U.S. Pension Funds Are Looted and Melting Down

by John Hoefle

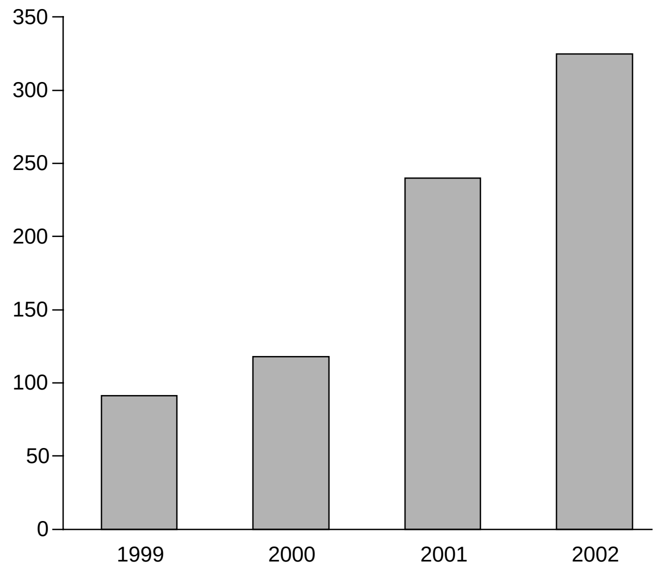
With the soaring rise of the U.S. stock markets in the 1990s, came a boom in the values of pension funds. The sharp appreciation of the values of the stocks in America's pension portfolios made any corporate pension funds appear, then, to be temporarily overfunded. Observing this apparent surplus, many corporations began looking for ways to grab some of that cash.

One popular method was to terminate "overfunded" plans, and replace them with cheaper plans such as insurance annuities. "Defined benefit" plans, in which the employer promises to pay the employee a set retirement income, were increasingly replaced by "defined contribution" plans, in which the employer makes a fixed contribution to an investment plan. The difference is crucial: in the defined benefit plans, the company must make up the difference if the pension plan suffers investment losses; while in the defined contribution plans, the employees take the losses in the form of reduced pension income.

The flip side is also true, namely that if stocks were to keep rising, the employees would benefit more under defined-contribution plans. That was a major selling point in inducing employees to accept these new plans last decade. After all, stocks only go up, right?

FIGURE 1

Number of Companies in the S&P 500 With Underfunded Pensions



Source: Credit Suisse First Boston.

Pensions Diverted to Corporate Earnings

In 1990, faced with the wholesale looting of corporate pension funds by the takeover bandits operating through Drexel Burnham Lambert's junk-bond machine, the U.S. Congress imposed a 50% excise tax on corporate withdrawals from pension funds. While this was good for the employees, it annoyed the speculators; and in 1995, Texas Republican Bill Archer, then chairman of the House Ways and Means Committee, proposed a repeal of that tax. Archer claimed that allowing companies to pull "surplus" cash out of their pension funds would not only boost corporate incomes, but also Federal tax receipts.

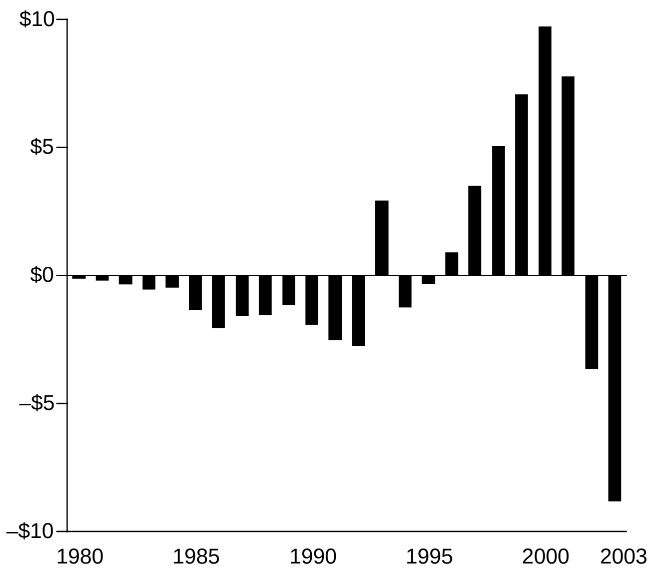
The Pension Benefit Guarantee Corporation (PBGC), the Federal agency which guarantees corporate pensions, was aghast at Archer's proposal. PBGC estimated that some $20 billion had been drained out of corporate pension funds during the 1980s by corporate raiders, with many pension funds cashed out and replaced by portfolios of soon-to-be-worthless junk bonds. PBGC executive director Martin Slate denounced the measure as "open season on pensions," pointing out that for the measure to generate the $9 billion in new Federal tax revenues promised by Archer, some $30-40 billion would have to be removed by employers from employees' pension funds.

