

Pensions: A Christian Perspective

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Introduction

It is likely that for most workers in the United States, more time is spent on thinking about how to improve their retirement than on how to improve their current work situation. With the aging of the baby boom generation, planning for retirement has become a growth industry, with thousands of available websites, books, and magazines. There are financial planners everywhere, and they promise to help you obtain the life that you desire upon your escape from work. As Christians we are to view our work as a calling to serve the Lord, not just a period of time that we attempt to endure until we retire. At the same time, as stewards of the resources that God has given us, we need to responsibly plan for the time when we no longer work for financial remuneration.

Our ability to provide for ourselves and our family will depend on a number of factors, including the status of Social Security, the amount of private savings, the level of lifestyle that we desire to live, and the amount of our pension benefits, if any. Social Security at this time faces many questions about its future sustainability and design, as

well as ethical questions concerning both its funding and benefit distribution. At the same time, private saving in the United States is quite low for a majority of the population. Pensions, for those that have them, are likely to be a primary source of future income. While many individuals are depending on pensions, businesses increasingly desire to remove themselves from pension provision to employees. In addition, numerous current pension systems that employers are providing are underfunded, so in many cases promises that have been made to employees may not be kept.

Whenever there are transfers of funds between institutions and individuals, there are always issues of stewardship and justice to consider. Pension plans also have a significant impact on the income distribution of the nation. How are we as Christians to view pensions? What are the obligations of both employers and employees? How should pensions be structured to meet the Biblical directives of stewardship and justice? We believe there has been little systematic consideration by Christians of these questions.

In this paper we attempt to outline the beginning of a Christian perspective on the issue of pensions. First, we will examine the history of pensions and how they have developed in the American economy. Second, we will describe some of the current issues in pension provision, highlighting the shift from defined benefit plans to defined contribution plans. In this section we will also consider some of the changes in the government regulation of pension plans. Third, we will examine several Biblical principles that we believe are relevant to the provision and use of pensions. Finally, we will suggest the implications of these principles and provide some suggestions concerning the design and use of pensions for both employers and employees.

History

Historically, pensions have had little relevance. It was not until the 20th century that pensions became a significant part of a worker's compensation. Prior to this, the tendency was that one worked one's entire life, or was cared for by one's family. In the latter half of the 19th century, life expectancy was less than 65 years of age, and for those males that did live to 65, 75 percent were still working (Sass, 1997).

Government pensions were awarded to veterans of the Revolutionary War, but it was not until 1875 that the American Express Co., a transcontinental freight hauler, set up the first private company pension fund. Fueled by the industrial revolution, the number of workers employed in manufacturing quadrupled from 3.5 million to 14.2 million between 1870 and 1910 (Greenblatt, 2006). During this period, railroads were the leaders in offering pensions to employees. Their motivation was twofold. First, pensions kept workers tied to companies, and second, they encouraged older less productive and expensive employees to retire. Though the reasons for offering pensions were largely pragmatic, employers and society were also driven by a sense of social ethics. "To keep worn-out, incapacitated workers on the payroll is an economic waste," but "to turn such [people] adrift is not humane and exercises a depressing influence upon workers still in the prime of life (Wooten, 2004)." In 1912, Lee Wielling Squier wrote "From the standpoint of the whole system of social economy, no employer has a right to engage men in any occupation that exhausts the individuals' industrial life in 10, 20, or 40 years, and then leave the remnant floating on society at large as a derelict at sea (McGill, 1979)."

The government of the United States encouraged the idea of private pensions, but did not take an activist role in their development. In 1921, the first tax incentive for employers was introduced that exempted income from pension and profit-sharing trusts. Even still, the majority of private companies did not offer private retirement plans. In 1935, when the Social Security System was created, less than 15 percent of the workforce was covered by a private retirement plan, and those companies that did offer plans had strict age and years-of-service requirements. Only about 50 percent of covered employees lived long enough, usually age 65, to receive full benefits (Greenblatt, 2006).

During World War II, two factors caused private pensions to begin to flourish. First, Social Security and other government programs led to increased federal income tax rates as high as 70 percent for top wage earners. Pension plans became a popular shelter as they were a benefit that was not immediately taxed. Second, since wage-and-price controls prohibited unions from negotiating for increased wages, pension benefits became an attractive alternative. In the two year period from 1942 to 1944, the IRS approved 4,000 pension plans and over the seven year period from 1938 to 1945, the number of people covered by private pension plans tripled to 6.5 million employees (Sass, 1997). The automobile industry began offering pensions in 1949 and by 1960, 40 percent of all private-sector employees were covered by pension plans.

