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RAILROAD RETIREMENT AND SURVIVORS' IMPROVEMENT ACT OF 2000

OCTOBER 3 (legislative day, SEPTEMBER 22), 2000.—Ordered to be printed

Mr. ROTH, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 4844]

The Committee on Finance, to which was referred the bill (H.R. 4844) to amend the Internal Revenue Code of 1986 to modernize the financing of the railroad retirement system and to provide enhanced benefits to employees and beneficiaries having considered the same, reports favorably thereon with an amendment to provide clarification that members of the Railroad Retirement Board will be considered fiduciaries for purposes of appointing the trustees of the Railroad Retirement Investment Trust Board and make other changes recommends that the bill as amended do pass.

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I. SUMMARY AND BACKGROUND

A. SUMMARY

The bill, H.R. 4844, as amended (the "Railroad Retirement and Survivors' Improvement Act of 2000"), will improve benefits and modernize financing of the railroad retirement system. Key provisions of the bill include:

Railroad Retirement Trust Fund.—The bill creates a new railroad retirement investment trust (the "Trust") for the investment of surplus Railroad Retirement funds in the private capital markets. The Trust will be governed by a seven-member board of trustees which will independently manage and invest the assets of the Trust.

Railroad retirement benefits.—The bill increases tier 2 benefits for widows and widowers to 100 percent of the deceased employee's benefits on the date of death. Also, the bill reduces the number of years of covered service to be vested in the railroad retirement system (both tier 1 and tier 2) from 10 years to 5 years. In addition, the bill reduces the age at which full tier 1 benefits are payable from 62 to 60 for employees with at least 30 years of rail service (with such benefits paid from tier 2 funds). Finally, the bill repeals the present-law maximum limit on monthly railroad retirement benefits (both tier 1 and tier 2).

Amendments to the Internal Revenue Code of 1986 (the "Code").—The bill makes the following changes to the Code: (1) lowers the tier 2 payroll tax rates for employers and employee representatives in 2001 and 2002 and provides a modified method of calculating the rate of all tier 2 taxes after 2002; (2) repeals the supplemental annuity tax; and (3) provides tax-exempt status for the Trust.

B. BACKGROUND AND NEED FOR LEGISLATION

The railroad retirement system is unique, in effect a multi-employer pension plan operated by the Federal government for the employees of a single industry, the railroad industry. The railroad retirement system was created through a series of laws enacted in the 1930's, culminating in the Railroad Retirement and Carriers' Taxing Act of 1937. Substantive changes to the Railroad Retirement and Carriers' Taxing Acts of 1937, including its replacement by the current Railroad Retirement Act of 1974 and substantive amendments to that latter Act, have generally been enacted on the basis of joint recommendations negotiated by representatives of railroad labor and management. The last major reform to railroad retirement occurred in 1983 with enactment of the Railroad Retirement Solvency Act.

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

tion of railroad management. The Chair is appointed to represent the public at large.

The railroad retirement system provides annuities to retired and disabled railroad workers and certain family members; and to the survivors' of deceased railroad workers. Annuities paid under the Railroad Retirement Act consist of different components called "tiers." The Tier I benefit is based upon both the railroad and non-railroad earnings of the railroad employee, using social security formulas, and approximates what would be payable under the Social Security Act. Tier II benefits are based on an employee's railroad service only and are computed under benefit formulas in the Railroad Retirement Act. Tier II is the functional equivalent of a private industry-wide pension plan.

Payroll taxes on railroad employers and employees serve as the primary source of funding for railroad retirement benefits. The total payroll tax is 36.3 percent. Other sources of funding include transfers under the financial interchange with the Social Security system; investment earnings from the trust funds; general revenue appropriations for vested dual benefits; income taxes on benefits; and a work hour tax paid by railroad employers called the "supplemental annuity tax."

In fiscal year 1999, the Railroad Retirement Board paid $8.2 billion in retirement and survivor benefits to 748,000 beneficiaries. At the end of fiscal year 1999, there were 316,358 railroad retirees, 167,478 spouses or divorced spouses of retirees, and 219,341 survivors receiving railroad retirement benefits.

H.R. 4844 would improve benefits under the railroad retirement system, modernize the financing of the system, and increase railroad industry (company and labor) responsibility for operations of this pension system. The benefit changes made in H.R. 4844 would be funded from the tier II component of railroad retirement. The principal innovation in railroad retirement system financing would be the creation of an investment trust that would invest surplus railroad retirement funds in the private capital markets, in a manner similar to private pension funds.

C. Legislative History

The Committee on Finance marked up the provisions of the bill on September 28, 2000, and approved the provisions, as amended, on September 28, 2000, by a voice vote with a quorum present.