Secretary of Labor Robert Reich was equally blunt, saying that if the Archer proposal became law, "We are going to see raids on pension assets that will make the train robberies during the days of Jesse James pale in comparison. . . . Companies are being given license to reach into retirement funds. This is a pension grab, and we will not stand for it." At the time, the Labor Department was investigating more than 300 companies for diverting funds from their pension plans to pay other bills.

Fast-forward to today, with the stock markets well below their 2000 peak. After a series of tax and pension "reforms" designed to help Wall Street at the expense of ordinary Americans, America's pension system is in shambles. The surpluses have disappeared, leaving pensioners in the lurch, and the PBGC facing hefty costs to cover the payments on failed pension plans.

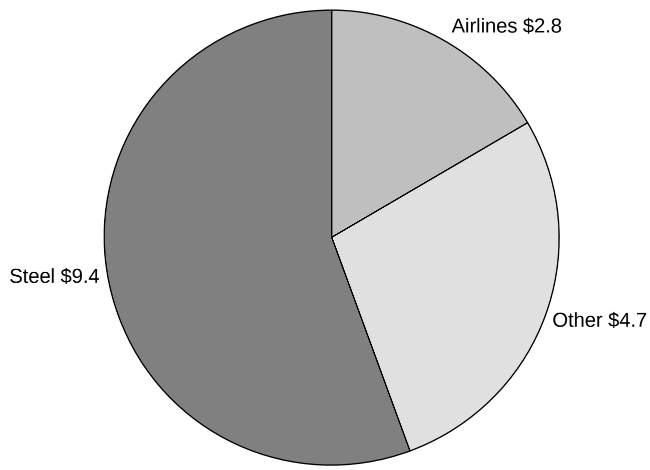
As of 2002, according to a study by Credit Suisse First Boston, 325, or 65% of the companies in the S&P 500 had underfunded pensions, up from only 81 such companies in 1999 (see **Figure 1**); only 33 of the 500 companies had "overfunded" pensions, compared to 261 in 1999. CSFB estimated that the companies in the S&P 500 had $904 billion in their pension plans, while facing $1,147 billion in projected pen-

FIGURE 2
Pension Insurance Shortfalls of PBGC-Insured Single-Employer Plans
($ Billions)



Source: PBGC.

FIGURE 3
Steel and Airlines Lead Pension Blowout PBGC Claims, FY 1975-2003
($ Billions)



Source: PBGC.

sion payouts—a shortfall of $243 billion in employee pensions among America's top 500 companies.

The Federal PBGC itself paints an even more dismal picture. "As of Dec. 31, 2000, total underfunding in the single-employer defined-benefits system was less than $50 billion," PGBC Executive Director Steven Kandarian told a U.S. Senate hearing Oct. 14, 2003. "Because of declining interest rates and equity values, as of Dec. 31, 2002—two years later—the total underfunding in single-employer plans exceeded $400 billion, the largest number ever recorded. Even with recent rises in the stock market and interest rates, PBGC projects that underfunding still exceeds $350 billion today.

"PBGC's financial position has deteriorated sharply in the last two years," due to record pension underfunding, and the failure of a number of pension plans, Kandarian testified. During Fiscal Year 2002, the PBGC's single-employer insurance program "went from a surplus of $7.7 billion to a deficit of $3.6 billion—a loss of $11.3 billion in just one year. The $11.3 billion loss is more than five times larger than any previous one-year loss in the agency's 29-year history." Kandarian also stated that the latest figures show that the deficit had grown to $8.8 billion as of Aug. 31, 2003, a whopping $18.5 billion decline from the program's peak surplus of $9.7 billion in 2002 (**Figure 2**).

Kandarian noted that, as of Fiscal 2002, plans sponsored by "financially weak" companies had $35 billion in unfunded vested benefits, and that the agency expects "underfunding in financial troubled companies to exceed $80 billion at the end of FY 2003. If companies do not fund the pension promises they make," he concluded, "someone else will have to pay—either workers in the form of reduced benefits, other companies in the form of higher PBGC premiums, or taxpayers in the form of a PBGC bailout."

Deregulation and Decay

The perilous state of the U.S. pension system is a reflection of the "controlled disintegration" of the economy over the past three decades, with its shift out of industrial production into information, services, and consumerism, and the concurrent dismantling of the regulatory apparatus built since the 1930s, which had protected the nation from speculative looting.

The pension benefits of workers in the American steel industry have been most devastated as virtually the entire steel sector has sunk into bankruptcies and sell-offs of companies to corporate raiders. Some 40 American steel firms are in Chapter 11 bankruptcy or in outright liquidation. Of the $17 billion in claims paid out by the PBGC during the Fiscal Years 1975-2002, $9.4 billion—56% of the total—came from steel companies (**Figure 3**). That includes $3.9 billion for Bethlehem Steel, $1.9 billion for LTV Steel and $1.3 billion for National Steel, with lesser amounts for Acme, Empire, Geneva and RTI. In addition, the PBGC announced on Oct. 21 that it would assume responsibility for the pensions of 9,200 workers and retirees of the bankrupt Weirton Steel Co.