During the 1970's, individual retirement plans (IRA's) became more appealing to employers than other forms of private pensions. This was largely due to their lower cost to employers as well as increased government regulation. In 1974, the historic Employee Retirement Security Act (ERISA) was passed by Congress. In addition to establishing the Pension Benefit Guarantee Corporation (PBGC), this legislation required companies

to adhere to funding and vesting rules. In 1978, Congress established 401(k) accounts, chiefly to allow executives to shelter income from tax rates as high as 70 percent. Employers, however, soon peddled 401(k) accounts to employees, extolling their ability to be fully portable. In reality, 401(k) plans were much cheaper for employers, requiring no obligation once an employee retired. An exception to this trend has been government workers (i.e., civil servants). Today, the vast majority of state and local government employees still have a defined benefit pension with a guaranteed payout, whereas only a minority of all private sector employees has such a plan (Byrnes, 2005).

Current Situation—A Shift to Personal Responsibility

There are two primary types of pension plans offered to workers, defined benefit plans and defined contribution plans. In defined benefit plans, a worker's pension is based on a formula determined by the company (usually based on years of service), and funds for all of a company's workers may be held together in one fund. In contrast, with defined contribution plans, each individual has a separate account where employer contributions accumulate, and employees often have some control over how and where these funds are invested. From 1975 to 1998, there was an increase of 42 million Americans enrolled in non-Social Security retirement programs, from 44 million to 86 million. In 1975, the predominant plan was defined benefit with 32 million Americans participating in 103,000 different defined benefit plans. At the same time, 10 million Americans were participating in 208,000 different defined contribution plans. By 1998, forty-six million workers had defined contribution plans while 40 million had defined benefit plans (Migration News). The trend is clearly away from defined benefit plans,

and even financially healthy companies, such as IBM, Hewlett Packard, and Motorola have frozen their traditional pension plans and replaced them with 401(k)'s (Donlan, 2006). Newer companies, such as Southwest Airlines and Microsoft, have never provided defined benefit plans which guarantee payments after retirement. Rather, they offer tax-deferred defined contribution plans (e.g., 401(k) plans).

Because of this shift from traditional defined benefit plans to self-managed defined contribution plans, an increasing number of people are being forced to make financial investing decisions for retirement. Unfortunately, according to the nonprofit group Jump\$tart Coalition for Personal Financial Literacy, many people are financially illiterate. According to the organization's 2006 survey, high school seniors were able to correctly answer only 52.4 percent of questions about personal finance and economics (Jump\$tart). Federal Reserve Chairman Ben Bernanke recently told Congress that "Sharpening Americans' financial know-how and skills is crucial to consumers' ability to make smart money choices and is also good for the overall economy" (Aversa).

For those employed in the private sector with a defined benefit pension, the "insurance agency" backing those plans is the PBGC. Just recently, in February 2006, the premium paid by employers to the PBGC was increased from \$19 to \$30 per participant per year. For those employers with underfunded plans, an additional amount is paid. The PBGC is currently in a precarious financial state. In 2004, the PBGC had a \$23 billion deficit and estimates by the Congressional Budget Office predict that the deficit could increase to \$142 billion by the year 2024 unless stricter pension-funding rules are enacted (www.pbgc.gov). This should be a cause of concern for all Americans

given that taxpayers would bear the burden of such a shortfall. In many ways, the current PBGC situation can be likened to the savings and loan crises of the 1980s.

Another pivotal factor pertaining to pensions is the looming possible overhaul of the current Social Security system. Social Security faces a future of trillions of dollars of future deficits, and demographic changes in the population are forcing the need to revisit Social Security as it currently exists. In the next two decades the number of people over the age of 65 will nearly double from what it is today (Schwadron, 2006). In 1950, there were 16 workers to support every one beneficiary of Social Security. Today, there are only 3.3 workers supporting every Social Security beneficiary, and it is projected that in 45 years, there will be only 2 workers supporting each beneficiary (Rohrich, 2005). One proposed solution to the current Social Security situation is personal (or private) Social Security accounts. These personal accounts would function very similarly to defined contribution retirement accounts, with individuals periodically investing into mutual funds. Should personal Social Security accounts become a reality, it will instigate millions of new investors to become more involved in retirement investing.

