Introduction

The history of railroad retirement begins in the private sector, at the end of the nineteenth century, when the railroads created the nation’s earliest private sector employee pension programs. But since the Great Depression, when the government took over these employer plans, Railroad Retirement has been a government program. Like Social Security, also created in the Great Depression, Railroad Retirement is funded by a payroll tax on workers and employers, the benefits paid out are defined by an act of Congress, and its assets are government assets.

In 2001, however, a key component of the program was privatized. Railroad Retirement covers workers who are primarily employed by large rail corporations and represented by strong rail labor unions. In the late 1990s, these employers and unions developed a plan to privatize the investment of Railroad Retirement assets. These assets, until then, had only been invested in government bonds. The industry plan would invest Railroad Retirement assets like the assets held in private sector pension trusts—in equities and other private sector securities, which have much higher expected returns than the returns on government bonds.

Rail management and labor saw the higher expected returns on equities as allowing a cut in Railroad Retirement payroll taxes and/or an increase in Railroad Retirement benefits. These gains were not free. Equities are riskier than government bonds, as well as offering higher expected returns. The industry plan thus included a mechanism that automatically raised taxes, if necessary, to keep the program on track. The parties accepted this risk, and on balance saw investing Railroad Retirement assets in equities as beneficial.

Congress was generally inclined to enact the industry plan. The major concern was the precedent it set for Social Security, which was a much larger program and covered nearly the entire U.S. workforce. More to the point, the Social Security Trust Fund held about 100 times the assets as the Railroad Retirement program. If just 40 percent
of those assets were invested in equities, Social Security could soon own 5 percent of the U.S. stock market. To many, this crossed a critical line and opened the door to unwanted government involvement in the private economy.

Congress enacted the industry plan in 2001 with one major change: it allowed the investment of Railroad Retirement assets in equities, but it removed, as best it could, government involvement in the investment process. It created a private sector trust—the National Railroad Retirement Investment Trust (NRRIT)—to invest Railroad Retirement assets in equities. Private sector employer and union Trustees would oversee NRRIT’s operations. The government would receive periodic financial reports and could take legal action should NRRIT fail to meet its fiduciary obligations, but Congress otherwise excluded government employees from any participation in NRRIT’s operations.

The book analyzes this reform and its implications going forward. Chapter 1 reviews the history of railroad retirement programs to the late 1980s, from their origins in the private sector to the government takeover in the 1930s, to the expansion of Railroad Retirement in the postwar period, to the benefit cuts and tax increases needed in the 1980s to keep the program afloat. Chapter 2 discusses the growing appeal of equity investment as a way to reduce payroll taxes and restore lost benefits, and the difficult management-labor negotiations needed to develop a proposal that could capture these gains. Chapter 3 discusses the difficult negotiations needed to win congressional enactment, negotiations made especially difficult by the precedent it seemed to set for investing Social Security assets in equities. Chapter 4 reviews the experience of the reformed program to date and offers a case study of management-labor collaboration in overseeing pension investments. It also discusses the ability of the program’s unique automatic adjustment mechanism to negotiate the difficult financial markets in the first dozen years after the reform. Chapter 5 discusses the effect of the reform on rail workers and companies, with special attention given to the potential impact on employer tax rates. Chapter
6 discusses implications for Social Security. It finds no significant lessons on the issue that most concerned Congress in 2001—how to invest Social Security assets in equities without government involvement in the private economy—but an important example of the value of an automatic adjustment mechanism, such as that introduced in the reformed Railroad Retirement program.