Table 2.—Social Security employee taxes as a percent of Federal income taxes, 1980–90

Year	Low earner [1]		Average earner [1]		Maximum earner [1]	
	Single	Married	Single	Married	Single	Married
1980 . .	83	329	44	66	31	37
1981 . .	80	224	46	67	27	36
1982 . .	80	188	48	68	28	38
1983 . .	81	163	49	70	30	39
1984 . .	80	148	49	69	29	38
1985 . .	84	155	52	73	30	40
1986 . .	86	159	52	74	31	40
1987 . .	86	159	52	74	31	40
1988 . .	86	159	52	74	30	39
1989 . .	86	157	52	74	30	39
1990 . .	91	165	55	78	32	41

[1] See table 1 for definition of earnings level and the assumptions used to calculate the Federal income tax.

The Social Security taxes shown are the employee taxes only and are derived by applying the combined OASDI and HI tax rates in the present law to the projected earnings amounts. The Federal income taxes shown are approximate and are based on a summary of the provisions of The Economic Recovery Tax Act of 1981 (Public Law 97-34). For the years 1985 and later, when the income tax brackets, the zero bracket amounts (standard deduction), and the personal exemption will be adjusted for changes in the Consumer Price Index, the assumed changes in the CPI are those of Alternative II-B of the 1981 Trustees Report, adjusted to a 12-month average basis for each fiscal year.

The relationship between Social Security taxes and Federal income taxes in future years is expected to continue the recent trend in that Social Security taxes will exceed Federal income taxes only in those cases of married workers with low earnings. This is especially noteworthy considering the magnitude of the income tax reductions included in Public Law 97-34 and the fact that Social Security taxes are scheduled to increase significantly through 1990.

Table 3.—Social Security employee taxes as a percent of gross wages up to maximum taxable earnings base, 1980–90

Year	Tax rate [1]	Year	Tax rate [1]
1980	6.13	1986	7.15
1981	6.65	1987	7.15
1982	6.7	1988	7.15
1983	6.7	1989	7.15
1984	6.7	1990	7.65
1985	7.05		

[1] For the Old-Age and Survivors Insurance (OASI), Disability Insurance (DI), and Hospital Insurance (HI) programs combined.

Table 4.—Federal income taxes as a percent of gross wages, 1980–90

Year	Low earner [1]		Average earner [1]		Maximum earner [1]	
	Single	Married	Single	Married	Single	Married
1980 . .	7.4	1.9	13.8	9.2	19.5	16.7
1981 . .	8.3	3.0	14.5	9.9	24.6	18.3
1982 . .	8.3	3.6	14.1	9.8	23.7	17.6
1983 . .	9.1	4.1	13.6	9.6	22.7	17.2
1984 . .	8.3	4.5	13.7	9.7	22.9	17.5
1985 . .	8.4	4.6	13.7	9.7	23.2	17.7
1986 . .	8.3	4.5	13.6	9.6	23.3	17.9
1987 . .	8.3	4.5	13.7	9.7	23.4	18.0
1988 . .	8.3	4.5	13.6	9.6	23.6	18.2
1989 . .	8.3	4.6	13.7	9.7	23.8	18.4
1990 . .	8.4	4.6	13.8	9.8	24.0	18.7

[1] See table 1 for definition of earnings level and the assumptions used to calculate the Federal income tax.

Recent Changes to the Railroad Retirement Act*

The recently enacted Economic Recovery Tax Act of 1981 (Public Law 97-34) and the Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) make significant changes in the Railroad Retirement system to improve its financing situation. Public Law 97-34 provides for increased Railroad Retirement revenues through a new payroll tax on railroad employees and an increase in the payroll tax for railroad employers. Public Law 97-35 reduces the overall benefit outgo under the system, although certain minor benefit liberalizations are provided for. The changes made by these two acts were necessary because, under prior law, the Railroad Retirement system would have had insufficient funds to pay benefits by April 1982.

The new legislation is expected to preserve the financial solvency of the Railroad Retirement system for at least the next 10 years. However, Public Law 97-35 also requires the President to report to Congress by October 1, 1982 (the start of the new fiscal year), on options to assure the system's long-term actuarial soundness.

