Workers' pensions in jeopardy

US: $400 billion deficit in pension plan funding

Jamie Chapman
25 September 2003

The head of the federal Pension Benefit Guaranty Corporation (PBGC) raised the specter of a crisis in the government-insured pension system that could make the savings and loan bailout of the 1980s pale in comparison.

In testimony before Congress earlier this month (September 4), Steven Kandarian, the federal pension insurance agency's executive director, estimated the total underfunding of pension obligations at a whopping $400 billion at the end of 2002, up from a previous record $150 billion in 2001. These huge shortfalls result in large measure from losses on pension funds invested in the stock market along with record low interest rates. With their focus on the bottom line, companies have held back making payments to restore depleted pension funds.

Kandarian also noted that the PBGC's own accounts had gone from a surplus of $7.7 billion in 2001 to a deficit of $3.6 billion at the end of 2002. The one-year loss of $11.3 billion is five times larger than the largest loss ever previously incurred in the 28-year history of the agency. Preliminary figures show that the deficit has continued to skyrocket in 2003, standing at $5.7 billion as of July 31.

The record loss occurred due to the aggressive use of bankruptcy filings by major corporations to offload their liabilities and sharply reduce labor costs. Bankruptcy court judges authorized three steel companies—National Steel, LTV Steel and Bethlehem Steel—to terminate their pension plans, forcing the PBGC to assume unfunded liabilities of $7.1 billion for these three plans alone. The companies then sold their assets to competitors, free of responsibility for their former workers.

In March 2003, the PBGC took over pension payments to 6,000 US Airways pilots, as part of the company's negotiations to emerge from bankruptcy. The plan's deficit was estimated at $2.5 billion, although only some $600 million of that amount is covered under the PBGC program. The maximum benefit insured by the PBGC is $44,000 a year, leaving highly paid workers such as airline pilots with significantly reduced payments. In addition, the federal insurance program excludes extras such as early retirement supplements, often used by corporations as incentives to reduce their workforce.

Kandarian described the effects of a pension takeover: "[T]he burden often falls heavily on workers and retirees. In some cases, participants lose benefits that were earned but not guaranteed by the pension insurance system. In all cases, workers lose the opportunity to earn additional benefits under the terminated pension plan."

The PBGC pays only those benefits accrued at the time of termination. Nor does the PBGC—or any other government agency—pick up retiree medical benefits that are reduced or eliminated when companies go bankrupt.

The PBGC was set up under the Employment Retirement Income Security Act (ERISA) of 1974, a comprehensive measure regulating both private and public employee pension plans. The agency insures nearly 44 million workers and retirees covered under some 32,000 defined benefit plans—those that promise to pay a specific amount for life based on a formula usually involving age, years of service and final salary. Employers are expected to set aside enough funds to meet their pension obligations, based on actuarial assumptions about the life expectancy of their retirees as well as assumptions about the rate of return they will receive from investing the funds they set aside.

Since the 1980s, hundreds of companies have converted their defined benefit plans to "cash-balance" plans—similar to 401(k)s—under which the employer makes no promises as to future benefits. At the time of conversion, the company estimates the value of the defined benefits already accrued for each employee and sets the money aside in a cash account, to which they add a defined amount—usually a percentage of salary—plus interest, for as long as the employee works for the firm. At retirement, however much money has accumulated in the employee's account is simply paid out and the company walks away, ridding itself of the investment and mortality risks associated with defined benefit plans.

In a conversion, older workers in particular find their benefits reduced—often as much as 50 percent—because the cash-balance plan places no premium on longevity. The defined benefit formula, by contrast, gives extra weight to years of service and salary in the final and presumably highest earning years.

Not only do companies with an older workforce save money

© World Socialist Web Site

by reducing benefits paid, but all companies that convert receive an earnings boost because they no longer have to account for their future pension obligations as liabilities on their balance sheet.

In 1999, in one of the largest conversions to date, IBM Corp. saved some $200 million a year on its pension costs. Last July, a federal judge ruled the conversion illegally discriminated against older employees, in a wording broad enough to place the legality of all such conversions in question.

