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BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

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The Pension Issue—A Summary

Broadened Old-Age Benefits Create New Problems

Vastly expanded private and governmental retirement benefit programs are already affecting the American economy, and must be accorded an increasingly important place among the factors which will influence the long-term economic outlook. Interest in pensions expanded sharply last fall after the report of the Steel Industry Fact Finding Board, which recommended that the companies grant the pension demands of the union. However, the problem of helping individuals to prepare for the time when earning power has ended or has been reduced substantially is not new. Some private organizations in this country have been paying retirement benefits for 75 years, and military pensions date back even further.

Congress turned to old-age security legislation in the mid-thirties as an answer to the more extreme demands of the Townsendites, Ham-and-Eggers, and other groups which pressed welfare legislation of a similar type. The program was undertaken at a time when general business conditions were depressed and the gradual aging of our population was becoming recognized. Many persons lost their savings of a lifetime in a brief period following the collapse of security markets and the bank closings. The breakdown of the family and the community as self-sufficient units seemed to require governmental aid in preparing individuals to meet the needs of their declining years.

Although the desire for security is one of the basic human drives, the quest has been intensified in recent years. This development has resulted primarily from the realization that security can be achieved, in some measure at least, by means of pressure upon Government through Congressmen and upon business management through union activity.

THE IMPACT OF THE NEW PROGRAMS

The current issue of *Business Conditions* is devoted entirely to the pension problem. Three aspects of the question are considered: (1) the current status of the Federal program, (2) the implications for business, and (3) the effect upon the general economy.

In "Federal Old-Age Insurance Program Expanded" the first major revision of the Social Security Act since 1939 and current problems concerning the Federal program are discussed. On August 28 the President signed the new bill, which had been passed by an overwhelming vote of 374-1 in the House and 81-2 in the Senate. It provides for expanded coverage, so that about three-quarters of the labor force is now included under the Federal program, and for increased benefits which will raise the average payment from about $26 to slightly over $50 per month in the next few years. Old-age insurance financing is gradually moving toward a pay-as-you-go basis, which raises the question as to whether the plan should be funded at all. There are arguments for abandoning the attempt at providing "insurance" and substituting coverage for the entire population on an adequate flat-rate basis to be financed by a uniform percentage increase in the personal income tax. It also has been proposed by some that a system of disability payments be added to the program, since an individual unable to find employment because of injury or sickness is in much the same position as a person too old to work.

"Industrial Pensions—A Problem in Business Finance" points out that private pensions must be accepted as a continuing factor in business thinking and discusses some of the problems created. Certain advantages accrue to the firm in having a pension plan, principally through improved morale and reduced labor turnover. Costs are reckoned in most cases at no more than 5 to 8 per cent of pay roll, but since business firms assume a huge and continuing liability when a pension program is undertaken, it is necessary to avoid provisions which may result in substantially greater costs in the future. How should the plan be financed? It is necessary in each case to investigate the desirability of turning the matter over to an insurance company or investing pension money through a trust agreement. The investment problems created by the accumulation of large reserves are substantial, and the managers of certain pension funds are turning to common stocks as a means of increasing yields and thereby cutting down the cost of a program.

In the "Economics of Old-Age Pensions" the increasing numbers of aged and their apparent inability to save enough out of earnings to provide retirement income are cited as the basic reasons behind the pension movement. The disadvantages of private plans, such as inadequate coverage, the restrictions placed upon labor mobility, the increased difficulties for older workers attempting to find jobs, and the lack of certainty that the payments will actually be made when due, favor an adequate Federal program with universal coverage which could solve these problems. Pensions have inflationary connotations, and the purchasing power of payments is in turn affected by changes in price levels. A continuance of the rapid rise in prices witnessed during the past decade would cause present pension benefits to become hopelessly inadequate in the years ahead. The real cost in terms of current production of goods and services must be recognized; a decision is needed as to the size of the burden upon the productive workers of the country which should be incurred. Encouragement of lengthened employment of older workers could reduce this real cost. A wise pension policy can contribute to a stable business economy and add to the general welfare of our population.

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Federal Old-Age Insurance Program Expanded

Benefits Raised, Coverage Extended, But Some Major Problems Still Unsolved

The approval of H. R. 6000 on August 28, after Congressional hearings and debates extending over a period of 18 months, marks the first major revision of the Federal old-age and survivors insurance (OASI) system since 1939. The system, originated by the Social Security Act of 1935, was meant to provide the primary source of retirement income for the working members of our economy. However, in the 10 years during which benefits have been paid, the restricted coverage, strict eligibility provisions, and inadequate benefit payments have led increasingly to the use of substitutes which are limited and also costly—public assistance, provided only to indigent persons, and, more recently, supplementary private pensions. The deficiencies in these alternatives, together with growing recognition of the problems of an aging population, have generated widespread support for the improvements in OASI now enacted through H. R. 6000. These include extension of coverage to approximately 10 million additional persons, substantial liberalization of the eligibility requirements, increases in benefit amounts averaging 80 per cent, and numerous other revisions; together they are expected to result in doubled outlays for benefits in the years immediately ahead.

EXTENT OF COVERAGE

Perhaps the most serious deficiency in the OASI system has been its lack of coverage. Under the provisions currently in force (the amendments in H. R. 6000 take effect on January 1, 1951), 35 million persons, or about 57 per cent of the employed labor force, are working in covered employment. The problem of lack of coverage is considerably more acute for persons now approaching the retirement age; in addition to those working in noncovered employment, there are many persons either unemployed or not in the labor force due to illness or disability. At the beginning of 1950 only about one-fourth of the population aged 58-64 was fully insured, that is, eligible for benefit payments in the absence of further covered employment. It is estimated that only about 35 per cent of the men over 65 and five per cent of the women will be fully insured during 1951.

TABLE 1
INCREASES IN OLD-AGE AND SURVIVORS INSURANCE BENEFITS
(To nearest dollar)

Increases for Persons Now Receiving Benefits

Monthly Primary Insurance Benefit		Maximum Family Benefits Payable	
Prior to H.R. 6000	Under H.R. 6000	Prior to H.R. 6000	Under H.R. 6000
10	20	20	40
15	30	30	48
20	37	40	59
25	47	50	74
30	54	60	101
35	59	70	129
40	64	80	150
45	69	85	150

Monthly Benefits for Workers Retiring in Future

Average Monthly Wage	Prior to H.R. 6000		Under H.R. 6000	
	Single	Married[1]	Single	Married[1]
50	21	32	25	38
100	26	39	50	75
150	32	47	58	86
200	37	55	65	98
250	42	63	72	109
300	42	63	80	120

[1]With wife age 65 or over.

Coverage in OASI is defined by exclusions: that is, all employment except that specifically excluded is covered. The major exclusions now in force are self-employed persons, agricultural and domestic labor, and employees of governments and nonprofit institutions. H. R. 6000 substantially reduces these exclusions, to bring an additional 9.9 million persons under OASI. The major occupational groups added include nonfarm self-employed persons (about five million), one million agricultural workers (mostly persons regularly employed by the same employer), a similar group of domestic workers (about one million), employees of nonprofit organizations (about 600,000), and employees of state and local government who are not covered by an existing retirement system (about 1.4 million).

Despite these additions, more than one-fourth of the employed labor force will remain outside OASI. Approximately nine million excluded persons are in agriculture —self-employed, unpaid family workers, and irregular hired labor. An additional million is composed of nonfarm self-employed persons, including both specifically designated groups of professionals and persons with self-employment income below the specified minimum. The reason given for the exclusion of these groups, together with an estimated 700,000 irregularly employed domestic workers and 400,000 unpaid family workers, is the administrative difficulty involved in collecting taxes and maintaining earnings records. The other major groups excluded comprise persons covered by existing public retirement systems—2.4 million employees of state and local governments, 1.5 million railroad workers, and 2.2 million Federal civilian employees.

