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Weak Pension Funding Standards

Backdoor Loan Guarantees

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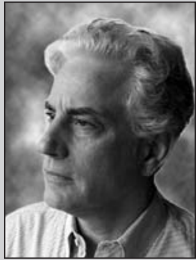

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The latest proposal from Representatives Portman and Cardin of the House Ways and Means Committee is reported by Mary Williams Walsh in the *New York Times*, April 11, 2003.

Many members of Congress who would not support loan guarantees for weak airlines and weak auto companies may be inclined to go along with weak pension funding standards. In substance, however, weak funding standards for weak companies are loan guarantees. Consider:

A promise of future cash flows (in effect, a debenture) made by a weak auto or airline might be exchanged in the capital markets (a bond issue or a borrowing) for $80. That same promise, if it were made by a strong company, might raise $120 in new loans.

A promise of those same cash flows to the firm's employees in exchange for wage concessions amounts to borrowing from one's own employees. In the absence of guarantees, the employees would concede no more than $80 worth of wages. But, in the form of pensions that are protected by the Pension Benefit Guaranty Corporation, the employees recognize that the promise is worth $120. Thus they are happy to concede $100 worth of wages for such guaranteed promises.

In effect the PBGC has written a loan guarantee to cover this special form of private borrowing. The company gets $100 in wage concessions when similar borrowing would net only $80 in the capital markets. The employees get a promise worth $120 in exchange for only $100 in wages. The remaining $40 is "contributed" by the PBGC. Every weak company that sponsors a weakly funded pension plan can effect this transaction in union negotiations—the checkbook of the PBGC may be signed by almost anyone.

Is this backdoor what Congress really wants to provide?

Interestingly, although the guarantee is made by a federal agency, the burden is likely to fall upon strong companies. When the pension plans of the weak firms do fail —and some will—more in bad times, fewer in good times—the PBGC must eventually raise the premiums that it charges to all companies. In some ways Congress really gets to write checks to weak companies on the accounts of strong companies. Of course, if things get bad enough, the cost will be borne by taxpayers. ◆