Background

The Railroad Retirement system provides a multitier system of benefits and is coordinated with Social Security. Tier I was roughly equivalent to Social Security, except that (1) certain small categories of auxiliary beneficiaries eligible under Social Security (such as divorced spouses, remarried widows, and dependent surviving parents) were not eligible under Railroad Retirement, (2) under Railroad Retirement, employees at-

*Prepared by the staff of the Office of Legislative and Regulatory Policy, Office of Policy, Social Security Administration.

taining age 60 with 30 years of service were eligible to retire with full annuities, and (3) Railroad Retirement employees were eligible to retire on an occupational definition of disability. (In the 1981 legislation, only item (1) of Tier I has been changed; items (2) and (3) remain the same.)

Tier II is a component based on the employee's length of service and taxable compensation in the railroad industry. In addition, a so-called "windfall-benefit" component is payable to employees and spouses who had vested rights to both Railroad Retirement and Social Security benefits prior to 1975 and who would, in the absence of this provision, have received lower benefits under amendments enacted in 1974. These amendments provided for closer coordination of future Railroad Retirement and Social Security benefits (among other things). The Railroad Retirement system also has supplemental annuities based solely on length of service in the industry.

The Social Security and Railroad Retirement systems are coordinated through a financial interchange. The purpose of the financial interchange, established in 1951, is to put the Social Security trust funds in the same position that they would have been in if railroad employment had been covered under the Social Security Act since 1937. Each year, the Railroad Retirement system credits to the Social Security system the amount of Social Security taxes that would have been paid if railroad employment had been covered under Social Security; at the same time, Social Security credits to the Railroad Retirement system the amount of Social Security benefits that would have been paid (less any actual Social Security benefits paid to Railroad Retirement beneficiaries based on nonrailroad work) if railroad employment had been covered under Social Security. This transfer of funds occurs approximately 8 months after the end of the fiscal year for which it is made. The net result has been that the Social Security Administration has transferred a total of $16.4 billion to the Railroad Retirement Account since 1950.

Financial Crisis in Railroad Retirement

The Railroad Retirement Act of 1974 was intended to put that system on a sound financial basis. Nonetheless, the financial condition of the system continued to deteriorate. Expenditures exceeded income in each year since 1974, and the fund was expected to have insufficient revenue to meet its obligations by April 1982. This financial crisis resulted from (1) a reduction in tax revenue below the level anticipated due to an unforeseen decline in railroad employment (about 600,000 employees on an average day in 1974, compared with 510,000 in the first half of 1981); (2) higher than anticipated cost-of-living increases; and (3) an underestimate of the cost of the "windfall" benefits coupled with inadequate appropriations for those benefits. In 1980, "windfall" benefits were paid to about 400,000 eligible recipients and amounted to approximately $440 million—but only $313 million was appropriated; the remaining $127 million was paid from funds in the Railroad Retirement Account.

In addition, although the lag in the transfer of funds from Social Security to Railroad Retirement does not contribute to the revenue shortfall over the long range, it does cause Railroad Retirement cash-flow problems because benefits must be paid before reimbursement is in hand. In fiscal year 1980, the amount transferred from Social Security to Railroad Retirement under the financial interchange was $1.4 billion, which represented 30 percent of total benefit payments ($4.8 billion) from the Railroad Retirement Account.

Recent Legislation

Recognizing the Railroad Retirement system's financial problems, Congress enacted legislation in 1980 (Public Law 96-582) requiring a joint railroad labor and management group to submit its recommendations to Congress for dealing with these financing problems by March 1981. Although this deadline was not met (because railroad labor and management could not reach a final agreement on the recommendations), the group's proposals on taxes, benefit revisions, and borrowing authority were considered by the Congress in its development of the new legislation during the budget reconciliation process. The most important provisions of Public Law 97-34 and Public Law 97-35 are summarized below.

Tax Increases and Benefit Reductions

To finance Tier-II benefits, Public Law 97-34 provides for an increase in payroll taxes for employers from 9.5 percent to 11.75 percent. It also provides for a new 2-percent payroll tax on employees in addition to the employee-employer equivalent of Social Security taxes that finance Tier I. This provision will result in an estimated increase in revenue of $1.8 billion for the three fiscal years 1982-84.