ELIGIBILITY PROVISIONS LIBERALIZED

A second dimension of the employment qualification for benefit payments is the duration of employment in covered occupations. The general eligibility requirement of 40 calendar quarters of coverage, equivalent to 10 years of continuous covered employment with earnings of at least $50 in each quarter, has caused little difficulty; the great majority of younger persons in covered employment will have met this requirement by retirement

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age. The main problem has been that of the special provisions required to treat older and middle-aged workers. The earlier provisions have proven to be quite restrictive; for example, for persons attaining age 65 in July 1950, the requirement is 27 quarters of coverage. Persons in this age group who are newly covered by H. R. 6000, or who shifted from covered employment to such noncovered jobs as Government shipyards and munitions plants during the war, cannot meet the requirement.

H. R. 6000 provides for significant liberalization of eligibility requirements. Formerly, the number of quarters required declined from 40 for persons attaining age 59 in the first half of 1951 to a minimum of six quarters for persons 76 or over in 1951. The revised requirement declines from 40 quarters for persons 45 or younger to six quarters for persons 62 or over. The Senate Finance Committee has reported that the "eligibility provisions would result in payment of retirement benefits to a much higher proportion of the aged during the early years of the system, but it would not increase beneficiary rolls and costs in the later years since the eligibility requirements would remain the same for workers now young."

INCREASE IN BENEFITS

The size of benefit payments in OASI has been widely recognized to be grossly inadequate; indeed, this probably has been the single most important stimulus to the recent rise in industrial pensions. Currently, the average beneficiary receives $26 per month, with an additional 50 per cent if he has a wife age 65 or over and additional amounts for minor children. In contrast, indigent aged persons who are aided under the Federal-state old-age assistance program, where payments are generally set at a figure considered to be the minimum needed, receive monthly amounts averaging $44. Old-age assistance payments rose with living costs during the inflationary postwar period, since they are computed on the basis of needs. OASI benefits on the other hand are computed as percentages of the average wages received by beneficiaries in pre-retirement employment. The effect on such averages of low earnings during the late 1930's and early 1940's is pronounced. Increases in prices and wages do not affect the size of the benefits received by persons already retired.

H. R. 6000 provides for substantial increases in benefits both for persons now receiving benefits and persons retiring at future dates (see Table 1). Existing benefits are raised through the use of a conversion table; the increases in general match those payable to future beneficiaries and in the typical case will amount to about 85 per cent. Increases for future beneficiaries are achieved through a combination of changes in the law. The formula for computing the monthly primary benefit is changed from 40 per cent of the first $50 of the average monthly wage and 10 per cent of the remainder up to $200 to 50 per cent of the first $100 and 15 per cent of the remainder up to $200. In addition, the base for computing the average monthly wage has been changed; if it results in a higher benefit, a person may base the computation on his wage record after 1950 rather than on the whole period since 1936. This will provide a means of excluding years in which wage levels were low and unemployment high. A further factor in the increases in H. R. 6000 is the raising of the minimum monthly benefit from $10 to $20.

For workers retiring in the next few years, the changes are expected to raise the average benefit to $50-55, which is significantly above the average amount currently paid under old-age assistance. Since special allowances for dependents of retired workers and for dependent and aged survivors of deceased insured workers are computed as percentages of the primary benefit amount, these will rise in like proportion. Furthermore, the maximum total benefit payable, including the special allowances, is increased from $85 per month to $150.

COST OF PROGRAM

The provisions of H. R. 6000 will require very large additional outlays for benefit payments; the increase will probably exceed 140 per cent in the early years and 60 per cent in later years (see Table 2). Since OASI is financed by pay roll taxes on employers, employees, and the self-employed, it is useful to compute costs as percentages of pay rolls. The estimates in Table 2 assume an increasing population, stable wage rates, and high levels of employment. Higher wage levels would produce lower percentage figures and lower employment would result in higher figures, due to the effects on the size of pay rolls.

A convenient device for measuring the effects on costs of changes in the legislation is that of the level-premium rate, that is, the combined contribution rate which, if charged from 1951 on, together with the interest received on existing and increased old-age and survivors insurance trust fund holdings of Government bonds, would meet all benefit payments after 1950. The level-premium cost under provisions currently in force is 4.1 per cent of pay rolls. The changes made in the benefit formula by H. R. 6000 make a net addition of 1.5 per cent. Other liberalized provisions add smaller percentages, and the extension of coverage, through the increase in pay rolls, would reduce the cost by .35 per cent. Taking into account interest and administrative costs, OASI as amended by H. R. 6000 would cost about 5.4 per cent.

TABLE 2
ESTIMATED COST OF BENEFIT PAYMENTS IN OLD-AGE AND SURVIVORS INSURANCE[1]

Year	Amount (In billions of dollars)		Per Cent of Taxable Pay Roll	
	Prior to H.R. 6000	Under H.R. 6000	Prior to H.R. 6000	Under H.R. 6000
1951	.9	2.1	.9	1.7
1955	1.3	2.8	1.5	2.1
1960	1.8	3.8	1.9	2.8
1970	2.9	5.8	2.8	3.9
1980	4.3	7.9	3.9	5.2
1990	5.8	10.0	4.9	6.4
2000	6.8	11.2	5.5	6.9
Level-premium[2]	—	—	4.1	5.4

[1]Intermediate-cost estimates.
[2]Assumes average rate of interest of two per cent on Government obligations held by the trust fund.

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The pay roll tax schedule actually included in H. R. 6000 differs from the level-premium cost estimate in that it provides for rates which are lower than level-premium in the earlier years and higher in later years. This difference means that the program will actually approach a pay-as-you-go basis, as discussed below. The tax schedule provides the following rates:

Year	Employee	Employer	Self-Employed
1950-53	1½	1½	2¼
1954-59	2	2	3
1960-64	2½	2½	3¾
1965-69	3	3	4½
1970—	3¼	3¼	4⅞

PAY-AS-YOU-GO FINANCING

Perhaps the most important of the problems which H. R. 6000 fails to resolve is that of the financing of the insurance program. Dissatisfaction with the existing approach led to the passage of a resolution, during the Senate debate on H. R. 6000, directing the Senate Finance Committee to make a major new study of the social security program with emphasis on "proposed programs for a pay-as-you-go universal coverage system."

At present, the system is financed by a tax on earnings up to $3,000 per year of one and one-half per cent on both employers and employees (one per cent prior to January 1, 1950). The excesses of pay roll tax collections over the amounts required for payment of benefits, which in recent years have exceeded one billion dollars annually (see Table 3), are accumulated in the Federal old-age and survivors insurance trust fund and invested in United States Government obligations. The interest on these holdings, which now amount to nearly 12.5 billion dollars, increases the accumulation in the trust fund. As the system matures—the population is increasingly composed of retired persons eligible for benefits—costs will rise. Under the provisions existing prior to the passage of H. R. 6000, costs would begin to exceed tax collections, were the one and one-half per cent rate to be continued, around 1970. Under the amended eligibility and benefit provisions, this would occur about 10 years earlier at the one and one-half per cent rate. In any event, without regard to specific tax changes the system is constituted so that a point will be reached some time in the future at which benefit payments will exceed tax receipts. At that point, the excess of benefit payments would be met out of interest on the accumulated balances and by redeeming bonds held by the trust fund, if necessary.

