SECTION 5 - EARNED ENTITLEMENTS FOR RAILROAD EMPLOYEES

CONTENTS

OVERVIEW

Retirement, unemployment compensation, sickness, disability, and death benefits for railroad employees are administered by the U.S. Railroad Retirement Board (RRB), a Federal agency headquartered in Chicago. That these entitlement benefits for a particular private industry are a function of Federal authority follows from actions taken during the 1930s, when threats to the stability of the nation's railroads caused Congress to pass legislation placing the industry's primary employee benefit programs under Federal law. Federal involvement in the rail industry was not unprecedented. Indeed, much of the foundation underlying the enormous success the industry enjoyed was in place because the Federal Government provided numerous incentives for early development of this first great industrial giant.

The RRB, which refers both to the agency that administers the Federal benefits of industry employees and to the 3-member governing board that oversees its operations, maintains records on 12 million present and former railroad employees. The RRB disbursed $8.6 billion in retirement and survivor benefits to 684,000 annuitants during fiscal year 2002. During the 2001-2002 benefit year, the RRB disbursed $47 million in daily compensation to about 18,000 unemployed workers and $51 million in net sickness benefits to 23,000 employees. The RRB paid $5 million in lump-sum payments to survivors of deceased workers in fiscal year 2002. Table 5-1 provides an overview of cash benefits received by various categories of beneficiaries in February 2003. Through its payroll and beneficiary record keeping system, the RRB verifies the collection of taxes on payroll and benefits with the Internal Revenue Service, which in fiscal year 2002 collected $4.6 billion in taxes on railroad payrolls and $343 million in taxes on railroad retirement beneficiary payments.

In the House of Representatives, jurisdiction over Railroad Retirement and Unemployment Benefit Programs is divided between two standing committees. The Transportation and Infrastructure Committee has jurisdiction over legislation pertaining to "railroads . . . and railroad retirement and unemployment (except revenue measures related hereto)." The Subcommittee on Railroads of the committee has primary responsibility for the Railroad Retirement Act (RRA) and amendments affecting railroad retirement. The Committee on Ways and Means has jurisdiction over all revenue measures, including the Railroad Retirement Tax Act (chapter 22 of the Internal Revenue Code; see Research Institute, 1997). Within the Committee on Ways and Means, jurisdiction over employment taxes and trust fund operations relating to the Railroad Retirement System lies within the Subcommittee on Social Security.

THE RETIREMENT AND SURVIVOR ANNUITY STRUCTURE

The Railroad Retirement System provides retirement, disability and survivor annuities to workers whose employment was connected with the railroad industry for at least 10 years, or in some cases at least 5 years after 1995. The program is governed by the Railroad Retirement Act, Federal legislation enacted by Congress with input from all affected segments of the rail industry system. Railroad retirement came into existence in 1936, and was substantially modified by the Railroad Retirement Act of 1974 (Public Law 93-445) which provided for closer coordination with the Social Security System. Credits are primarily secured by employment in the railroad industry, although any Social Security credits earned during employees' work careers are included in the benefit computation. Benefits are financed through a combination of employee, employer, and Federal Government contributions.

TABLE 5-1--MONTHLY RAILROAD RETIREMENT CASH BENEFITS IN CURRENT PAYMENT STATUS, FEBRUARY 2003

Category of Beneficiary	Number	Percent of Total	Average Monthly Benefit
Retired Workers	249,900	39.3	$1,509
Disabled Workers [1]	45,700	7.2	1,872
Spouse	145,600	22.9	595
Divorced Spouse	3,500	0.5	361
Aged Widow(er)s	157,400	24.7	968
Disabled Widow(er)s	5,200	0.8	813
Widowed Mothers/Fathers	1,100	0.2	1,243
Remarried Widow(er)s	5,500	0.9	640
Divorced Widow(er)s	9,500	1.5	644
Children	12,800	2.0	743
Parents	100	(2)	646
Total	636,100	100.0	$1,144

[1] Under full retirement age.

[2] Less than 0.05 percent.

Note: Includes tier 1, tier 2, and vested dual benefits. Excludes 130,900 supplemental employee annuities averaging $42. Total includes fewer than 5 survivor option annuities averaging $70, payable under laws in effect before August 1946.

Source: U.S. Railroad Retirement Board.

The 1974 act established three benefit components. The ongoing benefit system was divided into two “tiers,” one which approximates Social Security (tier 1) and one which provides a retirement benefit specifically for railroad workers (tier 2). The third component, a vested dual benefit, preserved certain benefits for employees who qualified for both railroad retirement and Social Security benefits prior to the 1974 act.

The Railroad Retirement System was substantially modified again in 2001. The Railroad Retirement and Survivors’ Improvement Act of 2001 (Public Law 107-90), signed into law by President Bush on December 21, 2001, made several changes to railroad retirement benefits and financing. The 2001 law expanded benefits for some widows and widowers; lowered the minimum age at which employees with 30 years of experience may be eligible for full retirement benefits;

reduced the number of years required to be fully vested for tier 2 benefits; repealed a maximum limitation on benefits; expanded the system's investment authority to include investment of trust funds in *nongovernmental* assets; and phased in changes to the tier 2 tax structure. About 149,000 spouses and divorced spouses of retired or disabled workers receive railroad retirement benefits. About 192,000 survivors are on the RRB annuity rolls.

TIER 1 AND TIER 2 BENEFITS

Employees are eligible for a tier 1 retirement annuity if they have at least 10 years of total railroad service, or at least 5 years of railroad service after 1995 and "insured status" under Social Security rules (generally 40 quarters of coverage) based on combined railroad retirement and Social Security-covered earnings. Railroad retirement tier 1 benefits are based on the Social Security benefit formula, using the employee's combined railroad earnings and Social Security-covered earnings up to the Social Security maximum wage base. The tier 1 benefit is roughly equal to what the Social Security benefit would have been had the worker's railroad employment been covered by the Social Security program. Because the tier 1 benefit is based on both railroad and Social Security employment, any Social Security benefit to which the railroad retirement beneficiary also is entitled is subtracted from the tier 1 benefit amount. Tier 1 benefits are automatically adjusted annually for the cost of living by the same percentage as Social Security benefits.

Tier 2 benefits, which are payable in addition to tier 1 benefits, are based entirely on the employee's service in the railroad industry. Employees are eligible for a tier 2 *retirement* benefit if they have at least 10 years of total railroad service, or at least 5 years of railroad service after 1995. (Employees must have at least 10 years of total railroad service to be eligible for a tier 2 *disability* benefit before age 62.) For current retirees, the tier 2 benefit is equal to seven-tenths of 1 percent of the employee's average monthly earnings in the 60 months of highest earnings, times the total number of years of railroad service, less 25 percent of any employee vested dual benefit payable. Tier 2 benefits are automatically adjusted annually at a rate equal to 32.5 percent of the Social Security cost-of-living adjustment.

DUAL BENEFIT PAYMENTS

One of the primary purposes of the Railroad Retirement Act of 1974 was to coordinate railroad retirement and Social Security benefit payments to eliminate certain dual benefits considered to be a "windfall" for persons receiving benefits under both systems. This “windfall” was a result of the fact that the total benefit these retirees received from both systems was higher than the benefit they would have received if their benefit were based on their total career earnings but paid only under railroad retirement. The total benefit was higher in these cases because the Social Security benefit formula favors workers who have low average earnings throughout their careers. Low career average earnings result from a career of low wages or from a relatively short career in Social Security-covered employment. Workers who spent a period of time in employment covered by Social Security received the benefit of this “tilt” in the benefit formula, even though they may not have had low career earnings.

