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The End of Pensions

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By ROGER LOWENSTEIN

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I. THE LATEST FINANCIAL DEBACLE

When I caught up with Robert S. Miller, the chief executive of Delphi Corporation, last summer, he was still pitching the fantasy that his company, a huge auto-parts maker, would be able to cut a deal with its workers and avoid filing for bankruptcy protection. But he acknowledged that Delphi faced one perhaps insuperable hurdle - not the current conditions in the auto business so much as the legacy of the pension promises that Delphi committed to many decades ago, when it was part of General Motors. This was the same fear that had obsessed Alfred P. Sloan Jr., the storied president of G.M., who warned way back in the 1940's that pensions and like benefits would be "extravagant beyond reason." But under pressure from the United Auto Workers union, he granted them. And as future auto executives would discover, pension obligations are - outside of bankruptcy, anyway - virtually impossible to unload. Unlike wages or health benefits, pension benefits cannot be cut. Unlike other contracts, which might be renegotiated as business conditions change, pension commitments are forever. And given the exigencies of the labor market, they tend to be steadily improved upon, at least when times are good.

For the U.A.W., Miller noted forlornly, "30 and Out" - 30 years to retirement - became a rallying cry. Eventually,

the union got what it wanted, and workers who started on the assembly line after high school found they could retire by their early 50's. "These pensions were created when we all used to work until age 70 and then poop out at 72," Miller told me. "Now if you live past 80, a not-uncommon demographic, you're going to be taking benefits for longer than you are working. That social contract is under severe pressure."

Earlier this month, Miller and Delphi gave in to the pressure and sought protection under the bankruptcy code - the largest such filing ever in the auto industry. It followed by a few weeks the Chapter 11 filings of Delta Air Lines and Northwest Airlines, whose pension promises to workers exceeded the assets in their pension funds by an estimated \$16 billion.

The three filings have blown the lid off America's latest, if long-simmering, financial debacle. It is not hedge funds or the real-estate bubble - it is the pension system, both public and private. And it is broken.

II. THE MORAL HAZARD OF INSURANCE

The amount of underfunding in corporate pension plans totals a staggering \$450 billion. Part of that liability is attributable to otherwise healthy corporations that will most likely, in time, make good on their obligations. But the plans of the companies that fail will become the responsibility of the government's pension insurer, the Pension Benefit Guaranty Corporation. The P.B.G.C., which collects premiums from corporations and, in theory, is supposed to be self-financing, is deeply in the hole, prompting comparisons to the savings-and-loan fiasco of the 1980's. Just as S. & L.'s of that era took foolish risks in part because their deposits were insured, the P.B.G.C.'s guarantee encouraged managements and unions to raise benefits ever higher.

In such situations, individuals are tempted to take more risk than is healthy for the group; economists, in a glum appraisal of human nature, call it "moral hazard." In effect, America's pension system has been a laboratory demonstration of moral hazard in which the insurance may end up bankrupting the system it was intended to save. Given that pension promises do not come due for years, it is hardly surprising that corporate executives and state legislators have found it easier to pay off unions with benefits tomorrow rather than with wages today. Since the benefits were insured, union leaders did not much care if the obligations proved excessive. During the previous decade especially, when it seemed that every pension promise could be fulfilled by a rising stock market, employers either recklessly overpromised or recklessly underprovided - or both - for the commitments they made.

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Roger Lowenstein, a contributing writer, has written about Social Security and health care reform for the magazine.

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