IBM has vowed to appeal, but is thought to be waiting for the US Treasury Department to issue new regulations that are expected to sanction the conversion process. The Treasury Department is headed by John Snow, until January the CEO of the transportation giant CSX Corp., which adopted a cash-balance plan for new employees earlier this year.

Cash-balance conversions have become so controversial that the Treasury Department has imposed a moratorium pending issuance of its new regulations. A measure to block the lifting of the moratorium passed the Republican-controlled US House of Representatives by 258 to 160. Business groups seeking to defeat the amendment went so far as to take out a full-page ad in the *New York Times* claiming that it would "destroy America's pension system."

Corporate moves to close out defined benefit pensions further aggravate the PBGC's deficit, since fewer companies pay in premiums to the agency. The total number of plans insured has dropped 20 percent since 1999.

In his testimony, Kandarian stated that benefit payments in 2002 exceeded $1.5 billion and would rise to nearly $2.5 billion in 2003. This compares with premium income of only about $800 million in each of the last three years.

Chronically underfunded companies are required to pay a penalty premium, but the formula is written so favorably to employers that even Bethlehem Steel had not been required to pay the penalty in any of the five years preceding the termination of its plan. Its 2001 estimate of pension plan assets stood at 84 percent of current liabilities, but on takeover in 2002, the PBGC found assets covered only 45 percent of liabilities, with the deficit amounting to $4.5 billion.

Even worse, US Airways pilots found that their terminated pension plan covered less than one third of liabilities, even though the company's last filing had indicated that the plan was 94 percent funded.

In spite of the favorable treatment of pension liabilities that companies receive under the current system, many are now so far in the hole that regulations will require them to make substantial "catch-up" payments by year-end. This has led to cries for relief, with corporate lobbyists threatening that if companies are asked to pony up too much, many of them will drop their pension plans altogether.

Under the guise of pension "reform," a number of measures have been introduced to artificially reduce the calculation of pension liabilities, and thus the size of company payments required to cover them. The Bush administration has proposed an increase in the interest rate used to figure the estimate of investment income that will be earned on pension accounts. Greater investment income would mean lower company contributions.

In addition to the interest rate increase, this week the Senate Finance Committee also approved a measure allowing companies in deficit to suspend "catch-up" payments altogether for three years. Other proposals involve amending the mortality tables to recognize the shorter lifespan of blue-collar workers—while leaving unchanged the tables used for white-collar workers, who live longer. Another would provide special exemptions for airlines, and yet another for manufacturers, allowing them to amortize their "catch-up" payments over 20 or even 30 years, with payments not even beginning until 2008.

In still another bit of financial sleight of hand, the Treasury Department recently granted an exception to its ban on using company stock to fund pensions, allowing Northwest Airlines to make up $223 million of its $1 billion shortfall by contributing stock in its regional subsidiary Pinnacle Airlines. Of course, if Northwest goes under, its subsidiary's stock is likely to be worthless as well, leaving workers and the PBGC holding the bag.

The AFL-CIO unions—acting as accomplices of the corporations—generally support the various schemes to reduce employer requirements for pension funding, absurdly claiming that leaving the companies with more cash on hand will allow them to negotiate larger wage increases. Never mind that the lower funding level increases the likelihood that the workers will never see the pensions that their unions have negotiated!

All of these "reform" measures are aimed not at securing the retirement of American workers, but at postponing the day of reckoning, at which time the pension crisis will have inevitably deepened. And there is no guarantee that Washington would organize a bailout should the PBGC run out of money.

Even as ordinary workers' retirement has never been in greater jeopardy, corporate executives are pushing more and more of their multimillion-dollar compensation packages into their pensions, which generally come under less scrutiny at a time when the public is in an uproar over obscene levels of CEO pay. Of the $140 million taken home last month by the now-dismissed chairman of the New York Stock Exchange Richard Grasso, some $80 million had accumulated in his multiple pension plans.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site