

No. 31

November 28, 2001

## **H.R. 1140 – Railroad Retirement and Survivors’ Improvement Act of 2001**

This bill was referred to the Finance Committee (as was a similar bill, S. 697); neither bill has been marked up or reported, and no hearings have been held.

### **NOTEWORTHY**

- Having failed to receive unanimous consent to proceed to the Railroad Retirement and Survivors’ Improvement Act ([H.R. 1140](#), [H.Rept. 107-82](#)), Majority Leader Daschle on Tuesday (November 26) filed cloture on his motion to proceed to H.R. 10, the Comprehensive Retirement Security and Pension Reform Act of 2001. Senator Daschle intends to use H.R. 10 as a vehicle to offer the text of H.R. 1140 or something similar. A **cloture vote** on the motion to proceed to H.R. 10 will occur on Thursday, November 29. This Notice addresses H.R. 1140 as it was passed by the House.
- **Proponents**, including the 75 cosponsors of the Senate version (S. 697), note H.R. 1140 would improve the Railroad Retirement System by increasing benefits (through greater surviving spouse’s benefits, a lower retirement age, accelerated vesting, and repeal of the maximum benefit limit), lowering payroll taxes, and increasing returns on Railroad Retirement funds by allowing them to be invested in private securities.
- **Senators opposed** to H.R. 1140 contend the bill (1) would drain \$15.6 billion from the 2002 surplus, (2) would fraudulently hide this money drain by redefining outlays, (3) would allow government ownership of private companies, (4) would increase benefits to and would decrease taxes on railroad workers in the face of a \$40 billion unfunded railroad pension liability, (5) would lower the retirement age for railroad workers from 62 to 60 while the retirement age for other workers is rising from 65 to 67, (6) ultimately would increase taxes on rail employers, and (7) that there have been no Senate hearings on the bill.
- **The House approved** H.R. 1140 on July 31, 2001, by a vote of 384-33.
- **The Bush Administration** in a May 8, 2001, letter expressed its opposition to allowing government investment in the stock market, as H.R. 1140 would do (see Administration Position section, p. 6).

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## HIGHLIGHTS

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H.R. 1140 would make significant changes to the Railroad Retirement system. Borne of an agreement between railroad labor and management, the bill would (1) enhance retirement benefits for rail workers and their widows, (2) reduce payroll taxes on employers, employee representatives, and employees, and (3) allow Railroad Retirement funds to be invested in the stock market. The enhanced benefits would include:

- Allowing 100 percent benefits for widows and widowers of eligible retirees (compared to 50 percent in current law),
- Lowering the retirement age from 62 to 60 years,
- Allowing full vesting in the retirement program after 5 years (compared to 10 years in current law), and
- Eliminating the upper limit on retirement benefits.

Payroll taxes on employers and employee representatives would be reduced in 2002 and again in 2003. Thereafter, payroll taxes on these groups and employees would float according to the ratio of assets to liabilities (benefits payable). If assets are less than four times benefits, payroll tax rates would rise. If assets are greater than six times benefits, tax rates would fall. This would occur without congressional action.

Finally, H.R. 1140 would create a National Railroad Retirement Investment Trust that would be authorized to invest railroad retirement funds in securities, including stocks and bonds. Proponents argue the higher rates of return on private securities would better enable the Railroad Retirement system to meet its obligations to retirees.

Support for H.R. 1140 is overwhelming in both the House (where it passed 384-33) and the Senate, as measured by the 75 senators sponsoring its counterpart, S. 697. However, objection was heard to the motion to proceed, thus precipitating the cloture vote. [For details on opponents' concerns, see the Other Views section of this Notice.]

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## BACKGROUND

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The following text is taken from House Report 107–82, Part I, (May 24, 2001, pp. 11-13).

The railroad retirement system was created separate from the Social Security program through a series of laws enacted in the 1930's, culminating in the Railroad Retirement and Carriers' Taxing Acts of 1937. There was ample precedent for legislation taking into account the particular circumstances of the rail industry. Numerous laws pertaining to rail operations and safety, as well as the Railway Labor Act of 1926, had been enacted since the Interstate Commerce Act of 1887, and many more have been enacted since the 1930's.

The need for a separate railroad retirement system arose from the inadequate financing of many of the railroads' preexisting private pension plans, and a desire to promote employment opportunities for younger workers in the nation's largest industry through the creation of a system of immediate benefit payments to older workers based on accumulated service. Social Security did not begin paying benefits until 1940 and did not credit service prior to 1937.