Much of the interest in a pay-as-you-go financing arrangement stems from an impression that the existing mechanism involves double taxation for benefit payments. The current excesses of pay roll tax receipts, when exchanged for Government obligations held by the trust fund, are then used by the Treasury in its general fiscal operations. When excesses of benefit payments appear, the interest on and redemption of the trust fund's holdings will be met through additional taxation or borrowing. Actually, the use of current trust fund operations by the Treasury as a source of funds merely replaces the need for additional taxation or borrowing for general purposes at the present time, and there is no real double taxation for social security purposes.

Unless the trust fund were to accumulate billions of dollars in cash, a method which no one has seriously proposed, a pay-as-you-go basis in terms of *actual cash operations* is unavoidable. All Federal cash receipts are used for current purposes, and all Federal cash expenditures must be met from current receipts or current borrowing. The pay-as-you-go basis proposed by many differs from this; it implies a balancing of current receipts for social security purposes with current expenditures for this purpose. Under a system of this type, pay roll tax rates would be about one-half of one per cent on both employers and employees currently and increase to about four per cent on each in the year 2000.

As noted earlier, if existing pay roll tax rates are maintained, rather than increased rapidly as scheduled, the system will approach a pay-as-you-go basis within a relatively short time due to increased levels of benefit payments. There is some feeling that the current surpluses of social security tax receipts, by providing a ready source of funds to finance deficits in the general fund of the Treasury, encourage extravagance in expenditures and that a more rapid approach to a balance of receipts and disbursements for old-age and survivors insurance would remove this stimulus. An additional argument in favor of financing the system on a current basis is that it would justify more readily the use of taxes other than those on pay rolls. Pay roll taxes, through their effects on business costs and prices and their regressive impact on personal income, are believed to exert an overly restrictive influence on the level of economic activity. The suggestion has been made that the old-age program be financed through a flat percentage rate addition to the personal income tax rate, the addition to be specially designated in the return.

UNIVERSAL COVERAGE AND FLAT-RATE PENSIONS

Closely associated with the idea of current financing are proposals for an old-age program with universal coverage and lessened emphasis on the previous earnings experience of beneficiaries. The existing program, both prior to the effective date of H. R. 6000 and after it, is a compromise between two often conflicting elements of social insurance—contributory financing through special taxes related to gross earnings and the provision of national minimums in income.

The contributory financing idea has led to the development of a variable benefit formula, with benefits closely related to contributions. Persons earning amounts close to or more than the maximum taxed receive substantially greater benefits than those making smaller total contributions.

The national minimum concept is reflected in existing law by provision for benefit payments to all persons establishing eligibility at least equal to a minimum which is high relative to contributions. In the extreme case, a

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combined total employer-employee contribution of $12, representing the minimum quarters of coverage with the lowest earnings, will provide the minimum monthly benefit of $20 for life. Further emphasis on this aspect of social insurance is urged by those who believe that it is the function of government to provide only some agreed-upon minimum benefit amount and that it is the responsibility of higher-paid persons to provide for their post-retirement wants in excess of this minimum through other means. Uniform benefit payments, with special provision for dependents of retired persons and their dependent survivors, are characteristic of most foreign social insurance programs. Adoption of this type of program would permit the elimination of the maintenance of millions of wage records and probably cut administrative expenses by more than 50 per cent. On the other hand, if flat-rate benefits were paid only to those persons demonstrating need, as has been suggested by some observers, the costs of administering the "means test" would probably exceed those of the present program.

The major advantage of a system of flat-rate benefits divorced from previous earnings experience is that it would afford an opportunity to achieve universal coverage more easily. Of the 11 million members of the labor force still not covered by any publicly administered retirement system, more than half comprise groups excluded from OASI coverage because of the administrative difficulty of collecting employment taxes and maintaining earnings records. Even more important numerically are the large number of persons, primarily women, who will not be covered, except as dependents of beneficiaries, because of their lack of work experience. Universal coverage, while obviously more expensive than the OASI program at present, would permit the rapid elimination of the Federally aided old-age assistance program, which, operating on a "needs" basis, involves the expenditure of more than 1.3 billion dollars annually, nearly double the current rate of expenditures for OASI. The arguments for and against a currently financed, flat-rate, universal coverage program undoubtedly will be explored during the Senate Finance Committee's forthcoming two-year study of the social security system.

THE PROBLEM OF DISABILITY

An additional unsolved problem in social security is that of providing for the permanently and totally disabled. Because of the size of the problem—there are more than two million such disabled persons in the United States, with only about five per cent of the disability work-connected and hence benefiting from workmen's compensation laws—and because of the parallels with income loss due to old-age retirement, it has been proposed frequently that a system of permanent and total disability benefits be integrated with OASI. Examples of similar integration are the Federal civil-service retirement system and those of many state and local governments, the railroad retirement system, and many of the new industrial pensions. A further argument in favor of disability benefits is that under the existing OASI provisions an insured worker who suffers disability prior to age 65 has his benefits reduced because of the loss of earnings in covered employment.

The major arguments against the inclusion of such benefits into the OASI program include the fear of widespread opportunities for malingering and of major additions to cost. The House of Representatives version of H. R. 6000 included disability benefits payable only to persons completely unable to perform any gainful activity; it provided for benefits computed in the same manner as the primary insurance amount for retired persons, with no special allowances for dependents. Such a program was estimated to add .5 per cent of pay rolls to the level-premium cost. This program was not included in the final act. However, H. R. 6000 does provide for a public assistance program for the needy permanently and totally disabled, with provisions substantially similar to those of the existing Federal-state programs for old-age assistance and aid to the blind. It was estimated that this program would cost the Federal Government about 66 million dollars annually, an addition of about six per cent to Federal outlays for public assistance.

TABLE 3

CASH RECEIPTS AND EXPENDITURES OF THE FEDERAL GOVERNMENT AND OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND FISCAL 1946-50

(In millions of dollars)

Item	1946	1947	1948	1949	1950[1]
Federal Government totals:					
Cash receipts from the public	44,510	43,571	45,372	41,582	40,945
Cash payments to the public	62,710	36,972	36,524	40,575	43,040
Excess of receipts (+) or payments (−) (surplus or deficit)	−18,200	+6,599	+8,848	+1,007	−2,195
Old-age and survivors insurance trust fund:					
Cash receipts (employment taxes)	1,238	1,459	1,616	1,690	2,106
Cash expenditures (benefit payments)	321	426	512	660	784
Excess of receipts (+) or payments (−)	+917	+1,033	+1,104	+1,030	+1,322

[1]Estimated.

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Industrial Pensions—A Problem in Business Finance

Many Important New Plans Adopted

Union-management negotiations during the nine months' period preceding the Korean crisis had been dominated by the comparatively new issue of private pensions. Retirement benefit demands by the unions were at first met by strong resistance, but now it is evident that industrial pensions with all of their merits and shortcomings must be accepted as a continuing problem in financial management of American business. One by one the major firms in the steel and automobile industries have agreed to new retirement plans for their employees, and these firms have in the past proved to be the bellwethers of trends in union-management negotiations.

The pressure for pensions has lessened as the unions have turned their attention to higher "take-home" pay now that developments in Korea and the rearmament program have started prices upward once again. However, pensions appear to have been added permanently to the list of business costs, and businessmen are attempting to lessen the burden as much as possible through careful study of the problems involved. What are the costs of retirement benefits? How should the plan be financed? Should it be insured or self-administered? How should the pension funds be invested, and what problems do they pose for the capital markets? Most of these questions must depend upon time for a definite answer, but a considerable body of information based upon experience can aid in making the necessary decisions.

