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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114817

JANUARY 11, 1979

The Honorable Warren G. Magnuson
Chairman, Committee on Appropriations SEN00300
United States Senate

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Dear Mr. Chairman:

As requested in your Committee's August 16, 1978, report on the appropriation bill for the Departments of Labor and Health, Education, and Welfare and related agencies (No. 95-1119), we reviewed the Railroad Retirement Board's calculations of the annual appropriation necessary to phase out dual railroad retirement and social security benefits (commonly called the windfall appropriation). We independently projected windfall costs and identified alternate methods of financing.

We project (1) an increase of about \$2.9 billion in estimated windfall costs above the \$7.1 billion originally estimated by the Board's actuary and (2) an increase of about \$3.5 billion in general revenue appropriations through the year 2000. Using the present funding method, 21 level annual appropriations of \$415 million beginning in 1980 would be needed to pay future windfall benefits. The Board originally estimated an annual general revenue appropriation of \$250 million. The windfall appropriations could also be funded on a pay-as-you-go cash basis, which would stretch out payments through the year 2046. A table showing required windfall appropriations under the present and cash basis methods is enclosed.

BACKGROUND

The Railroad Retirement Act of 1974 created the so-called windfall benefits. The act provided that after 1974 individuals could no longer qualify for separate full benefits from the social security and railroad retirement programs that, in total, were larger than the benefits they would have earned had all their earnings been credited to only one program. Individuals entitled to these dual benefits before 1975 became eligible for windfall payments (additional amounts required to make payments equal to the total amount the individuals would receive from full dual benefits based on earnings through 1974 or the last year of railroad employment).

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(105057)

Railroad workers qualify for windfall benefits if, before 1975, they

1. (a) had 10 years of railroad service and were fully insured under the Social Security Act or

   (b) had 10 years of railroad service and their spouses were fully insured under the Social Security Act 1/ and

2. (a) worked in the railroad industry in 1974,

   (b) worked in the industry during 12 of the 30 months preceding December 31, 1974, or their retirement, or

   (c) had 25 years of railroad service.

In addition, persons vested under both acts but not meeting any of the last three requirements receive windfall benefits based on pre-1975 laws and earnings if they were vested under social security before the end of the last year they worked in the railroad industry.

Under certain conditions, spouses and surviving spouses also qualify for windfall benefits.

The amount of the windfall is intended to reflect the excess benefits payable to railroad retirees because their employment was split between railroad and nonrailroad service. To determine the windfall amount, three separate benefits are calculated using the social security benefit formula and counting employment only through December 31, 1974, or through the year the individual last worked for a railroad, if the individual did not have 25 years of service or a current connection. The windfall is equal to the social security formula applied against social security earnings, plus the formula applied against railroad earnings, less the formula applied against combined earnings under both systems. For a nonretired employee, the windfall benefit is increased by automatic cost-of-living increases that occur between December 31, 1974, and the date the employee retires, at which time it will be frozen.

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1/Applicable only to female employees or male employees who were dependent on social security employees.

For retired employees receiving annuities at the end of 1974, a windfall benefit was calculated and paid only if the employees were entitled to social security benefits. Their windfall benefits were frozen at that time. For those receiving annuities, but not entitled to social security benefits at the end of 1974, windfall benefits are payable later if they were insured under social security before 1975. Their windfall benefits are computed when the annuitants become entitled to social security benefits. For example, an employee who at December 31, 1974, was not yet 62--and thus, not eligible for social security benefits--but had previously been awarded a regular railroad retirement annuity at age 60, would become eligible for windfall benefits at age 62.

Variations of these calculations are used to compute spouse and surviving spouse windfall benefits.

## BOARD ACTUARIAL ESTIMATES

The Railroad Retirement Act of 1974 authorizes level annual appropriations of general revenue from 1976 through 2000 to finance the costs of phasing out the windfall portion of dual benefits. The act also liberalizes the investment rules governing the Railroad Retirement Account and provides that the resulting increase in interest earned be applied against windfall costs. Basically, it grants the Board the authority (1) to make mandatory requests to the Secretary of the Treasury to purchase authorized securities and (2) to determine when and which securities are to be redeemed for benefit payments or for reinvestment.

The original estimate, made in 1974 by the Board's actuaries, was that the windfall benefits would cost $285 million annually over the 25-year period and that $35 million a year would be gained from the new investment provisions. Accordingly, $250 million was requested and appropriated for fiscal year 1976.