Substantive changes to the Railroad Retirement and Carriers' Taxing Acts of 1937, including its replacement by the current Railroad Retirement Act of 1974, and substantive amendments to that latter Act have generally been enacted on the basis of joint recommendations negotiated by representatives of rail labor and management.

The last major reform of railroad retirement occurred in 1983 with enactment of the Railroad Retirement Solvency Act. This Act raised tier 2 tax rates on both employers and employees, and for the first time subjected railroad retirement tier 2 benefits to federal income tax. It also raised the age at which one can receive a full annuity from 60 with thirty years of service to 62 with thirty years of service.

The railroad retirement system is administered by the Railroad Retirement Board, which is an independent agency in the executive branch of the United States Government. The Board has three members, each of whom is appointed by the President and confirmed by the Senate. The Railroad Retirement Act requires that one Board Member be appointed upon the recommendation of railroad labor and another Member appointed on the recommendation of rail management. The Chair is appointed to represent the public at large.

The primary annuities paid under the Railroad Retirement Act consist of two different components called tiers. The tier 1 benefit is based upon both the railroad and non-railroad earnings of the railroad employee, using social security formulas, and approximates (with some minor exceptions) what would be payable under the Social Security Act. Tier 2 benefits are based on an employee's railroad service only and are computed under benefit formulas in the Railroad Retirement Act. Tier 2 is the functional equivalent of a private industry-wide pension plan.

In fiscal year 2000, the Railroad Retirement Board paid \$8.3 billion in retirement and survivor benefits to 724,000 beneficiaries. At the end of fiscal year 2000, there were 308,597

railroad retirees, 161,283 spouses or divorced spouses of retirees, and 211,291 survivors receiving railroad retirement benefits.

Payroll taxes on railroad employers and employees serve as the primary source of funding for railroad retirement benefits. Other sources include fund transfers under the financial interchange with the Social Security system for tier 1 benefits; investment earnings from the trust funds; general revenue appropriations for vested dual benefits; income taxes on benefits; and a work hour tax paid by railroad employers called the supplemental annuity tax.

The changes made in H.R. 1140 apply only to the tier 2 component of railroad retirement and are funded entirely by payroll taxes on railroad employers and employees and earnings from the investment of those taxes. Currently, railroads pay a 16.1 percent payroll tax and employees pay a 4.9 percent payroll tax for tier 2 benefits. H.R. 1140 would not create any general fund subsidies to the railroad retirement system.

### **Legislative History and Committee Consideration**

On September 17, 1998, the Subcommittee on Railroads held a hearing on H. Con. Res. 52, modifying the Railroad Retirement tier 2 Benefits for Widows and Widowers, which had been introduced by Congressman Jack Quinn (R-NY). H. Con. Res. 52 was a concurrent resolution urging that the railroad industry, including rail labor, management and retiree organizations, open discussions for adequately funding an amendment to the Railroad Retirement Act of 1974 to modify the guaranteed minimum benefit for widows and widowers. Following the hearing, rail labor and management initiated discussions on a comprehensive reform of railroad retirement.

H.R. 4844, introduced in the 106th Congress, was cosponsored by the bipartisan leadership of the Transportation and Infrastructure Committee and the Ways and Means Committee, and represented the agreement between management and a majority of rail labor that came out of those negotiations. Following Committee consideration, H.R. 4844 was brought to the House floor, where the bill passed 391–25. The legislation was subsequently reported out of the Senate Committee on Finance, but not considered on the Senate Floor. The Railroad Retirement reform measure was reintroduced in the 107th Congress by Chairman of the Transportation and Infrastructure Committee, Don Young, and Ranking Member Jim Oberstar, as H.R. 1140. H.R. 1140 was identical to the House-passed version of H.R. 4844. In Committee, the Subcommittee on Railroads amended H.R. 1140, inserting new effective dates to reflect the passage of time, and making other minor technical changes. On May 9, 2001, the Subcommittee on Railroads met in open session and favorably reported H.R. 1140. On May 16, 2001, the Committee on Transportation and Infrastructure met in open session and favorably reported H.R. 1140.

