

THE IMPACT OF INDUSTRIAL PENSIONS
ON THE AMERICAN ECONOMY

Address given by Roger F. Murray, Vice President,
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The American people have long since reached their decision in favor of working out plans to provide for the aged, preferably in a manner which preserves the independence and dignity of the individual. Having made this decision and having selected this as one of the objectives of our joint efforts, the principal questions with which we are concerned today pertain solely to the best means of achieving the desired ends. On the basis of past performance, there is no reason to doubt our ability to carry a reasonable program of old age pensions. If we can continue to increase from year to year the productivity of our land, labor, capital goods, and managerial efforts, the working population will be able to carry the burden of adequately supporting retired workers because of the larger current output available to share with them.

The Federal Government's Participation

The first of the major questions which arise in designing a sound pension system relates to the extent of the Federal government's participation.

A Federal pension program has certain unique advantages. It can provide for small groups, or even the self-employed, who could not qualify under any other kind of an arrangement. Of greatest importance, however, is the universal coverage which it permits. The twofold advantages of complete coverage are, of course, the mobility of labor permitted and the avoidance of discrimination against the older worker. These advantages are not being fully obtained from the present Old Age and Survivors Insurance program, because less than 60% of the employed civilian labor force is covered at the present time. The proposed amendments to the Social Security Act adopted by the House of Representatives in H.R. 6000 last fall would increase the coverage to about 75%, but even this does not appear to go far enough in approaching universal coverage.

The other unsatisfactory feature of the present Federal program is the low level of benefit payments. If the original purpose is to be served of providing a minimum basic retirement income on which the individual has an incentive to build his own savings program, it seems obvious that an average primary benefit payment of about \$26 per month is quite inadequate. The revised scale proposed in H.R. 6000 would increase benefits by about 70% on the average, which would just about offset the rise in the Consumers' Price Index since 1939. Such an adjustment to take into account the rise in living costs would seem to be the minimum necessary to restore pensions related to employment and productive effort to their proper position in the Federal old age program.

With further revisions to improve coverage and the level of benefits, therefore, we can have a workable Federal system to take care of the basic pension objectives. Over a period of years, this should permit a gradual transfer of the Old Age Assistance program to the states and local communities where it properly belongs.

Private Pensions

Assuming that these improvements are made in the Federal program, what developments can we anticipate in the private pension field? It seems to me that the answers are to be found in the recent history of pension plans in industry. The functions of private plans have included rewarding the employee whose value to the company is enhanced by regularity and continuity of service. Because of the long training periods involved and because of the personal element in sales and service activities, reductions in turnover were sought particularly in executive and other customer contact positions. This supplementary form of compensation was used primarily to encourage salaried employees to identify their futures with that of the company. Where hourly-paid workers were included, it was often in those industries where wages are a relatively small portion of total costs and where workers are largely in the skilled categories.

This orderly, gradual development was interrupted by the publication on September 10, 1949 of the findings of the Steel Industry Board. While finding against an increase in current wages, the Board came up with the conclusion that: "Social insurance and pensions should be considered a part of normal business costs." In spite of qualifying language elsewhere in the report, this was taken in the steel and other labor negotiations to mean that pensions are an element of cost for which every company should make provision. The Board gave strong support to a movement which in a matter of months might attempt nearly to double the coverage of employees under private pension plans. Although experience indicates that most sound plans have been evolved over a period of years, it was suggested that a few days, weeks, or months would suffice to negotiate satisfactory terms and coverage. In a sense, you might consider this wave of negotiated private pension plans a selective increase in the Federal Old Age and Survivors Insurance system through collective bargaining channels. In its lack of applicability to many workers and in its tendency to impose pattern settlements it can be fairly considered as one of our less happy adventures in blueprinting wage agreements.

As a result, we are still in the midst of a highly confused and confusing situation. What will be the outcome? It goes without saying that your guess is as good as mine, but I am going to use my guess because I need to have a working hypothesis or set of assumptions in order to trace some of the economic effects of the recent acceleration in the growth of industrial pensions.

The Possible Outcome

I think it is reasonable to assume that the Federal pension program will be revised this year and perhaps again in 1951 or 1952. I expect that it will provide virtually complete coverage of our employed labor force and a scale of benefits adequate to prevent dependency. With these changes, the emphasis of the large industrial unions on pensions may well be somewhat reduced. Perhaps company pensions in many instances will be continued for hourly-paid employees as a supplement to the Federal program, but on the basis that the company's portion will be the minor fraction of the total retirement income of the worker. Thus, there will not be such great pressure against mobility of labor or against the hiring of older workers.

