Notes and Brief Reports

Recent Changes to the Railroad Retirement Act*

The recently enacted Railroad Retirement Solvency Act of 1983 (Public Law 98-76) makes important changes in the Railroad Retirement system in order to improve its financial situation. In the absence of corrective legislation, tier II benefits—the railroad pension component—would have been reduced by 40 percent effective October 1, 1983. As a result of the changes made by Public Law 98-76, it is expected that the Railroad Retirement system will able to meet its obligations for the foreseeable future.

Background

The Railroad Retirement system provides a multi-tier system of retirement, survivor, and disability benefits and is coordinated with the Social Security Old-Age, Survivors, and Disability Insurance (OASDI) program. Tier I retirement benefits are roughly equivalent to retirement benefits under Social Security. However, under the Railroad Retirement system, employees reaching age 60 with 30 years of service are eligible to retire.

Tier II benefits are based only on the employee's length of service and taxable compensation in the railroad industry. In addition, a dual benefit is payable to employees who had vested rights to both Railroad Retirement and OASDI benefits before 1975 and who would, in the absence of this provision, have received lower benefits under Railroad Retirement legislation enacted in 1974. The Railroad Retirement system also pays supplemental annuities based solely on length of service in the industry.

Social Security and the Railroad Retirement system are coordinated through a financial interchange. The purpose of the financial interchange, established in 1951 but retroactive to 1937, is to put the OASDI Trust Funds in the same position that they would have been in if railroad employment had been covered under Social Security. (A financial interchange also exists between the Hospital Insurance Trust Fund and the Railroad Retirement system.) Each year, the Railroad Retirement system credits to the OASDI Trust Funds 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 OASDI benefits that would have been paid (less any OASDI benefits actually 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 OASDI Trust Funds have transferred a total of $22 billion to the Railroad Retirement system since 1950.

In major railroad legislation enacted in 1981 (included in Public Law 97-35, the Omnibus Budget Reconciliation Act of 1981), Congress authorized the Railroad Retirement Board to borrow from the general fund of the Treasury against amounts due but not yet payable from the financial interchange. The law further provided that in any fiscal year in which the Railroad Retirement Board estimated that it would use 50 percent or more of the borrowing authority, railroad management and labor must submit proposals to the President and the Congress to deal with the funding situation. Also, in any year in which revenues would be insufficient to pay benefits, regulations must be issued reducing Railroad Retirement benefits; however, benefits could not be less than individuals would have received if their railroad employment had been covered by Social Security.

Under these provisions, railroad management and labor reported to the President and the Congress in February 1983 that in fiscal year 1983 the Railroad Retirement Board would use more than 50 percent of its borrowing authority. They also advised that regulations were being prepared to cut tier II benefits an estimated 40 percent effective October 1, 1983, rising to an estimated 80 percent effective October 1, 1984. Among the factors contributing to the crisis in the financing of the Railroad Retirement system were the continuing decline in railroad employment levels that led to lower than anticipated revenues and borrowing by the Railroad Unemployment Insurance program from the Railroad Retirement Account. (Currently, all Railroad Retirement system revenues from taxes and the financial interchange are deposited in the Railroad

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Retirement Account, and tier I and tier II benefits are paid from the Railroad Retirement Account.)

1983 Legislation

The major provisions of the Railroad Retirement Solvency Act of 1983, enacted August 12, 1983, are summarized below.

Revenue Provisions

The following tabulation shows the tier II Railroad Retirement tax rates as a percentage of earnings for employers and employees under Public Law 98-76 and prior law.

Year	Employer	Employee
Prior law	11.75	2.00
Public Law 98-76:		
1984	12.75	2.75
1985	13.75	3.50
1986	14.75	4.25

The 1983 legislation also annualizes both the tier I and tier II wage bases effective January 1, 1985, and provides for future increases at a rate equal to average wage growth in the economy. Prior law provided for a monthly wage base equal to one-twelfth of the Social Security wage base for tier I taxes. The tier II monthly wage base was one-twelfth of what the Social Security wage base would have been without the ad hoc increases provided in the Social Security amendments of 1977. Taken together, these provisions are estimated to provide an additional $2.6 billion in revenue for the five fiscal years 1984-88.

The new law also provides that tier II benefits and dual benefits will be treated for income tax purposes in the same way that benefits received under a tax qualified pension plan are treated—that is, the payments are includable in gross income when the amount received exceeds the amount the employee contributed. This provision is effective for benefits received on and after January 1, 1984. (The 1983 Social Security amendments, which provided for the taxation of Social Security benefits, also provided that tier I benefits will be treated in the same way as Social Security benefits for tax purposes.) The revenue from these provisions will be deposited in the Railroad Retirement Account until fiscal year 1989 and will be available for the payment of benefits. Beginning in fiscal year 1989 (or, if earlier, when the revenue attributable to taxation of tier II benefits reaches $877 million), the proceeds from taxation of tier II benefits will be deposited in the general fund of the Treasury. Beginning in fiscal year 1989, the revenue from the taxation of dual benefits will be deposited in the Dual Benefits Payments Account. (This account is funded by appropriations from the general fund and is used to pay dual benefits.)

Public Law 98-76 also requires railroad employers to deposit Social Security and income taxes on railroad employment on the same schedule as nonrailroad employers. Under prior law, less frequent deposits of taxes were required for railroad employers. This provision is effective after 1983. Another provision imposes an unemployment compensation repayment tax on railroad companies for the period July 1, 1986, through September 30, 1990. Revenue raised by this repayment tax will be used only to repay loans the Railroad Retirement Account has made to the Railroad Unemployment Insurance program.