The 1974 act also provides that, at the time of each actuarial valuation of the Railroad Retirement Account made before fiscal year 2000, the Board will determine whether the windfall appropriation should be adjusted. Accordingly, an updated projection was published in August 1976 in conjunction with the Board's 13th actuarial valuation. This projection was that the level appropriation starting with fiscal year 1977 should have been $350 million ($360 million gross less $10 million additional investment income). The increase over the original projection was attributed chiefly to three factors. The later projection

--included cost-of-living increases through 1980,

--used a smaller investment offset and interest rate, and

--used better actuarial assumptions and techniques.

Because only $250 million was appropriated for 1977 and 1978, the Board's actuary increased the estimated level appropriation to $363 million starting with fiscal year 1979 to compensate for the $200 million shortage in 1977 and 1978 and the loss of interest on that sum. However, only $313 million was appropriated for fiscal year 1979.

OUR ACTUARIAL ESTIMATES

In late 1978 we made an actuarial estimate of the level annual appropriation necessary to fund windfall benefits. Our assumptions differed from those in the Board's 13th actuarial valuations in that we used

--actual rather than estimated windfall benefit payments for 1976 and 1977 and appropriations for 1977 through 1979,

--a 6-1/2-percent rather than a 3-percent interest rate,

--newer mortality tables, and

--estimated cost-of-living increases beyond 1980.

Our estimates show that, using the present funding method, 21 level appropriations of $415 million beginning in 1980 would be needed to pay future windfall benefits and amortize the $748 million (at December 31, 1977) negative balance. This appropriation reflects a reduction of an estimated $10 million a year for interest gained from the liberalized investment rules.

An alternate method of funding windfall benefits from general revenue appropriations is available. The present method, a series of actuarially calculated level annual payments, could be replaced by a pay-as-you-go cash approach. The latter method would result in slightly higher initial payments./ How long this would last depends on the period over which the present negative balance would be amortized. For example, if the debt is amortized through the year 2000, the cash basis appropriation would be less than the actuarially based appropriation beginning in 1983. If the debt is amortized through 2046--the last year in which windfall benefits totaling more than $100,000 would be paid--cash basis appropriations would drop below the $415 million actuarial level in 1982.

The cash method of funding would eliminate the need for actuarial approximations, with their associated uncertainty, and would result in a slower outflow of general revenue appropriations. That is, instead of windfall benefits being paid off by the year 2000, payments--which would decrease each year--would be made through 2046.

The Board's chief actuary did not object to the assumptions we used or the results obtained.

An additional consideration is a pending class action suit--Lipp et al. v. Railroad Retirement Board (No. 76-419C, SD Indiana)--which seeks to provide windfall benefits to all workers who, before 1975, had 10 years of railroad service and were fully insured, or had spouses who were fully insured, under the Social Security Act. Board officials estimate that, if the plaintiffs win their suit, the windfall appropriation would have to be increased by $84 million annually under the actuarial method.

GAO We hopes this information helps Congress you select the best method for financing future windfall benefits.

Also, the Board is performing its triennial valuation of the Railroad Retirement Account. It is based on data as of December 31, 1977, and should be released in mid-1979. As agreed with your office, we intend to review this valuation and, if appropriate, independently determine the account's stability under alternative economic and actuarial assumptions.

As arranged with your office, unless you publicly announce its contents earlier, we will make this report available for unrestricted distribution in 7 days from the date of the report.