As a result of the 1974 act, “windfall” benefits were eliminated for any railroad employees not qualified for such benefits as of January 1, 1975. The benefits generally were preserved for those individuals who were vested under both railroad retirement and Social Security before 1975. These vested dual benefits are financed by the general revenue fund through an annual appropriation**,** rather than from the Social Security or Railroad Retirement Trust Funds. They are subject to reduction during any year in which the appropriation is less than the amount required for full benefit payments. The total appropriation for the Dual Benefits Payments Account includes an estimation of the amount collected from income taxes on the dual benefit, with the implication that dual benefits are partially financed by income taxes on dual benefits. The fiscal year 2002 appropriation was $146 million, including the income tax transfers. The fiscal year 2003 appropriation was $131 million, including income tax transfers. Currently paid to about 12 percent of railroad retirement beneficiaries, the average vested dual benefit is $147 per month.

DISABILITY ANNUITIES

Workers who are totally and permanently disabled for all employment are eligible for tier 1 and tier 2 benefits if they have at least 10 years of total railroad service. Workers who have at least 5 years of railroad service after 1995 (but less than 10 years of total service) are eligible only for *tier 1 benefits* before age 62 if their combined railroad retirement and Social Security earnings credits satisfy Social Security eligibility requirements (*tier 2 benefits* would be payable at age 62). Otherwise, workers with periods of employment under Social Security would have their railroad retirement credits transferred to Social Security and eligibility for Social Security disability insurance payments would be determined under Social Security program rules.

In addition, workers who become totally disabled for their regular railroad occupation are eligible for an occupational disability benefit at age 60 with at least 10 years of railroad service, and at any age with at least 20 years of railroad service. To qualify, the worker must have a current connection with the industry, which generally means that he or she worked for a railroad in at least 12 of the 30 consecutive months before the month in which an annuity begins to accrue.

SPOUSE ANNUITIES

Spouses of retired or disabled railroad retirement beneficiaries also may qualify for benefits, the amount of which may depend on such factors as the spouse's age and work history, and the age, date of retirement, and years of railroad service of the railroad worker. Spouses also may qualify for benefits based on caring for a rail worker's unmarried or disabled child. Tier 1 spouse benefits are based on 50 percent of the railroad worker's tier 1 benefit. Tier 2 spouse benefits are equal to 45 percent of the retired or disabled worker's tier 2 benefit. Divorced spouses also may be eligible for benefits from tier 1 but not from tier 2 unless specified in a divorce decree.

SUPPLEMENTAL ANNUITIES

Under the 1974 act, employees may qualify for a supplemental annuity at age 60 if they have at least 30 years of total railroad service, or at age 65 if they have 25-29 years of railroad service, and a current connection with the railroad industry. The supplemental annuity is $23 for 25 years of service plus $4 for each additional year of service, up to a maximum of $43 per month. Under the 1981 Omnibus Budget Reconciliation Act (OBRA), employees first hired after October 1, 1981, are not eligible for supplemental annuities.

SURVIVOR BENEFITS

Annuities may be payable under both tiers to surviving spouses, children, and certain other beneficiaries. With the exception of the lump-sum death benefit (discussed below), eligibility for survivor benefits depends on whether the employee was insured under the RRA at the time of death. An employee is insured if he or she has at least 10 years of railroad service, or at least 5 years of service after 1995, and a current connection with the railroad industry. If the worker had at least 5 years of railroad service after 1995 (but less than 10 years of total service), tier 1 and tier 2 survivor benefits are payable if the worker had insured status under Social Security rules based on combined railroad retirement and Social Security-covered earnings. Otherwise, only tier 2 survivor benefits are payable. Generally, a tier 1 survivor benefit, which is based on the worker's combined Social Security and railroad retirement earnings credits, is approximately equal to that provided by Social Security (benefit is based on the Social Security benefit formula). The tier 2 widow(er)'s amount is equal to 100 percent of the deceased worker's tier 2 amount.

Public Law 107-90 established an "initial minimum amount" for widow(er)'s benefits which yields, in effect, a widow(er)'s tier 2 benefit equal to the tier 2 benefit the employee would have received at the time the widow(er)'s annuity is awarded (minus any applicable age reduction). It does so by adding a "guaranty amount," initially set at 50 percent of the employee's tier 2 amount, to the 100 percent tier 1 and 50 percent tier 2 benefits provided under prior law. This guaranty amount is offset each year by the dollar amount of the cost-of-living increases payable in both the tier 1 and tier 2 benefits provided under prior law. As a result, such a widow(er)'s net benefit payment will not increase until such time as the widow(er)'s annuity, as computed under prior law with all interim cost-of-living increases otherwise payable, exceeds the widow(er)'s annuity computed under the initial minimum amount formula.

LUMP-SUM DEATH BENEFITS

A lump-sum death benefit is paid when there is no person eligible for a monthly survivor benefit in the month in which the worker died. The lump-sum death benefit is payable if the worker had a current connection with the railroad industry and at least 10 years of total railroad service, or 5 years of service after 1995 and insured status under Social Security rules. For employees with at least 10 years of railroad service before 1975, the amount of the benefit is based on the 1937 act (the average benefit payable is about $900). For all other railroad workers, the benefit is equal to the amount that would be paid under the Social Security Act ($255, unless survivor benefits are paid).

Generally, if monthly benefits are not payable at the time of the employee's death or in the future, a *residual* lump-sum payment may be made. A residual lump-sum payment is, in effect, a refund of the employee's pre-1975 railroad retirement taxes plus an amount in lieu of interest, less benefits already paid. An employee can designate a person as beneficiary for any residual payment that ever becomes due. Otherwise, it is payable to the widow(er), children, or other family members in a prescribed order of precedence. Once a residual is paid, no further benefits are payable on the basis of the employee's railroad earnings. (A widow(er) or parent under age 60 can waive rights to future monthly benefits in order for the residual payment to be made. The widow(er) or parent who elects a residual also gives up rights to Medicare based on the deceased employee's railroad service.)

