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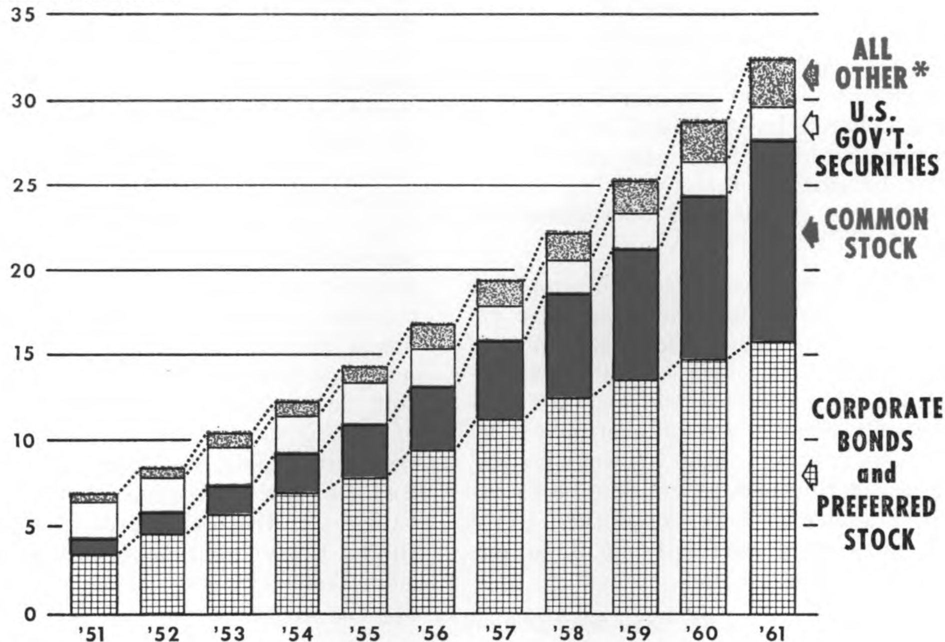

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Corporate Pension Funds And Capital Markets

Pension funds have become increasingly important in capital markets during the postwar period. As a result primarily of the greater emphasis on fringe benefits (including retirement systems) which developed in labor-management bargaining during and following World War II, pension funds have experienced rapid expansion both in size and in extent of coverage.

Company-paid retirement systems were among the fringe benefits offered in lieu of higher wages to attract workers when price and wage controls were in effect during World War II. The attractiveness of pension funds for workers, however, did not diminish when wage controls were terminated. Labor unions, recognizing the value of such programs for their members, negotiated for the inclusion of pension plans in labor-management contracts. In 1949, the courts upheld the National Labor Relations Board decision that such programs are a legitimate objective of collective bargaining, thereby giving further impetus to the growth and development of pension funds.

The limited tax exemption of employer contributions to pension funds has also enhanced the growth of such funds as a form of personal saving. Employer contributions are not taxable until they are paid out in retirement benefits. Since a worker's retirement income is usually smaller than his wage income, employer contributions to pension funds are generally taxable at lower rates than if the same monies were originally paid to employees as income.

The pension funds which have been accumulated in response to such a situation have served as an important source of capital for the financing of corporations, government, and real estate transactions.

Private pension funds basically take two different forms, insured and noninsured plans. The funds of insured pension programs are placed in the hands of life insurance companies. Noninsured funds, however, are invested either by an appointed manager or by a bank which acts as trustee for the fund.

Noninsured corporate pension funds grew at a much faster rate during the 1951-1961 period than did the insured funds—fivefold as compared with threefold. This development was due largely to the fact that the managers and trustees of noninsured funds have more freedom in their investment policies than do life insurance companies. That is to say, the assets of insured pension funds are generally invested as part of the total asset structure of life insurance companies, with the result that the former are subject to the same restrictions that apply to the investments of life insurance companies in general. These restrictions preclude, for example, heavy investment in common stock. Recently, however, the Securities and Exchange Commission has proposed some changes which would permit life insurance companies to segregate pension fund resources and to invest them separately without the regulation of the SEC. If the new proposals are adopted, they will enable life insurance companies to compete more effectively with commercial banks for trusteeships of private pension funds. Commercial banks are currently exempt from SEC regulation in the managing of pension funds.

