and one based on heavily weighted social security credits—is often higher than the amount of a single benefit figure under the social security formula based on combined railroad retirement and social security credits. The cost of this "excess" amount of dual benefits or differential is what, in effect, is borne by the railroad retirement system through the financial interchange.

In addition, the payment of dual benefits has been criticized on the grounds that it gives an unintended windfall to employees who split their working careers between railroads and other industries, in comparison with employees who devote their entire working careers either to the railroad industry or to industries covered under the Social Security Act. The former get a proportionately greater return for their taxes than the latter. About 40 percent of the railroad retirees were estimated to be entitled to OASDHI benefits at the end of 1974.

The new law in effect provides for the eventual elimination of the payment of concurrent benefits from the social security system to railroad bene-

<sup>1</sup>The financial interchange provision (in existence since 1951) places the social security trust funds in the same positions they would have been in if railroad employment had been covered after 1936 under the Social Security Act by: (1) crediting those trust funds each year with the social security taxes that would have been collected if railroad employment had been so covered and (2) crediting the railroad retirement account each year with the additional amounts of benefits (and administrative costs) that the social security system would have incurred on behalf of railroad beneficiaries if railroad employment had been covered under the Social Security Act. The net effect of the financial interchange has been a transfer over the years of \$8.2 billion from the social security system to the railroad retirement system.

ficiaries by not permitting individuals to earn credits toward a dual benefit based on wages after December 31, 1974. In the future, employees and spouses, like survivors previously, will receive benefits under either the Railroad Retirement Act or the Social Security Act (if the employee has less than 10 years of railroad service) but not both, on the basis of the employee's combined railroad and social security credits. To protect the equities of retirees now receiving dual benefits as well as of individuals not yet retired who already have vested rights under both systems, Congress provided in the new law for the gradual phasing out of dual benefit rights.

Persons receiving both railroad retirement and social security benefits as of December 31, 1974, will continue to receive their dual benefits in full.<sup>2</sup> The excess portion of these dual benefits—the part a beneficiary would not have received if a single benefit had been calculated on the basis of the combined railroad and nonrailroad service—will not, however, be subject to future increases in the level of OASDHI benefits. In effect, therefore, the excess is frozen as of the changeover date.

The vested rights of employees with sufficient railroad service (10 years) and quarters of coverage under the Social Security Act to be fully qualified under both systems who did not retire before January 1, 1975, will also be protected under certain conditions.

These persons are divided into two groups. The first consists of employees who had (1) some railroad work in 1974; (2) 25 or more years of railroad service before 1975; or (3) a current connection with the railroad industry, either as of December 31, 1974 or as of the date of retirement. This group will receive, upon retirement, a dual benefit based on service before January 1, 1975. The excess part of the dual benefit (the amount determined to be in excess of the amounts that would have been payable if the employee's railroad service and nonrailroad service had been combined in determining his benefit) is to be subject to cost-of-living increases in the level of OASDHI benefits occurring between Decem-

ber 31, 1974, and the date of retirement, at which point it will be frozen as in the case of dual beneficiaries retiring before January 1, 1975.

The second group consists of inactive railroad employees (defined generally as those without a current connection to the railroad industry and with less than 25 years of railroad service) who had fully qualified under both systems at the close of a year before 1975 in which they left railroad service. They will receive an excess dual benefit, upon retirement, calculated in the same way as for the first group, except for the exclusion of any earnings after the end of the year in which the employee left railroad service. Cost-of-living increases in OASDHI benefits before retirement will also be allowed.

For persons who retire after December 31, 1974, without vested rights, the dual benefits are eliminated. As noted earlier, such employees upon retirement will in effect receive a single benefit calculated on the basis of their railroad and nonrailroad service and thus will no longer be able to receive benefits in excess of the amounts payable if railroad service were covered under the Social Security Act. Upon retirement, such employees (or their survivors in case of the employee's death before retirement) may be entitled, however to a lump-sum refund of part of their employee taxes paid under the Railroad Retirement and Social Security Acts. Such refunds are computed by applying the employee tax rate under the Social Security Act (exclusive of the Medicare tax) to that portion of combined taxable earnings from both systems that exceeds the maximum amount creditable for 1951-74 under the Railroad Retirement Act. Beginning 1975, if the employee pays excess social security taxes because of multiple employment, he can obtain a refund promptly by claiming it on his Federal income tax return for the year.

The new law contains generally similar provisions for terminating or phasing out dual benefits of spouses and survivors of railroad employees.

## ELIGIBILITY REQUIREMENTS

The eligibility requirements for regular employee annuities for age and disability remain

<sup>2</sup> Under certain conditions, the railroad dual benefit is subject to offsets included in the old law to eliminate the railroad duplication of increases under the 1965, 1967, and 1969 social security amendments.

unchanged under the new law. The conditions under the 1974 Act for an employee's entitlement to a supplemental annuity differ only to the extent that, for employees whose annuities first began after June 30, 1974, the employee with 30 years of service is eligible for a supplemental annuity at age 60, rather than at age 65. This liberalization is designed to provide consistency with the early retirement provisions enacted in 1973 (Public Law 93-69) that allowed male railroad employees to receive an unreduced regular annuity at age 60 after 30 years' service—an option previously available only to women employees.

