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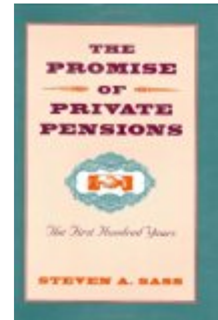
Steven A Sass. *The Promise of Private Pensions: The First Hundred Years.* Cambridge: Harvard University Press, 1997. ix + 332 pp. $39.95, cloth, ISBN 978-0-674-94520-3.



Reviewed by Samuel H. Williamson

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The rise and fall of private pensions in the United States is very much a twentieth-century story. Thus, publication of this book by Steve Sass is well timed. It tells the story of how the institution takes off with the creation of the Pennsylvania Railroad Pension in 1900, peaks in the post-war period, and slides into decline in the last two decades. In chapter one, Sass explains that during the first half of the nineteenth century most men worked in handicrafts or farming, and support in old age was provided by their offspring who had taken over the family business or farm. The last third of that century saw manufacturing employment increase at twice the rate of population growth, and these new workers needed to find a different way to provide for their old age. This was also a period when banks, insurance companies and the stock and bond markets were developing many new financial capital instruments for retirement saving. While there is some debate on the adequacy of these new methods of "life-cycle" saving practices, it is clear that for many older workers "retirement was not an option they could afford."

This was also a period of widespread labor unrest, with violent strikes and the rise of labor unions. As the nineteenth century ended, employers faced an aging work force with potentially diminished capacity. In response, some of the more enlightened employers started providing a variety of benefits for their workers--a response that has been called "welfare capitalism." The railroads were the nation's first large business and the first to develop a hierarchical labor structure. Sass lays out how the industry started the first pensions, basing them on three different rationales: career, welfare and efficiency. In 1874, the Grand Trunk, a Canadian line, created a pension only for their management. The plan required employees to join by age 37 and remain at work until at least age 55. The pension deferred part of their wages until retirement, thus "buying" loyalty in what labor economists call a "wage-tilt" contract. Ten years later, the Baltimore and Ohio added pensions to a relief program that already included death, accident and sickness benefits. Such relief plans required membership contributions, but worker membership was voluntary. In 1900 the Pennsylvania Railroad, the largest private em-

ployer in the country, established the first modern pension. After much study and deliberation, it created a plan that was equal to one percent of the average wage in the last ten years of employment times the number of years worked. The plan, including a mandatory retirement age of seventy and covering all workers, was justified as a "payroll" saving since older workers could be replaced with less expensive and more productive younger workers. In order for the company to have complete control, the plan was non-non-contributory ^H^H^H^Ho and the pension board did not include labor representation. (Sass is in error when he states that "Because of the thirty-year service requirement, the original cohort of retirees in 1900 had all been hired prior to 1870 (p. 58)." The 35-year service requirement was needed only to qualify for disability at age 65 to 69; all workers who reached age 70 were pensioned regardless of length of service. The new maximum age of hiring at 35 was designed to make a minimum tenure of 25 years the rule, but this rule applied only to new hires.)

The Pennsylvania plan established a model that was soon followed by other railroads and large corporations in other industries during the next twenty years. At first pension plans were justified as a tool to increase workers' loyalty, and to reduce strikes and turnover. As employers found that pensions were not very successful meeting these objectives, they became more interested in the value of mandatory retirement. This was the period of scientific management, when it was thought that older workers (over 45) could not keep up.

In chapter 4, Sass explains that private pension providers at first had little understanding of the actuarial realities of the pension plans they were creating. During the first two decades of this century, most large corporations financed their pensions from operating funds and had no reserves. After the well-publicized failure of the Morris Packing Company pension in 1923, suggestions for reform came from government, consultants and insurance companies, specifically, that pension cost should be accrued, funds should be held with an independent fiduciary, and workers should be vested. Reforms were resisted on all three counts. From the beginning, most plans were non-contributory so that employers could terminate them at any time. Actuarial costs were difficult to estimate with most plans because benefits were based on final salaries. Building trust funds was expensive and these might be seen as employee assets. Corporations did not want to turn over funds to another institution when they felt they could better use the funds themselves. Finally, vesting was the least desirable idea, since employers wanted to give pensions to reward only long-serving employees. In general, there was a conflict between the reformers' view of pensions as deferred wages and the corporations' views of pensions as tools for controlling their work force.