Because the assets of insured pension funds are indistinguishable from the other assets

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of life insurance companies, the remainder of this discussion is centered on noninsured corporate pension funds.

Growth of Assets

According to the annual surveys of the Securities and Exchange Commission, the assets of noninsured corporate pension funds totaled $32.4 billion at the end of 1961, a marked increase from $6.9 billion in 1951.

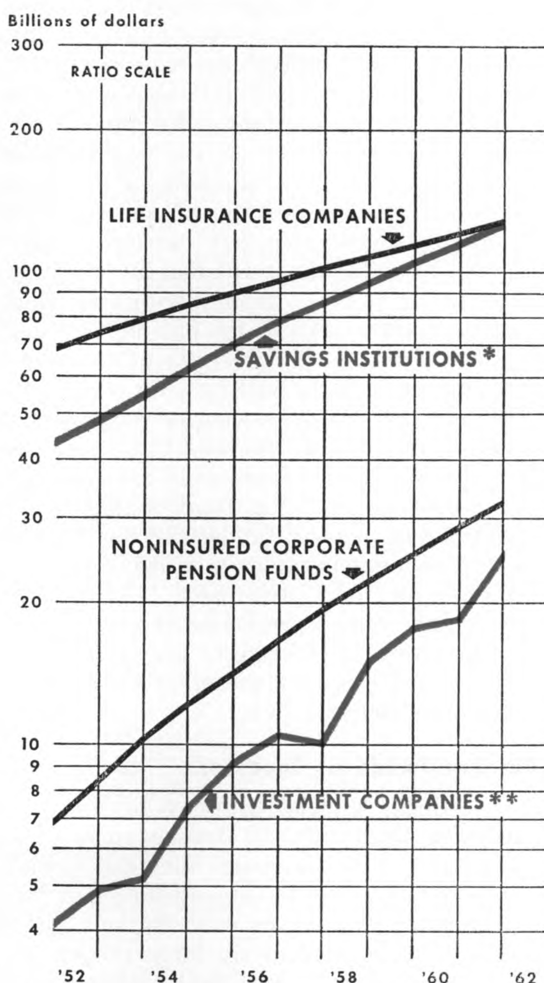
Among the various competitors for personal savings, noninsured corporate pension funds are relatively small. Life insurance companies, for example, held assets amounting to $126.8 billion at the end of 1961, nearly four times the amount held by noninsured corporate pension funds. Deposit-type savings institutions,[1] including savings and loan associations and mutual savings banks, held assets totaling $124.9 billion. Investment companies, like pension funds, hold only a small proportion of total personal savings.

The importance of noninsured corporate pension funds stems not from their current size but from the growth record during the past decade—a record marked by both rapid and steady expansion. With reference to growth, noninsured corporate pension funds are similar to investment companies. Pension funds expanded at an average annual rate of 17 percent during the ten years from 1951 through 1961, while investment companies grew at an average annual rate of 21 percent. On the other hand, the larger institutions chalked up slower rates of growth. For example, life insurance companies expanded at an average annual rate of only 6 percent during the ten-year period, while deposit-type savings institutions grew at an average annual rate of 11 percent. (In both of the latter cases, the starting base was of course at a much higher level.)

In terms of growth patterns, noninsured corporate pension funds have been much akin

(1) Credit unions and commercial banks also are deposit-type savings institutions. Commercial banks, however, perform other services so that their assets are not representative of their role in personal saving. Credit unions have experienced rapid growth in recent years but at the end of 1961 their total shares and deposits amounted to only $5.7 billion.

TOTAL ASSETS OF SELECTED FINANCIAL INSTITUTIONS (as of end of year)



* Includes Savings and Loan Associations and Mutual Savings Banks.

** Includes both closed- and open-end investment companies.

to life insurance companies and deposit-type institutions, with all three advancing at a fairly steady pace during the 1951-1961 period. Investment companies, on the other hand, reflected quite clearly the impact of the ebb and flow of business activity, i.e., the business cycle, in that the pace of advance was not characterized by steadiness. This was

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due in part to the fact that investment companies report their assets at market value, which often fluctuates widely. Investment companies combine the investment funds of many people, and in turn invest these funds in securities. Investment companies are considered by many individuals more as an outlet for investment-type funds, similar to common stock, than as an outlet for current savings. It is recognized that the possibility of price declines and fluctuations in dividends associated with the holding of common stock in an investment company carries a larger degree of risk for the individual investor than does placing funds in those institutions which guarantee the return of the amount invested. The flow of funds into investment companies depends more on prevailing economic conditions and the state of securities markets than is the case with other financial intermediaries. Also, investment companies do not have the advantage of a pension fund, whereby contributions to pension funds take the form of payroll deductions rather than being an overt act of saving or "investment." Thus, holdings of investment companies have not shown the steadiness in the rate of growth that has been demonstrated by the other financial institutions discussed here.