In the case of salaried employees, it seems to me that the trends of

the last decade are bound to continue. It will be just as important for management to keep turnover low and it will be just as difficult under the individual income tax rate schedules to give current rewards for increasing contributions to the operation of a successful business. More and more salaried employees, it seems to me, will be covered and the terms of pension plans will be liberalized further.

Perhaps this sounds like too pedestrian a view of the outcome of recent developments. I cannot view with alarm or plead for restraint in describing this kind of a picture. My diagnosis is that the subject of pensions became highly dramatized in the steel industry wage dispute as the central issue of the Fourth Round. In due course, I am expecting the return of a more normal perspective which will keep pensions among the active industrial relations topics but not in the forefront of all discussions. This would mark a gradual return to the orderly development of industrial pension plans which has been in progress for many years.

On the basis of these assumptions as to the possible outcome of recent developments, what will all this do to the economy? I should like to discuss four major aspects of the subject: first, the Federal budget; second, the capital markets; third, productivity and prices; and fourth, economic education.

The Federal Budget

For the year 1949, the Old Age and Survivors Insurance Trust Fund had total receipts of \$1.8 billion, but the total of benefit payments and administrative expenses was only slightly in excess of \$700 million. As you know, these net receipts are used to purchase special obligations of the U. S. Treasury, bearing interest at the average rate payable on the public debt. Thus, another \$1.1 billion was added to the reserve in government bonds, bringing the total fund up to almost \$12 billion. At present, because of the increase in rates effective at the first of this year, payroll tax collections exceed benefit payments by an even larger sum. Even if the Administration's proposals to liberalize benefits and enlarge coverage are adopted, the surplus of receipts over benefits is estimated at \$1.7 billion for the 1951 fiscal year.

This operation is excluded from the regular budget receipts and expenditures, but has the effect on a cash basis of offsetting a significant portion of the current deficit. This surplus of receipts from operation of the Old Age and Survivors Insurance system will disappear in another five years or so unless payroll tax rates are increased. The reason for the rising level of benefits is, of course, the fact that many more covered workers will reach retirement age each year and start drawing benefits for which they and their employers have not made a corresponding contribution since the start of the program.

Thus, as the years pass, it is anticipated that the costs of the program may range up to two and three times the present 3% of taxable payrolls. This is a fairly conservative estimate. One of the factors contributing to this trend of increasing costs is the changing composition of our population. Whereas in 1950 there are over 7-1/2 persons in the productive ages between 20 and 65 for every person 65 and over, in another fifty years, if present trends continue, there will be only 4-1/2 persons in the age groups between 20 and 65 for each person who has passed his 65th birthday. Assuming a constant retirement age of

65, therefore, the productive members of society will be called upon to contribute increasing amounts from the fruits of their current efforts to maintain the same level of pensions for retired persons.

We may be justified, however, in anticipating a general postponement of the retirement age for the great majority of employees. In the case of executives, it may frequently seem desirable to provide for compulsory retirement at age 65 in order to make way for younger men. But this does not apply to the production worker who is still able to handle his tasks efficiently and wishes to work. To many of these individuals, retirement is not a release to leisure but a sentence to enforced idleness. In recent plans, therefore, optional retirement at 65, with or without compulsory retirement at 68, has usually been provided for hourly-paid employees.

The increase in longevity which has accompanied progress in medical science, and which is likely to continue, in itself suggests that the individual may be better equipped to work during his later years than in the past. In spite of the programs which will be developed over the years to prepare people for retirement, it is probable that the inclination to work will continue strong among many people who enjoy a congenial working atmosphere. From an economic point of view, this should be encouraged; it is the only way to keep down the rising cost of pensions with the advance in age of our population. Everyone working past age 65 can be a contributor of revenues to the pension system while reducing the duration of the benefits which he will receive.

On this basis, I think that we can reasonably contemplate the lower of the several estimates which have been made of the future cost of the Old Age and Survivors Insurance program. After the next few years, I would expect the payroll tax rate to be raised only rapidly enough to keep in prospect a small surplus of receipts over benefit payments. The tendency of payroll taxes to curtail consumption would be offset by the prompt spending of benefit payments by the pensioners receiving equivalent amounts. As the growth in benefits takes place, the Federal budget should be relieved of heavy Old Age Assistance outlays.

Thus, the budgetary aspects of the Old Age and Survivors Insurance program do not appear especially troublesome. Since benefit payments will be more stable than payroll tax collections, the program can have mildly contracyclical effects.

The Capital Markets

The Federal government can handle its pension obligations on a pay-as-you-go basis because it has an assured continuity and a taxing power which are enjoyed by no other type of institution. The private company, on the other hand, may consider fully funding its past and current liabilities in order to give its present and future pensioners a comparable degree of assurance. It is not possible to state categorically the extent to which funding can or should be undertaken in every case. Obviously, the nature of the company, conditions in the industry, the kind of employee group, and the terms of the particular pension plan will affect the degree to which reserves are needed to assure performance on the promises which the company makes.

