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AMERICAN PATERNALISM AND THE ONE FUND SOLUTION

*Gordon T. Butler**

The Republicans want an ownership society.
What they mean is that you are on your own. [1]

Barack Obama, 2008

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[1] *See* RAHM EMANUEL & BRUCE REED, THE PLAN: BIG IDEAS FOR AMERICA 43 (2006) ("That was the central promise of Bush's Ownership Society: If Americans agreed to a riskier retirement (or health plan or public school system), went the argument, they'd have the chance to earn a higher return.").

I. INTRODUCTION

For years Americans have heard dire warning from economists and politicians that Americans save too little and that by saving too little not only will the growth of the American economy be retarded, but individual Americans will face uncertain futures.[2] At the same time Americans are admonished that they must continue their heavy and debt financed spending in order to keep the nation and the world from economic slowdown and recession.[3] The American consumer is the engine of worldwide economic growth and prosperity. Politicians are all too accommodating by providing tax and other incentives to save and to spend.

The result is that America has experienced a party over the last thirty years as the country has low taxes coupled with increased Federal spending financed by the creation of the largest national debt in history and the largest expansion of personal debt ever seen. Americans have also come to the point where a two wage-earner family is the only economic unit able to maintain a respectable household standard of living. At the same time we have been all too willing to overwhelm our children with the burden of starting life with heavy personal educational debt. There is the belief that such burdens can be borne forever since the only question is whether you can pay the accruing interest which is kept at a minimum by an aggressive low-interest monetary policy endorsed by the Federal Reserve. Is there no end to the party? Like other debtors, someday may we be forced to consider liquidating assets? Can we sell Alaska to Russia or Texas to Mexico?

It has been recognized for half a century that children born between 1946 and 1964, called the "baby boomer" generation,[4] will reach the Social Security full retirement age of 66 beginning in 2012. The impact of 78.8 million baby boomers on the social fabric of American culture has been to dominate and change each age group as it passed through that age. It is now poised to cause an enormous strain on the nation's ability to fund the retirement income (Social Security) and health care (Medicare) promises made to them in 1936 and 1966 and enhanced several times along the way.

To meet the needs of the baby boomers and their children the United States Federal Government ("Federal Government") has taken numerous steps by creating incentives under the Federal Income Tax Code (the "Tax Code") for

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[2] RONALD T. WILCOX, WHATEVER HAPPENED TO THRIFT?: WHY AMERICANS DON'T SAVE AND WHAT TO DO ABOUT IT (2008).

[3] How can these two constant refrains be consistent? Perhaps it is simply a matter that we must spend in the short term but save in the long term and no one knows when the short term becomes the long term. Nevertheless, this inconsistency allows politicians to blame every economic problem on the American consumer.

[4] The baby boomers are often broken into the "early boomers," those born between 1946 and 1955, and the "late boomers," those born between 1956 and 1964.

housing, education, health care, retirement, and emergencies (collectively referred to as the "family planning challenges"). All of these areas have been hot topics of conversation in Washington D.C. and are getting hotter as 2012 looms closer. You can see this in recent publications by a former Speaker of the House,[5] the current White House Chief of Staff,[6] a prominent U. S. Senator,[7] a sociologist,[8] an economist,[9] a journalist,[10] a law professor,[11] and a martial artist.[12] All have addressed the issue and proposed solutions. One common thread of these solutions is that they all presume the ability of the Federal government to successfully affect such solutions and to some extent they all predate the current economic crises that may overshadow and undermine the government's ability to carry out any serious reform or even fulfill its promises.

Much of this article will focus on retirement planning because it presents unique challenges in which individuals must be able to understand the long-term impact of investment returns, taxes, and inflation on their planning. In this area economist Teresa Ghilarducci's recent book, *When I'm Sixty-Four*, provides a wealth of information about approaches to funding retirement including a plan to supplement Social Security income and will be discussed extensively in this article.

Part I of this article will consider several problems faced by individuals seeking to save for their future needs and the complexity presented by current incentives facilitated through the Tax Code. Part II will explore various ways families have addressed the family planning challenges and the support for such solutions provided by the Tax Code. Included in Part II will be descriptions of several proposed plans, including the One Fund Solution, to resolve the coming crisis. Part III will discuss criteria for selecting a solution and will advocate the One Fund Solution which recognizes that long-term building of family wealth is the solution that can, over the long term, minimize the role of the Federal Government in individual decisions and allow maximum life choices to a free self-governing people.