Pension Funds as Investors

Investment policies of pension funds are subject to conditions and circumstances which differ from those of many financial institutions. For example, the steady inflow of both employee and employer contributions makes it unnecessary to maintain large proportions of assets in short-term, liquid holdings. This situation is pointed up in the fact that, to date, the contributions to pensions funds have been more than sufficient to meet the pay-out of retirement benefits. In addition, the managers of pension funds are able to formulate relatively accurate forecasts of the amount and timing of benefits to be paid. Consequently, the cash flow of most pension funds lends itself to longer-term investment portfolios.

A second item is that the asset distribution of noninsured pension funds, in many instances, is not affected by as many legal restrictions as is the asset distribution of other financial institutions, such as savings and loan associations and life insurance companies. As a result, the managers and trustees of noninsured pension funds have been able to invest heavily in higher-yielding, higher-risk securities.

Another important characteristic of noninsured pension funds as investors is the tax exemption of income. This feature makes it unnecessary for pension funds to balance gains and losses for tax purposes, or to invest in tax-exempt securities.

Distribution of Assets

The growth of noninsured corporate pension funds in the past ten years has been characterized by a marked change in the distribution of assets. A basic shift has been away from lower-yield, liquid holdings into less liquid investments which provide a higher rate of return. Moreover, there has been a marked shift away from fixed-income securities into common stocks.

As shown in the chart on the cover of this issue, the largest share of the rapid expansion in the assets of noninsured corporate pension funds has occurred in corporate securities. Corporate bonds and preferred stock — which are fixed - income corporate securities— accounted for 49 percent of the total assets of noninsured corporate pension funds at the end of both 1961 and 1951. During that period, however, preferred stock declined as a percent of the total, from four percent to two percent. On the other hand, corporate bonds expanded to a peak level of 54 percent of the total at the end of 1957 from 45 percent in 1951, and then dropped back again to 48 percent in 1961. At the end of 1961, noninsured corporate pension fund holdings of corporate bonds totaled $15,754 million as compared with only $3,397 million at the end of 1951.

In contrast to fixed-income corporate securities, holdings of common stock have in-

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creased steadily as a proportion of the total assets of the pension funds under review. Common stock (book values) represented 37 percent of total assets at the end of 1961 as compared with only 12 percent in 1951. At year-end 1961, noninsured corporate pension funds held $11,799 million in common stock in contrast to $812 million at the end of 1951.

At the end of 1961, holdings of real-estate mortgages by noninsured corporate pension funds amounted to $907 million. In 1955, the first year for which data are available, real estate mortgages held by these funds totaled $146 million. The small absolute growth of investment in mortgages by pension funds is attributable largely to the relative attractiveness of returns on other types of investments and the large administrative costs involved in handling mortgages.

The increase in holdings of corporate securities has been accompanied by a significant decline in the relative importance of holdings of U. S. government securities. Treasury securities accounted for only six percent of the total assets of noninsured corporate pension funds at the end of 1961, as compared with nearly one-third of the total in 1951. In fact, managers of the funds actually decreased dollar holdings of U. S. government securities during the 1951-61 period of rapid asset growth, with the decline amounting to five percent.

The shift in emphasis to corporate securities from U. S. government securities has been due primarily to the traditional yield differential between the two classes of securities. The higher yields of corporate securities have made them relatively more attractive to pension fund managers. The relevant yield differentials are shown in the following table, which includes the highs and lows on both U. S. government securities and corporate bonds in each year since 1951.