In August 2006, President Bush signed into law what he has called “the most comprehensive reforms to America’s pension system in 30 years” (Dairyple, 2006). The changes impact both employers and employees. Under most circumstances, employers with underfunded plans (an estimated 30,000 defined benefit plans totaling \$450 billion) are now given seven years to reach 100 percent funding. The law also encourages defined contribution plans by allowing companies to automatically enroll workers in 401(k) programs, and it increases the amount individuals can contribute annually to IRAs. Critics of the law fear that it will encourage employers to drop defined

benefit plans in favor of defined contribution plans, and they denounce the fact that the law further shifts the responsibility of retirement savings from the employer to the employee. We, however, find these aspects of the law that are being criticized to be favorable and in accordance with Biblical principles.

Biblical Principles

What guidance do the Scriptures give us in terms of how we should view the subject of pensions and retirement? In this section of the paper we suggest several Biblical principles, some of which apply to business, some to individuals, and some principles that apply to both. These principles can be useful in developing policy recommendations with respect to the provision of pensions.

A foundational Biblical principle that applies to both businesses and individuals is that of stewardship. All resources that we have belong to God and are placed in our trust to use for serving God and our neighbors as well as ourselves. The principle of stewardship has been written about in a large variety of places and is viewed by many Christians to be a central organizing principle for our economic and business activity. Psalm 24:1-2 states: “The earth is the Lord's, and everything in it, the world, and all who live in it; for he founded it upon the seas and established it upon the waters.” From the very beginning of creation, humankind was given the responsibility to take care of God’s creation. Throughout the Bible humans are given many directives as to how to take care of God’s earth and how to treat others, and are also instructed that we will be held accountable for our behavior.

A second Biblical principle that also applies to both businesses and individuals is that planning for the future is seen as a positive and necessary activity. The story of Joseph in the book of Genesis records the very positive results of his activity in storing up grain for future years of famine and drought. His foresight not only benefited the people of Egypt and helped insure the future of the Israelites and of his father and brothers; it earned him a position of great authority and influence. Proverbs twice extols the behavior of ants (Proverbs 6:6-8; Proverbs 30:24-25) as creatures who are extremely wise specifically because they store food away now for use in the future.

A third Biblical principle is the command to conduct business in a fair and honest manner. Leviticus 25:14 describes conditions for the buying and selling of land: “If you sell land to one of your countrymen or buy any from him, do not take advantage of each other.” The book of Proverbs has many verses that command ethical business behavior. For example, Proverbs 11:1 notes that “the Lord abhors dishonest scales, but accurate weights are his delight.” In the New Testament, Jesus says the second most important commandment is to “love your neighbor as yourself (Matthew 22.39).”

A fourth Biblical principle speaks to how businesses are to compensate their employees. Malachi 3:5 states that the Lord will be quick to judge those who defraud laborers of their wages, and James 5:4 warns businesses that “the wages you failed to pay the workmen who mowed your fields are crying out against you. The cries of the harvesters have reached the ears of the Lord Almighty.” Deuteronomy 24:15 implores employers to pay a worker “each day before sunset, because he is poor and is counting on it. Otherwise he may cry to the LORD against you, and you will be guilty of sin.”

Throughout the Bible, God commands that fair and timely compensation is an important obligation for all employers.

A fifth Biblical principle applies primarily to individuals and has important implications for the design and implementation of pensions. Individuals are commanded to provide for their families as best as they can. 1 Timothy 5:8 states: “if anyone does not provide for his relatives, and especially for his immediate family, he has denied the faith and is worse than an unbeliever.” 2 Corinthians 12:14 suggests that parents should be saving money for their children, and not children for their parents. Proverbs 13:22 states that “a good man leaves an inheritance for his children's children.” This provision for one’s own family does not, of course, preclude help for other families who are in need.

A sixth Biblical principle suggests that we should not overemphasize the provision of material goods for ourselves and our families. Anytime we note that the Bible views positively the act of planning for the future, we must also realize that this activity is not to be the major focus of our lives. Jesus in the Sermon on the Mount confronts us with this statement: “Therefore I tell you, do not worry about your life, what you will eat or drink; or about your body, what you will wear. Is not life more important than food, and the body more important than clothes (Matthew 6:25)?” But instead, we are to “seek first his kingdom and his righteousness, and all these things will be given to you as well (Matthew 6:33).” We interpret this as a command to give our plans for the future the proper perspective, and not as an instruction to neglect our future or to neglect working for justice in the economic and business arena.