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[5] NEWT GINGRICH, REAL CHANGE: FROM THE WORLD THAT FAILS TO THE WORLD THAT WORKS (2008) [hereinafter GINGRICH, REAL CHANGE]; NEWT GINGRICH, WINNING THE FUTURE (2007) [hereinafter GINGRICH, WINNING THE FUTURE].

[6] EMANUEL & REED, *supra* note 1.

[7] SENATOR CHUCK SCHUMER, POSITIVELY AMERICAN: WINNING BACK THE MIDDLE-CLASS MAJORITY ONE FAMILY AT A TIME (2007).

[8] CHARLES MURRAY, IN OUR HANDS (2006).

[9] TERESA GHILARDUCCI, WHEN I'M SIXTY-FOUR: THE PLOT AGAINST PENSIONS AND THE PLAN TO SAVE THEM (2008).

[10] MATTHEW MILLER, THE TWO PERCENT SOLUTION: FIXING AMERICA'S PROBLEMS IN WAYS LIBERALS AND CONSERVATIVES CAN LOVE (2003).

[11] DANIEL SHAVIRO, MAKING SENSE OF SOCIAL SECURITY REFORM (2000).

[12] CHUCK NORRIS, BLACK BELT PATRIOTISM: HOW TO REAWAKEN AMERICA (2008).

The One Fund Solution can be funded by recognition that Federal Paternalism should support a floor or "safety net" for its citizens and insure full, fair, and accurate disclosure of financial information provided within the safety net, but require citizens that desire more than the paternalistic safety net to assume responsibility for building their own wealth and pay current taxes on accumulations. The One Fund Solution is modeled after the traditional whole life insurance policy that has successfully provided a life-time wealth building strategy with minimal investment decisions on the part of the policy holder. The insurance model coupled with the assumption that government has a responsibility to exercise a degree of paternalism to insure people are not left without a "safety-net" can provide the individual with the financial protection needed. At some point the Federal Government must recognize there are limits to the use of tax incentives and if the tax system is stripped of numerous other tax incentives to fund the One Fund Solution there will be sufficient revenue to fund the transition from the current Social Security system over an extended period of time. The key to financial security is that individuals start saving when they are young, coupled with the government providing protection against inflation and taxation. The article concludes that honesty and integrity are the hallmark of free government and that solving a problem that has been building for over 70 years may take 70 years to resolve.

II. AMERICAN PATERNALISM

In the 1930s the Federal Government undertook to provide a universal retirement income system that would provide a minimal amount of income for each person to live on after reaching age 65. At the time life expectancy was short and funding was minimal. During the 1940s the Federal Government, through its income tax system, promoted employer based health care by providing tax deductions and income exclusions for health care benefits. In 1946 the Federal Government took another step into the economy by undertaking to guarantee full employment for all Americans.[13]

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[13] RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 247 (1954).

> In spite of their failure to end the depression, the policy makers of the thirties did at least present a new philosophy of prosperity. Under this revised concept the source of prosperity was at the bottom of the income scale rather than the top; the restoration of good times depended upon better economic conditions among all groups and all along the economic line. Prosperity was not a class affair, but had to circulate freely throughout the entire population. . . . The core of this philosophy . . . finally emerged in the Employment Act of 1946, which recognized that the Federal government should not stand idly by the wayside when the economy subsided into depression, but rather should assume an affirmative responsibility for the maintenance of employment, production and purchasing power.

Id.

In 1966 the Federal Government created the Medicare program to guarantee health care to all Americans reaching age 65. Beginning in the 1970s and continuing to the present time the Federal Government has created tax incentives for American taxpayers to save money through restricted trust accounts to provide for future needs for education, health care, and retirement. Throughout this period, and to the present time, a variety of tax incentives in the Tax Code promoted home ownership. The bottom line is that when considering family planning challenges the Federal Government has become the dominant player and individuals make no decisions without considering the impact of federal authority.

The result of all this federal action is that people have poured money into homes and savings plans on the understanding that they were acting responsibly and playing their part in securing their own future. The effect of all these programs is now being questioned as the value of investments in the stock market plummeted 40–50% in 2008 and the value of homes plummeted 40% or more over two years putting the value of many homes below the amount of mortgages secured by the home.[14]

It was the willingness of Americans to borrow on their homes to obtain a tax deduction for the interest that provided the consumer wealth to fuel the world's economic engine. People now find those dreams evaporating as the financial system borders on collapse and as the Federal Government seems to find unlimited resources to "bailout" every bad decision in the finance and banking communities. The already recognized insurmountable problems of funding entitlements for Social Security and Medicare are now dwarfed as trillions of U.S. dollars are pledged to support the basic structure of the economic system. The banker of last resort is tapping itself to the limit and consequently, there remains no banker of last resort. The artificial prosperity is in danger of evaporation.

