The Impact Of

INDUSTRIAL PENSIONS

on the

CAPITAL MARKETS

A View
of the
Prospects for 1950 and 1951

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THE ESTABLISHMENT OF NEW INDUSTRIAL pension programs has caused concern over the probable impact on the capital markets of the large sums which will be seeking investment over the next year or two. Because some of the amounts mentioned have been rather large, we thought it would be useful to examine the facts now available and to make some projections on the basis of such assumptions as appear reasonable at the present time.

We have restricted our projections to a relatively short period because of the difficulty of determining to what extent private pension plans will spread through industry several years from now. Furthermore, even after making a guess on this point, there are many other questions as to the possible terms of such plans. We have observed, for example, that there are at least ten major variables which would affect the size of the pension contribution for each covered employee.

RECENT DEVELOPMENTS

The growth of industrial pensions received its greatest impetus since the wartime period when the board appointed by the President submitted its report on September 10, 1949 dealing with the basic steel industry. The Steel Industry Board enunciated the novel principle that: "Social insurance and pensions should be considered a part of normal business costs to take care of temporary and permanent depreciation in the human 'machine,' in much the same way as provision is made for depreciation and insurance of plant and machinery." This curious doctrine did not receive widespread acceptance; in fact, union leaders were more disposed to talk of pensions as "deferred compensation." However, the effect was to center attention on the idea that private plans should be developed to supplement whatever benefits hourly-paid workers may be entitled to receive under the Federal Old Age and Survivors Insurance program.

The demand for private pension plans has been so extensive that some observers have jumped to the conclusion that an impossible situation will develop. In order to fund pensions on an actuarially sound basis for the bulk of the workers in commerce and industry, they argue, it would be necessary to own or place claims against a large proportion of the country's wealth. In the process, interest rates might be driven so low that the earnings of the funds would prove inadequate to meet pension liabilities. Ultimately, according to this rather extreme view, the system of private pensions would have to be restricted and provision for retirement incomes made by the Federal Government through the collection of increasingly burdensome payroll taxes.

THE POSSIBLE RATE OF GROWTH

The lack of adequate statistics in such a relatively new field is enough to discourage any attempt to project the growth of pension funds even over the next few years. Nevertheless, it is possible to make some informed guesses on the magnitudes involved and to allay the fears of those who see in recent developments the basis for a major transformation of the capital markets. The procedure we have followed has been to make certain basic assumptions as to the likely expansion of coverage by company pension plans and to translate them into estimates for the major groups of employees in the labor force.

We have assumed:

1. That the bulk of the new plans will be the result of collective bargaining between the larger companies (those employing over 250 persons) and the larger industrial unions.
2. That during the next year or two, few industry-wide, union-wide, or "Locality" plans will be adopted.
3. That there will be no major changes in the scale of benefits provided by company plans already in operation, but that many of them will be amended to include hourly-paid as well as salaried employees.
4. That the general pattern of costs (i.e., the added charges against corporate earnings) established in recent negotiations will prevail.

Some of these assumptions are debatable; but we feel that they reflect the trends in evidence today, without indulging in fruitless speculation as to what the situation may be several years from now. Based on the evidence currently available, we conclude that the present drive for industrial pensions is merely an extension of the impetus given to company plans by the wartime combination of wage controls and excess profits taxes.

Additions to trusteed and insured pension funds are estimated to have been at the rate of about $1.2 billion for 1949, compared with about $1.1 billion in 1948. On the basis of our assumptions, we estimate that by the end of 1950 or by early 1951 the rate of annual additions to pension funds may rise from $1.2 billion in 1949 to about $1.7 billion. This increase of roughly $500 million is, therefore, our tentative appraisal of the consequences of the current trend in pension negotiations. This would represent contributions on behalf of perhaps 5,000,000 additional employees. The margin of error in our estimates is admittedly substantial, but we feel confident that on the basis of our assumptions the range is from $400 to $700 million at the outside, which is well below figures of $1 to $1.5 billion or more frequently mentioned. Even our estimates will prove to be too high if there develops any substantial trend toward pay-as-you-go plans.

THE POTENTIAL FIELD

Because an estimate of $500 million is so at variance with some of the stratospheric figures which have been given wide publicity, it is useful to review briefly the reasoning which we have followed.

The field for industrial pensions starts with about 43 million employees in nonagricultural establishments. From this total, there are substantial eliminations:

all of	5.9	million in government.
all of	4.8	million in some 850,000 service enterprises.
all of	2.2	million in 320,000 contract construction activities.
most of	9.4	million in about 1,900,000 retail & wholesale trade firms.
most of	3.9	million in transportation & public utilities because of the extent of present coverage.
a large part of	1.8	million in finance because of present coverage.
a large part of	0.9	million in mining because of present coverage.
Total	28.9	

It seems doubtful that as many as 1 million employees in these groups totaling about 29 million will be included in new or expanded company pension plans during the next year or two.

These eliminations leave for closer analysis about 14 million employees in manufacturing. Many important industries show a high proportion of employees already covered. Chemicals, paper, petroleum refining, meat packing, and tobacco are examples. Among other groups, such as divisions of the textile, lumber, publishing, apparel, and machinery industries, the combination of relatively small business units and lack of union interest in pensions suggests that these are not promising fields for expanded coverage. We believe that in manufacturing more than three-fourths (slightly over 3,000,000) of the possible increase in employees covered is likely to come from the durable goods industries. In this group, iron and steel, automobiles, and certain kinds of machinery will be most important. Less than 1 million might be added from the nondurable goods industries. In effect, we did not discover many large groups of employees who might be logically included among the near-term prospects for industrial pensions apart from those currently publicized in wage negotiations.

SOME CONCLUSIONS

During 1950, net new issues of corporate securities, both bonds and stocks, may show a decline of around $750 million from the 1949 total of about $5 billion. Although new offerings of state and municipal bonds will be larger in 1950, it is anticipated that the demand for private real estate financing will be somewhat less than in 1949. On the other hand, it is expected that new funds available for investment by life insurance companies and other savings institutions will be almost as great as in 1949, without allowing for any increase in the rate of growth in pension funds.

The change in the rate of annual pension fund accruals from an estimated $1.2 billion to, say, $1.7 billion must be considered, therefore, in relation to a declining volume of new corporate security issues. There may be greater emphasis on preferred stocks, and in the case of trusteed plans common stocks may be purchased in larger amounts, and the establishment of new plans may prove to be a minor factor in those markets.

An offset to this declining supply of new corporate issues may be found in the expected larger volume of revenue bond and long-term tax exempt offerings. There will be stronger reasons for a change in Treasury financing plans to include long-term bonds in order to satisfy the requirements of non-bank investors.

We conclude, therefore, on the basis of our assumptions, that the amounts made available for long-term investment by new pension plans during the next year or two will be within the capacity of the capital markets.

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