TABLE 5-2--TOTAL BENEFIT PAYMENTS AND NUMBER OF BENEFICIARIES, SELECTED FISCAL YEARS 1950-2002

Fiscal Year	Benefit Payments (In Millions) [1]				Beneficiaries (In Thousands) [2]		
	Total Dollars		Retirement	Survivor	Total	Retirement	Survivor
	Current	Constant[3]					
1950	$301.6	$2,476.8	$248.2	$53.4	458	272	189
1955	549.7	3,874.2	424.5	125.2	700	452	252
1960	925.7	5,536.9	711.5	214.2	873	584	299
1965	1,117.7	6,086.4	834.0	283.7	980	650	340
1970	1,593.5	6,937.8	1,177.0	416.5	1,051	702	366
1975	3,060.3	9,365.1	2,222.4	837.9	1,094	733	380
1980	4,730.6	9,782.2	3,389.8	1,340.8	1,084	731	367
1981	5,286.6	9,912.9	3,779.9	1,506.7	1,074	726	363
1982	5,725.5	10,028.1	4,097.9	1,627.6	1,067	722	359
1983	6,041.1	10,110.7	4,354.2	1,686.9	1,056	715	357
1984	6,099.8	9,728.5	4,417.8	1,682.0	1,040	705	351
1985	6,250.9	9,638.3	4,539.3	1,711.6	1,023	694	343
1986	6,329.5	9,524.5	4,608.1	1,721.4	1,007	684	339
1987 [4]	6,520.3	9,549.5	4,773.6	1,746.7	994	675	333
1988	6,675.9	9,477.1	4,915.0	1,760.9	981	666	328
1989	6,938.5	9,497.9	5,140.9	1,797.6	967	659	322
1990	7,194.6	9,526.6	5,357.0	1,837.6	951	650	315
1991	7,490.8	9,499.4	5,593.2	1,897.6	932	638	307
1992	7,693.9	9,437.0	5,754.0	1,939.9	913	626	301
1993	7,872.3	9,418.3	5,896.0	1,976.2	898	615	298
1994	7,978.9	9,351.8	5,978.9	1,999.9	874	599	288
1995	8,059.2	9,226.4	6,042.9	2,016.3	847	582	282
1996	8,113.6	9,075.1	6,089.1	2,024.4	818	565	272
1997	8,205.7	8,991.9	6,166.3	2,039.4	800	549	263
1998	8,246.6	8,924.0	6,199.0	2,047.5	772	530	254
1999	8,248.5	8,785.8	6,207.2	2,041.3	748	514	246
2000	8,294.5	8,612.5	6,254.1	2,040.3	724	499	237
2001	8,411.4	8,542.0	6,352.6	2,058.8	700	483	228
2002	8,643.5	8,643.5	6,535.9	2,107.5	684	475	219

[1] Retirement benefits include tier 1 and tier 2 employee and spouse benefits, employee and spouse vested dual benefits, and supplemental employee annuity payments. Survivor benefits include tier 1 and tier 2 benefits, vested dual benefits and lump-sum payments. Total benefits include hospital insurance benefits for services in Canada.

[2] Number of beneficiaries represents all individuals paid benefits in each year. In the total number for each year, beneficiaries are counted only once, even though they may have received more than one type of benefit. In fiscal year 2002, some 10,000 individuals received both retirement and survivor benefits. Figures are partly estimated.

[3] Constant 2002 dollars were calculated using the Office of Management and Budget's composite outlay deflator; see Executive Office of the President (2003), table 10.1.

[4] Benefits paid for fiscal years beginning in 1987 are not strictly comparable to those for prior years due to a change in accounting systems.

Source: U.S. Railroad Retirement Board.

PROGRAM DATA

Table 5-2 summarizes railroad retirement benefit payments and the number of recipients in selected fiscal years 1950-2002. The table shows that the number of beneficiaries increased until about the mid-1970s and has declined thereafter. Similarly, as shown by the constant dollar column in table 5-2, after rapid increases between 1950 and about 1975, total benefit payments increased at a modest rate until the early 1980s and then declined by about $1.5 billion over the next 19 years.

Table 5-3 presents data on new awards for February 2003.

TABLE 5-3--NUMBER AND AVERAGE AMOUNT OF NEW AWARDS, FEBRUARY 2003

Beneficiary Type	Number	Average Amount
Employee Annuities:		
Retired Workers	794	$2,192
Disabled Workers (Under Full Retirement Age)	394	2,193
Spouse	756	763
Divorced Spouse	30	427
Survivor Benefits:		
Aged Widow(er)s	804	1,344
Disabled Widow(er)s	18	1,204
Widowed Mothers and Fathers	18	888
Divorced and Remarried Widow(er)s	86	697
Children	60	989
Parents	0	0
Insurance Lump Sums	457	877
Residual Benefits	5	4,130
Total	3,422	-----

Source: U.S. Railroad Retirement Board.

FINANCING THE SYSTEM

The Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90) made significant changes to the way the Railroad Retirement System is financed. The 2001 law provided for investment of railroad retirement funds in *nongovernmental* assets (as well as government securities), adjustments in payroll tax rates paid by employers and employees, and repeal of the supplemental annuity work-hour tax paid by employers. Railroad retirement and survivor benefits are financed by: (1) payroll taxes paid by covered employees and employers on railroad earnings, up to a certain maximum wage base; (2) income from the Social Security financial interchange; (3) appropriations from general revenues (including transfers of income taxes collected on benefits); and (4) investment income.

PAYROLL TAXES

The primary source of income to the Railroad Retirement Account is payroll taxes levied on covered employers and their employees. These taxes are imposed on wages below an annual maximum amount, known as the "wage base." Currently, both employers and employees pay a tier 1 tax that is equivalent to the combined Social Security (Old-Age, Survivors and Disability Insurance) and Hospital Insurance (Part A of Medicare) tax rate. In addition, a tier 2 tax is paid by both rail employers and employees. The 2003 annual tier 1 and tier 2 wage bases are $87,000 and $64,500, respectively. Since 1994, there has been no wage limit for the hospital insurance portion of the tax (1.45 percent on employers and employees, each). Thus, this tax is imposed on all wages.

Under the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90), the tier 2 tax rate paid by employers was lowered from 16.1 percent to 15.6 percent in 2002 and 14.2 percent in 2003. The tier 2 tax rate paid by employees remained unchanged at 4.9 percent in 2002 and 2003. Beginning in 2004, tax rates paid by employers and employees will be adjusted annually based on the 10-year average ratio of certain asset balances to the sum of benefits and administrative expenses (the "average account benefits ratio"). Depending on the average account benefits ratio, tier 2 tax rates for employers will be between 8.2 percent and 22.1 percent. Tier 2 tax rates for employees will be between 0 percent and 4.9 percent. Scheduled tier 1 tax rates and projected tier 2 tax rates are shown in Table 5-4.

The tier 1 wage base is equal to the Social Security wage base and automatically increases with wage growth in the economy. The tier 2 wage base is equal to what the Social Security wage base would have been without the ad hoc increases in the wage base established by the Social Security Amendments of 1977 (Public Law 95-215).

FINANCIAL INTERCHANGE

The Railroad Retirement System and the Social Security Program have been coordinated financially since 1951. The purpose of the financial interchange is to place the Social Security Trust Funds in the same position they would have been in if railroad employment had been covered under Social Security since its inception. Generally, under the interchange, for a given fiscal year the revenue that would have been collected by the Social Security Trust Funds if railroad employment had been covered directly by Social Security is netted against the amount of benefits

Social Security would have paid to railroad beneficiaries based on railroad and nonrailroad earnings during that period. Where Social Security benefits that would have been paid exceed income to the trust funds that would have been due, the excess, plus an allowance for interest and administrative expenses, is transferred from the Social Security Trust Funds to the Railroad Retirement Board's (RRB) Social Security Equivalent Benefit Account. If income exceeds benefits, a transfer is made from the RRB's Social Security Equivalent Benefit Account to the Social Security Trust Funds. (Before 1985, transfers were made to or from the Railroad Retirement Account.)

