Pension cuts and inequality wiping out retirement for American workers

Jonathan Keane
24 April 2006

For a growing number of US workers, dreams of a decent retirement are quickly evaporating as companies shift retirement costs onto workers, in the form of deductions from already declining wages, in order to maintain profits in a competitive global economy.

In the wake of the post-World War II business boom, US workers were granted certain limited concessions in a three-legged system of retirement security that included individual savings, government programs and private employer pensions. Between the 1940s and the 1980s, private pensions with a guaranteed payout (also known as defined-benefit pensions), became a standard component of compensation for a large section of the American workforce.

However, in the early 1980s, defined-benefit pension coverage peaked and then fell in part due to that decade's deindustrialization. The service sector jobs that supplanted industrial jobs had, for the most part, lower wages, fewer employer-paid benefits and less job security.

According to a recent study by the Aon Corporation, a consulting firm, a majority of over 1,000 US employers surveyed believe that a large portion of the US workforce will not have enough income to retire at a reasonable age. Of the employers surveyed, 32 percent said that between half and three-quarters of their employees would not have the needed income to retire between the ages of 62 and 65. And 37 percent asserted that one-quarter to nearly half of their employees would not be able to retire in this age range.

"A growing number of companies are shedding their pension plans, accelerating a trend that has resulted in the loss of nearly three-quarters of pension plans during the past two decades," Tami Luhby wrote in *Newsday* April 3. "Just under 47,000 companies offered defined-benefit pensions in 2001...down from more than 170,000 in 1985."

Company after company is now freezing its pension plan, replacing defined benefits with employee-paid 401(k) defined contribution plans. These include Alcoa Inc., General Motors Corp., Hewlett-Packard Co., IBM Corp., Lockheed Martin Corp., Sprint-Nextel, Unisys Corp. and WellPoint Inc.

Whatever differences there are in the new plans being implemented, what all of these corporations have in common is their desire to drastically reduce their exposure to retirement costs under conditions in which declining equities markets and falling interest rates have drained pension plan assets and driven up liabilities.

A study of 100 large employers by actuarial consultant Milliman Inc. showed plan assets from the end of 2001 to the end of 2002 fell by approximately "$90 billion, or about 10%, while plan liabilities increased by about that amount, or nearly 11%." Milliman also found, as the *New York Times* reported ("Pension Rule Could Lower Net Worths," April 14), that new accounting rules for pensions that are scheduled to take effect at the end of this year, will "wipe away about 8 percent of corporate America's net worth, revealing hidden weaknesses all across corporate America." Companies with financial difficulties and troubled pension funds will face the biggest crises, in some cases seeing their entire net worth wiped out. General Motors is one potential example. Overly optimistic assumptions about pension fund growth have inflated assets currently held on company balance sheets that do not really exist. The new rule reevaluates pensions with numbers pegged to realistic market-based pension values.

A recent study by Demos, a national think tank on business and society ("Shredding the Retirement Contract" by Heather McGhee and David A. Smith), relates, "Today, less than half of households nearing retirement include someone earning a traditional, employer-provider defined-benefit pension—down from almost two-thirds in 1983. The decline is even more pronounced among younger workers." The Demos study underscores the shift away from defined-benefit pensions toward defined-contribution plans, like 401(k)s and IRAs, which rely on employee savings and individual stock market choices rather than employer contributions. The latter plans are now utilized by 40 percent of American households.

The shift to reliance on individual contributions for retirement will make retirement for many untenable, especially since real wages have fallen and debt has increased.

The personal savings rate has reached the lowest level since the height of the Great Depression. McGhee and Smith report that "In 1981, the average family saved 11 percent of income and held 4 percent in credit card debt. In 2000, the average family held 12 percent of income in credit card debt and saved—1 percent." The resources of working people have been stretched to the breaking point by rising costs in education, health care and child care while hiring has also been increasingly geared to a contingent labor force that has meant less regular employment for millions of workers. The result is that many American workers cannot afford to make contributions to either savings or mutual fund investments for retirement.

McGhee and Smith predict "given the nation's growing wealth inequality, that a greater reliance on the individual's retirement contribution will create more income inequality among elderly households in the decades to come." The authors go on to say that seniors are now the fastest growing age group in bankruptcy courts. One out of every five middle-to-low-income seniors on fixed incomes faces debt hardships, spending more than 40 cents of every dollar on debt payments.

The gap in wealth between the top 20 percent and the bottom 20 percent was 30-fold in 1960. In four decades, that gap increased to more than 75-fold. Stagnant or declining real incomes for the bottom 60 percent have been the reality for working families now approaching retirement. US stock ownership is extremely concentrated: its majority is held by the wealthiest 5 percent of the population. Mutual funds are now held by 21 percent of pre-retirement households (i.e., those between 55 and 64 years old), however, with a base of only $20,000 in median defined contribution pension wealth, this inadequate amount has put more pressure to have more savings to make up the difference.

Congress's proposed pension reform bill provides no solutions. The bill only hands out more tax breaks to high earners who stand to gain by increasing the amount of allowable tax-exempt 401(k) contributions. The legislation would make permanent the $15,000 contribution cap (rather than returning it to $10,500), while automatically raising it each year with inflation. As only 5 percent of US households have enough money to contribute that much to a 401(k), only the wealthy and the most privileged sections of the middle class will benefit from this provision. Meanwhile, as with other tax breaks for the rich, it will leave the government with a reduced revenue base to fund social services.

Thus, the proposed legislation will only intensify the inequality that finds its consummate expression in the destruction of pension plans for hundreds of thousands of workers by corporate executives who themselves rack up retirement benefits worth tens if not hundreds of millions.

IBM CEO Samuel Palmisano, for example, is on track to receive an annual retirement benefit worth $4 million. At the beginning of this year, IBM announced a freeze on the pensions of 113,000 of its employees, with an anticipated savings for the company of $3 billion over the next four years.

Pfizer CEO Henry McKinnell is expected to receive the largest executive retirement package, worth more than $6.5 million annually when he reaches age 65. McKinnell is chairman of the Business Roundtable, one of the principal backers of the Bush administration's proposal to privatize Social Security.

To cite another recent example, Richard C. Green, chief executive for the utility firm Aquila Inc., stands to earn an annual pension of $900,000 despite an unprofitable tenure that saw the company's stock plummet to barely 10 percent of its previous value and approximately 1,000 of its employees laid off.