IT STARTED WITH THE RAILROADS

The first industrial pensions in this country were originated about 75 years ago in the railroad industry. Public utilities and some manufacturing concerns joined the movement in the years that followed, and by 1920 approximately three million workers, half of them in railroading, could look forward to retirement benefits. The pension idea made little progress, however, between the two world wars, and in 1939 the Senate Finance Committee noted that only 415 plans were in operation. The current flurry of pension agreements began in the midst of World War II.

In 1944 no less than 6,000 new retirement plans were awaiting approval by the Bureau of Internal Revenue. Partially, this upsurge was a result of the Revenue Act of 1942 which clarified the status of pension funds and company contributions under Federal income taxes, but of far greater importance during the war were the 95 per cent excess profits taxes and the freeze on wages. Under such a tax rate the Government bore practically the entire cost of a pension program, and firms were able to offer special rewards to employees through liberal pensions at a negligible cost.

The amendment to the Revenue Code in 1942 continues the provisions of the 1928 act, which allows a firm to take as a deduction for Federal income tax purposes the full amount of current pension contributions plus ten per cent of the unfunded liability created when the plan was established, providing that the plan is permanent and nondiscriminatory and that reserves are placed in an irrevocable trust. From 1943 through 1946, 9,370 pension and profit-sharing plans were approved by the Bureau of Internal Revenue. As of June 30, 1950, this total had reached 14,000 plans covering perhaps seven million workers.

Many of the pension plans currently being negotiated, as well as those of the war period, are largely a result of management decisions. Retirement benefits may be advantageous to the firm offering them in several ways: (1) older employees who are no longer operating efficiently can be removed more easily from the pay roll, and turnover of top personnel can be speeded up, thereby encouraging younger men; (2) turnover of the labor force as a whole is reduced, particularly in the 30-45 age group (younger employees have little interest in pensions, and older men would stay anyway); (3) worker morale and incentive are improved; and (4) competition for desirable employees, especially those on the executive level, is aided.

Soon after the war certain labor unions began to press the pension issue, and in May of 1946 the Krug-Lewis agreement granting coal miners $100 per month upon retirement, as well as other benefits, was announced. In 1948 the Seventh Circuit Court of Appeals upheld the National Labor Relations Board view that pensions were a proper subject for collective bargaining since they were a "condition of employment." Refusal to bargain on pensions became an unfair labor practice.

The wide interest on the part of union leaders in pensions is a recent development. Unions once opposed noncontributory pensions as a form of "welfare capitalism" which might drive a wedge between the worker and his union. It was considered preferable to restrict union demands to wage increases under the theory that, if a worker received adequate compensation, he would provide for his own security.

The reversal in union attitudes is traceable to a number of factors: (1) pensions offered a new bargaining issue with a strong emotional appeal after the cost of living leveled off in late 1948; (2) union security had been bolstered through demands for a strong voice in the committee deciding eligibility of workers to obtain pensions; (3) rivalry developed among union leaders in obtaining these special benefits; and (4) many companies had taken advantage of the war to introduce liberal pension plans for high-salaried executives.

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When the pension issue arose during the negotiations before the steel strike last fall, the Steel Industry Fact Finding Board recommended that the union's basic wage demands should be withdrawn, but that pensions should be granted by the steel companies. The Board stated that social insurance is a modern necessity. Government payments are inadequate, and pensions for employees should be considered a normal business cost—"depreciation of the human machine." Other unions began drawing the pension issue into labor-management negotiations, and the stage was set for strikes in the strategic steel and automobile industries.

$100 A MONTH—AND MORE

Early in September 1950 Ford agreed to raise the company's standard pension benefit to $125 per month, but the major interest in current attempts to renegotiate labor contracts springs from a desire to increase wage rates. The general pattern of settlement of the pension issue in labor disputes had been set previously (see accompanying table). The usual benefits include a $100 monthly payment, less social security, upon retirement at age 65 after 25 years' service, plus other payments in case of death, disability, injury, or sickness. The differences between particular agreements are in the detailed scale of benefits and method of financing.

Bethlehem Steel Company, first of the major steel companies to agree upon a new retirement plan, had been granting pensions prior to the strike, and it was merely necessary to liberalize existing provisions. The present plan sets a minimum payment of $100, including social security, at 65 for a worker with 25 years' service. An individual's monthly benefit may be above this amount since it is calculated as one per cent of average monthly earnings in the last ten years of service multiplied by the number of years of service. The average pension under the Bethlehem plan is expected to be $110 per month. In addition to the retirement benefits, which may cost the company ten to fifteen cents per man-hour, insurance provided in the agreement in case of death, disability, or medical expense will cost about five cents per hour, half to be borne by the worker.

The Ford and Chrysler settlements are much like the Bethlehem plan except that the past-service liability, i.e., the amount which would have been accumulated had the plan been in effect during the term of service of those currently employed, will be accumulated in a fund on a level-payment basis over a period of 30 years. The General Motors plan is similar to the Ford and Chrysler plans except that minimum payments are calculated as $1.50 a month for each year of service. Contributions by General Motors will not be changed in most cases even with increased social security payments.

THE EFFECT ON LABOR COSTS

Most firms retiring workers at half of terminal pay expect the current cost to be from five to eight per cent of the eligible pay roll. The United States Steel Corporation has announced that the cost of its new pension program will be about 78 million dollars a year or about eight per cent of the total wage bill. Aside from present expense the past-service liability in most cases will be 100 to 200 per cent of annual pay roll. Decisions on the methods of financing a pension plan will affect a firm's profit picture for many years ahead.

The principal difficulties in evaluating the cost of a pension program for a firm are the long-run nature of the liability and the many variables which must be considered in any cost analysis. Among these uncertain factors are the amount of labor turnover through quits or dismissals, future wage and salary levels, changes in social security benefits, trends in interest rates, worker mortality, and the retirement age if it is voluntary. Stable concerns with a long history and a large enough labor force to permit actuarial computations find it difficult to make these estimates accurately, but the plight of the small new firm without the financial strength to withstand shock has been a major concern to observers of the development of industrial pensions. Many businesses have felt compelled to agree to union pension demands without a careful evaluation of the long-run implications in order to continue production during a period of brisk sales.

In case of a decline in business activity additional cost factors must be considered. Not only do pension payments continue to those already retired while the regular pay roll declines, but some older workers will elect to go on a pension at a reduced level of payments rather than suffer a layoff, if the choice is open to them. In addition, seniority arrangements usually require that older workers be kept on the pay roll at a time when younger men, covered at a lower cost if at all, suffer a layoff. The type of retirement plan now being put into effect may prove an increasing burden at the very time when a firm is hardest pressed financially.

The variables in the pension-cost picture point up the futility of stating costs in terms of cents per man-hour. It is possible to pledge either a definite company contribution toward pensions for its workers or to assure a definite level of payments, but because of the uncertainties inherent in pension planning, it is not possible to fix both benefits and contributions for a given plan; one or the other must remain flexible. Another objection to the cents-per-hour method of computing pension costs from the standpoint of the firm is that unions are less likely to agree to a smaller company contribution if social security benefits are increased.

The cost of purchasing a $100-per-month annuity for a man retiring at age 65 is about $15,000. It is not necessary, however, that this entire amount be set aside for each worker in cash. First of all, company contributions are discounted for interest earnings and for workers who leave the company and thus forfeit their pension rights. In addition, expenses can be reduced in a number of ways. Eligibility of workers can be restricted, usually by setting a maximum age at which an employee can begin to participate in the pension plan. The cost of

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making provision for pensions for younger employees is relatively small. At the age of 25 there is one chance in three that an individual will not reach 65, and interest earnings permit a doubling of dollar contributions over a forty-year period. However, at 60 there is only one chance in seven that a worker will die before 65, and investment earnings starting at this age will provide only a small portion of the amount needed at retirement.

