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The Birth of the Federal Employees Pension Plan

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Chapter 9
The Birth of the Federal Employees Pension Plan

The previous chapters have presented a detailed history of the development of military pensions in America. The analysis has focused primarily on military pensions because of their early development, widespread coverage, and unique history. The use of pensions to compensate other public employees is a more recent development in the United States dating from the middle of the nineteenth century. Despite this late start relative to the military, pension coverage for civilian employees in the public sector came earlier and expanded more rapidly than pension coverage in the private sector. As the earlier chapters have shown, economic reasons encouraged the adoption of pensions for military personnel. Many of these reasons were unique to those workers; however, challenges associated with attracting, retaining, and retiring workers in the nonmilitary public sector are similar to those facing the military services at least with respect to some features. In addition, some of the problems of managing the funds associated with military pensions, the high variance in annual revenues, and the political implications of supporting aged and disabled workers also applied to civilian public employees.

Despite some similarities, both the timing and the economics of nonmilitary public pension plans differ in some respects from those for military personnel. The underlying motivation for a pension agreement between public sector workers and the state is quite similar to that for private sector agreements. Pensions represent an exchange in which organizations provide greater lifetime incomes for employees, and employers offer these higher lifetime incomes based on the expectation that workers will behave differently when a portion of their compensation is in the form of future pension benefits. Chapter 2 provides a detailed explanation of pension economics and describes the various incentives imbedded in many pension plans. In general, pensions can be viewed as components of efficient contracts that tie the receipt and size of the deferred benefit to a worker's longevity. Employers profit from this arrangement through a reduction in turnover costs and the orderly retirement of older workers. Workers gain from the increase in their lifetime incomes. Modern pensions offer other advantages as well. For example, they provide retirement income insurance and tax shelters for workers (Bodie 1990). Of course, the tax-deferred nature of pension compensation provided little comfort in an age when only the highest paid workers were subject to the personal income tax. Public sector workers were not typically among this group.

By the 1920s, pension plans existed for a wide array of public sector employees at the state, local, and federal levels even though such plans were still rare among private workers. Furthermore, in many cases, these plans were considerably more lucrative than private plans in place at that time or during the subsequent two decades. This observation is consistent with a number of studies that find that public sector workers are frequently "overcompensated" relative to private sector workers, perhaps by as much as 20 percent (Smith 1976, 1977, 1981; Venti 1987; and Krueger 1988). Consequently, understanding the issues which are unique to public plans, including the timing of their creation, is crucial to understanding the role of these plans in the economics of the public sector. Our analysis focuses on three characteristics that caused the history of public sector pensions to diverge from that of private sector pensions: (1) rent seeking by public employees, (2) patronage versus merit in public sector hiring practices, and (3) Progressive Era politics.

As with other aspects of the employment contract, the difference in compensation between public and private workers may be due to rent seeking on the part of public employees. In this context, rent seeking may be thought of as the pursuit of gain through political lobbying rather than through productive economic activity in the marketplace. As a component of total compensation, one could reasonably expect pensions to have been the object of at least some rent seeking by public sector workers. A share of these rents may have reflected what is called in a broader context "organizational rents," which accrue, at least partly, from the costs of monitoring workers (Aoki 1984). That is to say, because monitoring is costly, the optimal level of shirking is not zero; workers get paid for work they don't perform. Although the level of deferred compensation embodied in public sector pension plans may have contained organizational rents in excess of those found in the private sector, rent seeking cannot entirely explain the history of public sector pension plans. While rent seeking alone might yield greater pension benefits, several features of these early public sector plans are consistent with optimal contracting between public workers and the state. First, the state provided greater pension benefits and hence higher lifetime incomes to workers while workers offered some productivity-enhancing behavior in return, such as lower turnover. In addition, many plans contained mandatory retirement clauses, and just as predicted in

Chapter 2, there is evidence that workers also accepted lower wage profiles in return for their pension plans. In other words, workers were willing to trade some current income for a retirement benefit. All these characteristics point to optimal contracting rather than rent seeking.