	Average Yield on New Issues of High-Grade Corporate Bonds—* Adjusted to "Aaa" Basis		U. S. Government Long-Term Bonds	
	High	Low	High	Low
1951	3.36	2.74	2.70	2.39
1952	3.25	2.94	2.75	2.57
1953	3.82	3.09	3.13	2.79
1954	3.01	2.74	2.69	2.47
1955	3.41	2.99	2.95	2.68
1956	4.29	3.07	3.40	2.85
1957	4.81	4.04	3.73	3.22
1958	4.56	3.61	3.80	3.12
1959	5.29	4.29	4.27	3.90
1960	4.96	4.37	4.37	3.79
1961	4.65	4.26	4.06	3.73

* Source: First National City Bank of New York

In addition to a reduction in holdings of highly-liquid assets, pension funds have tended to reduce the proportionate amount of cash held. Cash and deposits amounted to only 1.5 percent of total assets of noninsured corporate pension funds at the end of 1961, which was a reduction from the 4.2 percent figure in 1951.

Comparing Investment Patterns

A look at the composition of the assets of various financial institutions reveals quite clearly that there are distinct individual investment patterns. It should be noted that, of all the institutions, noninsured corporate pension funds have experienced the sharpest redistribution of assets in the past decade.

Deposit-Type Savings Institutions. Deposit-type savings institutions are subject to legal restrictions which regulate their investment policies. The result is that they invest primarily in mortgages, government securities and high-grade, corporate bonds.

Life Insurance Companies. Life insurance companies, the largest of the three institutions which invest heavily in corporate securities, held nearly 39 percent of their total assets in corporate bonds at the end of 1961. This represented a larger holding in absolute terms — $49 billion — than that of pension funds — $15 billion — but nevertheless represented a smaller percentage of the total assets of life insurance companies than of pension funds.

The second largest category of investments held by life insurance companies is mort-

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gages, representing 35 percent of the total at the end of 1961. In contrast, pension funds held only three percent of their total assets in real estate mortgages. On the other hand, noninsured corporate pension fund holdings of common stock were larger, both in dollar volume and in proportion to total assets, than those of life insurance companies. Pension funds held $12 billion in common stock at the end of 1961, while life insurance companies held only $6 billion in common and preferred stock. Corporate stock made up only five percent of the total assets of life insurance companies at year-end 1961. Although both common stock and mortgages provide relatively high rates of return, life insurance companies have channeled more of their resources into mortgages than have pension funds because of the legal restrictions placed on life insurance companies. Life insurance companies are limited in regard to the proportion of total asset portfolios which can be held in common stock.

As in the case of pension funds, holdings of U. S. government securities have declined in relative importance in the portfolios of life insurance companies. This shift in emphasis away from Treasury securities has also been prompted by the relatively lower yield on such securities.

Investment Companies. Investment companies have pursued still another investment pattern. At the end of 1961, they held $21 billion in common stock, which represented 85 percent of their total assets. As holders of common stock, investment companies outranked both life insurance companies and noninsured corporate pension funds; not only was the dollar amount larger, but common stock holdings represented a larger share of the total assets of investment companies than of the other institutions. At the end of 1961, investment companies held 10.3 percent of their assets in corporate bonds and preferred stock and 4.3 percent in liquid assets.

Impact on Corporate Securities Markets

Noninsured corporate pension funds are of growing importance in the supplying of capital for private investment. Pension funds are among the largest institutional investors in corporate securities. In addition, noninsured corporate pension funds rank second only to life insurance companies as holders of corporate bonds. Moreover, among institutional holders of common stocks, pension funds rank second only to investment companies. Finally, as purchasers of common stocks, pension funds have been the largest institutional buyer since 1951.

Noninsured corporate pension funds are likely to remain important in capital markets because of their growth and because of the stability of their investment patterns. Although investment companies have been growing at a faster rate than pension funds, the former's inflow of funds is more dependent on economic and market conditions. On the other hand, pension funds, because of the nature of their source of funds, have a relatively steady inflow and large magnitude of funds which can be invested. Consequently, they are able to maintain a relatively stable investment pattern, regardless of market conditions, and thus have tended in this respect to be a stabilizing factor in capital markets.