Pension costs can be kept to a minimum by making certain that a plan is approved by the Bureau of Internal Revenue (BIR). If this is done, a substantial portion of the cost is paid with money which would otherwise have gone to the Government in tax payments. From the cost angle it is expensive for the firm to agree to vesting any portion of the company's contribution, since cost saving through labor turnover is lost if workers are permitted to take part of their accrued benefits with them upon leaving the company. Survivorship benefits not only complicate the expense computation, but are extremely costly because wives are usually younger than their husbands and, in addition, have a greater life expectancy.

CONTRIBUTORY OR NONCONTRIBUTORY

Most of the new plans are noncontributory—the employer carries the entire cost. In general the CIO has opposed contributory plans, but AFL unions in several cases have demanded that retirement planning be handled in this manner. Advantages of contributory plans to the worker include the following: (1) The plan is funded and more stable. (2) Benefits are usually larger and more adequate. (3) The worker is made conscious of the cost of the pension program. (4) The worker has a vested right to a portion of the accumulation in the fund.

Against contributory pensions the following arguments are offered: (1) It is not always possible to obtain employee consent to participate, and the Treasury insists that 80 per cent of those eligible must be covered by a plan. Even if the required number of workers join the plan, the need to provide for the old age of those who do not choose to join is still present. (2) Administration is more difficult. (3) Although employee contributions seldom pay over one-third of the cost of a plan, the deduction from pay checks runs about five per cent which reduces "take-home" pay and may lead to new wage demands. (4) From the standpoint of the firm the vesting provision tends to reduce the effectiveness of a pension plan in cutting down employee turnover.

PROFIT SHARING—AN ALTERNATIVE

Most of the financial problems involved in the ordinary pension plan can be resolved through the device of providing retirement benefits through profit sharing. This method is particularly applicable to the small firm or to a company whose earnings fluctuate widely, since contributions are made as a portion of company earnings before taxes.

Benefits under a profit-sharing plan can be substantial. The Sears and Roebuck fund is largely invested in Sears stock, and lump sum payments to individual workers upon retirement have reached $70,000, partly as a result of market-value appreciation of the company's stock. However, the unions usually have not taken a favorable attitude toward profit-sharing plans, believing that workers' retirement benefits should not be de-

PROVISIONS OF SOME RECENT INDUSTRIAL PENSION PLANS

Firm	Minimum Monthly Pension	Includes Social Security	Contributory	Announced Cost	Method of Funding	Remarks
American Telephone and Telegraph Company	$100	Yes	No		Fully funded	20 years' service required for eligibility.
Bethlehem Steel Company	$100	Yes	No	12 cents per hour	Money paid into trust fund	Original plan adopted in 1923.
Chicago Transit Authority	$75	No	Yes		Trust fund	Allowance reduced 5 per cent per year if employee retires before 65.
Chrysler Corporation	$100 at 65 with 25 years' service	Yes	No		Fully funded over 30-year period	If disabled after 55, employee receives $50 payment until 65 when regular benefits begin.
General Motors Corporation	$100	Yes	No	$67,000,000 annually	Fully funded over 30-year period	5-year contract.
Inland Steel Company	$100	Yes	Optional		Trust fund	75 per cent of employees on contributory basis.
United States Steel Corporation	$100	Yes	No	4.8 per cent of pay roll	Interest paid on past-service liability	Employees contribute toward welfare benefits.

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pendent upon good management.

TO FUND OR NOT TO FUND

Much of the current discussion on the pension question has centered upon the methods to be adopted by a firm in meeting its obligations. When a company agrees to a retirement plan, it assumes a contingent liability often of enormous proportions. This "past-service liability" results from the fact that present employees are usually assumed to have acquired pension rights during the years they have worked for the firm. Orthodox finance would require that this amount be segregated in a special fund to meet future pension obligations. If shown on the company's books, the past-service liability would wipe out the capital and surplus of many otherwise stable firms.

There are several methods of financing a pension plan: (1) Employees can be kept on the pay roll at a reduced rate after retirement. (2) The benefits due each employee can be funded at the time he retires through the purchase of an individual annuity, a contract under which the insurance company agrees to pay a fixed scale of benefits for the rest of the beneficiary's life. (3) Current-service benefits plus assumed interest on the past-service liability can be paid into a fund. This method is one type of "partial funding." (4) The past-service liability can be completely funded either at once or over a period of years.

Some firms are inclined toward pay-as-you-go financing because of its simplicity and lower initial cost. This simplicity is deceptive because a refusal to make a careful calculation of the future costs involved in a retirement system could result in insolvency. The lower cost in the first years of operation hides the fact that in the long run pay-as-you-go is more expensive than other methods of financing because interest does not work toward building the fund. Furthermore, current obligations tend to increase in the future, perhaps at a time when the firm can least afford additional burdens. The recent difficulties of the coal miners' welfare fund and the unhappy experience of many pension plans during the depression are used to support the view that funds are necessary for stability.

Opponents of full funding note that the past-service liability will never be paid off unless the firm liquidates or declines in size. If the number of a firm's employees, their average age, and term of service remain the same, the past-service liability will stay at a constant amount. Why create a reserve which will constitute a drain on a firm's working capital if the money will be needed only in case the business is liquidated? Some authorities suggest that only the current-service credits plus interest on the past-service liability be placed in a fund. A contingency reserve could be provided to take care of fluctuations in the amounts needed to meet current obligations.

Only the largest and strongest concerns can possess any degree of certainty that pension payments can be continued for generations ahead on a pay-as-you-go basis. Sound management seems to require full funding or an unconditional guarantee from outside the firm. The trend appears to be toward complete funding. Last fall the Bethlehem agreement did not require funding, but each of the major auto companies has agreed to total funding of past-service credits over a period of 30 years.

INSURED OR SELF-ADMINISTERED PLANS

If a firm decides to fund its pension program, it may use an insurance company to provide annuities for retired workers, or a trust may be set up to handle the reserves and administer the plan. In 1946 about 60 per cent of the plans registered with the Bureau of Internal Revenue were insured, but only 30 per cent of the covered workers were under this type of program.

The insured plans are most applicable to smaller companies with an insufficient number of employees to permit calculations upon an actuarial basis. There are three main types: (1) Individual annuities which can be used most advantageously by very small firms. These contracts are usually purchased on a level annual premium basis. (2) Standard group annuities under which a minimum of 25 or 50 persons are covered by one policy. Past-service liability is usually paid up over a period of time, and premium rates are adjusted after five years. (3) Deposit administration plans under which the insurance company receives payments from the company and invests the money. When an employee retires, an annuity is purchased for him through the fund. Usually at least 500 employees are necessary to provide this type of agreement. The deposit administration arrangement is the most flexible of the insured plans. It is sometimes combined with the standard group or individual annuity.

Most important among the advantages of insured plans are stability and safety. When the purchase of an annuity is completed, the past-service liability is funded automatically. The obligation is then that of the insurance company no matter what happens to the employer. Although 238 pension plans had been reported as failures through 1938, no insured plan has ever fallen into difficulties.

The group annuity was first made available in 1925. Since that time its development has been fairly rapid, partially because of the fact that the Revenue Act of 1928 gave an advantage to group annuities over trusteed plans. From then until 1942 past-service liability on an annuity could be written off for tax purposes at once, while under the trusteed type it could be done in a minimum of ten years. Since 1942 both types of plans have been on the ten-year basis.