TABLE 5-4--SCHEDULED TAX RATES FOR TIER 1 AND TIER 2, SELECTED YEARS 1975-2008

Year	Tier 1			Tier 2			Combined [2]	
	Employer	Employee	Wage Base[1]	Employer	Employee	Wage Base	Employer	Employee
1975	5.85	5.85	$14,100	9.50	0.00	$14,100	15.35	5.85
1980	6.13	6.13	25,900	9.50	0.00	20,400	15.63	6.13
1985	7.05	7.05	39,600	13.75	3.50	29,700	20.80	10.55
1986	7.15	7.15	42,000	14.75	4.25	31,500	21.90	11.40
1987	7.15	7.15	43,800	14.75	4.25	32,700	21.90	11.40
1988	7.51	7.51	45,000	16.10	4.90	33,600	23.61	12.41
1989	7.51	7.51	48,000	16.10	4.90	35,700	23.61	12.41
1990	7.65	7.65	51,300	16.10	4.90	38,100	23.75	12.55
1991	7.65	7.65	53,400	16.10	4.90	39,600	23.75	12.55
1992	7.65	7.65	55,500	16.10	4.90	41,400	23.75	12.55
1993	7.65	7.65	57,600	16.10	4.90	42,900	23.75	12.55
1994	7.65	7.65	60,600	16.10	4.90	45,000	23.75	12.55
1995	7.65	7.65	61,200	16.10	4.90	45,300	23.75	12.55
1996	7.65	7.65	62,700	16.10	4.90	46,500	23.75	12.55
1997	7.65	7.65	65,400	16.10	4.90	48,600	23.75	12.55
1998	7.65	7.65	68,400	16.10	4.90	50,700	23.75	12.55
1999	7.65	7.65	72,600	16.10	4.90	53,700	23.75	12.55
2000	7.65	7.65	76,200	16.10	4.90	56,700	23.75	12.55
2001	7.65	7.65	80,400	16.10	4.90	59,700	23.75	12.55
2002	7.65	7.65	84,900	15.60	4.90	63,000	23.25	12.55
2003	7.65	7.65	87,000	14.20	4.90	64,500	21.85	12.55
2004	7.65	7.65	88,200	13.10	4.90	65,400	20.75	12.55
2005	7.65	7.65	92,100	13.10	4.90	68,400	20.75	12.55
2006	7.65	7.65	96,000	13.10	4.90	71,400	20.75	12.55
2007	7.65	7.65	99,900	13.10	4.90	74,100	20.75	12.55
2008	7.65	7.65	103,500	13.10	4.90	76,800	20.75	12.55

[1] The wage base for the 1.45-percent hospital insurance tax, included in the 7.65-percent tier 1 rate, is $125,000 in 1991, $130,200 in 1992, $135,000 in 1993, and no limit in 1994 and later.

[2] These rates apply only up to the tier 2 maximum wage base.

Note: Wage bases and tier 2 tax rates for years 2004-2008 are projected.

Source: U.S. Railroad Retirement Board.

The determination of the amount to be transferred through the financial interchange for a given fiscal year is made no later than June of the year following the close of the preceding fiscal year. Table 5-5 shows the actual operation of the financial interchange for selected years for the two Social Security Trust Funds (Old-Age and Survivors Insurance and Disability Insurance) and the Medicare Hospital Insurance Trust Fund.

In order to make funds available to the Social Security Equivalent Benefit Account from the forthcoming financial interchange on a more current basis, the Railroad Retirement Solvency Act of 1983 provided for transfers from general Treasury funds to the Social Security Equivalent Benefit Account each month. The amount transferred each month equals the Social Security benefits paid from the account during the month less the Social Security taxes received by the account in that month. The amount so transferred for a particular month is repaid when the Social Security System makes reimbursement for that month under the financial interchange program.

GENERAL REVENUE APPROPRIATIONS

Vested dual benefits are funded solely through general revenue appropriations. The Congress authorized such funding through the year 2003 in the 1974 act that substantially reformed the Railroad Retirement System. The total appropriated for the first 28 fiscal years (1976-2003) for which these benefits were payable was $8.12 billion.

The Omnibus Budget Reconciliation Act of 1981 (Public Law 97-35) established a Dual Benefits Payments Account. Each year an amount which is appropriated for the payment of vested dual benefits is placed in this account. If the amount appropriated is insufficient to pay full vested dual benefits to all eligible beneficiaries for the year, the Railroad Retirement Board is authorized to prorate payments from the dual benefits account so that the amounts paid do not exceed the amounts appropriated.

In addition to amounts transferred to the Dual Benefits Payments Account through the regular appropriations process, the Railroad Retirement Solvency Act of 1983 provided for the appropriation of approximately $1.7 billion to the Railroad Retirement Account in three installments paid on January 1, 1984, 1985, and 1986. These three appropriations were to reimburse the Railroad Retirement Account for prior shortfalls in annual appropriations. The actual amounts received, including interest, totaled $2.128 billion. This amount is not included in the figure given above for total appropriations between 1976 and 2003.

TABLE 5-5--AMOUNTS TRANSFERRED TO OR FROM (-) THE SOCIAL SECURITY EQUIVALENT BENEFIT ACCOUNT[1] AND THE SOCIAL SECURITY AND MEDICARE HOSPITAL INSURANCE TRUST FUNDS, SELECTED FISCAL YEARS 1954-2002

[In Millions of Dollars]

Fiscal Year	Old Age and Survivors Insurance	Disability Insurance	Hospital Insurance	Total
Through June 30, 1954	-$21.1	-----	-----	-$21.1
1955	-7.4	-----	-----	-7.4
1960	318.4	-$4.9	-----	313.5
1965	435.6	23.6	-----	459.3
1970	578.8	10.4	-$63.5	525.7
1975	981.8	28.5	-132.5	877.8
1980	1,442.0	-12.1	-244.3	1,185.6
1985	2,310.2	42.7	-371.4	1,981.5
1990	2,969.3	79.9	-367.4	2,681.8
1991	3,374.6	82.1	-352.2	3,104.5
1992	3,148.4	58.0	-374.5	2,831.9
1993	3,352.5	82.8	-400.5	3,034.9
1994	3,419.6	106.0	-412.9	3,112.6
1995	4,052.3	67.8	-396.1	3,724.1
1996	3,554.1	2.2	-401.3	3,154.9
1997	3,688.1	59.1	-419.1	3,328.1
1998	3,662.2	156.8	-419.4	3,399.7
1999	3,681.4	134.6	-429.9	3,386.1
2000	3,538.2	159.4	-465.3	3,232.3
2001	3,273.1	9.7	-469.7	2,813.1
2002	3,493.3	153.5	-424.7	3,222.1
Total	82,339.5	1,914.8	-10,050.3	74,204.1

[1] Before 1985, transfers were made to or from the Railroad Retirement Account.

Source: U.S. Railroad Retirement Board.

INVESTMENT INCOME

Funds that are not needed immediately to pay benefits or administrative expenses are invested to provide additional income for the Railroad Retirement System. Before enactment of the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90) in December 2001, the Railroad Retirement Board was authorized to invest funds only in interest-bearing U.S. government or U.S. government-guaranteed securities. Public Law 107-90 established the National Railroad Retirement Investment Trust (NRRIT), which has authority to invest funds in *nongovernmental* assets (such as equities and debt securities), as well as government securities. The NRRIT is not a government agency. It is a nongovernmental entity legally domiciled in the District of Columbia and administered by a Board of Trustees.