Another characteristic of the early public sector pension plans involves the nature of civil service contracts before the rise of merit systems. In the absence of civil service legislation protecting the tenure of public workers, elected officials employed patronage as the means of distributing rents and enforcing the provision of some minimum level of publicly provided goods. In the United States prior to the late nineteenth century most federal civil servants were patronage employees. Once government workers were granted de facto lifetime tenure along with the rigid pay and promotion standards associated with a civil service bureaucracy, administrators had to develop some other means of distributing rents. Not coincidentally, the movement from patronage to merit began at roughly the same time as public sector pensions began to emerge and grow (Johnson and Libecap 1994). Initially, converting patronage jobs to civil service positions sufficed. The politicians responsible for granting de facto lifetime tenure on whole classes of public employees could expect to receive a great deal of loyalty and support in return. However, after roughly a generation of growth in nonpatronage employment, elected officials discovered that they were in the so-called "Lazear trap" (Craig 1995). This situation occurs when elderly workers receive a wage greater than their reservation wage—that is, the minimum wage required to induce labor force participation. Receiving compensation in excess of the reservation wage meant that workers would not retire when their compensation exceeded their productivity. In order to force the retirement of these workers, public sector employers frequently adopted mandatory retirement provisions in conjunction with the establishment of pension plans. As we saw in the previous chapter, the army and navy both followed this path.

Also, the emergence of public sector pension plans on a large scale coincided with an era of progressive politics in the United States. At all levels of government, the era of the late nineteenth and early twentieth centuries was marked by efforts to move toward the welfare state. Although ultimately this movement would not see much success on a broad scale until the federal government became involved during the Great Depression (Goldin and Libecap 1994), the reforms in public sector employment were one part of the agenda that did achieve some success. Of course, one element of that particular part of the agenda was the movement from patronage to merit. This movement had some unanticipated effects on the emergence and growth of public sector pension plans, but the explicit adoption of pension plans or "old-age relief" was another part.

The movement to create public sector pension plans involved more than just a general improvement in the working conditions of public employees.

In fact, it was tied to the growth of the welfare state in Europe. Many American progressives envisioned the nascent European "cradle-to-grave" programs as the precursor of a better future in the United States. According to progressives, old-age pensions represented the last step before the "grave" in the Good Society. By the early twentieth century, 32 countries around the world had some type of old-age pension for their nonmilitary public employees. The fact that such reactionary regimes as Russia, Spain, and Austria-Hungary had state pensions gave a great deal of moral weight to the arguments of U.S. reformers. At a time when progressive politicians in the United States were calling for universal old-age pensions, it seemed only natural to create such plans for government workers. Although the progressives failed in their efforts to provide plans for everyone or even all workers, they were often successful in providing plans for the workers over whom they had the most direct influence, public sector workers.

Ironically, the creation of public sector pension plans for nonmilitary workers followed a path from one political unit to another that went in exactly the opposite direction of the creation of the units themselves. Congress created states from territories and states created cities. In contrast, cities were the first political units to offer pensions, beginning in 1857. The states began to establish pensions for their employees in 1911. Lagging behind these efforts, the federal government did not adopt a universal pension plan for civilian employees until 1920. This is not to say that there were no federal pensions before 1920. Pensions were available for some retiring civil servants, but Congress created them on a case-by-case basis. In the year before the federal pension plan went into effect, there were 1,467 pension granted (912) or annuities increased (555) by special acts of Congress (U.S. Department of the Interior, 1921). This process was as inefficient as it was capricious. With respect to pensions before the act of 1920, federal workers were reduced to the status of French bureaucrats during the *ancien régime,* who received a pension only with the blessing of their patron. Individual pensions in this period were discretionary and granted on a case-by-case basis. Ending this system became a key objective of congressional reforms. The remainder of this chapter is devoted to the development of a formal pension system for federal employees.