If a company is of substantial size with several thousand employees, it is usually advantageous to undertake a self-administered or trusteed plan. The cost becomes proportionately lower as the size of the fund and the number of employees are increased. In addition, the trusteed plan is more flexible than the insured method. Since the company keeps control of the funds through the trustee, contributions can be adjusted yearly by the

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actuary on the basis of experience. Furthermore, actual contributions can be withheld so long as the unfunded liability is no larger than it was at the start of the plan. Payments can be suspended on annuities under certain circumstances, but the degree of flexibility is much less.

SOME PENSION FUNDS ARE BUYING STOCKS

Possibly seven billion dollars are in the hands of pension fund trustees, at present. This money is already a substantial factor in the capital markets, and the amount is increasing at an accelerating rate. It has been estimated that, if all firms in this country with 50 or more employees would accumulate fully funded pension reserves, the total might reach 200 billion dollars or more. Some observers believe that this huge figure will never come close to fulfillment and that the funds will increase only gradually in the years ahead.

The Bankers Trust Company has estimated that the amount of net accumulation in pension funds will increase to a rate of about 1.7 billion dollars toward the end of this year, up about five hundred million from 1949. An addition of this magnitude should not greatly upset capital markets, which currently absorb close to ten billion dollars each year. However, the amount will probably continue to increase each year for decades ahead and may create investment problems in the future.

Earlier this year concern was voiced over the inadequate supply of new debt instruments to satisfy the needs of the steadily rising pension funds. The volume of corporate bond issue was running at a lower rate than in previous postwar years, and new residential mortgages were being absorbed fully by institutions and individuals. Municipal issues continued at a high level, but the tax exemption privilege is of no value for pension fund investments. In recent months, however, all types of private debt have increased rapidly. The volume of new corporate bonds probably will be heavy for many months ahead as industrial leaders revise upward their capital expenditure programs. Rising interest rates suggest that no plethora of investable funds is likely to exist in the near future.

It has been suggested that pension funds invest in equities to help relieve pressure on the bond markets and cut the costs of pensions to industry by raising the yield on fund investments. Yield on investment is an important consideration in pension-cost calculations since an increase of one-half of one per cent on a fund's earnings will reduce the cost of pensions by 15 to 25 per cent. One-fifth of a pension fund invested in high-grade common stocks yielding five per cent with four-fifths in bonds yielding 2.5 per cent would mean an overall yield of three per cent.

Most pension funds could place a substantial portion of their assets in equities without worry about liquidity considerations. Wise investment by trustees with emphasis upon yield instead of appreciation could contribute to the stability of the stock market. On the other hand, many authorities state flatly that common stocks have no place in a pension fund portfolio because of the risk inherent in this type of investment. Retirement benefits are usually stated in definite dollar terms, and a higher yield than anticipated or profits on portfolio switches will not result in higher payments, whereas a cut in yield or substantial portfolio losses could be disastrous. On the other hand, profit-sharing plans or "money purchase" pension funds, in which final benefits are determined by the amounts accumulated at the time of an employee's retirement, may buy stocks after reaching a moderate size. The basic investment problem of finding an outlet for the plethora of savings is not solved by equity investment, however, since the purchase of securities in the market merely results in shifting of funds from one holder to another. Pension trustees will be careful to buy only the highest grade of common stock in established companies which seldom offer new stock for cash.

Encouragement has recently been given to equity investment by pension funds by the change in the New York law which now allows restricted trust funds to invest up to 35 per cent of assets according to the "prudent man" theory which would permit purchase of high grade common stock. Other evidence of the trend is found in a booklet issued by the Old Colony Trust Company of Boston which stated that "Diversification of investment, including the sound use of common stocks should enable a pension trust to show . . . . a better performance than if the fund's portfolio were rigidly restricted."

MANAGEMENT OF THE PENSION FUND

The pension fund must be placed in an irrevocable trust which involves the appointment of trustees, but the employer may exercise control of the investment policy through provisions in the trust instrument. Various methods are used. The trustee may be relatively unrestricted in making new investments, or specific issues may be purchased upon the direction of the employer. Sometimes funds are restricted to Government securities, or to investments legal for trust funds, savings banks, or life insurance companies.

Although normally a fund should not have to engage in forced selling since current contributions and investment income should meet payments, it is necessary to keep a certain liquidity through holdings of cash, short-term Governments, and railroad trust certificates.

In the small trust fund of 50 to 100 thousand dollars, investment of all funds in Governments is probably the wisest course. In larger trust funds diversification should be achieved by types of industry and company. Maturities should be spread evenly to permit a continuing flow of cash without the need for selling on the market. Conservative opinion would restrict investment to the highest grade bonds, perhaps half Governments, with maturities strung out over 30 years. The believer in equity investment for pension funds would add investment trust shares and "blue chip" common stocks with long records of dividend payments, particularly those of banks or public utilities.

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Economics of Old-Age Pensions

Basic Security Should be Provided Through an Expanded Federal Plan

The problem of providing for our rapidly increasing number of aged is one of the most important peacetime issues facing the United States. Since it is apparent that most persons do not save during their working years the large amount necessary to provide a satisfactory income upon retirement, there is a growing conviction that old-age security should be the responsibility of society as a whole. As such, retirement incomes would be provided through a sort of compulsory saving, reflected either in larger tax payments to Government or indirect costs of private pension benefits. It appears that a Government program providing universal basic coverage is preferable in many respects to widespread private pensions in meeting this obligation, but, partly because of the inadequacies of the Federal social security program prior to the recent legislation, the demand for privately financed pensions has gained substantial momentum during the past year.

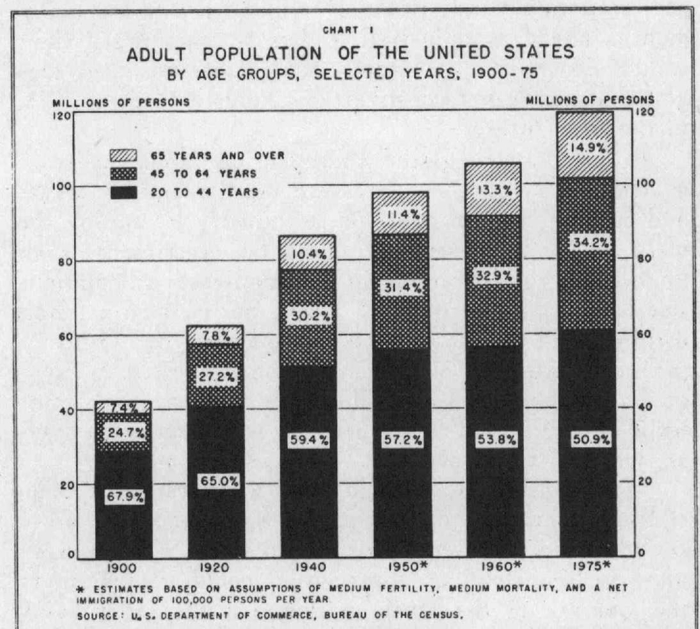
The recent emergence of collectively bargained industrial pension plans, which are doubtless only in the first stages of development, will have significant effects upon our economy. The decision as to whether such private pensions are to be encouraged as a matter of public policy must be made. What are the disadvantages of industrial plans? Should private plans be funded or operated on a "pay-as-you-go" basis? What are likely to be the economic effects of the alternative types of plans being developed? Should the demand for basic retirement security be met by a Government program with universal coverage? What are the effects of pension programs upon the continued productive employment of older workers, and what will be the cost in real terms of widespread retirement plans? These are some of the basic questions which will have to be answered if a sound over-all program of old-age security is to be developed.