II. EXPLANATION OF THE BILL

A. Railroad Retirement Reform

1. Amendments to the Railroad Retirement Act of 1974

a. Structure and administration of railroad employee benefit system (secs. 105–108 of the bill and secs. 3, 4, 7, 15, and 22 of the Railroad Retirement Act of 1974)

PRESENT LAW

The Railroad Retirement Board is the Federal agency responsible for the administration of the Federal employment benefits system earned through railroad industry employment. It is headed by a

three-member governing board that oversees its operations. The railroad retirement system provides retirement, disability and survivor benefits to qualifying individuals.[1] Generally, a qualifying individual is any eligible individual with at least ten years of railroad service and the individual's spouse and dependents. The system, funded primarily by payroll taxes on covered employers and employees, includes a benefit roughly equivalent to Social Security (the "tier 1" benefit), an additional benefit similar those allowed in some private defined benefit pension plans (the "tier 2" benefit), and certain other benefits. Amounts received into the railroad retirement system are held in Federal accounts (primarily in the railroad retirement account) within the Federal Treasury until needed to pay benefits. The money in these accounts is invested in special interest-bearing Treasury obligations.

REASONS FOR CHANGE

Between 1985 and 1998, the average annual return on Railroad Retirement Account (RRA) assets was 9.12 percent. This return lagged far behind the 15.17 percent return earned by large multiemployer pension plans over the same period. The bill allows the railroad retirement industry pension (tier 2) to take advantage of the higher returns available in the private sector in an account established outside of Treasury. The increased income projected from private investment permits an increase in employee benefits and a reduction in employer tax rates while maintaining an average benefit reserve of 4 years or more.

EXPLANATION OF PROVISION

Railroad Retirement Investment Trust

The bill creates a new railroad retirement investment trust (the "Trust"). The bill provides that the Trust is a private entity and not a department, agency, or instrumentality of the Federal government. The Trust is organized in the District of Columbia and is governed by a seven-member board of trustees.[2] The board will independently manage and invest the assets of the Trust. Five members of the board will constitute a quorum and, with the exception of the adoption of investment guidelines, which must be by a unanimous vote of the trustees, all decisions must be made by a majority vote. The board of trustees will: (1) retain independent advisers to assist it in the formulation and adoption of its investment guidelines; (2) retain independent investment managers to invest the assets in a manner consistent with board guidelines; (3) invest the assets of the Trust pursuant to the adopted investment guidelines; (4) pay administrative expenses of the Trust from the money in the Trust; and (5) transfer money to the disbursing agent to pay benefits and administrative expenses related to those benefits. The board will be subject to fiduciary standards similar to those applicable to pension fund fiduciaries under the Employment

[1] The railroad unemployment insurance system also provides uniform unemployment insurance to covered employees.

[2] The board of trustees is comprised of the following seven members: (1) three representing the interests of labor; (2) three members representing the interests of management; and (3) one member representing the interests of the general public. The three members of the Railroad Retirement Board are not eligible to serve on the board of trustees. The term of each member of the board of trustees is three years, but the initial members have staggered terms.

Retirement Income Security Act of 1974, as amended. The Railroad Retirement Board will enforce these standards. Also, members of the Railroad Retirement Board will be considered fiduciaries for purposes of appointing the trustees of the Railroad Retirement Investment Trust Board.

The Trust's financial statements will be audited by an independent qualified public accountant. The Trust will be required to provide an annual management report to Congress about the operations and financial condition of the Trust.

Transfers to the Trust

Upon the creation of the Trust, the Railroad Retirement Board shall direct the Secretary of the Treasury to transfer to the Trust: (1) the portion of the railroad retirement account which is not needed to pay current administrative expenses; and (2) the portion of the Social Security equivalent benefit account[3] which is not needed to pay current benefits. The Board of Trustees for the Trust will consult with the Secretary of the Treasury to develop an appropriate method of transferring or converting existing obligations held by the accounts.

EFFECTIVE DATE

The provisions generally are effective on the date of enactment.

b. Increased railroad retirement benefits (secs. 101–104 of the bill and secs. 2, 3, 4, 5, 18, and 19 of the Railroad Retirement Act of 1974)

PRESENT LAW

Annuity benefits for widows and widowers

The railroad retirement system, funded primarily by payroll taxes on covered employers and employees, provides a benefit roughly equivalent to Social Security (the "tier 1" benefit), an additional benefit similar to those allowed in some private defined benefit pension plans (the "tier 2" benefit) and certain other benefits. The spouse of a deceased railroad employee may be eligible for any of these benefits.[4] A widow's or widower's tier 1 benefit generally equals the amount of the deceased employee's tier 1 benefits on the date of death.[5] Tier 2 benefits for the widow or widower, however, are limited to one-half of the deceased employee's tier 2 benefits on the date of death.[6]

Retirement age

Generally, an employee aged 60 with 30 years of service may retire and collect full tier 2 benefits. However, tier 1 benefits for an employee with 30 years of service are actuarially reduced for retire-

[3] The Social Security equivalent benefit account annually receives amounts from or pays amounts to the Social Security trust funds based upon a hypothetical calculation which assumes railroad employment had been directly covered by Social Security.

[4] Generally, the benefits for the surviving spouse are calculated with reference to the railroad retirement benefit for the deceased employee at the date of death before any benefit reductions required under the Railroad Retirement Act, the Social Security Act, and any public service pension.

[5] These amounts are indexed for inflation annually.

[6] These amounts are indexed for inflation annually.

ment before age 62. This actuarial reduction did not apply prior to 1984.

Vesting requirements

Under present law (both tier 1 and tier 2), an employee must have 10 years of covered service to be vested in the railroad retirement system.