The Board of Trustees has 7 members: 3 chosen by rail labor, 3 chosen by rail employers, and 1 chosen by a majority of the other 6 members to represent the general public. With the assistance of independent advisors and investment managers, the Board of Trustees invests assets, pays administrative expenses, and will transfer funds to a disbursing agent (a qualified nongovernmental financial institution) responsible for benefit payments (in the interim, the Treasury Department will continue to issue railroad retirement benefit payments). The Board of Trustees is subject to reporting and fiduciary standards similar to those under the Employment Retirement Income Security Act of 1974 (ERISA), which covers most private sector employee benefit plans. If any provisions of the Railroad Retirement Act are violated, the Railroad Retirement Board may bring civil action against the NRRIT. An independent qualified public accountant will audit the financial statements of the trust fund annually. A management report will be submitted each fiscal year to Congress, the President, the Railroad Retirement Board, and the Office of Management and Budget.

Public Law 107-90 directed the Railroad Retirement Board (RRB) to transfer funds in the Railroad Retirement Account that are not needed to pay current administrative expenses to the NRRIT. (Funds needed to pay benefits and related administrative expenses are transferred to a disbursing agent.) In addition, the RRB was directed to transfer funds in the Social Security Equivalent Benefit Account that are not needed to pay current benefits and administrative expenses to the NRRIT (such funds may be used to pay benefits or invest in government securities only). In fiscal year 2002, the Railroad Retirement Board transferred $1.502 billion to the NRRIT. The RRB transferred an additional $10.25 billion between October 1, 2002 and January 24, 2003. All eligible assets are expected to be transferred to the NRRIT by the end of fiscal year 2003.

The NRRIT, which began operations in February 2002, began investment activities in September 2002. The NRRIT's annual report for fiscal year 2002 indicates that, from September 13-30, 2002, the market value of NRRIT assets declined 5.3 percent due to falling stock prices. The report goes on to state that "overall during fiscal year 2002, the market value of the total railroad retirement assets, including NRRIT investments, increased $1.4 billion after benefit payments due in large part to significant increases in the market value of railroad retirement investments in Federal securities as interest rates declined during the year" (National Railroad Retirement Investment Trust, 2003).

INCOME TAXATION OF RAILROAD RETIREMENT BENEFITS

Before 1984, railroad retirement benefits, with the exception of supplemental annuities, were not subject to Federal income taxation. However, as a result of the Railroad Retirement Solvency Act (Public Law 98-76) and the Social Security Amendments of 1983 (Public Law 98-21), tier 1, tier 2, and vested dual benefits received after December 31, 1983, are subject to taxation. The taxation provisions were subsequently amended by the Consolidated Omnibus Budget Reconciliation Act of 1985, the Tax Reform Act of 1986, and the Omnibus Budget Reconciliation Act of 1993. Under current law, the Social Security-equivalent portions of tier 1 benefits are taxed in a manner identical to Social Security benefits. The proceeds derived from the taxation under pre-OBRA 1993 rules of tier 1 benefits which are equivalent to Social Security benefits are deposited in the Social Security Equivalent Benefit Account and credited to the Social Security Trust Funds through adjustments in the financial interchange. The additional income taxes attributable to OBRA 1993 are deposited in the Hospital Insurance Trust Fund (Part A of Medicare). Tier 1 benefits in excess of Social Security-equivalent levels (including early retirement benefits payable at ages 60-61 and occupational disability annuities) and tier 2 benefits are taxed in a manner identical to private and public service pensions, with the proceeds deposited in the Railroad Retirement Account. Vested dual benefits are taxed like private and public service pensions, with the proceeds deposited in the Dual Benefits Payments Account.

The Omnibus Budget Reconciliation Act of 1987, which increased tier 2 payroll tax rates in January 1988 by a total of 2 percentage points, allowed revenues from Federal income taxes on tier 2 railroad retirement benefits to be returned to the Railroad Retirement System until October 1, 1989. Subsequent legislation extended the date to October 1, 1990, and then to October 1, 1992. Legislation in 1994 extended these transfers on a permanent basis.

FINANCIAL STATUS OF THE RAILROAD RETIREMENT SYSTEM

Along with the investment performance of the NRRIT, one of the most important factors affecting the financial status of the Railroad Retirement System is the level of employment in the industry. The recent history of industry employment is shown in table 5-6. Continuing decline in railroad employment raises concern about the financing of the Railroad Retirement System. Section 502 of the Railroad Retirement Solvency Act of 1983 requires a report each year by the Board on the system's actuarial status, and financing recommendations when appropriate. The

Board's 2003 financial report to Congress, which addresses the 75-year period from 2002-2076 under optimistic, moderate, and pessimistic employment assumptions, indicates no cash flow problems under the optimistic and moderate employment assumptions. Under the pessimistic assumptions, cash flow problems are projected to occur in 2022 (U.S. Railroad, 2003a). Overall, the report concludes that "barring a sudden, unanticipated, large drop in railroad employment, the railroads retirement system will experience no cash flow problems during the next 19 years. The long-term stability of the system, however, is not assured. Under the current financing structure, actual levels of railroad employment and investment return over the coming years will determine whether additional corrective action is necessary."

TABLE 5-6--RAILROAD INDUSTRY EMPLOYMENT, SELECTED YEARS 1940-2002

Year	Number (Thousands)
1940	1,195
1945	1,085
1950	1,421
1955	1,239
1960	909
1965	753
1970	640
1975	548
1980	532
1985	372
1990	296
1995	265
1996	257
1997	253
1998	256
1999	256
2000	246
2001	238
2002	227

Source: U.S. Railroad Retirement Board.

THE RAILROAD UNEMPLOYMENT INSURANCE PROGRAM

OVERVIEW

The Railroad Unemployment Insurance System has been in existence since 1938. Railroad workers were initially covered by the unemployment provisions of the Social Security Act of 1935. However, the Railroad Unemployment Insurance Act (Public Law 75-722) was passed in 1938 to provide a uniform unemployment insurance system for all railroad workers, regardless of the State in which they worked or lived. The main reasons for this action were to avoid administrative problems in handling claims for railroad workers who earned wages in a number of States and to accommodate the railroad unions' desire that individuals throughout the industry be treated the same for purposes of unemployment compensation.

Table 5-7 summarizes Railroad Unemployment Program statistics for selected years between 1970 and 2002. The table shows projected statistics for 2003 and 2004.

BENEFITS AND ELIGIBLITY REQUIREMENTS

A new benefit year for unemployment and sickness benefits begins every July 1. To qualify in the benefit year beginning July 1, 2002, a worker must have base year railroad earnings of at least $2,625 in the preceding calendar year, not counting earnings over $1,050 per month. Under the indexing provisions of the law reflecting growth in average national wages, a worker must have base year earnings of $2,750 in calendar year 2002, not counting earnings of more than $1,100 per month, to qualify in the benefit year beginning July 1, 2003. If the base year was the first year of railroad service, the worker also must have worked in 5 months of that year (see Table 5-8).

No benefits are payable for the first 7 days of the first claim (or claims) for unemployment and sickness in a benefit year. This generally results in a 1-week waiting period. A claimant is normally paid for days of unemployment or sickness over 4 in 14-day registration periods. The maximum daily benefit payable in the benefit year that began July 1, 2002 is $52, and maximum benefits for biweekly claims is $520. The maximum daily benefit rate increases to $55 on July 1, 2003 and $56 on July 1, 2004.