Putting citizens on their own in planning for retirement has been facilitated by a finance theory that held that a well balanced portfolio eliminates firm specific risk and the capital asset pricing model permits an investor to minimize risk associated with a given projected return.[15] In other words the investor can

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[14] In a recent editorial, editor-in-chief and billionaire Mortimer B. Zuckerman characterizes the current crises as one of confidence in which the banks and the American people need to begin spending. Zuckerman states, "[n]ot surprisingly, American consumers are hoarding cash, cutting spending to replenish the $10 trillion plus in collective wealth they have lost through declines in their stockholdings and their housing. Individually understandable, collectively disastrous." Mortimer B. Zuckerman, *No Time To Lose*, U.S. NEWS & WORLD REPORT, Mar. 2009, at 80.

[15] An additional principle making investment acumen unnecessary is the efficient capital market hypothesis that posits that in an efficient market all available information is reflected in the current price of the stock. The effect on the market decisions of this principle is as follows:

> If capital markets were perfect, then it would simply not be possible (apart from corruption or a failure to diversify the portfolio across a sufficient number of assets)

take a random walk down Wall Street and select an appropriate fund to meet his general investment objectives and forget about the return because it will be 7–9% over the long term, thereby beating inflation. Recent events call that strategy into question and even if it works as planned the individual investor must be willing to weather the investment roller coaster associated with the volatile movements of stock on Wall Street.[16] It is also important to recognize that saving for retirement is often deferred to the last 10 to 15 years before retirement because the costs of establishing and raising a family capture all available revenue up until age 50.[17]

The uncertainty of the stock market can be seen in a simple example: an individual whose income increases from $40,000 in 1991 to $96,000 in 2009 and invests 20% of his income in a relatively conservative stock mutual fund. If the individual retires on December 31, 2007 the value of the fund is $409,000, but if the retirement is 14 months later the value would have fallen to $237,000 after making the 2008 and 2009 contributions. A bond fund receiving the same contributions over the same period would have produced a value of $356,000.[18]

> for funds to be badly invested. *Efficient markets ensure that returns are commensurate with risk*, as long as the investment portfolio is sufficiently diversified. Given efficient markets, those that accuse the government of investing poorly therefore must be accusing the government either of corruption, or of choosing a portfolio that does not correspond to the risk preferences of pensioners. With respect to the latter, little evidence is typically presented.

Peter R. Orszag & Joseph E. Stiglitz, *Rethinking Pension Reform: Ten Myths about Social Security Systems, in* THE WORLD BANK, NEW IDEAS ABOUT OLD AGE SECURITY 1, 37 (1999) (emphasis in original).

[16] JEREMY J. SIEGEL, STOCKS FOR THE LONG RUN: THE DEFINITIVE GUIDE TO FINANCIAL MARKET RETURNS AND LONG-TERM INVESTMENT STRATEGIES 140–141 (4th ed. 2008) (questioning the value of the random walk theory, the capital asset pricing model, and the efficient market hypothesis).

[17] It goes without saying that stocks are risky at least over the short-term and for most individuals they will be making their largest investments in the years immediately preceding retirement when other obligations have been discharged. People are generally risk adverse. Orszag & Stiglitz, *supra* note 15, at 17.

[18] The example assumes a 48 year-old individual earning $40,000 in 1991 and getting 5% per annum salary increases. By 2009 he is earning $96,000 per annum. The individual decides to invest 20% of his income in a tax advantaged account over the next 19 years until normal Social Security retirement age of 66. The individual decides to invest in TIAA-CREF mutual funds making deposits into his account at the end of each year. TIAA-CREF is a respected company providing retirement products to the non-profit community for over 90 years. Fund performance data is available back to 1991. *See* TIAA-CREF: Fund Research, http://www.tiaa-cref.org/performance/index.html (last visited March 31, 2009). Over the 19 years the individual would invest $290,000 and the value of that account, if the investment was 100% in the basic "Stock Fund" would be $409,000 on December 31, 2007 but would fall to $237,000 by February 28, 2009. The same investment in the "Bond Fund" would be valued at $356,000 as of February 28, 2009. The example assumes a full year investment in 2009 and that the end of year value equaled the ending value on February 28, 2009. Other investment results for TIAA-CREF funds as of February 28, 2009 under the same assumptions would be: equity index fund—$235,000; social choice fund (a balanced fund)—$287,000; and 3% bank passbook account—$309,000.