Railroad retirement maximum benefit

Present law limits the total amount of monthly railroad retirement benefits (tier 1 and tier 2) payable to an employee and an employee's spouse at the time the employee's annuity payout begins. The maximum benefit is based on the highest two years of creditable railroad retirement or social security covered earnings in the 10–year period ending with the year the employee's annuity payout begins.

REASONS FOR CHANGE

The bill makes several changes to the benefit structure of the Railroad Retirement system. First, widow(er) benefits are increased. Concurrent resolutions (H.Con.Res. 52 and S.Con.Res. 80) introduced in both the House of Representatives and the Senate urged rail labor, management, and retirees to negotiate an improvement to widow(er) benefits. This proposal incorporates the negotiated improvements. Second, vesting requirements are reduced from 10 years to 5 years. Under current law, workers with less than 10 years of rail service are ineligible for benefits under the railroad retirement system, and should their Railroad employment terminate before 10 years, they forfeit all of their payroll tax contributions to the system. A 5-year vesting requirement is consistent with many multi-employer pension plans covered by ERISA. Third, the retirement age at which full benefits are payable for career workers is reduced from 62 to 60 for Tier I. (Historically, the full retirement age was 60. However, the age was increased to 62 in 1983 when the Railroad Retirement system faced insolvency.) Finally, the railroad benefit maximum is repealed. This provision in current law is intended to limit benefits for certain workers. However, it unintentionally affects spouses and many low-wage workers who may have worked in low-paying jobs in the 10 years prior to benefit entitlement.

EXPLANATION OF PROVISION

Benefits for widows and widowers

The bill increases tier 2 benefits for widows and widowers to 100 percent of the deceased employee's benefits on the date of death. When coupled with the present-law tier 1 benefit for widows and widowers, the bill provides widows and widowers essentially the same benefit as that payable to the railroad employee prior to death.

Retirement age

The bill reduces the age at which full tier 1 benefits are payable from 62 to 60 for employees with at least 30 years of rail service (with such benefits paid from tier 2 funds).

Vesting requirements

The bill reduces the years of covered service to be vested in the railroad retirement system from the present 10 years to 5 years. For this purpose, employees with less than 10 years of railroad employment before 1996 will have to meet either the 10-year vesting requirement or have 5 years of post-1995 railroad service to be vested.

Railroad retirement maximum benefit

The bill repeals the present-law maximum limit on monthly railroad retirement benefits.

EFFECTIVE DATE

The provision related to the expansion of benefits to widows and widowers is effective on January 1, 2001, and applies to annuity amounts accruing after December 31, 2000. The provision related to retirement is effective for annuities that begin to accrue on or after January 1, 2001. The provision relating to the faster vesting requirement is effective after December 31, 2001. The provision relating to the repeal of the railroad retirement maximum benefit is effective on January 1, 2001, and applies to annuity amounts accruing for months after December 31, 2000.

2. Amendments to the Internal Revenue Code of 1986 (the "Code") (secs. 001–204 of the bill and secs. 501, 3201, 3211, 3221, and 3241 of the Code)

PRESENT LAW

In general

Present law also imposes a tier 1 tax on railroad employers, employees, and employee representatives. This tax is essentially equivalent to Social Security taxes, and is used primarily to fund tier 1 benefits, which are essentially equivalent to Social Security benefits. Tier 2 railroad retirement benefits are funded primarily through a tier 2 payroll tax. Present law also imposes a supplemental annuity tax, which is used to finance supplemental annuity benefits, as well as some tier 2 benefits.

Tier 2 payroll taxes

Present law imposes a tier 2 payroll tax on railroad employers, employees, and employee representatives. The tax on employers is equal to 16.1 percent of covered compensation. The employee-level tax is equal to 4.9 percent of covered compensation.[7] The tier 2 tax on railroad employee representatives is equal to 14.75 percent of covered compensation.

The maximum amount of compensation taken into account for tier 2 payroll tax purposes is $56,700 (for 2000).

Supplemental annuity tax

A cents-per-hour tax is imposed on railroad employers and employee representatives to fund supplemental annuity benefits. The rate of tax is determined quarterly by the Railroad Retirement

[7] Like tier 1 and Social Security taxes, the employee-level tier 2 tax is deducted from the employee's compensation and remitted by the employer.

Board based on the level necessary to fund current benefits, plus administrative costs. The current rate of tax is 26.5 cents per hour. Special rules apply in the case of an employer with respect to employees covered by a supplemental pension plan established pursuant to collective bargaining.

REASONS FOR CHANGE

The bill reduces the tier 2 payroll tax rate paid by employers and employee representatives and provides a tax adjustment mechanism for years after 2002. According to the Railroad Retirement Board, the assets of the RRA at the end of 2000 will be sufficient to pay more than 5 years of benefits. As a result, the tier 2 tax rate can be lowered over the next two years without impacting the ability to pay benefits. Beyond the next two years, the tax rate will be set each calendar year pursuant to a statutory formula based on the average benefit ratio. If the program becomes underfunded, the tax rate will automatically increase to bolster the system's income, placing the burden and investment risk on the industry rather than the general taxpayer. Alternatively, if the trust fund balance increases to a certain level relative to benefit payments, tax rates will decrease. The automatic tax adjustment mechanism allows the tax rate to be more responsive to the system's financing needs.