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Employment Changes In The Fourth District, 1960-62

AVAILABLE DATA on major labor market areas indicate that differences in the magnitude of change in nonfarm employment in nine major metropolitan areas of the Fourth Federal Reserve District during the recent recession-recovery period have been directly related to differences in the economic profile of the individual metropolitan areas. Differences in the amounts of decline in nonfarm employment in these areas during the 1960-61 recession (dated as beginning in May 1960 and ending in February 1961) reflected the respective amounts of employment accounted for by manufacturing industries (including especially durable goods manufacturing and the primary metals industry) within the employment structure of the particular areas.(1)

During the expansion that has occurred since the trough of business activity in February 1961, the recovery in total nonfarm employment in these same metropolitan areas has tended to be strongest in those areas which have relatively large percentages of nonmanufacturing employment.(2) In contrast, in only one of the nine areas was manufacturing employment higher in September 1962 than it had been in May 1960.

Each of the nine major labor market areas discussed in this article is a standard metropolitan statistical area (as defined by the Bureau of the Census) and has an estimated civilian labor force in excess of 100,000 persons. Nonagricultural payroll employment includes between 80 and 85 percent of the labor force in each area, and ranges from 100,000 in Canton to 750,000 in Pittsburgh.

Differences in the distribution of employment by major industry for these nine areas and the U. S. are shown in the chart on the following page. Each of the areas except Columbus has a heavier concentration of manufacturing employment than the U.S. as a whole. Within the manufacturing sector there is a heavier concentration of employment in durable goods manufacturing in all areas, except Akron, than is true for the U. S. (Even in Akron, however, the behavior of employment in the dominant rubber industry — which is classified as nondurable goods — follows by the activity of the automobile industry — classified as durable goods — and thus behaves in a fashion similar to durable goods employment.)

The heavy concentration of primary metals employment within durable goods manufacturing is also particularly noticeable in the employment structure of the Youngstown-Warren, Canton, and Pittsburgh areas. More than one-fourth of all nonfarm employment in Youngstown-Warren, and one-sixth of all

(1) As used throughout this article, employment refers to payroll employment for which monthly estimates are published by the state employment services of Ohio and Pennsylvania in cooperation with the U.S. Bureau of Labor Statistics.

(2) Because of the lack of area data prior to 1958, all percent changes are based on data which are not adjusted for seasonal variation. For this reason, the percent changes referred to in this article reflect both cyclical and seasonal changes. However, with the few exceptions noted herein, seasonal changes are small compared with cyclical changes. For example, the difference between the implied seasonal factors for May, 1960 and September, 1962 was 0.1 percent in durable goods manufacturing employment and 1.2% in nonmanufacturing employment on a district-wide basis.

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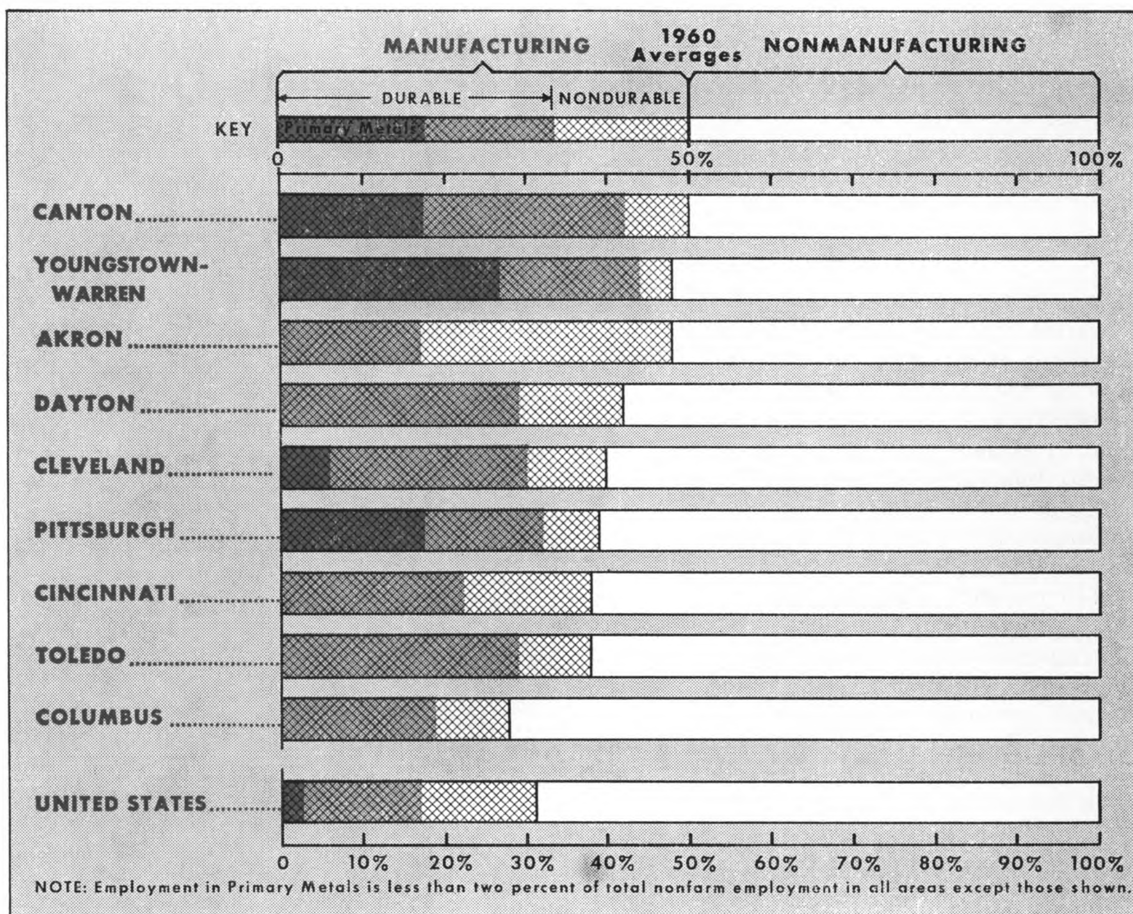
PERCENTAGE DISTRIBUTION OF NONFARM WAGE AND SALARY EMPLOYMENT