Public Law 97-35 contains two provisions that will reduce "windfall" benefit costs. The first provides that no new "windfall" benefits may be awarded after enactment to any employee on the basis of a spouse's Social Security employment. Also, after the date of enactment (August 13, 1981), no new spouse or widow "windfall" benefits will be awarded. This provision was enacted to avoid a sharp rise in "windfall" costs due to the recent decision of the U.S. Court of Appeals (Seventh Circuit) in **Gebbie v. United States Railroad Retirement Board.** The court held that the Social Security Act's dependency requirements for widowers (and, therefore, for husband's benefits), which were held unconstitutional by the U.S. Supreme Court in 1977, also do not apply in determining entitlement to "windfall" benefits. This provision will save $396 million in the three fiscal years 1982–84.

The second provision establishes a Dual Benefits Payment Account, from which "windfall" benefits are to be paid. The gross amount of "windfall" payments from this account cannot exceed the amounts appropriated to it; if the appropriation is insufficient to pay all benefits due under the law, the Railroad Retirement Board is required to allocate the available funds equitably. A shortfall in appropriations can no longer be made up from other funds in the Railroad Retirement Account. For the three fiscal years 1982–84, savings are estimated at $199 million. Based on anticipated appropriations, the average "windfall" benefit will be reduced by an estimated 21 percent.

Public Law 97–35 also provides for a reduction in the spouse's Tier-II annuity from 50 percent of the employee's Tier-II annuity (but with a maximum, which was not often applicable) to 45 percent (with no maximum). The rates of Tier-II survivor annuities are also changed—from 30 percent of the employee's Tier-I (Social Security) benefits to 50 percent of the employee's Tier-II annuity for a surviving spouse and to 15 percent for a surviving child, with a family minimum of 35 percent and a family maximum of 80 percent. Also, the cost-of-living adjustments will be at the rate of 32.5 percent of the Consumer Price Index change, rather than 100 percent, and will be applicable to beneficiaries on the rolls at enactment as well as new beneficiaries. Savings as a result of these changes are estimated at $102 million for the three fiscal years 1982–84.

In addition, Public Law 97–35 eliminates the supplemental annuity benefit for employees hired after October 1981. This provision, however, will have no financial impact until after the year 2000.

Benefit Changes

Public Law 97–35 simplifies the Tier-II benefit formula. The intent of the change is to produce, on the average, about the same benefits as the previous complicated method. The old formula consisted of three components with calculations based on an employee's compensation and years of service during different time periods before and after 1974. Under the new method, the Tier-II benefit will equal 0.7 percent of an employee's average monthly compensation for his or her 60 months of highest earnings, multiplied by the number of years of service. Permanent authority is provided for annual Tier-II automatic cost-of-living increases equal to 32.5 percent of the corresponding Social Security increases. (Under prior law, such increases were not provided after 1980, although an increase was made on an ad hoc basis for 1981.) The estimated cost of these provisions is $102 million for the three fiscal years 1982–84 (due to the cost-of-living increases and the use of a benefit formula that responds automatically to wage increases).

Public Law 97–35 also provides Tier-I benefits for additional categories of beneficiaries—divorced wives, surviving divorced wives, remarried widows, and surviving divorced mothers. Before this change, no Tier-I benefits were payable to these groups, even though benefits were payable to such categories under Social Security, and funds equivalent to the amount of the benefits for the Railroad Retirement groups were transferred to the Railroad Retirement Account under the financial interchange. The estimated cost of this provision to the Railroad Retirement Account for the three fiscal years 1982–84 is $36 million.

Borrowing Authority and Benefit Preservation

In any month in which there are insufficient funds in the Railroad Retirement Account to pay benefits, Public Law 97–35 provides the Railroad Retirement Board with authority to borrow from the general fund against Social Security/Railroad Retirement financial interchange obligations due but not yet payable to the Railroad Retirement Account. Loans outstanding, which are repayable with interest, cannot exceed the amount that the Board projects is due from the financial interchange in a given fiscal year.

Public Law 97–35 further provides that, in any fiscal year in which the Board estimates that it will use 50 percent or more of this borrowing authority, railroad management and labor must submit proposals to the President and the Congress to deal with the funding situation. Additionally, in any year in which the Board estimates that revenues will be insufficient to fund benefits fully, it must issue regulations providing for the reduction of benefits in such a way as to assure a constant level of the maximum possible benefit payments throughout the year. In no case, however, may payments be less than individuals would have received if their railroad employment had been covered by Social Security.

Book Review

Aging and Retirement, by Anne Foner and Karen Schwab. Monterey, CA: Brooks/Cole Publishing Company, 1981. $8.95. 132 pages.

This book provides a short but comprehensive review of current research on a wide variety of issues related to