EXPLANATION OF PROVISION

In general

The bill makes the following changes to the Code: (1) lowers the tier 2 payroll tax rates for employers and employee representatives in 2001 and 2002 and provides a modified method of calculating the rate of all tier 2 taxes after 2002; (2) repeals the supplemental annuity tax; and (3) provides tax-exempt status for the Trust created by the bill (described in A.1., above).

Payroll taxes

The bill lowers the tier 2 tax rate on employers to 15.6 percent of covered compensation in 2001 and 14.2 percent in calendar year 2002. The bill lowers the tier 2 tax rate for employee representatives to 14.75 percent of covered compensation in 2001 and 14.2 percent in calendar year 2002. The bill does not change the tier 2 tax on employees for 2001 and 2002.

Beginning in calendar year 2003, the bill provides for automatic modifications in the tier 2 tax rates for employers, employee representatives, and employees based on the ratio of certain asset balances to the sum of benefits and administrative expenses (the "average account benefits ratio"). The average account benefits ratio is the sum of the account benefits ratio for the previous 10 fiscal years divided by 10. The account benefits ratio is determined by dividing the sum of the fair market value of the assets in the railroad retirement account and the Trust at the close of the fiscal year by the sum of total benefit payments and administrative expenses of the Trust for such fiscal year. Because the average account benefits ratio is expected to be between 4.0 and 6.1 in 2003, the table is designed to produce a 13.10 tax rate for employers and employee representatives and a 4.9 tax rate for employees in cal-

endar year 2003. The Secretary of the Treasury is to use the following table to make adjustments to the tier 2 tax rates.

Average account benefits ratio		Applicable percentage for employer and employee representative tier 2 taxes (percent)	Applicable percentage for employee tier 2 taxes (percent)
At least	But less than		
	2.5	22.1	4.9
2.5	3.0	18.1	4.9
3.0	3.5	15.1	4.9
3.5	4.0	14.1	4.9
4.0	6.1	13.1	4.9
6.1	6.5	12.6	4.4
6.5	7.0	12.1	3.9
7.0	7.5	11.6	3.4
7.5	8.0	11.1	2.9
8.0	8.5	10.1	1.9
8.5	9.0	9.1	0.9
9.0		8.2	0

Supplemental annuity tax

The bill repeals the supplemental annuity tax.[8] Supplemental annuity benefits are not affected by the elimination of the supplemental annuity tax.

Tax exemption for the Trust

The bill provides tax-exempt status for the newly created Trust under Code section 501(c).

EFFECTIVE DATE

The provisions generally are effective for calendar years beginning after December 31, 2000. The provision relating to the tax-exempt status of the Trust is effective on the date of enactment.

III. BUDGET EFFECTS OF THE BILL

In compliance with sections 308 and 403 of the Congressional Budget Act of 1974, and paragraph 11(a) of rule XXVI of the Standing Rules of the Senate, the following letter has been received from the Congressional Budget Office on the budgetary impact of the legislation:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 2, 2000.

Hon. WILLIAM V. ROTH,
Chairman, Committee on Finance,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4844, the Railroad Retirement and Survivors' Improvement Act of 2000.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Geoffrey Gerhardt.

Sincerely,

BARRY B. ANDERSON
(For Dan L. Crippen, Director).

[8] The funds in the supplemental annuity account will be transferred to the Fund and the account will be eliminated by the Railroad Retirement Board as soon as possible after December 31, 2000.

Enclosure.

H.R. 4844—Railroad Retirement and Survivors' Improvement Act of 2000

Summary: H.R. 4844 would make several changes to the Railroad Retirement program. The act would expand benefits for certain participants in the program and reduce the number of years of covered railroad service needed before a worker (and qualified spouse) can be vested in the system. The legislation would also eliminate the Supplemental Annuity tax and lower the payroll tax rate on railroad employers. Finally, the act would create a new Railroad Retirement Investment Trust and establish a board to manage this fund. That board would be authorized to invest the reserves of the Railroad Retirement System in private securities.

Assuming that investments in private securities are treated as budget outlays, as specified in OMB Circular A–11, CBO estimates that H.R. 4844 would increase direct spending by $13.2 billion during the 2001–2005 period and by $9.7 billion over the 2001–2010 period. It would reduce revenues by $1.7 billion from 2001 through 2005 and by $3.9 billion in the 10-year period. Because the act would affect direct spending and receipts, pay-as-you-go procedures would apply. The net effect of the act would be to decrease the budget surplus by $14.8 billion from 2001 through 2005 and by $13.6 billion over the 2001–2010 period. Because there is little precedent for the purchase of private securities by the federal government, alternative budgetary treatments are possible that could substantially alter the budgetary impact.

The legislation contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose on costs on state, local, or tribal governments.

Estimated cost to the Federal Govenment: The estimated budgetary impact of H.R. 4844 is summarized in Table 1. The costs of this legislation fall within budget function 600 (income security).