A seventh Biblical principle is also important for individuals as we consider the subject of pensions. The Bible reminds us in Colossians 3:23-24 that when we work, we

should “work at it with all your heart, as working for the Lord, not for men, since you know that you will receive an inheritance from the Lord as a reward. It is the Lord Christ you are serving.” We need to consider our work a calling and vocation in service to God. In the creation story, God gives humankind work to do, and it is considered good. Even with the fall of humans, work is still the task of humanity, even though it has been made more difficult. We are not to view retirement as the goal of our lives, counting down the days or years until we can be free from our work. We realize that this is much easier for one whose work offers stimulation and flexibility and is valued by the organization and society, yet all work can potentially be glorifying to God.

All of the above principles can help us organize our thoughts on pension design; we now turn to the implications of these Biblical principles on the design and implementation of pension plans.

Implications

Based on the principles noted above, we believe that businesses are not obligated to provide pensions to their workers. However, when they do provide pensions, they should be designed to be as fair as possible to workers. Businesses are called to be good stewards of the resources that they have, and are also obligated to compensate their employees in a fair and timely manner. Pensions are part of a worker’s overall compensation, and we realize that some workers will want different mixes of wages and salaries, pensions, and other fringe benefits such as medical insurance. Different firms have varying abilities to offer pensions, and workers also make differential contributions

to the output of their firm due to their training and experience. Market conditions for the product also impact the ability of firms to offer contributions.

If pension plans are to be offered, we believe that in most cases defined contribution pensions are more in line with the Biblical principles noted above than defined benefit pension plans. First of all, defined contribution plans make it easier for both firms and employees to exercise stewardship. With such plans, firms only need to add money to a plan at regular intervals, and they are not able (or tempted) to remove money or renege on their obligations as is possible with defined benefit plans. At the same time, since employees usually have some control of the funds in their defined contribution plans, they have an opportunity to manage their retirement funds. Both the firm and the worker will have an incentive to work together in order to help the worker make wise choices with the worker's pension.

Secondly, defined contribution plans make it easier for businesses to plan for the future. With these plans, obligations are known quite exactly, and there is no need to worry about making up for underfunded pension plans some time in the future. For workers, a defined contribution plan offers certitude that the money that is being set aside is an obligation already met rather than a promise that may not be completely fulfilled. Naturally, the total future value of a defined contribution plan is uncertain given that rates of return on the investment are unknown. Though defined benefit plans offer the comfort of a known salary for life, and are guaranteed by the PBGC for private sector employees (virtually all government pensions have been paid), there is still an element of uncertainty. The defined benefit plan may change or, for some, the benefit might be

reduced by the PBGC (the PBGC has maximum limits and does not guarantee health care benefits).

Third, we believe that defined contribution plans more easily allow businesses to both conduct themselves in a fair and ethical manner and meet their obligations to provide timely and fair compensation to their employees. When businesses provide these types of pension plans, potential investors can know more exactly the obligations the firm has, and workers have no chance of losing the money that employers have already contributed. Given this design, workers can also better provide for the needs of their families in the future (one of the principles noted above).

We also believe that the use of defined contribution plans has the potential to help workers not overemphasize the money in their lives and also to help better develop a sense of vocation. It is true that a private or government defined benefit pension can be extremely valuable and comforting, knowing a salary is guaranteed for life. However, a defined contribution plan is also reassuring in that the employer continually pays the employer the pension amount; it is not a promise to be fulfilled in the future. For some workers, when there is uncertainty about the availability of funds, this leads to a situation where the workers have more focus and worry on material goods. If workers are more secure in their financial future, they can focus on the important tasks of serving God and neighbor in their work. When both employers and employees have settled the area of pension provision so that employees are confident that their pensions will be there in the future, this allows the possibility for firms and workers to collaborate on issues of work design and other issues that can bring about a healthier attitude toward current work. We do acknowledge that there can be possible dangers when workers manage their own

money, as workers become obsessed with increasing monetary returns and spend an inordinate amount of time on this project (for example, organizing their lives around the next showing of “Mad Money” or the Suze Orman program). Firms and workers need to strive together to create job environments where employees are fulfilled in all aspects and are not overly focused on retirement; this places obligations on both parties.

Defined Contribution vs. Defined Benefit Plans—Practical Considerations

As described above, we believe that defined contribution pensions are more in line with the Biblical principles outlined in an earlier section of the paper. In today’s economic climate, defined benefit plans are also problematic for a number of practical reasons. A defined benefit pension promises future benefits, but it is a promise that is not always viable. Foremost, a private business does not even know if it will exist in the future. In the year 2005 alone, there were over 39,000 business bankruptcies in the United States, none of which were planned when these businesses were begun (U.S. Courts). Recently, some have even predicted the bankruptcy of General Motors (Welch, 2005). No firm, no matter how large or successful now, is necessarily immortal. Promises made now, even those made with the best intentions, may not survive a rapidly changing business environment.