Securities lawyers talk about how disclosure can be made user friendly and one wonders whether 200 million Americans want to become investment managers providing adequate monies for their own retirement and medical needs. Indeed one need look no farther than major United States companies such as General Motors to realize that managing wealth for retirees is no easy task. In fact, it is a task many companies are disposing of as quickly as practicable.[19] Even the Federal Government, with its management of revenues to provide for its promised benefits under Social Security and Medicare, has proved incapable of providing a sense of security that people will actually receive the benefits promised.[20]

Americans are admonished by the Federal Government to save. The failure of Americans to save is seen as threatening to the national well being. The savings rate is now less than zero which means that the people are consuming their wealth. On the other hand the American consumer is seen as the world's engine of economic growth. During recent recessions the consumer has been seen as the force in the economy that kept the economy growing. How is it that the American consumer can be both the engine to maintain economic growth and the source of savings to fuel long-term economic growth? Are these contradictory burdens?

Senator Chuck Schumer sees himself as representing the working class American and wants to focus his rhetoric in such a way that they can understand his decision. He has created his average constituent family:

> Joe and Eileen Bailey live in Massapequa, a medium-size suburb in Nassau County, Long Island. They are each 45 years old. Their home is about 30 minutes from the outskirts of New York City, but they don't go into town very often. They have a house, a mortgage, property taxes that never cease to go up, monthly

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[19] In the third of a trilogy of articles addressing minimum funding rules and benefit restrictions on defined benefit plans covered by ERISA and the Internal Revenue Code, the author analyzes the impact of the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006). Kathryn J. Kennedy, *The Demise of Defined Benefit Plans for Private Employers*, 121 TAX NOTES 179 (2008). The author sees the new law as drastically accelerating minimum funding requirements and imposing benefit restrictions on underfunded pensions and as being part of an effort to protect the Pension Benefit Guarantee Corporation against liability for underfunded plans. Pointing out that the stock market decline in the early 2000s along with depressed interest rates produced a "perfect storm" that left many plans underfunded the author concludes that while the purpose of the new rules may be applauded, the effect will be to cripple the approaches employers will have to meeting the new requirements. *Id.* at 180, 181, 201. Finally, the author states: "In response to these new rules, plan sponsors of existing defined benefit plans are drastically freezing accruals under the plans to minimize future plan liabilities, and are moving to defined contribution plans for future accruals." *Id.* at 201.

[20] It is asserted that Social Security is the individual's most secure source of retirement income. GHILARDUCCI, *supra* note 9, at 29. Social Security is not a risk-free investment since it is subject to political as well as long-term funding uncertainties. Shaviro, *supra* note 11, at 40.

> payments for two cars, and three kids in the local public schools. They both work because they want to and because they need to. Joe works for an insurance company and Eileen is a part time administrative assistant at a family physician's practice. They are middle class by New York standards, together earning about $75,000 per year, which translates to about $50,000 in a typical American community.[21]

Schumer goes on to discuss the Bailey's elderly parents, optimistic attitude, worries about the costs of health care and college, the chance of terrorist attacks and a multitude of other concerns that are common discussions around the middle-income kitchen tables in America. For Schumer, the Baileys are always at his side and he speaks to them when he speaks publicly. He wants to make their lives better.

Using the Baileys as our model family let's look at the family's financial plan. Assuming they are fortunate, they can begin their $50,000 income at age 20 when they are married and start life free of debt. They begin only with the American dream. They want a home of their own, college educations for their three children, health care, and a secure retirement. They also should be ready for an emergency. Let's say they need $25,000 in three years as a 10% down payment on a home, $25,000 a year for six years to fund three college educations beginning in 20 years, $25,000 in years 30 and 40 to fund family emergencies, and sufficient funds to retire in 45 years. The Baileys have determined that they can invest 20% of their income toward meeting these family needs. Ignoring inflation and assuming that the Baileys can invest at a 4% rate of return and any internal buildup of investment earnings is not currently taxable, the Baileys will begin retirement with a fund valued at $658,000—enough to allow the Baileys to withdraw $40,000 per year (80% of their pre-retirement income) until they are 91 years old.

This example does not address the Bailey's medical needs. It could be assumed that they are covered by a family health insurance policy provided by the Bailey's employer and in retirement they are covered by Medicare, although the deductibles and the Medicare Part B and D would have to be paid for by the Baileys.