TABLE 1.—ESTIMATED BUDGETARY EFFECTS OF H.R. 4844

	By fiscal year, in millions of dollars—									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CHANGES IN DIRECT SPENDING										
Benefit Changes:										
Expansion of Widow/er Benefits	68	91	91	93	94	96	98	100	101	103
Reduction in Retirement Age	31	105	172	209	234	260	304	355	391	412
Reduction in Vesting Requirements	(1)	(1)	(1)	(1)	(1)	(1)	1	1	1	2
Repeal of Ceiling on Railroad Retirement Benefits	10	14	14	15	16	17	18	19	21	23
Subtotal	109	210	277	316	343	374	421	475	515	540
Investment in non-Treasury Securities [2]	14,760	−460	−650	−830	−920	−990	−1,060	−1,130	−1,240	−1.340
Total	14,869	−250	−373	−514	−577	−616	−639	−655	−725	−800
CHANGES IN REVENUES										
Repeal of Supplemental Annuity Tax [3]	−60	−79	−81	−81	−79	−77	−76	−75	−74	−74
Adjustment in Tier II Tax Rate [3]	−74	−197	−321	−354	−357	−360	−367	−370	−377	−381
Total	−134	−276	−402	−435	−436	−437	−443	−445	−451	−455
TOTAL CHANGES IN THE BUDGET SURPLUS										
Increase or Decrease (−) in the Surplus	−15,003	−26	−29	79	141	179	196	210	274	345

/1/ =Less than $500,000.

[3] The budgetary treatment of this provision follows the instructions in OMB Circular A–11. CBO assumes that the investment board will maintain 20 percent of the portfolio in U.S. Treasury securities, 20 percent in corporate securities, and 60 percent in private equities.

[3] Assumes that 20 percent of employer-paid payroll tax reductions are offset by additional income and employee-paid tax collections.

Note.—Components may not sum to totals because of rounding.

Basis of estimate: The Railroad Retirement system has two main components. Tier I of the system is financed by taxes on employers and employees equal to the Social Security payroll tax and provides qualified railroad retirees (and their spouses, dependents, and widow(er)s) with benefits that are roughly equal to Social Security. Covered railroad workers and their employers pay the Tier I tax instead of the Social Security payroll tax, and most railroad retirees collect Tier I benefits instead of Social Security. Tier II of the system operates much like traditional multi-employer pension systems, with employers and employees contributing a certain percentage of pay toward the system to finance defined benefits to eligible railroad retirees (and qualified spouses, dependents, and widow(er)s) upon retirement. But while most multi-employer plans are run by a group of cooperating employers in the same industry, the federal government collects Tier II payroll contributions and pays out benefits.

H.R. 4844 would make fundamental changes to the Railroad Retirement System by expanding certain retirement benefits, reducing payroll taxes, and authorizing a new government organization to invest funds credited to the Railroad Retirement Account in the private securities market. In addition, the act would eliminate the separate account for supplemental benefits and pay those benefits directly from the Railroad Retirement Investment Trust.

Direct spending

H.R. 4844 would make several changes in Railroad Retirement benefits, including:

- Expanding benefits for qualified widows and widowers;
- Reducing the normal retirement age for Tier I benefits to 60;
- Reducing the system's vesting requirements; and
- Repealing the cap on Railroad Retirement benefits.

The act also would establish a new entity called the Railroad Retirement Investment trust that would be responsible for investing the reserves of the Railroad Retirement System in private securities, as well as in U.S. Treasuries.

Benefit changes

The four changes in Railroad Retirement benefits (described below) would increase spending by $0.1 billion in 2001 and by $3.6 billion over the 2001–2010 period.

Expansion of Widows' and Widowers' Benefits. Section 101 of the legislation would increase Railroad Retirement annuities payable to certain widows and widowers of railroad employees. Under current law, the Tier II component of a widow(er)'s Railroad Retirement annuity is generally equal to 50 percent of the Tier II benefit that was payable to the retired employee at the time of his or her death. Section 101 would provide a guaranteed minimum benefit for widow(er)s based on 100 percent of the employee's Tier II annuity. This proposal would generally provide widow(er)s with the same Tier II benefits that were previously being paid to the now deceased railroad retiree.

Section 101 would apply to benefits paid for months after December 2000. For widow(er)s whose benefits begin before January

2001, the guaranteed minimum would be based on the amount of the original annuity without adjustments for inflation.

According to the Railroad Retirement Board, this provision would initially affect approximately 50,000 widow(er)s currently collecting benefits. CBO estimates this provision would increase direct spending by $68 million in 2001 and by $935 million during the 2001–2010 period.

Reduction in Retirement Age. Section 102 of the legislation would provide for full retirement benefits at age 60 for railroad workers (and qualified spouses) who have at least 30 years of covered service. Under current law, retirees with 30 years of service may begin collecting full Tier II benefits at age 60, but Tier I benefits are reduced if they file before the age of 62. This legislation would eliminate that reduction in Tier I benefits, which was enacted in the Railroad Solvency Act of 1983. Based on data provided by the Railroad Retirement Board, CBO estimates this provision would increase direct spending by $31 million in 2001 and by $2.5 billion over the 2001–2010 period.

