

# While America Aged

## How Pension Debts Ruined General Motors, Stopped the NYC Subways, Bankrupted San Diego, and Loom as the Next Financial Crisis (Penguin Press, 2008)

BY ROGER LOWENSTEIN

**I**N A WHIRLWIND OF BOYHOOD FANTASIES, I walked the turf of Petco Park, home of the San Diego Padres. During the stadium tour, I envisioned myself as part of the action that would typically take place during any given summer night. For a moment, my thoughts were fixed on knocking a hanging curve ball off the Western Metal Supply Co. building just beyond the left field wall. Lost was any recollection of the fiscal nightmare stemming from a City Hall pension scandal that will plague the oilcan-shaped city for years to come. Nor did I contemplate how the costs of financing this picturesque ballpark in this picturesque city could somehow be related to that soap opera. On this particular 70-something-degree day in San Diego, I was thinking only about baseball.

Despite being well aware of San Diego's pension problems, it wasn't until a year later when I read Roger Lowenstein's *While America Aged* that I connected the dots. To pay the costs of financing vote-gaining pet projects, the cash-strapped tax haven of San Diego diverted dollars away from its municipal pension plans, ultimately leaving them shortchanged. And, as I would learn, that was just the tip of the iceberg. Underfunding was hidden by manipulative accounting, bonds were issued with faulty disclosures to conceal poor financing, and union reps were given plums to look the other way. All this led Standard & Poor's to suspend rating the city's bonds, thus denying San Diego of much-needed credit and eventually bankrupting America's seventh-largest city.

As I read the book, the boyhood dreams that I revisited at Petco withered, and my thoughts traveled to City Hall, a mere mile away from home plate. How could this happen, and who was to blame?

As the subtitle suggests, *While America Aged* tells the history of three pension plans whose troubles are emblematic of what Lowenstein calls "the next financial crisis." Though a historical narrative, the book reads more like a John Grisham thriller, filled with the flawed characters one would find in a Greek tragedy.

Through the chronological retelling of events, deeds, and misdeeds, Lowenstein illustrates how it happened. But the real story is who should shoulder the blame.

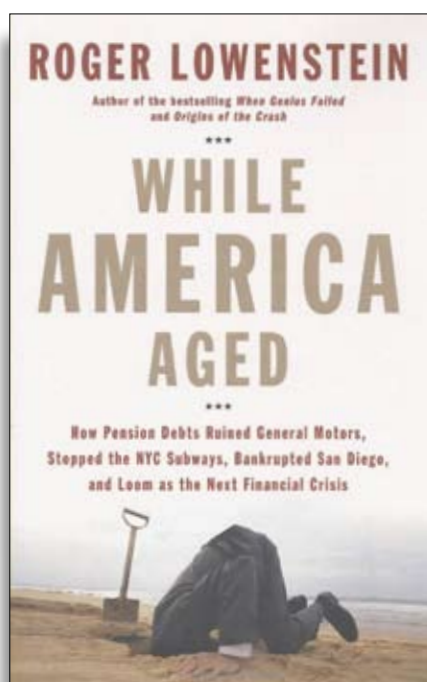
It's perhaps the unspoken addendum of Murphy's Law that when something goes wrong, someone needs to be blamed. Those in the actuarial community know the blame game all too well, and all too often from the perspective of scapegoat.

Lowenstein looks further and suggests that the biggest offenders were nearsighted employers, ruthlessly ambitious politicians, and insatiable union representatives.

Certainly market forces and economic conditions played a part. But in his account, Lowenstein shows how the aforementioned violated tried-and-true defined benefit principles, including that a pension should be a fraction of working income—one of three legs on the retirement stool. Employers were right to provide pensions, and the unions were right for demanding them, particularly for workers in hazardous and laborious occupations. But there came a point when the retirement benefits became too lavish.

By the end of the 1960s, a New York City transit worker could retire on 120 percent of his or her final salary if you included Social Security (to which the city contributed). And because benefits were calculated only on the last year of service, overtime abuse could instantly double final-year salaries and boost pensions even higher. Pensions are meant to provide a stable income in retirement, not a full paycheck. And as retirement becomes a boon for the wallet, pensions (contrary to their purpose) can get in the way of retaining an experienced workforce. New York would learn this the hard way when two-thirds of its subway maintenance crew retired within two years.

Another downfall of these plans was the flawed argument that the spoils of market upswings be shared with workers. During market booms, unions demanded a slice of the pie. Yet for defined benefit plans to remain healthy and sustainable, plan sponsors who assume all the risks inherent with the plan (market performance, longevity, etc.) need to be rewarded when times are good so as to shoulder the burden when times are bad. Disregarding this principle, higher benefits were granted, coupled in some



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cases with bonuses and “13th checks.” Of course, when the markets soured, the benefit hikes couldn’t be reversed, and greater contributions from the sponsors were necessary to keep the pensions funded.

As a matter of principle, healthy defined benefit plans need adequate funding. Lowenstein illustrates how this among all other principles was violated time and again. General Motors was willing to offer benefit hikes to keep wages low, keep the assembly lines moving, and grant hefty dividends to its shareholders. GM never planned for foreign competition, ignored warning signs from Studebaker’s experience, and believed it would always enjoy the lion’s share of the market. Benefit hikes instantly made all previous contributions inadequate, and unfunded liabilities were pushed off to the next generation. The United Auto Workers

could have negotiated ample funding, but that would have made it harder to leverage additional benefit boosts. Nor did the union consider funding to be its problem.

In the public sector, moral hazard was—well—hazardous to the health of defined benefit pension plans. Unions were a powerful voting bloc, and politicians were quick to please this constituency with bountiful retirement packages. They weren’t so quick to fund these perks—especially at the expense of unwelcome tax hikes or budget cuts. They preferred to let their successors deal with it after they were long gone. Even more depressing in San Diego, not only were plans deliberately underfunded; pension hikes were offered on a contingent basis in exchange for reduced pension contributions.

So what’s to be done? Well, the book is a

little thin on policy prescriptions, but Lowenstein’s diagnosis makes it clear that today’s promises cannot be mortgaged off. Reasonable benefits need to be funded, and delaying funding only exacerbates the situation.

For those who are overly familiar with the three pension plans detailed in *While America Aged*, the book might be old news. But for those who only know the basics (or less), Lowenstein offers a compelling overview. You may discover, as I did, that while the grandeur of places like Petco Park captures our imagination, it’s the unseen elements (mundane numbers on a piece of paper, unfunded liabilities) that cost the most in the end. Nothing is wrong with the former, but it should never come at the expense of the latter.

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