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## **BILL PROVISIONS**

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## **TITLE I – AMENDMENTS TO RAILROAD RETIREMENT ACT OF 1974**

### **Sec. 101. Expansion of widows' and widowers' benefits.**

This section would increase widows' and widowers' Tier II benefits from 50 percent to 100 percent of the amount for which the deceased employee would be eligible.

### **Sec. 102. Retirement age restoration.**

This provision would lower the full retirement age for railroad workers from 62 to 60.

### **Sec. 103. Vesting requirement.**

This section would reduce the length of service required to be fully vested (*i.e.*, fully eligible) for benefits from 10 years to five years of post-December 1995 employment.

### **Sec. 104. Repeal of railroad retirement maximum.**

This provision would eliminate the current maximum limit on total monthly benefits a retiree may receive. Currently, this limit is based on the average of the two highest-earning years of the last ten years of employment.

### **Sec. 105. Investment of railroad retirement assets.**

This section would create a National Railroad Retirement Investment Trust that would invest federal railroad retirement funds in securities, including stocks and bonds.

### **Sec. 106. Elimination of supplemental annuity account.**

The bill would eliminate this fund and direct the Treasury to transfer its assets to the National Railroad Retirement Investment Trust.

### **Sec. 107. Transfer authority revisions.**

This section governs how excess administrative funds may be invested.

### **Sec. 108. Annual ratio projections and certifications by the Railroad Retirement Board.**

This section would require the Railroad Retirement Board to calculate annually the ratio of assets to benefits for purposes of determining annual Tier II tax rates. If assets are less than four times benefits,

Tier II taxes would automatically increase. If assets are greater than six times benefits, the tax rates would automatically decrease.

**TITLE II – AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1986**

**Sec. 202. Exemption from tax for National Railroad Retirement Investment Trust.**

This section would make the National Railroad Retirement Investment Trust a tax-exempt organization under section 501(c).

**Sec. 203. Repeal of supplemental annuity tax.**

The supplemental annuity tax (\$0.265/worker/hour) finances a benefit for long-time railroad employees. This section would eliminate the supplemental annuity tax and finance this benefit out of the Railroad Retirement Account.

**Sec. 204. Employer, employee representative, and employee tier 2 tax rate adjustments.**

This section would change the current Tier II tax rates for employers, employee representatives, and employees. Employers and employee representatives would see their rates cut in 2002 and 2003. After 2003, all three groups would face tax rates determined by the 10-year average account benefit ratio formula.

	<u>Tier II Tax Rate</u>			
	<u>Current</u>	<u>2002</u>	<u>2003</u>	<u>2004 - Beyond</u>
<b>Employers</b>	16.1 percent	15.6 percent	14.2 percent	8.2-22.1 percent
<b>Employee Representatives</b>	16.1 percent	14.75 percent	14.2 percent	8.2-22.1 percent
<b>Employees</b>	4.9 percent	4.9 percent	4.9 percent	0.0-4.9 percent

**ADMINISTRATION POSITION**

On May 8, 2001, National Economic Council Director Lawrence B. Lindsey and Office of Management and Budget Director Mitchell E. Daniels wrote congressional leaders to express the Administration's concerns with H.R. 1140. They wrote [emphasis added]:

Last week, the President appointed a Commission to Strengthen Social Security, which has been instructed to make recommendations to strengthen and modernize Social Security according to six reform principles. One of these principles is that, '*Government must not invest Social Security funds in the stock market.*' Under H.R. 1140, the reserves in a Federal retirement trust fund would be invested in the private equities market, and the proceeds from those investments would be used to pay for federal entitlement benefits.

While we are concerned about this fundamental shift in trust fund policy, we are sympathetic to some of the goals of this legislation, such as its provision to increase widows' benefits in the railroad retirement system.

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## COST

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The Congressional Budget Office (CBO) [scored](#) H.R. 1140 as reported by the House Transportation and Infrastructure Committee on May 16, 2001. According to CBO:

The net effect of H.R. 1140 would be to decrease the budget surplus by \$15.5 billion from 2002 through 2006 and by \$14.6 billion over the 2002-2011 period. Because there is little precedent for the purchase of private securities by the federal government, alternative budgetary treatments are possible that could substantially alter the budgetary impact.

For fiscal year 2002, CBO estimates H.R. 1140 would result in increased outlays of \$15.5 billion and a revenue loss of \$0.1 billion for a total decrease in the surplus of \$15.6 billion.