The program offers "normal" and "extended" benefits. Qualified workers can receive normal benefits for up to 130 days or 26 weeks, but the total may not exceed their creditable wages in the base year. Workers with at least 10 years of railroad service may receive up to 65 additional days or 13 additional weeks of extended benefits. The average duration of benefits fluctuates with the unemployment rate. In the 1940-2002 period, it ranged from 7.4 to 19.1 weeks and averaged 12.1 weeks.

In 1946, a program of cash sickness benefits was established for railroad workers as part of the unemployment compensation system. Sickness benefits are financed out of the same employer-paid payroll taxes used to finance unemployment compensation benefits. A qualified railroad worker may receive sickness benefits if he or she files a "statement of sickness" signed by a doctor that is mailed within 7 days of the first day for which a day of sickness is claimed.

A rail worker who is unemployed due to a strike that is not in violation of the Railway Labor Act of 1926 can receive unemployment compensation benefits after a 14-day waiting period. Unemployment benefits cannot be paid to individuals participating in a strike that is in violation of the Railway Labor Act, and is therefore "illegal." Individuals who are unemployed due to an "illegal" strike, but who are not actually participating in the strike, are eligible for unemployment compensation benefits but are subject to the 14-day waiting period.

Total expenditures for unemployment and sickness benefits were $98 million in benefit year 2001-2002, which was 0.7 percent of total wages paid by the industry during the period. This compares to a peak of 5.1 percent in 1959. It is also much lower than in benefit year 1983, a recession year, when the figure was 3.9 percent. Since the beginning of sickness benefits, unemployment benefits have comprised over two-thirds of total payments. However, in benefit years ending 1999 through 2002, they accounted for less than half of the total.

Benefit payments vary directly with the insured unemployment rate, covered employment, average weekly benefit amount, and average duration of benefits. The insured unemployment rate is the percentage of workers qualified under the Railroad Unemployment Compensation System who drew benefits in a particular benefit year. The railroad insured unemployment rate has been high and volatile since the beginning of the program, averaging 12 percent. Since 1946, it has ranged from 4 percent to 30 percent.

Changes in covered employment have short-run and long-run effects on the unemployment program. In the short run, when layoffs cause employment to decline, the insured unemployment rate and benefits paid increase. In the long run, when employers have fewer workers to lay off, benefits decline and the program shrinks. Railroad industry employment has declined from 1,195,000 in 1940 to 227,000 in 2002. From 1940 to 1975, the average annual decline in railroad employment was 18,000. Since then, the average annual decline was 12,000.

TABLE 5-7--RAILROAD UNEMPLOYMENT AND SICKNESS INSURANCE PROGRAM STATISTICS, SELECTED YEARS 1970-2004

Program Statistic	Benefit Year Ending In													
	1970	1975	1980	1985	1990	1995	1997	1998	1999	2000	2001	2002	2003 (est)	2004 (est)
Insured Unemployment (Percent) [1]	11	12	17	18	9	6	5	4	5	5	6	7	6	6
Coverage (Thousands of Qualified Employees)	748	640	609	459	349	295	285	277	272	278	277	270	259	247
Unemployment (Average Daily Benefit):														
Current Dollars	$12.61	$12.68	$24.94	$24.98	$30.16[2]	$35.78	$40.57	$42.78	$43.81	$45.45	$47.81	$49.61	$51.60	$54.60
Constant Dollars[3]	$54.90	$38.80	$51.57	$38.52	$39.94	$40.96	$44.46	$46.29	$46.66	$47.19	$48.55	$49.61	$50.64	$52.60
Sickness (Average Daily Benefit):														
Current Dollars	$12.66	$12.69	$24.97	$24.99	30.25[2]	$35.75	$40.18	$42.90	$43.91	$45.65	$47.88	$49.85	$51.80	$54.80
Constant Dollars[3]	$55.12	$38.83	$51.63	$38.53	$40.06	$40.93	$44.03	$46.42	$46.77	$47.40	$48.62	$49.85	$50.83	$52.79
Number of Beneficiaries:														
Unemployment (Thousands)	79.2	77.9	101.6	81.7	29.9	18.7	15.3	11.3	12.6	13.7	16.7	17.8	16.3	15.1
Sickness (Thousands)	91.4	67.4	76.8	51.6	28.2	21.0	20.5	20.5	20.6	22.0	23.0	23.0	22.8	21.8
Benefit Exhaustions, Normal Benefits:														
Unemployment (Thousands) [4]	6.3	4.8	11.2	16.1	5.6	2.9	2.7	2.1	2.0	2.1	2.2	2.7	2.7	2.7
Sickness (Thousands)	16.8	7.9	9.5	8.0	6.1	4.3	4.3	4.3	3.9	4.1	4.5	5.1	5.1	5.1
Amount Paid:														
Unemployment (Millions) [5]	35.0	37.5	112.7	125.8	57.2	37.4	38.2	27.0	31.6	35.6	43.0	47.4	52.5	50.5
Sickness (Millions)	57.9	29.6	60.0	43.8	32.6	24.2	32.5	33.1	34.6	40.5	49.5	50.9	50.8	50.9

TABLE 5-7--RAILROAD UNEMPLOYMENT AND SICKNESS INSURANCE PROGRAM STATISTICS, SELECTED YEARS 1970-2004-continued

Program Statistic	Benefit Year Ending In													
	1970	1975	1980	1985	1990	1995	1997	1998	1999	2000	2001	2002	2003 (est)	2004 (est)
Total Tax Collection:														
Benefits Account (Millions)	122.7	109.4	173.3	223.1	192.5	5.6	9.6	35.5	87.2	68.8	19.9	63.6	114.5	126.8
Administration (Millions)	8.2	7.3	12.9	15.2	17.2	17.4	16.1	14.3	22.8	18.9	20.0	19.8	20.4	20.2
Outlays:														
Benefits (Millions) [4]	93.0	67.1	172.7	169.6	89.8	61.6	70.7	60.1	66.2	76.1	92.5	98.3	103.3	101.4
Administration (Millions)	6.6	7.3	11.2	14.8	14.6	15.9	16.2	13.3	13.7	14.1	13.8	13.2	15.6	16.0
Account Balance (Millions)[6]	81.3	113.9	40.8	50.8	188.4	177.5	77.2	59.7	89.6	95.7	34.8	16.1	24.9	57.0

[1] Unemployment beneficiaries divided by qualified employees; does not include sickness insurance beneficiaries.

[2] Benefit amounts for registration periods beginning on or after October 1, 1989, were originally reduced by 5.3 percent under the Gramm-Rudman-Hollings Act. On February 10, 1990, the final fiscal year 1990 Gramm-Rudman-Hollings sequestration rate of 1.7 percent was implemented for all days of unemployment and sickness after September 30, 1989. Refund payments were issued on February 13, 1990. Cumulative averages do not reflect these refunds.

[3] Constant 2002 Dollars were calculated using the Office of Management and Budget's composite outlay deflator (fiscal year basis); see Executive Office of the President (2003), table 10.1.

[4] Excludes supplemental extended benefits financed from general revenues.

[5] Includes benefits under title V of the Emergency Unemployment Compensation Act of 1991, as amended, which has provided extended unemployment benefits, regardless of years of service.