For spouses, the eligibility requirements were liberalized to allow a spouse of an employee with 30 years of railroad service, beginning January 1, 1975, to receive an unreduced annuity when both the spouse and the employee reach age 60. Previously, the spouse was eligible only if both had attained age 65. This liberalization is applicable only when the employee's annuity first began after June 30, 1974.

In addition, a spouse of an employee with less than 30 years of railroad service can receive either an *unreduced* annuity when the employee reaches age 62 and the spouse has reached age 65 or has a child of the employee in her care, or a *reduced* annuity when both the employee and the spouse reach age 62. Previously, the spouse (without a child in her care) could receive an unreduced annuity only when the employee and the spouse was aged 65 or a reduced annuity when the spouse was aged 62. This liberalization is applicable only where the employee's annuity first begins after December 31, 1974.

The eligibility requirements for survivor annuities in the old law are unchanged. Under the new law, future liberalizations of eligibility requirements under the Social Security Act for both cash benefits and Medicare, as well as any future additions of new types of benefits, will automatically apply to railroad employees—with certain exceptions generally intended to prevent duplication of benefits and to retain eligibility requirements not affected by such future amendments to the Social Security Act. The 1974 Act does not, however, qualify for entitlement those groups—such as divorced wives, surviving divorced mothers, or children of living employees—

that were not entitled to railroad retirement annuities under the old law.

## FINANCING

Public Law 93-445 makes permanent the employer-employee contribution schedule provided in the 1973 legislation. The tier 1 component (including hospital insurance) will be financed by equal contributions from employers and employees under the same contribution schedule as that used for the social security system (in 1975, 5.85 percent each on covered earnings of up to \$1,175 a month). The benefits will be financed by the social security system through the continued operation of the financial interchange.

All benefit costs other than those for tier 1 benefits are to be financed entirely by the railroad employers through the railroad retirement account. The 1975 rate for the tier 2 component is 9.5 percent of taxable payroll. (The entire employer rate for the two tiers is thus 15.35 percent.) These figures exclude the cost of the supplemental annuity plan, financed entirely by employers through a tax of 7½ cents per man-hour of work performed. Under the 1974 Act the tax rate for the supplemental annuity plan continues to be levied at rates necessary to support the supplemental annuities at the level provided under the old law, even though the new law provides smaller supplemental annuities. Any excess funds, will subsequently be transferred to the railroad retirement account.

The cost of phasing out the dual benefits after December 31, 1974, is to be met by annual appropriations from general revenues. The railroad retirement system is thus relieved of part of the expenses of dual benefits during the phase-out period—both for beneficiaries on the rolls at the changeover date and for subsequent beneficiaries who had acquired vested rights to OASDHI benefits. This issue of subsidizing the railroad retirement system from general revenues, which calls for estimated expenditures of \$7 billion over the next 25 years, was the major reason for the President's veto of the 1974 Act.

The new law shifts to the Railroad Retirement Board the authority over investment of funds now exercised by the Secretary of the Treasury and directs that any additional income earnings

produced by this arrangement will be used to reduce the general revenue cost of phasing out dual benefits.

#### **ADMINISTRATION**

Under the new law, the Social Security Administration will continue to administer the OASDHI benefits of railroad workers and annuitants with 10 or more years of railroad service who have qualified for such benefits before 1975. For workers with 10 or more years of railroad service (and their qualified dependents or survivors) who first become entitled to OASDHI benefits after 1974, the Social Security Administration will certify the amount of their OASDHI benefits to the Railroad Retirement Board instead of to the Secretary of the Treasury for payment.

If the person is not a railroad retirement beneficiary, the Railroad Retirement Board will forward the certification to the Secretary of the Treasury. If the person on whose behalf the certification has been made is at that time a railroad retirement beneficiary, the Board will compute or, when necessary, recompute the individual's tier 1 benefit. If the employee is eligible for dual benefits, the necessary adjustments (including the freeze on a portion of the benefits) will be made in the individual's check, which is to be paid out of the railroad retirement account and reimbursed under the financial interchange.

The Railroad Retirement Board thus has the task of determining the portion of each dual

beneficiary's railroad retirement check that is not subject to cost-of-living or other increases. Such a computation, however, need be made only once—initially when the Board computes or recomputes all benefits to split them into tier 1 and tier 2 levels. To determine the amount subject to the freeze, the Board will compute the OASDHI benefit to which the individual would have been entitled solely on the basis of railroad service and then the OASDHI benefit to which the individual would have been entitled solely on the basis on nonrailroad service performed either by him or the person through whom the benefit is determined. To the extent that the total of these two amounts exceeds the amount to which the individual would have been entitled under the Social Security Act on the basis of combined railroad and nonrailroad service, the excess will be frozen.

#### **OTHER CHANGES**

Beginning 1975, the compensation attributable to an individual's military service creditable under the Railroad Retirement Act is the amount reported as wages for such military service under the Social Security Act, instead of the previous flat \$260 a month.

Railroad disability annuities are to be converted to regular age annuities at age 65, as under the social security program. Previously, a disability annuity continued after the employee attained age 65.