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A System Going Under?

Projected Pension Shortfalls Turn Focus to Reform

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During his 35-plus working years at Bethlehem Steel in Baltimore, Melvin Schmeizer endured blazing heat and freezing cold, layoffs and odd shifts. But by volunteering for tough jobs and overtime, he boosted his income and, ultimately, his pension, to \$2,850 a month when he retired in 2001.

But Schmeizer's retirement plans were knocked out cold last year, when Bethlehem went into bankruptcy and the Pension Benefit Guaranty Corp. (PBGC), the government pension insurance arm, took over the company's pension plans. And while that means Schmeizer's pension will not vanish, it will be cut to \$1,700 a month.

Schmeizer, 56, observed wryly to a Senate committee last week that company and union officials had assured Bethlehem workers that "the sky would have to fall" for them not to get their full pensions.

"Well, the sky did fall," he said.

In fact, the sky is falling for a good number of American workers. Or the ship is sinking. Or any number of other metaphors for looming disaster, all of them applicable to the state of America's private pension system.

The country's entire retirement income structure is being battered by an unprecedented wave of demographic and economic changes. Just as Social Security's pay-as-you-go arrangement is being pressured by the rising number of retirees and the shrinking number of active workers, so established companies that sponsor traditional pensions are increasingly paying huge retiree costs when newer competitors have none.

In addition, the stock market plunge that began in 2000 has combined with falling interest rates to reduce asset values and boost liabilities for traditional pension plans. In many cases, this has triggered painful new funding requirements for employers. General Motors, for example, said last week that it has poured \$13.5 billion into its pension funds recently and may kick in as much as \$6 billion more in the coming months.

At the same time, many workers today have changed jobs repeatedly during their careers, so that those who do have traditional pensions -- and only a shrinking minority do -- will get less benefit from them than those who have worked decades at the same employer.

Partly in response to these pressures, and partly because they are cheaper and more predictable than traditional pensions, companies are increasingly shifting to 401(k) and similar plans in which workers and/or employers contribute to an investment account. Theoretically, such plans work better for mobile employees, but they assume that the workers will make good investment decisions and contribute faithfully over many years. How many workers will manage to harvest adequate retirement assets from such plans remains to be seen, but many experts worry, especially about lower-paid workers.

"As baby boomers near retirement, the pension system is wobbling," Peter R. Orszag of the Brookings Institution concluded at a pension conference there this year.

The private system today is complicated and costly in terms of tax revenue, Orszag added in a recent conversation, and it covers only about half the workforce at any one time. The increasingly popular 401(k) and other such plans offer generous tax benefits for saving, but those breaks go disproportionately to high-income households that would save anyway, he said.

At the same time, Orszag said, the system allocates too much risk to workers individually instead of spreading it across a company's workforce, or the workforce in general.

Congress, employers and workers, union and nonunion, have been trying for years to come up with a set of policies that would provide adequate and secure retirement for more people. But retiree security has often taken a back seat to revenue considerations, leaving what the Treasury Department's benefits tax counsel, William F. Sweetnam Jr., last week called "a crazy quilt" of rules that don't serve anyone well.

The collapse of Enron Corp. two years ago focused new attention on the risks of 401(k)s, and the recent fears expressed by employers and the PBGC about the funding of traditional plans, often called "defined benefit" plans, put them on the front burner.

So far, it is only those at each extreme of the debate who think there are easy answers. Some in Congress and the administration seem to feel that everyone ought to save for his own retirement, while others want to lock employers into certain types of traditional pensions.

But if the pension ship is sinking, bills currently being considered in Congress, critics say, amount to little more than rearranging the deck chairs on the Titanic. Most seek only to patch up problems in the present system. The Bush administration has called for fundamental reform of defined-benefit pensions but hasn't specified exactly what that would look like. The House recently approved a measure calling for reform to be studied and enacted within the next two years. But critics argue that the government's track record on fundamental reforms of any sort, when it is not driven by crisis, is uneven at best.

Recent tax law changes have boosted the amounts that workers can set aside in 401(k) and similar plans, but little else has been done.

"We are marching further and further in the wrong direction" of allowing those who can best afford to

save to reap additional tax benefits, Orszag said.

It is clear, though, that at least short-term patches must be made.

Traditional pensions -- operated by employers, backstopped by the government and promising a lifetime stream of income -- have been in sharp decline. Since 1986, some 97,000 such plans covering 7 million participants have been terminated. Today, only about 32,500 of these pension plans remain. But because the surviving plans are very large, they continue to cover about 44 million workers.

Many of the surviving plans are underfunded, meaning that their assets would not be sufficient to pay promised benefits if they were terminated today. This situation has alarmed the government's pension insurance agency, the PBGC, whose own balance sheet has plunged deeply into the red in the past three years.

Like GM, many of these companies will soon be required to pour large amounts of cash into their pension plans. In part, this is because an old rule tying liability calculations to the interest rate on the 30-year Treasury bond has magnified the cost of these pensions. Combined with the stock market slump, this rule has pushed many plans that were fully funded a few years ago, when the market was riding high, deeply into the red.

Employers warn that if they do not get relief, many will freeze their plans, a step that would bar workers from earning higher pensions as they work more years and would keep new hires from joining the plan. By some estimates, up to 25 percent of existing plans are already frozen.

Companies in a position to do so may choose to terminate their plans altogether.

The companies warn that they will have little choice. Some, like the U.S. automakers, are competing with foreign "transplants" that have only a handful of retirees. These transplants can undercut domestic manufacturers on price because they don't have the "legacy" costs of thousands of retirees.

Others, such as International Business Machines, compete with new companies, such as Microsoft, that never had traditional pensions. New firms typically offer workers stock-purchase, profit-sharing, 401(k) plans and other less-expensive retirement arrangements, generally lumped together as "defined contribution" plans.

Unions and employers with big pension plans have allied in an effort to win breaks from funding requirements for companies in order, the unions hope, to preserve defined-benefit pensions. Some 69 percent of union workers in the private sector have traditional plans, vs. 14 percent of nonunion workers.

"Defined-benefit plans are very important to us," said Sean O'Brien of the AFL-CIO. Labor's goals are, first, to reform the rule requiring the use of the 30-year Treasury rate, he said, followed in the long term by "a set of common-sense funding rules that recognize that pension plans are long-term benefit

promises."

On the 401(k) retirement account side, the Enron debacle exposed an array of problems. Workers at the failed energy giant were heavily concentrated in their employer's stock and saw their retirement accounts melt away when Enron went into bankruptcy.

There was an outcry after Enron's collapse, but so far few of the recommended reforms have become law.

Members of Congress disagree on whether to limit the amount of employer stock that a 401(k) participant can hold in his or her account. The House has passed a bill that would let workers diversify out of employer stock, but voluntarily. Critics say that would do little to reduce the overconcentration. And in the middle of all this, there is a heated dispute over a kind of hybrid pension -- called a cash-balance plan -- that has aspects of both a defined-benefit and a defined-contribution plan.

Under these plans, workers accrue benefits more evenly over their working lives than under traditional plans, in which benefits spike in the final years of a long career. The accrued benefits can be converted to cash when a worker leaves his company or retires.

The plans are technically defined-benefit, so they carry the PBGC guarantee, but they typically offer better benefits for short-term workers.

As for longtime workers like Bethlehem Steel's Melvin Schmeizer, learning firsthand how fragile a company's pension plan is was hard. What would he have done had he known his pension was so underfunded?

"I'd still be working," he told the assembled senators last week. "I wouldn't have retired."