The House-passed version of H.R. 1140 would, according to the [Congressional Research Service](#), "direc[t] the purchase and sale of non-governmental assets (other than gains or losses from such transactions) to be treated as a 'means of financing' rather than as an outlay for scoring purposes. This change is likely to substantially decrease the cost estimate of H.R. 1140." Republican Budget Committee staff address this issue in the following section.

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## OTHER VIEWS

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## **Senator Gramm**

*(Congressional Record, 11/27/01, S12036-12038)*

I think I can say without any fear of contradiction that of all the bills I have ever seen on which cloture has been filed, this comes closest to simply being an overt effort by two established and powerful special interests to literally pilfer the retirement fund that is available for railroad retirees, and the backing for that retirement fund. . . .

In railroad retirement, we have one worker supporting three retirees. Every problem we have in Social Security, multiply it by 9, and you have some index of the problem in railroad retirement. Also, you have the implicit taxpayer guarantee behind that program. . .

What gave rise to the bill that is now before us in the form of a cloture motion is that railroads, facing some financial difficulty, got together with the railway unions and basically said: We have built up a base of financial assets – in this case Treasury bonds – of \$19.2 billion. So what we should do is take \$15 billion of that money out of the retirement program and roughly give half of it to the railroads and give half of it to the retirees. And, in the process, commit the taxpayer to deal with the problem if insolvency is faced in the future. . . .

[T]hey came up with a clever ruse. The clever ruse is to say: Look, let's take this \$15 billion and invest it. Instead of having it in Government bonds, we will invest it in stocks and bonds. So as a result of this new investment and the new rate of return that we will get, we will be able to do some things to help the railroads and to help the employees.

The problem is, before any investment is ever made, they are lowering the retirement age. They are cutting taxes on the employers. They are expanding benefits for employees, and when you add it all up, even with a higher rate of return that they hope to gain over the next 25 years, the trust fund will be \$28.7 billion lower under this new proposal than it would be under current law. The \$15 billion in question would be completely pilfered over the next 17 years. These are not my numbers. These are the numbers of the Railroad Retirement Board.

I remind my colleagues that beginning this year, based on the Social Security solvency bill we passed in the early 1980s, the retirement age for American workers is starting to go up. We are moving from 65 to 67, the age that you have to be to draw full Social Security benefits. . . .

At the very instant that we are raising the retirement age for everybody else from 65 to 67, remarkably, almost unbelievably, we lower the retirement age for people who work for railroads from 62 to 60.

Survivors of railway workers already get substantially better benefits than survivors from Social Security, but we raise those benefits. We change the vesting requirements. The net result is that over 17 years, roughly \$7.5 billion is taken out of the railroad retirement trust fund and is given to the railroads. Roughly \$7.5 billion is taken out of railroad retirement and given to beneficiaries by

lowering the retirement age, by raising survivor benefits, by changing the vesting requirements – in essence, increasing benefits. . .

The victim, as is usually the case when powerful vested interests get together, is the taxpayer. The taxpayer stands in line to cover shortfalls in the future. . .

That is the problem before us. If the bill is in fact brought up, if cloture is obtained, then I think there have to be some changes. I do not per se object to investing the money. I think there have to be protections for the railroad worker to be sure the Government doesn't direct the investments to benefit some interests other than the worker. There needs to be some firewall between the investment committee and the Government.

### **Senator Nickles**

*(Congressional Record, 11/27/01, S12038-12039)*

Unfortunately, the majority leader is now moving forward with some legislation which, I think we have informed him, leaves a lot to be desired and which doesn't fit into any national criteria as far as a national emergency. . .

This bill wasn't written by the Finance Committee. . . This bill had no input by the Finance Committee. Not one member of the Finance Committee has had any input in this bill. This is a bill written by and for special interests. . . They benefit themselves by increasing benefits, cutting taxes, and keeping Uncle Sam as the guarantor of the benefit. . .

They increase benefits far and above what almost any other pension plan in America has. Name another private pension plan that has a 100-percent survivor benefit. Social Security doesn't do that. . . For Social Security, you don't get full retirement benefits at age 60. . . .

[Some have asked], isn't this \$15 billion that we are transferring to them their money? No, not really. They may claim it is in a trust fund. I have looked it up. For the life of the railroad retirement system, the total amount of money paid out in benefits exceeds all the payroll tax contributions by employees and companies by about \$90 billion. That means Uncle Sam has been putting in and subsidizing a lot of money for the railroad retirement system since its inception. . .