The Creation of Federal Civil Service Pensions

Discussion of federal civil service pensions dated from the late nineteenth century. The key to the creation of a civil service pension plan was the creation of a civil service. Prior to the late nineteenth century, federal employees were essentially patronage employees. With the tremendous growth of the number of such employees in the nineteenth century, the benefits of a patronage system were outweighed by the costs of managing it.[1] During the congressional debates leading up to passage of the Pendleton Act of 1883, which created the federal civil service, supporters made references to the growth of federal government expenditures and employment over the nineteenth century. For example, over the century as a whole the number of post offices grew from 906 to 44,848; federal revenues grew from $3 million to over $400 million; and nonmilitary employment went from 1,000 to 100,000. Indeed, the federal labor force nearly doubled in the 1870s alone (Johnson and Libecap 1994).

The problems associated with managing that growth took a heavy toll on the resources of the executive branch. In an environment where every job was up for grabs as part of the political spoils system, "no single human being, however great his intelligence, discrimination, industry, endurance, devotion, even if relieved of every other duty, [could] possibly, unaided, select and retain in official station those best fitted to discharge the many and varied and delicate functions of the government."[2] The Pendleton Act was passed at a time when the Republicans controlled both houses of Congress and the White House. It was passed on votes largely, though not entirely, along party lines. As the party in power, the Republicans saw the conversion of federal employment from patronage to "merit" as an opportunity to gain the lifetime loyalty of an entire cohort of federal workers. In other words, by converting in a single action patronage jobs to civil service jobs, the party in power attempted to create lifetime tenure of its patronage workers. Of course, there proved to be a cloud wrapped around this silver lining. Once in their civil service jobs, protected from the harshest effects of the spoils system, federal workers simply did not want to ever give up their jobs. They would not retire, and thus the conversion from patronage to civil service sprung the aforementioned Lazear trap. It took less than one generation before Congress and the executive branch realized what had happened. In response to this aging of the labor force, the quest for a federal pension plan began.

A bill providing pensions for nonmilitary employees of the federal government was introduced in every session of Congress between 1900 and 1920. Representatives of workers' groups, the executive branch, the United States Civil Service Commission, and researchers appointed by congressional committees all requested or recommended the adoption of retirement plans for civil service employees. The political dynamics among these parties was often subtle and complex. There were at least three employee groups lobbying for a federal pension plan—the postal unions, the U.S. Civil Service Retirement Commission, and the National Association of Civil Service Employees. These groups eventually formed the Joint Conference on Retirement, which led the campaign that culminated in the passage of a civil service pension plan after two decades of congressional wrangling. Congress finally passed the Federal Employees Retirement Act (FERA) on May 22, 1920, at the outset of the presidential campaign of that year.

Both major political parties supported a federal pension plan, though there was disagreement over the structure of the plan, and within each party there were major figures opposed to the adoption of any civil service pension plan. Throughout the debate leading up to the passage of the act, the government's contribution to the retirement plan proved to be a perpetual and most contentious issue. Supporters of pensions for federal employees argued that the act met the needs of three groups: federal workers, the government, and taxpayers. In a speech before the Senate, Thomas Sterling, FERA's most tireless defender, summed up the rewards to each of these groups from the establishment of a civil service pension plan (*Congressional Record* 1920). The act's sponsor in the Senate, Sterling was a progressive Republican from South Dakota. A former law professor at the University of South Dakota, Sterling argued persistently that the act would lead to a more efficient provision of public goods by simultaneously increasing the lifetime incomes of federal employees and encouraging the discharge of superannuated workers.

Sterling claimed workers would benefit through higher lifetime incomes; the government would benefit from the reduction in turnover of younger workers and the mandatory retirement of older workers. Finally, he argued that taxpayers would receive a more efficient provision of public goods leading to an increase in their confidence in the government. In short, Sterling argued, without exactly using the term, FERA represented an optimal contract in which all contracting parties were better off (Craig 1995).