THE COST OF PENSIONS

The underlying reason for the growing demand for old-age security is the upward trend in the age distribution of our population. Spectacular gains have been made in medical science during the past 50 years, with the result that mortality rates have been lowered substantially and longevity has been increased. In addition, the domestic birth rate has been declining steadily (except for the late war and immediate postwar years), and foreign immigration has declined sharply since 1930. Consequently, there has been a rapid growth in both the number and proportion of persons of retirement age. In 1900 there were only three million people 65 years and older; at the present time there are more than 11 million people of retirement age and, based on relatively conservative mortality assumptions, it is estimated that the number of aged will have increased to about 18 million by 1975. By that time, this group of older people will comprise nearly 15 per cent of the adult population, as compared with 11.4 per cent at the present time and only 7.3 per cent in 1900.

Obviously, the cost of providing pensions for this number of aged would be very large and could be expected to increase with the passing of time. For example, the annual cost of $75 per month pensions to all persons 65 years and older would be about 10 billion dollars at the present time, or nearly four per cent of the dollar value of our total production of goods and services during 1949. This annual cost would rise steadily to a level of about 16 billion dollars in 1975, in terms of current dollars. The cost of an individual annuity paying $100 monthly for life at the age of 65 is nearly $15,000, and it has been estimated that full funding of past-service credits for pensions covering the combined AFL and CIO memberships would require a reserve of about 45 billion dollars.

Regardless of whether the dollar cost of pensions is measured in terms of the annual payment liability, the expense of funding past- and current-service credits, or the amount necessary to provide an individual annuity at retirement, the real cost of providing pensions in terms of goods and services will be borne at the time the pensions are paid. Disregarding at this point the possibility that pension payments will act to stimulate business activity, the cost of supporting our growing number of aged will be met largely through a lower



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average standard of living for the active members of the labor force than would otherwise prevail.

For this reason, it is important that as many older people as possible be retained in productive jobs past the age of 65, provided they do not displace younger and more efficient workers. It is estimated that there are about three million persons 65 years and older in the labor force at the present time and that their contribution to output during 1949 amounted to about 11 billion dollars. To the extent that these older people can be kept employed, the *real* costs of old-age security will be lessened, and the general standard of living will be higher. In addition, the decision must be made as to what constitutes an adequate minimum pension and how far society as a whole can go toward providing it. The tremendous burden of a comprehensive old-age security program on the productive workers of our country must be recognized and weighed against the benefits of such a program.

PENSIONS AND BUSINESS ACTIVITY

An important aspect of large-scale pension planning is the effect such a program will have on business activity. If the pension scheme can be used to aid in maintaining business activity at a high and rising level, the real cost of such old-age security will be reduced considerably. If the development of retirement plans exerts a depressing influence on business activity, however, the loss in production of goods and services will add to the already substantial direct cost of the programs.

In appraising the probable effects of pensions on business activity, a distinction must be made between those plans which are funded and those which are not. The so-called "pay-as-you-go" plans merely meet pension payment obligations as they come due, much as if the retired worker is continued on company pay rolls. To the extent that business absorbs the cost of these payments, the available dollar income, and thus spending, of consumers will increase. Since firms probably will be unable or unwilling to absorb this additional expense through reduced profits, however, much of the cost of pensions may be passed on in the form of higher prices or lower wages than otherwise would prevail. Even so, the level of consumption may increase slightly, inasmuch as retired workers can be expected to spend a larger proportion of their income than does the general consuming public.

All contributory retirement programs, as well as many of the noncontributory industrial plans, provide for the gradual accumulation of a fund from which pension obligations will be paid as they occur. As with unfunded plans, it seems likely that much of the cost of funded pensions will be borne by the public in the form of higher prices or lower wages and, in the case of contributory plans, through direct deductions from employee pay checks. Since the receipts of such plans will have to exceed disbursements to retired workers for some time, in order to build up a reserve fund, the operation of funded pension plans initially will act to reduce real consumer income. If the drop in real income is not offset by a decline in personal saving, consumption will contract.

It does not seem likely that the accumulation of pension reserves will serve to counteract any possible decline in consumption by stimulating business capital spending. If the supply of funds seeking investment is ample, a further addition to this supply would exert a downward pressure on interest rates and current stock yields, but the consequent saving to business would have only a negligible influence on the determination of capital spending programs. More importantly, the possible depressing effect of pension funding on consumer demand would tend to discourage increased business spending. It is more probable that the increase in investment demand would serve to attract debt which is now held or otherwise would be acquired by the banking system.

The development of any type of pension plan on a large scale, however, is likely to have the desirable tendency to reduce fluctuations in business activity. Payments to pension recipients will remain relatively constant throughout the business cycle, and may even increase somewhat during depressed periods as job opportunities become fewer and layoffs more numerous. Like any type of transfer payment, therefore, pensions will exert a stabilizing force on total personal income and thus on expenditures.

In addition, for those pension plans which are designed in such a way that fund receipts are based on some factor which is affected by business activity, such as wage payments, sales, or profits, annual receipts will fluctuate with the business cycle. Since retirement payments will remain relatively constant, net receipts for the reserve fund during periods of prosperity may give way to net payments during periods of reduced business activity. Thus, the operation of such plans will tend to result in a downward pressure on consumption when demand is high and an upward pressure when demand is depressed.

Although real consumer income will tend to be reduced by the accumulation of pension reserve funds, this reduction probably will not be fully reflected in a lower rate of consumption. It is likely that the substantial pressure to maintain previous standards of living will result in a reduction in savings offsetting in part the decline in real income. In addition, the existence of a retirement program might discourage the accumulation of savings by reducing the will to save. If so, the growing coverage of pension programs may bring about an increase in consumption; if not, at least the funded type of plans may have a mildly restrictive influence on consumption.

According to the *1949 Survey of Consumer Finances*, the median difference between income and expenditure for all spending units during 1948 was only $75. Only about a quarter of the spending units saved $200 or more, and much of this probably occurred as a result of repayment of debt or purchase of real property. Considering that personal income during 1948 was very high and that provision for a retirement income requires a sub-

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stantial accumulation of funds, saving for old-age security is less prevalent than is generally supposed. Any weakening in the will to save for old-age retirement as a result of the development of pension programs, therefore, is not likely to affect a significant portion of total personal savings. Furthermore, the motivation to save for retirement may continue strong in many cases, in order to provide an income supplemental to that received from pension payments.

LIMITATIONS OF PRIVATE PLANS

There are several serious economic and social disadvantages to private pensions, particularly those which have been developed recently as the product of collective bargaining. First, private pension plans can never constitute a basic program for old-age retirement because they do not provide broad enough coverage. Millions of self-employed and agricultural workers could not be covered; millions more who work for small firms probably would not be able to obtain private pensions. Of a total labor force exceeding 62 million, 43 million are nonagricultural employees and only about 15 million of these are unionized. In addition, most of the new collectively bargained industrial plans cover only workers with long years of service with one firm; these long-service employees constitute only a small portion of the workers in most industries.

A second disadvantage of private plans is that they tend to restrict the movement of workers from one job to another as job opportunities and employment needs vary. This is particularly true of the noncontributory plans, since the pension rights in such plans do not attach to the worker. For the person with substantial tenure who has built up a valuable pension right, the loss of this right acts as a strong deterrent to leaving his job for what may be a better opportunity. Contributory plans allow for the building up of a fund which the worker receives in leaving his job, but even in these cases the pension rights which he has accumulated are usually of substantially greater value than the amounts he has contributed and is entitled to upon leaving company employment.