Selected Major Areas in the Fourth District



nonfarm employment in both Canton and Pittsburgh, is accounted for by primary metals employment, of which about seventy percent in Canton and about eighty percent in Youngstown - Warren is in the steel industry.

Employment Declines During 1960-1961

During the recent recession, reductions in total nonfarm employment were largest in those areas with high percentages of manufacturing employment. In this connection, the table on the opposite page illustrates the wide difference between the Youngstown-Warren area and the Columbus area.

In the nine areas studied, declines in employment in the durable goods industries ranged from six to eighteen percent, with reductions in Canton and in Youngstown-Warren at the top of the range. Within the durable goods sector, employment in primary metals industries declined by more than twenty percent between May 1960 and February 1961, a decline which was more severe

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COMPARISON OF EMPLOYMENT LOSS AND STRUCTURE OF EMPLOYMENT IN YOUNGSTOWN-WARREN AND COLUMBUS, MAY 1960-FEBRUARY 1961

Employment Category	Distribution of Employment		Percent Decline in Employment 1960-61	
	Youngstown-Warren	Columbus	Youngstown-Warren	Columbus
Manufacturing	48%	28%	17%	7%
Durable Goods	44	19	17	8
Primary Metals	27	—	21	—
Nondurable Goods	4	9	6	5
Nonmanufacturing	52	72	6	3
Nonfarm Employment	100%	100%	11%	4%

than in any other group of durable goods industries. The chart on page 8 emphasizes the very large share of primary metals employment in the Youngstown-Warren, Pittsburgh, and Canton areas as compared with other areas in the District, as well as with the average in the United States. The chart on page 11 shows that these are the same areas that suffered the most severe declines in total nonfarm employment between May 1960 and February 1961.

A "spill-over" effect into the nonmanufacturing sector is also noticeable in those areas in which there is a heavy concentration of durable goods and primary metals manufacturing employment. Larger declines in nonmanufacturing employment from May 1960 to February 1961 are apparent, for example, in the Canton and Youngstown-Warren areas than in either Columbus or Dayton, where there is a high concentration of government employment. Although it is not shown on the chart, the three areas of primary metals concentration experienced a more noticeable employment decline in the trade groups than did the other areas.

Employment Increases After February 1961

The recovery in total nonfarm employment as well as manufacturing employment and nonmanufacturing employment since February 1961 is also shown in the chart on page 11. The table on page 10 shows the percentage changes from May 1960 to February 1961, and the percentage changes from May 1960 to September 1962.