One of the key economic aspects of the various proposals was the promise of higher lifetime incomes associated with the pension plan. Two important economic issues are related to this promise. The first is that the promise is implicitly based on what economists today refer to as the "efficiency wage hypothesis."[3] This theory suggests that in some cases, usually situations in which monitoring is relatively costly, employers will pay a wage *above* the equilibrium or market-clearing wage in order to induce workers to self-monitor. The idea is that if a worker is paid above his opportunity cost, which equals the market-clearing wage, then he will monitor himself to avoid being discharged and having to go back into the labor market and receive his opportunity wage, which is below the efficiency wage. This self-monitoring reduces the likelihood of shirking. The discussion in the Senate indicates that supporters of FERA maintained a model of public employment not unlike contemporary theories of efficiency wages. They argued raising (lifetime) wages would increase productivity through self-monitoring on the part of federal workers.

The second important point connected to the notion of higher lifetime incomes is that workers would only receive the higher (lifetime) wage relative to a situation in which they retired at some point and received no pension. Workers who remained on the job rather than retiring with either no pension or the proposed federal pension would in fact receive a *lower* lifetime income than those who remained, because the pension payment was less than 100 percent of their pre-retirement earnings. Of course when they retire they no longer incur the disutility of working.

As a result of receiving the higher efficiency wage, workers do not quit their current jobs as frequently as they otherwise might; thus turnover rates are lower, other things equal. A member of the Civil Service Commission testified before the Committee on Civil Service Retrenchment in 1917 that "A retirement system would give stability to the service, create an inducement to capable men to continue in it, contribute to improved administration methods, and make possible a standardization of salaries and other needed reforms." Treasury Secretary Carter Glass concurred, testifying that "the efficiency of the [Treasury] Department is retarded for want of a retirement system" (*Congressional Record* 1920).

When it came to actually steering a pension act through Congress, Sterling faced a more difficult task in the Senate than did Republican Frederick Lehlbach, a former Newark, New Jersey prosecutor who was the act's sponsor in the House. Debate was considerably less acrimonious in the House, and the act ultimately passed in this body with a majority of more than five to one. The election of 1918 had swung the House dramatically to the Republicans, who picked up 30 seats and maintained a 50-seat majority in the 66th Congress. In the Senate, the Republican majority was a mere two seats. But the problems the act encountered in the Senate were only partly related to the Republicans' much smaller majority there. This smaller majority and Senate rules allowed individual senators to play a much larger role in shaping the debate on the pension bill and ultimately in the passage of the bill itself.

Opponents of the act countered that while they supported pensions for federal workers in principle the returns to both the government and the taxpayer from such a plan did not justify the costs. Among the senators who had the strongest reservations were Atlee Pomerene, a Democrat from Ohio, Republican Albert Cummins of Iowa, and Reed Smoot, a Utah Republican. Pomerene and Cummins were both former chairmen of the Civil Service Committee, now chaired by Sterling. They felt that the government incurred too large a share of the costs of the plan. "I am not opposed to a retirement plan," claimed Pomerene, "but I am opposed to [Sterling's] plan, and I think the majority of the Senate will be opposed to that plan when they realize how tremendous the cost is going to be" (*Congressional Record* 1920). Pomerene, apparently seeking to mollify federal workers, claimed time and again that he was a "friend of the civil-service employee." This constant reassertion of Pomerene's amity toward federal workers led his colleague Kenneth D. McKellar to proclaim, "if [Pomerene] was the friend of the civil-service employee, then God help the civil-service employee, because to my notion no man ever fought a measure with more vigor or success" (*Congressional Record* 1920). Exchanges such as these demonstrate the growing political clout of civil service workers. Die-hard obstructionists did not want to go on record as being opposed to pensions for federal workers, while the act's strongest supporters attempted to reveal opponents for what they were. Indeed, the Senate debates leading up to the passage of the act indicate that no senator wanted to go on record as objecting to the bill in principle as it circulated through Congress. Those who objected to establishing a pension did so on one of two grounds. One objection was to the method in which the plan would be funded. In this debate, some Senators thought the government's share should be smaller while others thought it should be larger. A second objection related to the then current postwar budgetary situation, which they argued should prohibit them from undertaking any new financial commitments of the scale such a plan required.