[T]hey reduce payroll taxes significantly in the immediate few years, and then they expect that by the years 2020 and 2021 the payroll taxes will go up about 69 percent. In other words, under their own scheme, they say: Oh, we are going to have lots of problems. . .

We have asked for hearings on the bill. This bill has never had a hearing in the Senate . . .

### **Federal Reserve Board Chairman Alan Greenspan**

Federal Reserve Board Chairman Greenspan made the following remarks at a January 25, 2001, Senate Budget Committee hearing on the federal budget outlook:

The federal government should eschew private asset accumulation because it would be exceptionally difficult to insulate the government's investment decisions from political pressures. Thus, over time, having the federal government hold significant amounts of private assets would risk sub-optimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living that would be achieved otherwise.

### **The Informed Budgeteer (Republican Budget Committee Staff)**

#### [Caution: Dangerous Railroad Crossing Ahead](#)

Last week [July 31, 2001], the House of Representatives passed (384 to 33) H.R. 1140 – the Railroad Retirement and Survivors Improvement Act of 2001 which would not only increase railroad retirement benefits but would also permit the federal railroad retirement trust fund to be invested in private securities. Both CBO and OMB estimate that the provision allowing private investment in equities would increase outlays by \$15.3 billion in FY 2002. The House, hoping to avoid the inconvenience of a \$15.3 billion outlay in 2002 and a corresponding reduction in the surplus, directed OMB to record the \$15.3 billion as a means of financing and not an outlay.

Two weeks ago the Bulletin explained in detail why the federal purchase of equity investments is properly scored as an outlay. As a refresher, the budget of the federal government is a cash budget, not a capital budget. It currently treats other investments, from infrastructure to R & D, to education and training as an outlay. There is no consensus to treat financial investments any differently. The House “directed scorekeeping” language would require OMB to record the \$15.3 billion outlay as a means of financing. Regardless, privately investing federal trust fund surpluses means that the government will have less cash to pay off the public debt, resulting in higher government interest payments to the public. In the case of Railroad Retirement, the outlay of \$15.3 billion in federal funds means that debt held by the public will be \$15.3 billion greater than it otherwise would have been, resulting in an additional \$10 billion in debt service over the next 10 years.

The House's deviant budgetary treatment of a government-controlled investment in the private markets sets a troubling precedent for Social Security Reform. Under current scorekeeping practices, both publicly and privately-controlled investments of federal trust fund balances in equities are treated consistently – they would increase outlays. Almost every policy expert believes that the Social Security system needs to receive a greater rate of return on accumulated funds than provided by low-yielding government bonds. Much of the debate revolves around whether the Social Security funds should be invested collectively by the federal government or individually

through privately-controlled accounts. If publicly-controlled investments were recorded as a means of financing (and consequently no longer decreased the surplus) these railroad retirement-type proposals would have a significant advantage over proposals to create individual accounts.

As a final note, inserting directed scorekeeping language will change the budgetary treatment of these transactions only after the bill becomes law. Astute budgeteers know that, despite the language in the House bill, one can not avoid the Budget Act points of order that lie against this bill. CBO, as always, will score the legislation as if the directed scorekeeping language were not present. Only if the bill is enacted would CBO record the costs as directed. Thus the measure would be subject to two 60-vote points of order: a section 302(f) point of order because the measure would cause the Finance Committee to exceed its allocation and a section 306 point of order because of the inclusion of the directed scorekeeping language. *If the bill is enacted as passed the House, budget enforcement mechanisms will be prevented from reflecting the real cost. So you can be sure that Congress then will be poised to spend this \$15 billion twice - without having to make the otherwise difficult decision of allocating scarce resources. . . .*

(*Informed Budgeteer*, 107th Congress, 1st Session: No. 22, 8/6/01, <http://www.senate.gov/~budget/republican/analysis/2001/BB222-01.pdf>); italics added.

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## POSSIBLE AMENDMENTS

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- Gramm. Strike provision to lower retirement age from 62 to 60.
- Gramm. Tie benefit increases to performance of investments.
- Nickles. Transfer Tier I benefits to Social Security system.
- Nickles. End federal guarantee of Tier II benefits.
- Craig. An amendment similar to the House-passed H.R. 4, minus the tax provisions.

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