Reduction in Vesting Requirements. Section 103 would reduce the number of years of covered service needed before workers (and qualified spouses) become vested in the Railroad Retirement System from 10 years to five years. The reduced vesting requirement would only apply to qualified service performed after 1995. Employees who had fewer than 10 years of qualified railroad employment before 1996 would either have to meet the current 10-year vesting requirement or have five years of covered service after 1995 in order to be vested. Section 103 would also provide conforming reductions in vesting requirements for disability and survivor benefits.

Based on information provided by the Railroad Retirement Board, CBO estimates this proposal would have a negligible effect on direct spending through 2006, but would increase direct spending by $5 million during the 2007–2010 period.

Repeal of the Ceiling on Railroad Retirement Benefits. Current law caps the total monthly benefits payable to a retiree and spouse under the Railroad Retirement system. This cap is calculated based on the employee's average monthly salary during the two years prior to retirement, or the worker's monthly Social Security earnings in the 10-year period prior to retirement. Section 104 would repeal this limit, effective January 1, 2001. The Railroad Retirement Board indicates that about 2,000 beneficiaries now collect reduced benefits because of the cap. CBO estimates that eliminating the Railroad Retirement maximum would increase direct spending by $10 million in 2001 and by $167 million from 2001 through 2010.

Investment in non-Treasury securities

Section 105 of H.R. 4844 would establish a new entity, the Railroad Retirement Investment Trust, which would be allowed to invest in non-Treasury securities, such as publicly traded stocks in private companies. By law, the fund's assets, which CBO estimates will total about $18.5 billion in December 2000, now consist solely of U.S. government securities. Because those securities are the safest possible investment, they generally earn a lower rate of return than riskier instruments like corporate stocks and bonds.

Similar restrictions apply to the investment policies of every major federal trust fund—Social Security, Medicare, Civil Service Retirement, Military Retirement, the Highway Trust Fund, and others. H.R. 4844 would make Railroad Retirement an exception to that rule.

Estimate Under Current Budgetary Treatment. The current budgetary treatment of federal investments in non-Treasury financial instruments is specified in the Office of Management and Budget (OMB) Circular A–11, which states that the purchases of such securities should be displayed as outlays and the sales of such securities and returns such as dividends and interest payments should be treated as offsetting receipts. Under this budgetary treatment, this act's authorization for such investment practices would increase outlays by $14.8 billion in 2001, decrease outlays beginning in 2002, and result in net spending of $6.1 billion over the 10-year period.

As required by the act, funds currently held in the Railroad Retirement Account and the Social Security Equivalent Benefit Account that are not currently needed to pay benefits would be transferred to the newly created Railroad Retirement Trust Fund. CBO assumes that about $18.5 billion in those accounts would be transferred on December 31, 2000, and would promptly be invested in various financial instruments. Based on the practices of other multi-employer pension plans, CBO further assumes the managers of the fund would keep 20 percent of the investment in U.S. Treasury securities, 20 percent in high-grade corporate bonds, and the remaining 60 percent in equities. Because purchases of Treasury securities are not considered outlays, only 80 percent of the initial investments of the fund would be shown as federal outlays. The estimates assume that Treasury securities yield a 6 percent return, high-grade corporate bonds a 7 percent return, and equities a 9 percent return.

Current Budgetary Treatment vs. Possible Alternatives. For most federal programs, accounting for outlays is straightforward. The federal government buys goods and services—such as defense and medical care—and makes transfer payments like Social Security and payments for Food Stamps by issuing a check or its equivalent. Those payments are counted as outlays when they are issued. The A–11 treats the purchases of assets—financial or physical—in the same way. The purchase price simply appears as a federal outlay. Specifically, the A–11 states:

> [w]e treat an investment in non-U.S. securities (equity or debt securities) as a purchase of an asset. You must record an obligation and an outlay for the purchase in an amount equal to the purchase price * * * You record interest received on such investments as a collection when you receive it and in the amount that you receive * * * You record the proceeds from the sale or redemption of a non-U.S. security as a collection when received and in the amount received.

In contrast, the A–11 directs that U.S. securities be treated as equivalent to cash, and tells agencies to count transactions involving such securities as a change in the mix of asset holdings rather than as a purchase or sale of assets. Thus, purchases of non-Treas-

ury securities are deemed to be outlays under the A–11 guidelines, but purchases of Treasury securities are not. In practice, this difference has been of little consequence because the government has only rarely acquired non-Treasury securities.

Some budget experts think that this long-standing practice is ill-suited to purchases of financial assets that the government acquires as a way of preserving (or enhancing) the value of cash balances. (For example, the current treatment would dictate that if current or future budget surpluses were entirely invested in non-Treasury securities, the budget would record government expenditures equal to receipts, which might not be a useful indicator of the government's financial condition.) It can also be argued that purchases of financial assets in order to preserve or enhance the value of cash balances are very different in nature, and should be treated differently in the budget, than purchases of goods and services, entitlement benefits, grants, employees' salaries, and other programmatic or operational activities of the government. Consequently, some analysts have argued that these purchases should not be treated as outlays, but rather as a means of financing the activities of the federal government. In this estimate, CBO has followed the instructions of the A–11, but we may consider a different budgetary treatment in the future.