The issue of mandatory retirement was related to both of these criticisms. Many appointed officials and federal department heads requested a mandatory retirement clause. However, a number of senators viewed this as a particularly budget-busting aspect of the act. In addition, these senators objected to an early retirement provision, claiming workers in good health should not be automatically awarded a pension upon reaching a specific number of years in service or a particular age. According to Pomerene, "the man who wants to retire at 60 or 62 or 65 years of age, if he is in good health, ought to have retired from the service before he entered it." Smoot agreed: "I am not willing, after having paid an employee who has reached the age of 60 years the salary which the Government would be compelled to pay him all that time, to allow him to leave the Government service, draw $720 from the Government, and give all of his energy and service, which ought to be given to the Government of the United States, to some outside concern. That is the whole matter in a nutshell" (*Congressional Record* 1920).

Taken at face value, Pomerene and Smoot's criticism of the pension plan could be interpreted simply as a complaint concerning the generosity of the plan. However, both were subtle men, and in fact neither had been wholehearted supporters of the spirit of the conversion of federal employment to a purely meritorious status. The key to getting workers to accept a pension plan that actually induced them to retire or forced them to do so at some point was to construct a plan that offered a retirement benefit that exceeded the workers' reservation wage[4]— that is, the lowest wage a worker would accept to supply his or her labor in the market. If, as Smoot and Pomerene demanded, the pension benefit were not generous enough to induce workers to retire or at least compensate them adequately after mandatory retirement, then the workers would not have embraced the plan, and it is possible that they might have rejected it outright through their workers' associations. Since collective bargaining was not an option for federal workers, it is impossible to say what the ultimate outcome of this dispute would have been.

Interestingly, the groups representing federal workers did not object to the mandatory retirement clause in the act. There are two implications of this observation. First, they may not have objected because the "early" retirement provisions were so lucrative that for the majority of their workers the mandatory provision was moot. In other words, the typical worker would have gladly taken his pension before mandatory retirement became an issue. The second implication is that, even for those workers who might have ultimately faced mandatory retirement, the pension payment over the remainder of their lives plus the absence of any disutility associated with work was enough to compensate them for the loss of income they incurred by being forced to retire.

The claim by the opposition senators that they supported a pension plan in principle while they spent years obstructing the passage of legislation that would establish a plan reflected the growing power of federal employees as a lobbying group. The lobbying efforts by federal employees were advanced by a number of their own worker associations, which had risen in number, size, and outspokenness since the shift from patronage to a merit-based civil service had begun forty years earlier. This shift originated with the Pendleton Act. By 1919, the year before the pension plan was created, 70 percent of federal civilian employees "were classified" as nonpatronage workers (Johnson and Libecap 1994). Since replacing patronage with a civil bureaucracy granted de facto lifetime tenure to a large class of federal employees, it also solidified them as an interest group.

Senate Republicans complained bitterly about some of the lobbying tactics of federal employees in general and their lobbying groups in particular. The flirtation of federal worker organizations with the American Federation of Labor received the harshest criticism. "Federal employees should be prohibited from allying themselves in any way whatever with powerful influences outside of the Government," declared Henry L. Myers during debate over the act. "I think they should be prevented from forming any allegiance or alliance with any influence other than that of the Government for which they work and to which their supreme duty is owing" (*Congressional Record* 1920).