We may conclude, therefore, that as in the past, private pension plans

will include some which are fully funded, some which are partially funded, and others which are substantially on a pay-as-you-go basis. I would hazard the guess, however, that the new trend toward minimum funding will continue, with the result that the accumulation of reserves for newly covered employees will be at a much less rapid rate than in the past. This means that corporations are undertaking an additional payroll cost which is sure to rise in future years instead of paying now the equivalent of a level premium rate.

This question of the extent of funding is, of course, the key to whether the further extension of private pension plans will materially affect the capital markets. We have estimated that for 1949 the additions to trustee and insured plans amounted to about \$1.2 billion. In the next year or two, the rate at which funds would be accumulating might be up to \$1.7 billion. If such an estimate proves to be reasonably accurate, we need not expect any major consequences in the capital markets. There will be more funds available for financing corporate expansion, construction, and the budget deficit, thus contributing to a continuation of low interest rates on long-term investments. The addition to demand for high grade preferred and common stocks, in my opinion, will be of only minor significance to those markets.

Looking beyond the next year or two, it is extremely difficult to reach any definite conclusions. One can do a great deal of speculating on each of perhaps ten variables which will affect the size of the pension contribution for each covered employee. The results of such speculating are neither rewarding nor convincing. But we can make one general observation based on the pattern of savings over a long period of years in the United States: There has been a tendency over several decades for people to add to their liquid savings a fairly fixed percentage of their disposable income, except in years affected by wars or depressions. This tendency suggests that the growth in the volume of new pension fund investments will be balanced, in part at least, by a shifting away from other forms of liquid savings.

On the whole, therefore, we can regard these insured and trustee pension funds as constructively created pools of savings. They will seek investment in sound projects which will contribute to the progress and productivity of the economy. In financing such projects, moreover, the pension funds will be enlarging the means of supporting a generous level of contributions.

Productivity and Prices

In the production of goods and services, employer pension contributions are a cost similar to wages and salaries. Whether the payments go to public or private programs, the result is an increased cost which ultimately will be largely shifted to the public in the form of higher prices. A universally applicable contribution is, of course, more certain to be shifted. When the bargaining power of the employee is strong, any contribution he may make is likely to be shifted to his employer, and from there to the public through price increases. This process can, of course, lead to economic stagnation or substantially reduce the purchasing power of the promised pensions.

Fortunately, this need not be the result. For example, the record shows that during the last 40 years it has been possible in this country to reduce the work week by over 20% while more than doubling real weekly wages. If we can make comparable progress in the future in improving the efficiency of the

utilization of all our resources, we can absorb pension costs from our gains. Either prices will not be reduced as much or wages will be increased less than would otherwise be the case. But either of these consequences are consistent with economic progress, just so long as there remain significant unpledged gains to act as an incentive for further development.

It is easy to overlook these sober realities of the situation and to listen to the siren call of those who urge us to vote ourselves a utopia of comfortable retirement. We did not achieve that shortening of the work week and increase in real wages by voting for it! We succeeded in raising our standard of living, - and we can likewise provide a sound pension program for our retired workers, - because we had the skills and the incentives to organize our resources with greater and greater efficiency. It is this increasing productivity which must be the measure of our ability to provide both incentives and old-age security.

Economic Education

This theme of increasing productivity as the basis for any sound pension program leads me to my fourth and concluding topic: economic education.

The process of establishing these pension programs welds together a very large group of people who are either receiving pensions or who are keenly aware that they will receive them in due course. These people can be made to see their vested interest in the kind of economic progress and in the sound public policies which will preserve the purchasing power of their retirement incomes. The provision of reasonable pensions to large groups on the basis of their earnings can, therefore, prove a constructive and stabilizing influence in the economy.

I doubt, however, that they fully understand the issues. The message which we have for them, it seems to me, is about as follows: If we fail to maintain our productivity gains over the years or if we pledge them for other purposes, there can be only one consequence in the long run. We shall have issued too many claims against our goods and services relative to the capacity or willingness of our economy to produce them. The escape from this situation is to dilute the value of the claims. In other words, unless we can make good on our expected gains in efficiency and productivity, the final result will be simply to reduce the purchasing power of the pension payments to a point where they will be more easily serviced out of current production. To issue pension promises in terms of dollars of continuously depreciating value is a kind of fraud and deceit, in which I am sure none of us would willingly collaborate.

This theme, which should accompany every employee benefit program, is not easy to popularize; but the increasing numbers of present and prospective pensioners certainly provide an exceptionally receptive audience if properly approached.