Revenues

H.R. 4844 would make several changes to the payroll tax specified in the Railroad Retirement Act, and would result in estimated net revenue losses of $0.1 billion in 2001 and $3.9 billion over the 10-year period. Because reductions in employer-paid employment taxes are assumed to be passed through to workers as higher wages, increased income and employee-paid payroll tax collections are assumed to offset 20 percent of the lost payroll tax revenues.

Supplemental annuity tax

Section 203 of the act would repeal the Supplemental Annuity tax, which is currently levied on employers to pay for a third layer of benefits on top of Tier I and Tier II. Instead of being paid from a separate account, supplemental benefits would be paid directly from the Railroad Retirement Account. Based on information provided by the Railroad Retirement Board, CBO estimates that this provision would reduce revenue by $380 million over the 2001–2005 period and by $756 million over the 2001–2010 period.

Tier II payroll tax rates

The act would also lower the Tier II tax rate on employers from its current level of 16.1 percent to 14.75 percent in calendar year 2001 and 14.2 percent in calendar year 2002. Thereafter, H.R. 4844 would link future Tier II tax rates to the financial condition of the Railroad Retirement Investment Trust (see Table 2). Specifically, the act would require the Railroad Retirement Board to calculate the ratio of assets held in the trust fund (using the average balance in the fund over the previous 10 years) to the total Railroad Retirement benefits paid out in a given year (the account benefit or trust fund ratio). In 2003, CBO expects the account benefit ratio would be about 5.6, which would cause payroll tax rates to be set at 13.1 for employers and 4.9 for employees (which is the current rate for

employees). CBO estimates that the Tier II tax rates will remain at the level through at least 2010 and that the changes in the tax rate would reduce revenue by $1.3 billion over the 2001–2005 period and $3.2 billion from 2001 through 2010.

If, however, the account benefit ratio rises or falls below expectations, a change in payroll tax rates could be triggered by the act. For instance, if the board determined that this ratio had gone above 6.0, then the Tier II payroll tax rate for both employers and employees would be reduced. Conversely, if the board determined that the ratio had fallen below 4.0, then the payroll tax for railroad employers would increase.

Under reasonable assumptions about railroad employment and investment income to the trust fund, CBO estimates that neither outcome would occur during the next 10 years. For example, if the new trust fund only held Treasury securities, the account benefit ratio would fall from 5.9 today to 4.1 by 2010. If the trust fund were invested in a wider variety of securities, and the rates of return matched CBO's assumptions, the ratio would be roughly 5.8 in 2010.

Although that conclusion represents CBO's best judgment, the unexpected could happen. For example, rapid growth in the railroad industry's payroll or spectacular returns in the stock market could trigger tax cuts by 2010. On the other hand, employment that is lower than expected or a drop in stock returns could lead to automatic tax increases.

TABLE 2.—DETERMINATION OF TIER II TAX RATE

If the acount benefit ratio is		The Tier II tax rates would be:	
At least	But less than	For employers	For employees
0	2.5	22.1	4.9
2.5	3.0	18.1	4.9
3.0	3.5	15.1	4.9
3.5	4.0	14.1	4.9
4.0	6.1	13.1	4.9
6.1	6.5	12.6	4.4
6.5	7.0	12.1	3.9
7.0	8.5	11.6	3.4
7.5	8.0	11.1	2.9
8.0	8.5	10.1	1.9
8.5	9.0	9.1	0.9
9.0	NA	8.2	0

NA = Not applicable.

Note.—The account benefit ratio is calculated by dividing average trust fund assets over the previous 10 years by the total Railroad Retirement benefits benefits paid in a given year.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go producers for legislation affecting direct spending and receipts. The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in Table 3. For the purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

TABLE 3.—ESTIMATED EFFECTS OF H.R. 4844 ON DIRECT SPENDING AND RECEIPTS

	By fiscal year, in millions of dollars—									
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Changes in outlays	14,869	−250	−373	−514	−577	−616	−639	−655	−725	−800
Changes in receipts	−134	−276	−402	−435	−436	−437	−443	−445	−451	−455

Intergovernmental and private-sector impact: H.R. 4844 contains no intergovernmental or private-sector mandates as defined by UMRA and would impose no costs on state, local, or tribal governments.

Comparison with other estimates: The Railroad Retirement Board has prepared an estimate of the individual benefit increases and projected trust fund holdings under H.R. 4844. The board's estimate contains trust fund projections using three different assumptions about employment levels in the railroad industry.

Using the middle employment assumption, which CBO believes is the most realistic, the Railroad Retirement Board estimates that the cost of benefits under H.R. 4844 would increase by $1.4 billion from 2001 through 2005 and by $3.8 billion during the 2001–2010 period, slightly more than CBO estimates. In addition, the board estimates that revenues from Tier II payroll taxes would decrease by $1.6 billion from 2001 through 2005 and $3.6 billion over the 2001–2010 period. The board's estimates do not include any impact the lower employer-paid payroll taxes might have on income and employee-paid payroll tax receipts. On a comparable basis, excluding impacts on income and employee-paid payroll tax receipts. On a comparable basis, excluding impacts on income and employee-paid payroll tax receipts, CBO estimates Tier II revenue losses of $1.6 billion over five years and $3.9 billion over 10 years. Both the board and CBO estimate that balances in the new trust fund would rise steadily over time, but would not be high enough to trigger a reduction in the payroll tax during the next 10 years.

