Retirement News Highlights

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The UAW Is Wrong About Pensions

Analysis by Allison Schrager | Bloomberg
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Shawn Fain, the president of the United Auto Workers union, wants to bring back the old-fashioned pension. That would be a mistake — both for the auto industry and its workers. There are good reasons that defined-benefit plans are increasingly rare, and trying to bring them back makes about as much sense as trying to revive the US economy of the 1960s.

It's a commonly held view that defined-benefit plans contributed to the decline of US automakers. Freezing the pensions for new hires in the 2000s was a big part of the reform that enabled them to stay competitive with foreign automakers.

Less well understood is that defined-benefit plans were never that great for workers, either. The idea — that your employer will keep paying your salary after you retire, and bear all the investment and longevity risk — sounds great. But just because these risks were on an employer's balance sheet doesn't mean employees and retirees were protected from them.

And managing these risks is extremely expensive. That helps explain why, even at their peak, not that many workers had defined-benefit pensions. Only about a third of workers were active participants in a pension in the 1970s. Participation only increased as corporations moved to cheaper defined-contribution plans.

Managing pension risk is difficult, and because the liabilities are so far into the future, there are always incentives to underfund. And when the pension funds got it wrong, retirees did not get the money they were counting on. It was a terrible outcome for all involved.

In response, the government stepped up its scrutiny. Yet this increased oversight had a perverse effect. Once federal laws forced plan providers to both properly fund defined-benefit pensions and use good accounting standards to measure their liabilities, it became clear how much pensions cost — and employers dropped them. Defined-benefit plans now exist mostly for public-sector workers, because those funds don’t face such stringent standards.

But even many of the few remaining corporate pensions still get it wrong. Today when a company goes bankrupt and has an underfunded pension, the pension goes to the Pension Benefit Guaranty Corporation, where beneficiaries get a big haircut. This is a risk retirees cannot control or manage. Even when your employer takes on a risk, it does not go away.

In addition to the risk that a pension will go bust, defined-benefit plans have another drawback: They incentivize workers to stay with a single firm, dampening the dynamism of the US economy.

Defined-benefit pensions are most valuable for workers who stay with one employer most of their career: They vest after several years of employment and become more valuable the longer an employee stays. In the 1960s, this was not a big issue. GM made cars GM’s way, and if you started work there at age 20, odds were good you’d be there when you were 50.

Nowadays work has become more mechanized, and more standardized across firms, making workers more mobile. This is an underappreciated benefit. Workers can change jobs when they get a better offer, and the industry overall becomes more competitive.

Pensions are even less appealing to younger workers (the ones who’d be included if Fain’s proposal gets in the contract). The fact that pensions become so much more valuable and expensive later in a career means younger workers get less generous retirement benefits. They are also the ones who are more likely to change jobs, and so would be better off with higher pay and a more portable plan, such as a 401(k). This is one reason that young public school teachers (who still have pensions) have such meager salaries.

Defined-benefit plans are good for unions — they help keep workers loyal to the cause and disproportionally reward older employees, who are more active members. But they should not be held up as some kind of symbol of a golden age of retirement — because that golden age never existed. In fact, if there ever was a golden age, it might be now: More people have retirement benefits, and higher income in retirement, than ever before.

I strongly suspect that Shawn Fain knows that a return to the era of defined-benefit pensions is unlikely, and is using the demand — along with his call for a 32-hour work week and a 46% raise over four years — as a bargaining chip. But even if Fain is serious about it, his members should know that the old union model is not the best fit for the modern economy.

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Allison Schrager is a Bloomberg Opinion columnist covering economics. A senior fellow at the Manhattan Institute, she is author of “An Economist Walks Into a Brothel: And Other Unexpected Places to Understand Risk.”