The conversion from patronage to civil service created a unique opportunity for elected officials to capture the political allegiance of these workers, which was one of the main reasons the Republicans had moved to a merit-based civil service in the late nineteenth century, but the government still faced the question of what to do with the workers who would not leave the job upon reaching old age. The growth of civil service employment and the related employment and tenure rules was not a seamless transition from the patronage system. Lifetime tenure for federal employees produced a proliferation of superannuated employees; again, the Lazear trap comes into play. The aging of the labor force resulted in an increase in the costs of providing goods and services. Many of the directors of federal departments practically begged Congress to provide pensions that included a mandatory retirement provision for these employees. Testimony during numerous hearings held between 1900 and 1920 on pensions for federal employees documented the complaints of federal administrators concerning the accumulation of elderly workers in the higher civil service grades (U.S. House of Representatives 1912; U.S. Senate 1919). The problem was that in the absence of a pension plan, which might or might not be accompanied by mandatory retirement, there was little or no incentive for a civil servant to retire.

To understand this issue more clearly, consider a typical civil servant around 1920. Suppose that she earned $1,200 a year. It would not require an annual pension payment of this magnitude to get her to retire voluntarily. Assume the worker incurs some disutility from engaging in employment—that is, *ceteris paribus*, she would rather be doing something else, such as gardening, reading, or playing with a grandchild. The pension payment required to induce retirement would be a payment that just equals the difference between the wage and the value the worker places on these other activities. In other words, what is the lowest amount the government would have to pay to get the worker to play with her grandchild rather than go to work and collect her full salary? For many if not most workers, there is some "replacement rate" that is less than 100 percent, perhaps substantially less than that amount, that would induce the worker to retire before reaching a mandatory retirement age. For other workers, however, either the disutility of work is so low or their capacity to shirk is so high that they will not accept the pension and choose to remain on the job indefinitely. Mandatory retirement was the destiny of those workers.

Ultimately, Sterling carried the day in the Senate, and the act passed. It did include a mandatory retirement clause. Among the key features of the original act of 1920 were the following:

1. All classified civil service employees qualified for a pension after reaching age 70 and rendering at least 15 years of service. Mechanics, letter carriers, and post office clerks were eligible for a pension after reaching age 65, and railway clerks qualified at age 62.
2. The ages at which employees qualified were also mandatory retirement ages. An employee could, however, be retained for two years beyond the mandatory age if his department head and the head of the Civil Service Commission approved.
3. All eligible employees were required to contribute 2.5 percent of their salaries or wages toward the payment of pensions.
4. The pension benefit was determined by the number of years of service. Class A employees were those who had served 30 or more years. Their benefit was 60 percent of their average annual salary during the last ten years of service. The benefits were scaled down through Class F

employees (at least 15 years but less than 18 years of service), who received 30 percent of their average annual salary during the last ten years of service.

Although subsequently revised, this plan remains one of the two main civil service pension plans in the United States (Hustead and Hustead 2001). Comparisons with other public and private pension plans in effect in 1920 show that, although several cities offered pension plans for at least some of their employees, and some states provided plans for their teachers, only one state, Massachusetts, had a civil service retirement plan by 1920.[5] Furthermore, there were relatively few private sector plans at the time. The Massachusetts plan, which is discussed at length in the next chapter, was offered as a model for the federal plan. In the Massachusetts plan, the state government paid 50 percent of the pension annuity. Ultimately, the federal government's share of the federal employees' pension plan was greater than 50 percent. Most contemporary estimates of the share of a federal pension that would end up being paid by the government fell between two-thirds and one-half, though they varied from somewhat below this range to almost 100 percent. This issue generated more controversy than any other surrounding the bill, as the comments by dissenters such as Pomerene and Smoot suggest. In fact, the discussions in the *Congressional Record* concerning the (expected) share paid by the government are enlightening solely for the amount of confusion they bring to the subject. This confusion was partly the result of political flummery and obfuscation, but it also reflected the absence of actuarial and accounting standards by which the debate could be constrained. During the 1920s, the federal government's actual share was two-thirds according to at least one contemporary scholar of the issue (Epstein 1928).