Even if a firm thrives, earlier decisions on pension design can make fulfilling a defined benefit pension promise difficult. When organizations do have defined benefit pension plans, they are required to set aside funds that will fulfill a pension’s promise. However, it can be very difficult to know much money needs to be allocated for future pension benefits; a number of variables need to be considered in the decision. How long

will a person live? What will be the rate of inflation and cost of health insurance (health insurance is often included in pensions)? What rate of return will the funds set aside earn? Though actuaries can estimate these amounts, there is no certainty. When there is uncertainty, there is a temptation to be overly optimistic (e.g., health care costs will increase only modestly yet the return on investments will be high, etc.), resulting in plans that are not adequately funded.

When defined benefits plans are poorly designed, this can have a negative impact on the future economic well being of a company. General Motors has a defined benefit plan that according to most observers is economically unsustainable. One result of this situation is that retirees at GM outnumber current active GM employees by 2.5 to 1. At General Motors, unsustainable pension benefits increase the cost of automobiles for all, making the company less competitive in a global market. This produces a negative feedback loop which makes the company even less able to fulfill its pension obligations. Decisions at GM also have had a negative impact on other companies; Delphi, a major automobile supplier to General Motors (with over 185,000 employees) has been forced to seek bankruptcy protection.

Role of Government

What is the role of government in the private provision of pensions? The Biblical mandate for governments is to provide justice for the population. Currently the government provides insurance for defined benefit pensions. Unfortunately in many cases the insurance rates are too low and the government ends up “holding the bag” when companies go bankrupt. With a move to more defined contribution style pensions, the

government can take less of a role in this area and move towards helping individuals make wise decisions in the investment of their pensions and help businesses design pensions that are the most beneficial to workers given their financial constraints. The government can also continue to regulate pension design to protect both employees and employers. The government also has significant work to do to reform Social Security, Medicare, and pensions for government workers.

Public organizations, in contrast to private organizations, are much more likely to have defined benefit pension plans. Ninety percent of state and local government employees have a defined benefit pension plan, compared with 24% of the private sector. There are several reasons why public organizations are more likely than private corporations to have defined benefit plans. First, governments and municipalities do not face the same threat of bankruptcy given their power to tax citizens; in some sense governments are more “immortal” than private corporations. Second, public organizations face less incentive to keep costs down because they do not face competition in the sense that private corporations do. Third, since politicians focus on short term issues in an attempt to maximize reelection possibilities, it is easy for them to make promises for payments in the future when they no longer plan to be in office. As a result, it is estimated that government pensions are underfunded by several trillion dollars (Byrnes, 2005).

When private corporations do declare bankruptcy, the PBGC guarantees the defined benefit pension. The burden is passed to another party, and ultimately to taxpayers. When public organizations promise future benefits but do not set aside funds for these promises, the obligations again fall on future taxpayers. We believe that it is

poor stewardship for businesses and governments to design pension plans that in many cases cause obligations to be met by third parties. Because of this, we also believe that it is improper for employees and unions to ask for such plans.

Conclusion

In this paper we have outlined a number of Biblical principles that we believe should impact the design and provision of pensions in a market economy. Working from these principles, we have concluded that in most cases defined contribution pensions will better meet the Biblical requirements of justice and stewardship. In both the private and public sectors, we believe that defined benefit pensions may in many cases provide an incentive to retire early or place an undue burden on others. Christians must maintain a unique balance of planning for the future (Proverbs 6:6-8; Proverbs 30:24-25), while not focusing too much on their future material well being. A Christian should live for each day, and have faith that God will meet the needs of tomorrow (Matthew 6:25-34).

However, in living this balance, a Christian should avoid being an imposition to others. Throughout the New Testament it is stressed that early Christians were conscious not to burden others in all ways, including materially (Acts 15:28, 2 Corinthians 11:9, 2 Corinthians 12:13-16, 1 Thessalonians 2:6-9, 2 Thessalonians 3:8).

As the baby boom generations ages and reaches their time of retirement, concerns and questions about pensions will become even more prominent in our society than they are now. To this point Christians seemed to have made few contributions to the debate on these issues. As Christians, however, we have an obligation to participate in discussions about economic matters, and bring salt and light to questions about pension

provision. As professors of economics and business students, we have a special opportunity to guide those individuals who will be the future designers of pension programs in the United States.

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