[6] Account balances do not reflect amounts due the Railroad Retirement Account. Pre-1985 loans were repaid in full with a $180.2 million cash repayment from the Railroad Unemployment Insurance Account on June 29, 1993. The small loan made in February 2002 is expected to be repaid in May 2003.

Source: U.S. Railroad Retirement Board.

TABLE 5-8--BENEFITS UNDER THE RAILROAD UNEMPLOYMENT INSURANCE SYSTEM, BENEFIT YEARS 2002-2003, 2003-2004, 2004-2005

Benefit Category	Benefit Amount
Qualifying Wages:	
Base Year 2001	$2,625
Base Year 2002	$2,750
Base Year 2003	$2,800
Daily Benefit Rate: Basic Rate	60% of daily rate of pay
Maximum: 5 Percent of Base Year Monthly Compensation Base	
Benefit Year 2002-2003	$52.00
Benefit Year 2003-2004	$55.00
Benefit Year 2004-2005	$56.00
Minimum Guarantee	$12.70
Maximum Normal Benefits:[1]	
For 14-day Period:	
Benefit Year 2002-2003	$520
Benefit Year 2003-2004	$550
Benefit Year 2004-2005	$560
For Benefit Year:	
Duration:	130 Compensable Days
Amount:[1]	
Benefit Year 2002-2003	$6,760
Benefit Year 2003-2004	$7,150
Benefit Year 2004-2005	$7,280
Maximum Extended Benefits:	
10 or More Years of Service:	
Duration:	65 Compensable Days
Amount:	
Benefit Year 2002-2003	$3,380
Benefit Year 2003-2004	$3,575
Benefit Year 2004-2005	$3,640

[1]Not to exceed the employee's taxable earnings in the base year, counting earnings up to $1,356 a month for benefit year 2002-2003 (base year 2001), $1,421 a month for benefit year 2003-2004 (base year 2002), and $1,447 a month for benefit year 2004-2005 (base year 2003).

Note: Some net sickness benefit payments are somewhat less than the above amounts since they are subject to tier 1 railroad retirement taxes.

Source: U.S. Railroad Retirement Board.

FINANCING

The Railroad Unemployment and Sickness Benefit Programs are financed by payroll taxes on railroad employers. Employees do not pay railroad unemployment taxes. The taxable earnings base in calendar year 2002 is the first $1,100 of each employee's monthly earnings. The earnings base is adjusted each year to equal approximately two-thirds of the cumulative increase in the maximum base for railroad retirement tier 1 taxes since 1984.

Experience-based tax rates, under which employers with higher levels of unemployment pay somewhat higher rates, were phased in on a partial basis in 1991 and 1992, and became fully effective in 1993 with a minimum rate of 0.65 percent and a maximum rate of 12 percent. The future maximum rate could be 12.5 percent if a maximum surcharge is in effect.

Railroad unemployment taxes are collected by the Railroad Retirement Board. Of each year's tax receipts, an amount equal to 0.65 percent of taxable payroll is set aside for administration. Excess funds allocated but not needed for administration are transferred to the Railroad Unemployment Insurance Account at the end of each fiscal year.

The Railroad Unemployment Insurance and Railroad Unemployment Insurance Administration Accounts are part of the Federal Unemployment Trust Fund. This trust fund has 53 State Unemployment Compensation Program accounts, 4 Federal accounts, and the 2 railroad accounts.

Since 1959, the Railroad Unemployment Trust Fund has been able to borrow funds from the railroad pension fund when employer taxes have not been sufficient to cover the costs of unemployment and sickness benefits. The unemployment program became depleted for the first time in 1960 after a long decline from peak reserves of nearly 18 percent of total annual wages in 1948. By 1963, it owed the retirement account $314 million, or 5.9 percent of total annual wages paid in the industry that year. The program gradually recovered during the 1960s until it had positive reserves again in 1974. The reserves were depleted again in 1976-78 and loans were again required beginning in 1981.

A rapid decline in 1981-82 in railroad employment during a recession resulted in substantial borrowing from the pension system. The borrowing reached a peak level of over $850 million at the end of 1986. This debt was repaid in full with a $180.2 million cash repayment from the Railroad Unemployment Insurance Account on June 29, 1993. Interest on the loan during the debt period was charged at the average rate earned by U.S. Treasury securities held by the retirement account so that the retirement account did not lose any investment earnings as a result of the loan.

Financial measures to assist the Railroad Unemployment Insurance Account were included in the Railroad Retirement Solvency Act of August 12, 1983. The Solvency Act raised the taxable limit on monthly earnings and the base-year qualifying amount. The waiting period for benefits during strikes was increased from 7 to 14 days. A temporary repayment tax on railroad employers began July 1, 1986, to initiate repayment of the loans made by the Railroad Retirement Account.

The 1983 legislation also mandated the establishment of a Railroad Unemployment Compensation Committee (1984) to review the unemployment and sickness benefit programs and submit a report to Congress. The Committee reviewed all aspects of the Railroad Unemployment Insurance System, especially repayment of the system's debt to the Railroad Retirement Account and the viability of transferring railroad unemployment benefit payments to State programs.

The Consolidated Omnibus Budget Reconciliation Act of April 1986 (Public Law 99-272) amended the temporary unemployment insurance loan repayment tax beginning July 1, 1986, continued authority for borrowing by the Railroad Unemployment Insurance Account from the Railroad Retirement Account, and provided a contingency surtax on rail employers if further borrowing took place.

Changes enacted under the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647) were based on the recommendations of the Railroad Unemployment Compensation Committee. The 1988 amendments improved financing by indexing the tax base to average national wages and experience rating employer contributions. Repayment of the unemployment system's debt to the retirement system was ensured by fixing the loan repayment tax at 4 percent of the contribution base and retaining this elevated tax rate until the debt was fully repaid with interest on June 29, 1993.

A contingency surtax (3.5 percent), effective in the event of further borrowing by the Railroad Unemployment Insurance Account, was eliminated in 1991. Instead, a surcharge will be added to employers' unemployment insurance taxes for a calendar year if the balance in the unemployment insurance account on the previous June 30 goes below $100 million (as indexed). The surcharge rate would be 1.5, 2.5, or 3.5 percent depending on how low the balance had fallen. If a 3.5 percent surcharge goes into effect for a given year, the maximum rate for any employer would be 12.5 percent rather than 12 percent. If the account balance on the preceding June 30 is above $250 million (as indexed), the excess will be refunded to the employers in the form of a rate reduction for the year through a pooled credit.

In 1996, Congress enacted H.R. 2594, the Railroad Unemployment Insurance Amendments Act of 1996 (Public Law 104-251). Among other provisions, this law raised daily benefit rates for retirement and sickness benefits and revised the formula for indexing future rates. The Act shortened the waiting period for initial unemployment and sickness benefits, cut the weeks of extended benefits payable to rail workers with more than 15 years' service, and established an earnings test for workers with days of employment as well as unemployment or sickness during each 2-week registration period.