Previous CBO estimates: On September 11, 2000, CBO provided the Committee on Ways and Means and the Committee on Transportation and Infrastructure with a cost estimate for H.R. 4844 as passed by the House of Representatives on September 7, 2000. Although the version ordered reported by the Finance Committee contains minor modifications to the version of H.R. 4844 that was approved by the House, CBO estimates that those changes would not affect the cost of the legislation. Therefore, the budgetary effects shown in this cost estimate are identical to those contained in the estimate of the House-passed act.

Estimate prepared by: Federal Costs: Geoffrey Gerhardt and Ed Harris. Impact on State, Local, and Tribal Governments: Leo Lex. Impact on the Private Sector: Ralph Smith.

Estimate approved by: Robert A. Sunshine, Assistant Director for Budget Analysis.

IV. VOTES OF THE COMMITTEE

In compliance with paragraph 7(b) of rule XXVI of the Standing Rules of the Senate, the following statements are made concerning the votes of the Committee on Finance in consideration of the bill, H.R. 4844.

A. MOTION TO REPORT THE BILL

The bill, H.R. 4844, as amended, was ordered favorably reported by a voice vote (with a quorum being present).

Present.—Roth, Grassley, Murkowski, Nickles, Gramm, Mack, Craig, Moynihan, Baucus, Rockefeller, Breaux, Bryan, Robb.

B. VOTES ON AMENDMENTS

(1) An amendment by Senator Gramm to strike the retirement age provision failed by a vote of 7 to 11.

Yeas.—Murkowski (proxy), Nickles, Gramm, Lott (proxy), Mack, Breaux, Graham.

Nays.—Roth, Grassley, Hatch (proxy), Jeffords, Craig, Moynihan, Baucus, Rockefeller, Conrad, Bryan, Robb.

(2) An amendment by Senator Grassley to add provisions providing for health insurance of certain children with disabilities was ruled not germane by the Chairman. A motion to waive the ruling of the Chair failed by a vote of 7 to 10, two-thirds of those present not having voted in the affirmative.

Yeas.—Grassley, Jeffords, Breaux, Conrad, Graham, Bryan, Robb.

Nays.—Roth, Murkowski, Nickles, Gramm, Mack, Thompson, Craig, Moynihan, Baucus, Rockefeller.

(3) An amendment by Senator Gramm to add a requirement that any benefit changes or tax reductions be annually contingent on returns to the investment trust, failed by a vote of 4 yeas to 15 nays.

Yeas.—Murkowski, Nickles, Gramm, Mack.

Nays.—Roth, Grassley, Hatch, Lott (proxy), Jeffords (proxy), Thompson (proxy), Craig, Moynihan, Baucus, Rockefeller, Breaux, Conrad, Graham, Bryan, Robb.

(4) An amendment by Senator Nickles to repeal the tier 1 component of the Railroad Retirement system and add a requirement that participants in the Railroad Retirement system join the Social Security system, failed by voice vote.

Present.—Roth, Grassley, Nickles, Gramm, Craig, Moynihan, Baucus, Rockefeller, Breaux, Bryan, Robb.

(5) An amendment by Senator Nickles that would add a provision that Railroad Retirement beneficiaries are no longer entitled to benefits but shall get benefits only to the extent sufficient funds exist in the Railroad Retirement investment fund, failed by a vote of 5 to 14.

Yeas.—Murkowski (proxy), Nickles, Gramm, Mack (proxy), Thompson (proxy).

Nays.—Roth, Grassley, Hatch (proxy), Lott (proxy), Jeffords (proxy), Craig, Moynihan, Baucus, Rockefeller, Breaux, Conrad (proxy), Graham (proxy), Bryan, Robb.

(6) An amendment by Senator Bryan to bar the Foreign Sales Corporation tax benefit to pharmaceutical companies when American patients are charged more than 100 percent for a drug charged to foreign patients, failed by a vote of 3 to 17.

Yeas.—Graham (proxy), Bryan, Robb (proxy).

Nays.—Roth, Grassley, Hatch (proxy), Murkowski (proxy), Nickles (proxy), Gramm (proxy), Lott (proxy), Jeffords (proxy), Mack (proxy), Thompson (proxy), Craig (proxy), Moynihan, Baucus (proxy), Rockefeller, Breaux, Conrad (proxy), Kerrey (proxy).

V. REGULATORY IMPACT AND OTHER MATTERS

A. Regulatory Impact

Pursuant to paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee states that the legislation will not significantly increase regulation of any individuals or businesses; will not adversely impact the personal privacy of individuals; and will result in no significant additional paperwork.

For further discussion of the impact of the bill on tax complexity, see section V.C., below.

B. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

C. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 (the "IRS Reform Act") requires the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Department of the Treasury) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code and has widespread applicability to individuals or small businesses.

The staff of the Joint Committee on Taxation has determined that a complexity analysis is not required under section 4022(b) of the IRS Reform Act because the bill contains no provisions that amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses.

VI. CHANGES TO EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the Committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of rule XXVI of the Standing Rules of the Senate, relating to changes in existing law made by the bill reported by the Committee.

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