It can be seen from the table on page 10 that only the two areas with the smallest declines — Columbus and Dayton — had fully recovered by September their recession losses in total nonagricultural wage and salary employment. And only in Columbus was manufacturing employment higher in September 1962 than it had been in May 1960. This means that recovery up to or beyond the prerecession peak in total nonfarm employment had to be accomplished by a greater increase in employment in the nonmanufacturing sector. As the table shows, by September 1962 nonmanufacturing employment in all areas except Toledo and Canton had surpassed the level of May 1960. But only in Dayton was

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PERCENTAGE CHANGE AFTER MAY 1960 IN NONFARM WAGE AND SALARY EMPLOYMENT

Percent Change May '60-Feb. '61				Percent Change May '60-Sept. '62		
Total Nonfarm	Mfg.	Nonmfg.	Area	Total Nonfarm	Mfg.[3]	Nonmfg.
— 4.4	— 7.2	— 3.2	Columbus	+ 6.1	+ 1.1	+ 8.1
— 4.7	— 6.1	— 3.7	Dayton	+ 2.3	— .1	+ 4.0
— 5.7	— 6.7	— 5.0	Cincinnati	— 1.5	— 6.2	+ 1.4
— 7.7	—11.7	— 5.0	Cleveland	— 2.1	— 8.1	+ 2.0
— 8.1	—10.5	— 5.9	Akron	— .8	— 3.2	+ 1.4
— 8.7	—12.6	— 6.3	Pittsburgh	— 4.6	—12.6	+ .3
— 8.8	—10.0	— 8.0	Toledo	— 2.6	— 6.6	— .2
—11.3	—16.6	— 6.4	Youngstown-Warren	— 8.6	—19.6	+ 1.8
—11.5	—15.6	— 7.4	Canton	— 5.4	—10.5	— .4

[3] The depressed state of the steel industry in September 1962 is directly reflected in the slow recovery apparent in Pittsburgh, Youngstown-Warren, and Canton. The figure for Youngstown-Warren also shows the effect of labor-management disputes.

the increase in nonmanufacturing employment sufficient to compensate for a loss in manufacturing employment and to raise the level of total employment above that of May 1960.

As previously stated, Columbus was the only one of the nine areas which, by September 1962, had surpassed the manufacturing employment level of May 1960. In fact, all other areas registered declines in manufacturing employment between May 1960 and September 1962, ranging from 0.1 percent to 12.6 percent.[4] It is interesting that only in Columbus did manufacturing employment register a net gain, rather than in one of the areas where the recession reduction had been largest. The result is that from one-half to nearly all of the original loss in manufacturing employment in most of the individual areas still existed or had recurred by September 1962.[5]

The areas with the largest portion of losses still unrecouped are those that had the largest losses originally. It would thus seem that a strong recovery in employment does not appear to have gone hand in hand with a sharp decline originally.

Recovery was less complete in durable goods than it was in nondurable goods manufacturing. The record was actually negative in those areas with a high proportion of employment in primary metals, as the behavior of this industry during the recovery period was reflected in employment levels in the areas where such employment bulks large.

Several factors generally have contributed to the growth in nonmanufacturing employment. One factor has been the expansion in state and local government employment which continued to move up uninterruptedly during the recession in all areas under review. Another factor has been the substantial recovery in employment from recession lows, in most areas, in the service and finance-insurance-real estate groups. However, trade employment in September in six of the nine areas was still below the 1960 peak. This sluggish behavior has been contrary to expectations based on national experience in previous recovery periods. The transportation-public utilities group has had an unfavorable employment showing during the recovery with the record in all areas reveal-

(4) This excludes Youngstown-Warren where manufacturing employment in September 1962 was below the level of February 1961 as a result of labor-management disputes.

(5) Youngstown excluded (see footnote 4). Seasonal changes in automotive industry employment and the arrival at a specific peak in employment in the steel industry earlier in the year may explain part of the secondary shortfall.