In chapter 5, Sass discusses how the Depression and the New Deal affected private pensions. In the early '30s, railroad workers succeeded in pressuring Congress to nationalize all railroad pensions. At first, carriers resisted for fear they would lose the control and loyalty a pension engendered, but finally agreed to a revised plan in 1937 (after the original 1935 plan was declared unconstitutional). The Railroad Retirement Act was the first step in the process of creating Social Security. One interesting aspect of the debate on this program was the Clark Amendment, which proposed to allow "corporations with plans no less advantageous to their employees to opt out of the federal program." In the end, however, corporations were happy to have the government take over. They hoped that Social Security would be mostly a welfare program for the poor, so corporations could influence workers by augmenting the government program with their own. After the Act went into effect, most private pensions, new and old, became "integrated" with Social Security; private pension benefits were reduced by

what the retiree was receiving from Social Security. The tax increases of the New Deal also created an incentive to use pensions for tax relief. Several changes in the tax code were made to tighten control of pension plans. The most important was the 1942 Revenue Act, which imposed a variety of rules on pension plan tax exempt status. Under normal circumstances this would have discouraged the creation of new plans, but during World War II, tax rates became very high and at the same time there were wage controls. Thus by increasing the promised pension, firms could give raises in the form of deferred wages and get a tax deduction by putting more funds in the pension reserves.

Chapter 6 examines the postwar period and the importance of union bargaining after the 1948 NLRB declaration that pensions "lie within the statuary scope of collective bargaining." First the United Mine Workers and then the CIO began pushing for industry-wide standards for pensions. Their success is measured by the fact that between 1945 and 1960 almost entirely due to union initiatives, pension coverage increased from 19 to 40 percent of the work force.

In chapter 7, Sass discusses how the pension industry reorganized. Insurance companies continued their efforts to convince employers to turn the functions of their pensions over to them. Results were mixed: most companies preferred to self-insure but actuarial consulting firms competed successfully to provide other services.

In chapter 8, Sass explains how, after over a decade of political debate, a massive new set of federal regulations of private pensions--the Employment Retirement Income Security Act (ERISA)--was signed into law in 1974. Issues addressed in the debate over reform were vesting, faster funding of past services, employer liability and federal pension insurance. Jimmy Hoffa's misuse of the Teamsters' pension fund and the failure in 1964 of the UAW Studebaker pension were important impetuses. Employers continued to resist the possible loss of freedom in setting pension rules and the expected increased costs from vesting and past service funding requirements. Over the period of debate, however, voters learned of more cases in which pensions failed and workers lost, and pressured Congress to act. When Gerald Ford sought to deflect national attention from his pardoning Nixon, Congress gave him the ERISA bill to sign on Labor Day, 1974.

In the epilogue, Sass neatly summarizes what he sees as the factors contributing to the post-ERISA decline in pension coverage. His theme is that the private pension system was a creature of big labor, big government and big business. During the last quarter of the century, "all three either grew weaker or became less interested in pensions." In the 1960s and 70s, unions negotiated increases in benefits and earlier retirement with full benefits. This added expense prompted employers to reduce their pension obligations, while the ability of unions to resist this reduction eroded; by 1994, union membership as a percent of the work force had fallen by over 50 percent. Insufficient terminations greatly increased claims on the Pension Benefit Guaranty Corporation, so Congress raised the premium that sponsors had to pay and narrowed the discretion they had in selecting actuarial assumptions such as the discount rate. At the same time, net wages were reduced as Social Security contribution rates were raised out of concern for the program's viability. Finally, since the maximum federal tax rate fell from 70 to 34 percent in the 1980s, the tax deferment advantage of a pension became less important.

Sass contends that, in the corporate sector, the market for labor was changing. Human capital was becoming less firm-specific, and productivity was more important than long and loyal service. When mandatory retirement was abolished in 1986, using a pension to encourage early retirement became potentially more expensive. New pension plans were overwhelmingly defined contribution or 401(k), where there was no uncertain

future burden. As the end of the century approaches, Sass sees a return to individual households needing to assume more direct responsibility for their retirement incomes. With the rise in life expectancy and the desire for earlier retirement, he is not sure if they are prepared.

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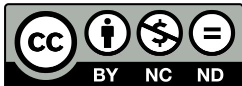

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