Weirton's retirement fund is only 39% funded, with assets of $530 million to cover nearly $1.35 billion in liabilities.

The assumption of the pension plans of these bankrupts, by PBGC, involves cutting down the pension benefits of their workers, including those already retired and living on those pensions. In many cases, such as the recent buyouts of LTV and Bethlehem Steel by financier Wilbur Ross, or that of National Steel by U.S. Steel, the health-care benefits of retirees are completely wiped out.

The latest of the 40 steelmakers to declare bankruptcy is Rouge Steel in Michigan, one so established and critical to the auto industry—and during World War II, to military aircraft production—that its location is officially a national historical site.

The airlines account for the next biggest chunk of PBGC claims: $4.7 billion, or 28% of the total. This includes the pension plans of TWA and the U.S. Airways pilot's plan, with more to come. The PBGC estimates the underfunding in the airline sector at $26 billion as of the end of 2002, and that shortfall is likely to increase.

The PBGC also paid claims for a number of failed retailers, including Bradlees, Caldor, Grand Union, and Payless Cashways.

Overall, pension claims against the PBGC in 2002 alone were greater than in all previous years combined (it was founded in 1974); and PBGC's own estimates is that it would take about 12 years of insurance premiums at the current rate just to cover the claims from 2002.

Making up pension shortfalls in a failing economy is a difficult task, and while some companies may be able to do it, many will fall further behind. Overall, the situation can only get worse.

General Motors, whose $78 billion pension plan is the nation's largest, contributed $4.8 billion to its pension fund in 2002, and expects to contribute $3-$4 billion annually in 2003 and 2004, and $2-$2.5 billion for the next three years after that.

States, Too

State pension funds also face huge shortfalls. According to a Wilshire Associates study released earlier this year, the 123 public pension funds which operate statewide, covering both state and local workers, had a shortfall of $180 billion in their plans. Wilshire said that these plans lost 6% of their assets in 2002 due to stock-market declines, while their liabilities grew by 10%.

The United States has some 2,200 state, city, and county pension plans, which cover about 17 million employees and 6 million retirees; and *as a whole, those plans are operating at a loss.* In 2001, the plans took in $65 billion in contributions while paying out $101 billion in benefits. The worst-funded public pension plan in the country, according to *USA Today*, is the West Virginia teacher's retirement system, which as of August had only 19% of the funds needed to pay current and future benefits. The State is planning on trying to borrow $4 billion to plug the hole.

Other states will follow suit. A *USA Today* survey of the 12 state retirement plans each having assets of $40 billion or more, shows that they had to pay—in the face of large and growing overall-budget shortfalls in each of these states—a combined $7 billion in state contributions in 2002, and will add $8 billion in 2003 and $9.6 billion in 2004. The largest such fund, the California Public Employees Retirement System (CalPERS), has $147 billion in assets and covers 1.4 million employees, retirees, and their families.

During the 1990s, CalPERS made a great deal of money on its investment portfolio, pulling in $12.5 billion in Fiscal 1994, $13 billion in FY 1995, $20.5 billion in FY 1996, and a record $23.5 billion in Fiscal Year 1997.

But its income declined to $17.6 billion in FY 1998 and $16.6 billion in 1999, and then the bottom fell out. CalPERS lost $12.2 billion in Fiscal 2000 and another $9.7 billion in FY 2001, before the stock market resurgence of Fiscal 2002 returned it to briefly to "the black" with a profit of $6 billion.

Systemic Weakness

Looking at the numbers, it seems simple enough: when the stock market goes up, so do the values of the pension funds, and when the markets decline, the pensions decline with them. When the Dow-Jones Industrial Average was down below 7,300 back in October 2002, things looked pretty grim; but with the Dow back up in the 9,700s, the worst for American workers' pensions should be over, should it not?

The answer to that question is an unfortunate but emphatic "No!"

The case of Enron is exemplary. According to many Enron employees, one day their pensions were worth millions, and the next day they were worthless. On paper, that might have been true; but in reality it was not, since the pension funds filled with Enron stock were never actually worth what they were reported to be. Their value was ephemeral, and when the illusion that Enron was a solid company vaporized, so did the value of its stock, and the value of its pensions. It was all a fantasy.

That is essentially the situation with the U.S economy and the pension funds of American workers today, as the employees of the bankrupt steelmaking corporations have been learning with the greatest pain. Pensions, like all debt, are claims upon the future performance of the economy; claims upon future economic growth. Today, our economy is collapsing, with production dying, debt soaring and the country dependent upon foreign production and capital.

The figures in this article are grim enough, but the truth is much grimmer. Without an industrial recovery centered around public infrastructure investment and jobs—the policy called "Super TVA" by Presidential candidate Lyndon LaRouche—the whole economy is going the way of Enron, and many millions of hard-earned pension are gone.