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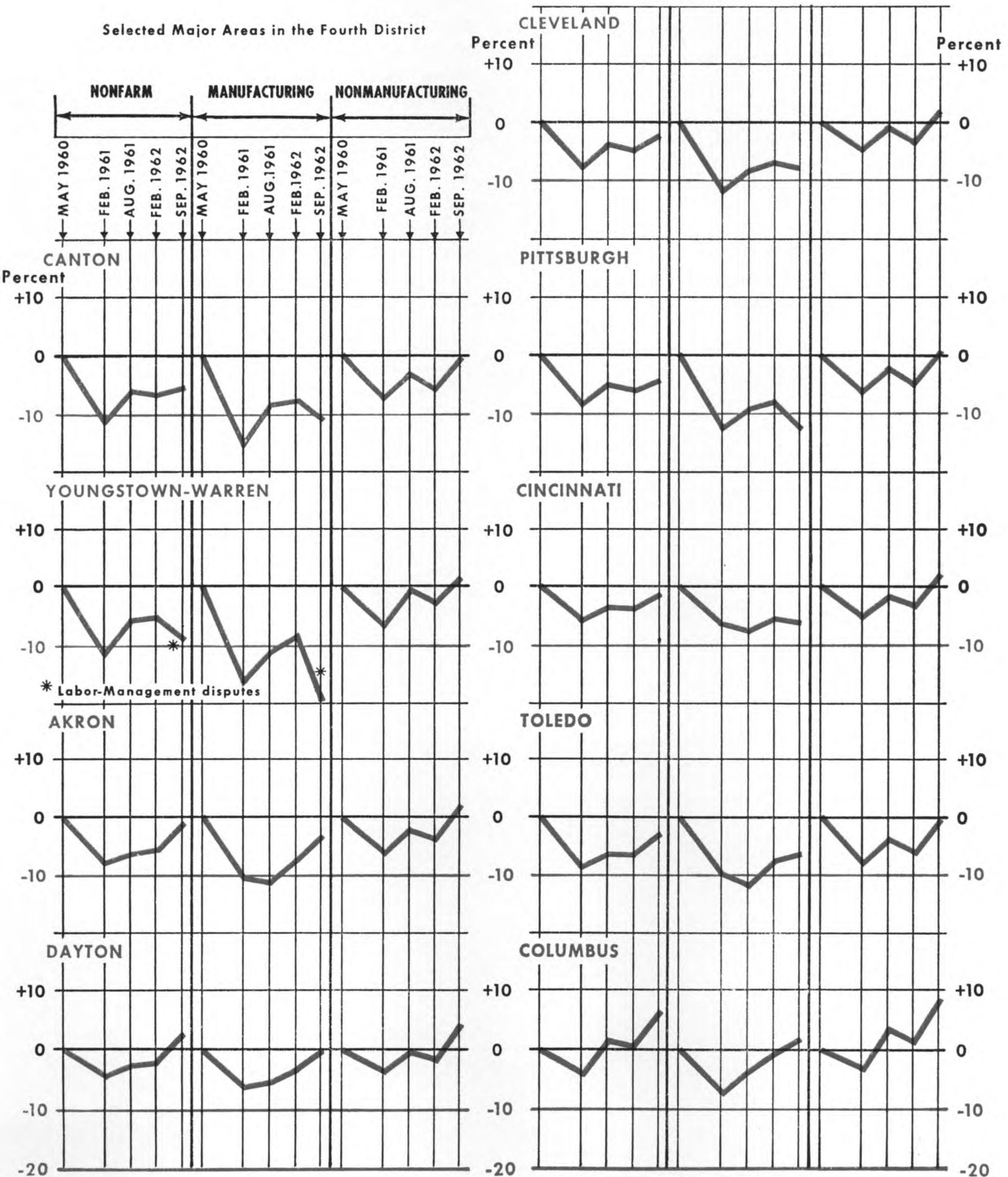
PERCENTAGE CHANGES IN NONFARM WAGE AND SALARY EMPLOYMENT DURING RECESSION AND RECOVERY



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ing either a decline after February 1961, or the recouping of only small amounts of earlier reductions.

On balance, however, the poor showing of the trade and transportation groups was more than offset by the upward push of the government, service, and finance groups, resulting in the previously noted slight advance in employment in the nonmanufacturing sector to above its previous peak level.

Effects of Recovery

The failure of manufacturing employment in the areas under review to return to prerecession levels in the same degree as nonmanufacturing employment probably indicates that the tendency toward reduced employment in manufacturing industries is unchanged. A shift in the labor force of these areas toward a larger proportion in nonmanuufacturing employment, however, might be desirable if it resulted from vigorous growth in that sector. A shift reflecting mainly the numerical decline of one sector without expansion of the other does not reveal much in the way of over-all growth, nor does it provide additional employment to the extent necessary to absorb workers displaced in a declining sector.

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