As stated above, pension coverage was relatively rare among private sector workers at this time. Only around 3 million U.S. workers, or roughly 13 percent of the private, nonfarm labor force, were covered by a pension plan in 1920. The lack of funding and vesting regulations meant that only a small proportion of these workers would ever receive a retirement benefit. Indeed, plans covering more than three-quarters of the total number of workers with a pension were discontinued during the first four years of the Depression (Craig and White 1993). Furthermore, the few plans that remained viable were not as lucrative as the plan for federal civil servants. Almost no private sector plans paid more than1.5 percent per year of service of some average of the worker's salary during the last few years of service. Few private plans matched the federal plan's minimum pensions of \$180 (Class F) to \$360 (Class A) for comparable years of service. Not only was the federal plan initially more lucrative compared to private or state plans, but it was also safer. During the Depression, when many private plans were discontinued, suspended, or closed to future employees, the federal government made its pensions even more valuable by eliminating the maximum payment provision of the original plan.

Summary

The federal government provided pensions for its employees before private sector firms; the federal plan also antedated those of all but one state government. The federal pension plan was enacted in response to lobbying by both workers and administrators, and the plan was more lucrative than most contemporary public or private plans. When many of those other plans defaulted during the Depression, the federal plan actually became more valuable. To one degree or another, these features are consistent with our discussion of the causes and economics of public sector pension plans.

This review of the development of nonmilitary, public sector pension plans at the federal level in the United States highlights four salient features of that history.[6] First, the timing of the establishment of most of these plans suggests that, prior to the early twentieth century, either public sector workers were not willing to accept the deferred component of a pension plan as part of their compensation or public sector employers were not willing to offer such plans. In fact given the nature of public sector labor markets in the nineteenth century, it is not surprising that relatively few public employees were covered by a pension plan. Much of the employment in the public sector was based on political patronage. Workers could easily find themselves out on the street after an election. The uncertainty of employment meant that workers were not willing to bear the risk of deferring a substantial proportion of their income until retirement.

Second, employers were not willing to offer a pension plan to workers who were likely to be unable to continue in their positions even if they so desired. Prior to the formal establishment of a civil service with protection from the vagaries of the political spoils system, no reason existed for a pension contract between workers and the state. After the conversion from patronage to merit, this situation changed dramatically; both employers and employees saw the advantages associated with pension plans. The government received mandatory retirement, and probably overall a smaller lifetime wage payment to workers, at least when compared to their lifetime wage profiles without mandatory retirement. Workers received retirement income, which, while less than their wages, was offered without the demand for work in return. It proved to be a good bargain for both sides.

Third, in spite of the fact that there was no federal civil service pension plan before 1920, the plan that ultimately passed was relatively lucrative. Early on the plan provided benefits equal to 30–60 percent of earnings at the time of retirement, and workers could typically retire at “full benefit” after 30 years or so of service. The federal plan was never explicitly funded by anything other than a promise on the part of the Congress to extract the tax revenues that would be necessary to meet its share of the pension contract.

Finally, the federal employees pension plan became a classic contributory, defined benefit pension plan for all federal civil servants. This turn of events had two implications for other employers in both the public sector and the private sector. First, to the extent federal workers valued their pension plan, it put economic pressure on other employers to offer competitive plans. Second, as the Progressives intended, the federal pension plan served as a model towards which reformers could point and strive to achieve in other sectors of the economy. Although they made substantial progress in expanding pension coverage for American workers in the 1920s, the Great Depression interrupted that progress, at least in the private sector.

Notes

1. This discussion of the demise of the patronage system owes much to Johnson and Libecap (1994).
2. From a U.S. Senate report, quoted in Johnson and Libecap (1994).
3. The seminal work on efficiency wages is Shapiro and Stiglitz (1984).
4. The economics of this issue is slightly more complicated than this discussion suggests (Craig 1995).
5. See Chapter 10.
6. For a comparison and review of the basic features of the various public sector pensions plans see Hustead and Mitchell (2001) and the papers in Mitchell and Hustead (2001).