The Board is required to submit an annual financial report to Congress on the status of the Unemployment Insurance System. The report must include recommendations for financing changes that might be advisable, specifically with regard to rates of employer contributions. The 2003 report (U.S. Railroad, 2003b) states that, under three different sets of employment assumptions (optimistic, moderate, and pessimistic), experience-based contribution rates are projected to respond to fluctuating employment and unemployment levels thereby maintaining fund solvency. Employer contribution rates, which include a surcharge of 2.5 percent in calendar year 2003, are projected to include a 1.5 percent surcharge in calendar years 2004 and 2005. The 2003 report shows that during the 11-year projection period (fiscal years 2003-2013), the average employer contribution rate is projected to remain well below the maximum, even under the pessimistic assumptions. The Board recommends no financing changes at this time.

LEGISLATIVE HISTORY

In the final quarter of the 19th century, railroad companies were among the largest in America. It was in the rail industry that the first industrial pension was established in 1874. By the mid-1920s, more than 80 percent of all rail workers were covered by pension plans. In the early 1930s these pension plans began to face enormous financial problems. The commercial success of the rail industry peaked in the period between 1900 and 1920, and rail employment decreased significantly in the 1920s.

Rail pension plans were for the most part poorly constructed. There was no regulation of railroad pensions and plans were frequently terminated, pension funds were chronically underfinanced, and most funds could not survive the financial pressures of the depression. These problems, plus a tradition of Federal regulation of the railroads, led to the enactment of the Railroad Retirement Act of 1934.

The original Railroad Retirement System was structured to provide annuities to retirees based on rail earnings and length of service. Benefits were disbursed for retirees at age 65, although workers with 30 years of service could retire at age 60 with a reduction in payments. The original disability provisions were very stringent. Little was provided for dependents, and nothing for spouses.

The Railroad Retirement System has been modified many times by Congress. In the late 1940s and 1950s, benefits were liberalized, and the Railroad Retirement System was brought into closer conformity with Social Security. For instance, in 1946, benefits were extended to survivors, based on combined railroad and Social Security-covered employment. This extension demonstrated congressional concern for the social goal of providing income security in old age, or social insurance, rather than simply rewarding career performance.

In the 1970s and 1980s, the Railroad Retirement System encountered recurrent financial crises as a result of employment declines in the industry, inflation, and more beneficiaries. Major legislation was enacted in 1974, 1981, 1983, and 1987 to prevent the system from becoming insolvent.

The Railroad Retirement Solvency Act of 1983 (Public Law 98-76) increased payroll taxes on employers and employees, deferred cost-of-living increases, reduced early retirement benefits, made tier 2 benefits and vested dual benefit payments subject to Federal income taxes on the same basis as private and public service pensions, and provided other measures designed to improve railroad retirement financing. (The Social Security Amendments of 1983 (Public Law 98-21) made up to 50 percent of tier 1 benefits subject to Federal income taxes on the same basis as Social Security benefits.) Without the enactment of this legislation, the Railroad Retirement Board would have been required to substantially reduce benefit payments in 1983.

The Omnibus Budget Reconciliation Act (OBRA) of 1987 (Public Law 100-203) increased tier 2 tax rates in January 1988 by a total of 2 percent: 1.35 percent on employers and 0.65 percent on employees. In addition, the law extended for 1 year, until October 1, 1989, the time during which revenues from Federal income taxes on tier 2 railroad retirement benefits could be transferred from the general fund of the U.S. Treasury to the Railroad Retirement Account for use in paying benefits.

Railroad retirement amendments were included with railroad unemployment insurance amendments in the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647). This legislation ensured repayment of the Railroad Unemployment Insurance Account's debt to the Railroad Retirement Account by extending a temporary unemployment insurance tax until the debt was fully repaid with interest in 1993. Public Law 100-647 also eased work restrictions and the crediting of military service in certain cases and provided more equitable treatment of severance pay for railroad retirement purposes.

The Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239) included a number of railroad retirement and Social Security provisions that affected payroll taxes and benefits beginning in 1990. The law increased the amount of earnings subject to Social Security and railroad retirement payroll taxes by including contributions to 401(k) deferred compensation plans in the measure of average wages, which is used to index the wage base. It also extended for 1 additional year, until October 1, 1990, the time during which revenues from Federal income taxes on tier 2 railroad retirement benefits may be transferred to the Railroad Retirement Account for use in paying benefits.

The Omnibus Budget Reconciliation Act of 1990 (Public Law 101-508) further extended the date of this transfer until October 1, 1992, and also permanently exempted supplemental annuities from reductions under the Gramm-Rudman deficit reduction measures adopted by Congress.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66) removed the maximum taxable earnings base for purposes of paying the Medicare tax, thus making all railroad retirement tier 1 earnings subject to the Medicare payroll tax. Public Law 103-66 also increased the amount of Social Security and railroad retirement tier 1 benefits subject to Federal income taxes for persons with higher incomes. A provision in the Social Security Administrative Reform Act of 1994 (Public Law 103-296) extended on a permanent basis the transfer to the Railroad Retirement Account of Federal income taxes on tier 2 railroad retirement benefits and a retroactive payment was made, covering the period October 1, 1992 through September 30, 1994.

The Senior Citizens' Freedom to Work Act (Public Law 106-182), enacted on April 7, 2000, eliminated the earnings limitation on beneficiaries beginning with the month the beneficiary reaches the full retirement age. In the calendar years before the year in which the beneficiary reaches the full retirement age, $1 in benefits is withheld for every $2 earned above an exempt amount ($11,520 in 2003). For months in the calendar year in which the beneficiary reaches the full retirement age (up to the month the beneficiary reaches the full retirement age), $1 in benefits is withheld for every $3 earned above an exempt amount ($30,720 in 2003).

The Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90) made a number of changes to railroad retirement benefits and financing. In terms of benefit changes, the 2001 law: (1) liberalized early retirement benefits for 30-year employees and their spouses (employees with 30 years of railroad service and their spouses may retire at age 60 with full tier 1 and tier 2 annuities); (2) repealed the cap on total monthly retirement and disability benefits payable to an employee and spouse; (3) lowered the minimum service requirement for retirement annuities from 10 years to 5 years of service performed after 1995; and (4) increased benefits for some widow(er)s.

In terms of financing changes, the 2001 law: (1) established the National Railroad Retirement Investment Trust (NRRIT) which is authorized to invest funds in *nongovernmental* assets as well as government securities (the Board of Trustees invests assets, pays administrative expenses and transfers funds to a disbursing agent responsible for the payment of benefits); (2) adjusted payroll tax rates paid by employers and employees (beginning in 2004, tier 2 tax rates will be based on a 10-year "average account benefits ratio" with employer rates ranging from 8.2 percent to 22.1 percent and employee rates ranging from 0 percent to 4.9 percent); (3) repealed the supplemental annuity work-hour tax; (4) eliminated the Supplemental Annuity Account and transferred the balance in the account to the NRRIT (the NRRIT will pay supplemental annuity benefits); (5) provided authority to transfer Railroad Retirement Account funds not needed to pay current administrative expenses to the NRRIT (the NRRIT will pay tier 2 benefits); (6) provided authority to transfer Social Security Equivalent Benefit Account (SSEBA) funds not needed to pay current benefits and administrative expenses to the NRRIT (the SSEBA will pay the Social Security level of tier 1 benefits and the NRRIT will pay the portion of tier 1 benefits in excess of the Social Security level); (7) provided authority to transfer Dual Benefit Account funds needed for dual benefit payments to a disbursing agent; and (8) provided tax-exempt status for the NRRIT. The 2001 law was based on joint recommendations to Congress negotiated by rail labor organizations and rail freight carriers.

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