Closely related to the disadvantage of reduced labor mobility is the possibility that the existence of pension plans will further increase the reluctance of business to hire older workers. Since the worker does not bring a pension right with him, the new employer would be faced with the choice of providing the older worker with the standard pension at greatly increased cost to him or offering him a proportionately smaller pension based on fewer years' work, which might not be desirable from the standpoint of employee morale and public relations. Vesting would allow the worker to take his pension rights with him, but would greatly increase the cost of pensions for the employer. Industrywide coverage and "Toledo plan" pensions, which allow the worker to move from one union plant to another within the area, are partial solutions to this problem, but have not yet gained wide acceptance by business, primarily because of the increased cost of coverage.

A fourth shortcoming of private pension plans is that the program itself may not offer adequate assurance that the younger worker will actually receive a pension at the age of retirement. This is especially the case with unfunded pay-as-you-go plans, since the continued survival of the plan is dependent upon the company's ability to meet its pension obligations. If the firm should fail, or become so weak that payment of pensions would cause it to fail, the retirement program would almost certainly collapse. The contractual obligation of the company to pay pensions is in the nature of a contingent liability (although the legal status of such pension plans in liquidation or reorganization is uncertain), but even if the workers with pension rights are considered as prior creditors, it is very doubtful that the large claim could be realized fully in many cases. A related disadvantage from the standpoint of uncertainty is that many collectively bargained industrial pensions run for only five years, after which time they are open for renegotiation.

A funded pension is more desirable in several respects than an unfunded one. It provides substantially more security for the worker and for the program. It may allow for vesting, which answers in part the problems of labor mobility and the bias against hiring older workers. In addition, it makes possible the development of a pattern of receipts and payments which possess anticyclical characteristics. Unfortunately, however, the cost to the business of such a pension is very large. It has been estimated that the cost of full funding of pensions for the employees of Ford Motor Company would amount to 200 million dollars, and for the United States Steel Corporation the cost would run over one billion dollars. Even though the fund could be accumulated gradually over 20 or 30 years, the financial strain would be severe for many companies, particularly if a period of reduced business activity and profits occurred during the funding operation.

The widespread adoption of industrial pensions necessarily will be reflected in business pricing policies. These new commitments will add to the cost of doing business, and as such are likely to be passed on in large part in the form of higher prices for the finished product. Moreover, pension payments will constitute a relatively inflexible expense over the business cycle. If the plans are unfunded, the dollar cost will remain high and may even increase during periods of contracted operations; even if the plans are funded on a cents-per-hour basis, the expense to the company will remain high per man-hour of work. Thus, the practice of adjusting prices rather than production in order to stimulate waning demand will tend to become even more difficult for business to follow.

A final disadvantage of private pensions, as well as public pensions, is the tendency such old-age security will have to reduce the workers' productive life. It is likely, of course, that many more workers of necessity would work past the normal retirement age in the absence of pension provisions than if they were available.

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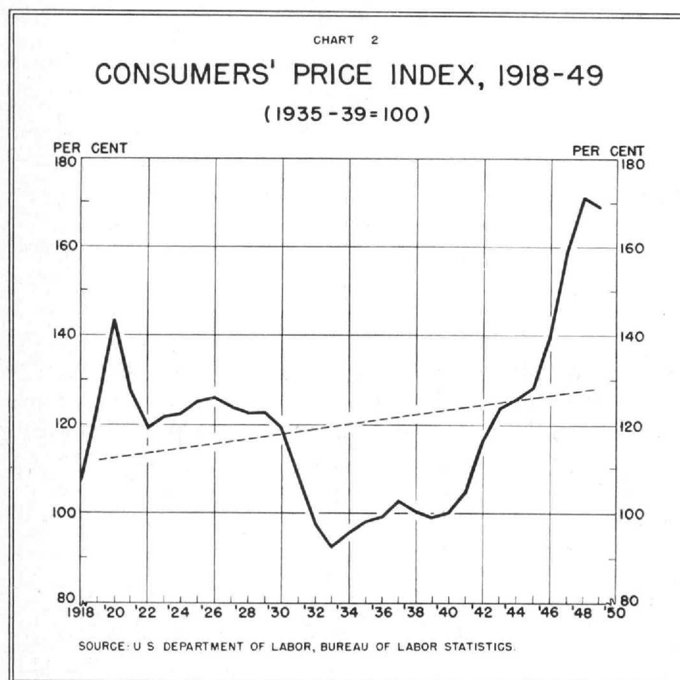
Also, there would probably be a greater feeling of obligation on the part of employers to find a place for older workers in some less demanding job, if laying off the employee meant that he would be faced with extreme financial difficulties.

GOVERNMENT VS. PRIVATE PENSIONS

An expanded Federal program of old-age security is preferable to a multitude of private plans in providing basic pension benefits in that it would not contain the economic disadvantages of private plans. It could be universal in nature, thus providing widespread coverage. The problems of mobility and bias against hiring of older workers would not be present, since the benefits would accrue to the worker regardless of his job. Funded or unfunded, a public program would provide adequate security, since it would be based upon the continued existence and the general taxing and borrowing powers of the state, and it would be permanent rather than temporary. Finally, it could be unfunded since there would be no problems of security or vesting, and thus a large supply of reserve funds seeking investment would not be accumulated.

Devising a Federal program to operate in a moderately anticyclical fashion would be a relatively simple matter. It could be a modified pay-as-you-go plan, with a relatively small fund accumulating through a constant rate of tax upon personal income. The fund would be expected to grow during periods of high income, thus reducing consumer demand, and to decline during periods of low income, thus adding to consumer purchasing power. Since the fund would be depleted gradually as the number of aged eligible for pensions increased, the tax rate would have to be raised at periodic intervals, after adequate notice.



The problem of encouraging older workers to remain in the labor force could be partially solved in one of several ways. First, it has been suggested that the age of eligibility could be advanced to 70 years, with the development of a suitable program of old-age assistance and permanent disability payments for the earlier years, perhaps between 60 and 70. Second, pensions could be paid without regard to the income of the recipient, thus encouraging continued employment, but wage levels for the types of work done by older persons might be depressed as a result. Finally, a premium in the form of a larger pension upon retirement could be offered to persons who work past the age of 65. The premium could be calculated on an actuarial basis and would not increase the cost of the program. According to the National Industrial Conference Board, the premium that could be offered without additional cost at the present time would be about one per cent of the basic pension for each month that the person remains employed after his 65th birthday.

The possibility of substantial further deterioration in the purchasing power of the dollar is one of the most important factors in the whole pension question. A continuation of the long-term upward trend in consumers' prices would gradually destroy pension values. Of immediate concern is the possibility that the strong inflationary forces characteristic of the past decade will recur, as a result of the tense international situation and recently expanded requirements for defense expenditures.

It has been suggested that a cost of living adjustment should be included in any comprehensive old-age security program, in order to provide a constant benefit in real terms. There may be some merit in considering such an adjustment factor, as a protection against relatively short-term fluctuations in prices. The real need under present circumstances, however, is for vigorous and effective anti-inflationary action, if the pension benefits currently being obtained are to be of substantial real value 20 or 30 years hence.

The place of private pensions in a comprehensive retirement program would be essentially to provide supplemental benefits, such as early retirement for workers in jobs which demand unusual physical stamina or additional pension payments for workers who have received higher-than-average salaries. The Federal program, as a plan to establish basic old-age security, should provide not more than the minimum amount necessary for meeting living expenses. Private plans, however, should be devised in such a way as to minimize the economic disadvantages of industrial pension programs, as outlined above. Such plans should be at least partially funded, so as to provide for vesting of the worker's pension rights and in order to provide some protection for the solvency of the fund against the uncertainties of the future. In addition, private plans should be designed so that receipts of the reserve fund will fluctuate with the level of business activity. Developed in such a way, the growth of widespread security for old-age retirement could be a desirable addition to the economic and social structure of this country.

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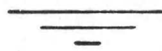
RESERVE DISTRICT



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