Benefit Provisions

The 1983 legislation provides for the reduction of tier I benefits payable to railroad workers retiring at age 60 with 30 years of service; tier II benefit levels were not changed. Previously, railroad employees could retire at age 60 with 30 years of service and receive full benefits. The new law provides that individuals aged 60 or 61 who retire between July 1, 1984, and December 31, 1985, inclusive, will receive tier I benefits that are 10 percent less than the full benefit. Effective January 1, 1986, individuals who retire at age 60 or 61 will receive tier I benefits that are 20 percent less than the full benefit. Benefits will also be reduced for spouses of workers who retire at age 60 or 61. This provision applies only to employees who have not completed 30 years of service and attained age 60 before July 1, 1984.

Public Law 98-76 made two changes with regard to cost-of-living adjustments (COLA's). First, there will be an offset of the amount of the tier I COLA, up to 5 percent, against the tier II benefit. However, the amount of the tier II benefit cannot be reduced below $10 as a result of this provision. Second, the timing of tier II COLA's was changed to January, to conform with the timing of tier I COLA's, effective with increases after January 31, 1984. (Because tier I benefits automatically receive a COLA whenever OASDI benefits receive a COLA, the timing of tier I COLA's was changed as a result of the 1983 Social Security amendments, which changed the timing of Social Security COLA's.)

Several other changes were made to conform Railroad Retirement benefits with OASDI benefits. The full benefit retirement age for tier I was increased to age 67 on the same schedule as under Social Security. A similar change was made with regard to tier II benefits for employees whose railroad service begins after the date of enactment of Public Law 98-76. Workers whose service began before August 12, 1983, will be paid tier II benefits under prior law. Other changes include conforming the beginning dates of annuities with Social Security benefits—for example, there will be a 5-month waiting period for disability annuities—and phasing out student benefits.

The 1983 legislation also provides that a court could consider an individual's Railroad Retirement benefit, other than the tier I benefit, in dividing property in a divorce case. This would treat Railroad Retirement benefits like other pension benefits. The only benefits paid to divorced spouses under the Railroad Retirement system are tier I benefits. Tier I benefits would continue to be immune from garnishment, attachment, assignment, levy, or other legal process, as are OASDI benefits.

Other Provisions

Public Law 98-76 establishes a Social Security Equivalent Benefit Account effective October 1, 1984. All Social Security equivalent revenues—including tier I taxes, revenues derived from taxation of tier I benefits and amounts transferred to the Railroad Retirement system through, or borrowed against, the financial interchange—will be deposited in this account rather than in the Railroad Retirement Account. All Social Security equivalent benefits will be paid out of this account.

The law placed on a fully current basis the authority of the Railroad Retirement system to borrow from general revenues against amounts due, but not yet payable, from the financial interchange. The Railroad Retirement system will be able to borrow, on a monthly basis, amounts that are due as a result of the financial interchange. (Under prior law, only the amount that would be needed to pay benefits in the following month could be borrowed.) The new law repeals the authority for the Railroad Unemployment Insurance program to borrow from the Railroad Retirement Account effective September 30, 1985. The legislation also provides for transfers from the general fund to the Railroad Retirement Account of amounts due because the full amount necessary to finance dual benefits was not appropriated in past years.

The Railroad Retirement Board is required to submit a report to Congress on the actuarial status of the Railroad Retirement system under various economic and employment assumptions on or before July 1 of each year, beginning with July 1, 1985. The report is to include any recommendations for financing changes. The Railroad Retirement Board is also required to submit an annual report to Congress on the financial status of the Railroad Retirement system over the next 5 years. This replaces the report now required in fiscal years in which the Railroad Retirement system was expected to use 50 percent or more of its borrowing authority.

This legislation establishes a five-member Railroad Unemployment Compensation Committee to review all aspects of the Railroad Unemployment Insurance program. The committee is to submit a report to Congress no later than April 1, 1984, containing recommendations based on its review of the program and recommendations on repayment of funds borrowed from the Railroad Retirement Account. The latter recommendations are to include adjustments in contributions and benefits that will enable the program to repay all loans from the Railroad Retirement Account by the end of 2000.

Chile Changes its Health Care System*

In August 1981, a new law in Chile gave workers[1] the option of remaining under the old government health care program or of joining a new private program intended to provide more comprehensive care than formerly had been available to most persons in that country. The new program is part of a government policy to shift certain social security programs from the public sector to the private sector.

In May 1981, a provident fund type[2] old-age program and a private disability and survivor insurance program were introduced. At the same time, the phasing out of the pay-as-you-go old-age, survivor, and disability insurance (OASDI) program—financed by the employee, the employer, and the government—was begun.[3] The employer's contributions were eliminated—not only for OASDI, but also for health insurance, unemployment insurance, and family allowances. The government covers the entire cost of unemployment benefits and family allowances, and workers are primarily responsible for financing old-age, disability, and health care programs. The government continues its partial subsidy of the old public health program but provides no financing for the new private program.

Background

In 1924, Chile became the first country in the Western Hemisphere to introduce national health insurance for a large majority of its blue-collar workers. The system

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[1] The terms "workers" and "employees" are used interchangeably in this note to refer to both wage earners (blue-collar) and salaried (white-collar) employees.

[2] A provident fund is a compulsory savings system under which the regular contributions withheld from employees are often matched by those of their employers. These contributions are set aside to the credit of each employee in a special fund for later repayment either in a single lump sum with accrued interest or under some form of deferred payment.

[3] See Barbara E. Kritzer, "Chile Changes Social Security," **Social Security Bulletin**, May 1981, pages 33-37.