Sincerely yours,

Comptroller General
of the United States

Enclosure

## WINDFALL APPROPRIATIONS UNDER DIFFERENT FUNDING ALTERNATIVES (note a)

| Year | Level appro-priation | Projected benefits | Projected benefits plus debt amortization over 21 years (note b) | Projected benefits plus debt amortization over 57 years (note c) |
|---|---|---|---|---|
| | (millions) | | | |
| 1980 | $424.9 | $387.7 | $437.7 | $425.5 |
| 1981 | 424.9 | 382.5 | 432.5 | 420.3 |
| 1982 | 424.9 | 375.5 | 425.5 | 413.3 |
| 1983 | 424.9 | 367.3 | 417.3 | 405.1 |
| 1984 | 424.9 | 358.8 | 408.8 | 396.6 |
| 1985 | 424.9 | 349.1 | 399.1 | 386.9 |
| 1986 | 424.9 | 338.7 | 388.7 | 376.5 |
| 1987 | 424.9 | 327.6 | 377.6 | 365.4 |
| 1988 | 424.9 | 316.9 | 366.9 | 354.7 |
| 1989 | 424.9 | 308.7 | 358.7 | 346.5 |
| 1990 | 424.9 | 300.8 | 350.8 | 338.6 |
| 1991 | 424.9 | 291.3 | 341.3 | 329.1 |
| 1992 | 424.9 | 281.3 | 331.3 | 319.1 |
| 1993 | 424.9 | 271.2 | 321.2 | 309.0 |
| 1994 | 424.9 | 260.2 | 310.2 | 298.0 |
| 1995 | 424.9 | 249.5 | 299.5 | 287.3 |
| 1996 | 424.9 | 238.5 | 288.5 | 276.3 |
| 1997 | 424.9 | 227.0 | 277.0 | 264.8 |
| 1998 | 424.9 | 215.5 | 265.5 | 253.3 |
| 1999 | 424.9 | 204.5 | 254.5 | 242.3 |
| 2000 | 424.9 | 194.3 | 244.3 | 232.1 |
| 2001 | | 183.5 | 183.5 | 221.3 |
| 2002 | | 172.3 | 172.3 | 210.1 |
| 2003 | | 161.0 | 161.0 | 198.8 |
| 2004 | | 150.3 | 150.3 | 188.1 |
| 2005 | | 139.7 | 139.7 | 177.5 |
| 2006 | | 128.0 | 128.0 | 165.8 |
| 2007 | | 116.9 | 116.9 | 154.7 |
| 2008 | | 106.1 | 106.1 | 143.9 |
| 2009 | | 95.7 | 95.7 | 133.5 |
| 2010 | | 84.6 | 84.6 | 122.4 |
| 2011 | | 75.5 | 75.5 | 113.3 |
| 2012 | | 67.0 | 67.0 | 104.8 |
| 2013 | | 59.0 | 59.0 | 96.8 |
| 2014 | | 51.3 | 51.3 | 89.1 |
| 2015 | | 44.9 | 44.9 | 82.7 |

| Year | Level appro- priation | Projected benefits | Projected benefits plus debt amortization over 21 years (note b) | Projected benefits plus debt amortization over 57 years (note c) |
|---|---|---|---|---|
| | (millions) | | | |
| 2016 | | $39.6 | $39.6 | $77.4 |
| 2017 | | 33.8 | 33.8 | 71.6 |
| 2018 | | 29.0 | 29.0 | 66.8 |
| 2019 | | 21.9 | 21.9 | 59.7 |
| 2020 | | 18.8 | 18.8 | 56.6 |
| 2021 | | 15.8 | 15.8 | 53.6 |
| 2022 | | 13.7 | 13.7 | 51.5 |
| 2023 | | 12.1 | 12.1 | 49.9 |
| 2024 | | 10.1 | 10.1 | 47.9 |
| 2025 | | 8.5 | 8.5 | 46.3 |
| 2026 | | 7.1 | 7.1 | 44.9 |
| 2027 | | 5.8 | 5.8 | 43.6 |
| 2028 | | 4.5 | 4.5 | 42.3 |
| 2029 | | 3.8 | 3.8 | 41.6 |
| 2030 | | 3.5 | 3.5 | 41.3 |
| 2031 | | 2.8 | 2.8 | 40.6 |
| 2032 | | 2.1 | 2.1 | 39.9 |
| 2033 | | 1.7 | 1.7 | 39.5 |
| 2034 | | 1.3 | 1.3 | 39.1 |
| 2035 | | 1.0 | 1.0 | 38.8 |
| 2036 | | 0.7 | 0.7 | 38.5 |
| 2037 | | 0.5 | 0.5 | 38.3 |
| 2038 | | 0.4 | 0.4 | 38.2 |
| 2039 | | 0.3 | 0.3 | 38.1 |
| 2040 | | 0.2 | 0.2 | 38.0 |
| 2041 | | 0.1 | 0.1 | 37.9 |
| 2042 | | 0.1 | 0.1 | 37.9 |
| 2043 | | 0.1 | 0.1 | 37.9 |
| 2044 | | 0.1 | 0.1 | 37.9 |
| 2045 | | 0.1 | 0.1 | 37.9 |
| 2046 | | 0.1 | 0.1 | 37.9 |

a/Appropriations do not include any reduction from excess interest earned as a result of the change in investment rules.

b/Fiscal years 1980 through 2000.

c/Fiscal years 1980 through 2046.