Since the Baileys are saving $10,000 per year they have to decide where they will save so that that the savings can build up in tax favored accounts. Here they have considerable choice since the Tax Code has provided several vehicles. They could invest in a 401(k) or 403(b) plan provided by his employer or one of

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[21] SCHUMER, *supra* note 7, at 23.

several types of individual retirement accounts.[22] Each plan has its own specific characteristics. The contributions may be tax deductible in the year made, or not deductible. If they are not tax deductible they may provide tax free income when the funds are withdrawn later for retirement.[23]

In planning for their children's education they have several investment options including Coverdale accounts that permit limited contributions for each child and allow the monies to grow tax free and be distributed tax free if used for certain educational expenses.[24] The Baileys also have the option of investing in prepaid college funds sponsored by various state agencies that can either provide certain tuition advantages at state colleges or merely provide investment vehicles for college savings.[25] In addition, as the college expenses are incurred, or loans are taken to pay for college expenses, the Baileys will have a number of deductions or tax credits that are available to help mitigate the cost of college by reducing the tax bill the Baileys will pay each year if they pay any tax at all.[26]

As for health care, the cost of the health insurance provided by the Bailey's employer is not considered income to the Baileys, and when claims are filed under the plan the benefits are not taxed to the Baileys.[27] Had they not been covered they may have availed themselves of a Medical Savings Account ("MSA") and purchased a high deductible health insurance policy and invested a certain amount

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[22] I.R.C. §§ 401(k), 403(b), 408 (2008). References to "section" numbers refer to sections in the Internal Revenue Code of 1986 (as amended).

[23] The individual type of investment can have significant impact on a person's savings depending on their marginal tax rate at the time of investment and at the time of distribution. However, assuming constant tax rates the traditional IRA permits tax deductible contributions and the Roth IRA, which permits tax deductible withdrawals, are economically equivalent investments. *Compare* I.R.C. § 408 (governing traditional IRAs) *with* I.R.C. § 408A (2008) (governing Roth IRAs). However, since both IRAs have a $5,000 annual contribution limit, a $5,000 contribution to a Roth IRA represents a larger investment than the same amount in a traditional IRA because the Roth IRA contribution produces a tax free distribution whereas distributions from the traditional IRA are reduced by the taxes paid upon distribution. I.R.C. § 219 (2008). Assuming that both investments have the same rate of return and both taxpayers make equivalent contributions, then the investments are economic equivalents. Further, two contributors to Roth IRAs can have greatly different amounts of tax free income depending on their respective investment choices. MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 765 (6th ed. 2009).

[24] I.R.C. § 530 (2008) permits contributions to a Coverdell education savings account of up to $2,000 per year and permit tax free distributions for qualified educational expenses at the primary, secondary or higher education levels.

[25] I.R.C. § 529 (2008).

[26] I.R.C. § 25A (2008) authorizes tax credits of up to $1,500 for the first two years of post secondary education (Hope Scholarship Credit) and up to $2,000 for education expenses not limited to the first two year of post secondary education (Lifetime Learning Credit).

[27] I.R.C. §§ 105, 106 (2008).

in an MSA to cover out of pocket future costs.[28] If the Baileys were covered by an employer health care policy, then each year the Baileys can set money aside tax free in a "flexible spending" account to provide for medical expenses that are not covered by their health insurance or to cover deductible amounts under the plan.[29]

To avail themselves of all these tax benefits the Baileys need the help of professional planners. With their 2009 gross income of $50,000 per year the Baileys take the standard deduction ($11,400) and with three children they are entitled to five personal exemptions ($3,650 each)—leaving the Baileys with a taxable income of $20,350. This places them in the 15% marginal rate and with tax before credits of $2,217. If their children are not yet 17 they will be entitled to child tax credits of $3,000 which reduces their 2009 federal income tax to zero. For the Baileys this means that the elaborate assortment of tax breaks described in the previous paragraph (other than those provided for employer provided health care) are essentially meaningless. Senator Schumer's New York Baileys making $75,000 per year would have some federal tax breaks but they would be valued at a 10% or 15 % marginal tax rate.

Each year the Joint Committee on Taxation produces the tax expenditure budget estimating the impact of various tax benefits on revenue collections for the current year and for five and ten years in the future. A "tax expenditure" is defined under the Congressional Budget and Impoundment Control Act of 1974 ("the Budget Act") as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[30] For the Baileys the above items are all considered tax expenditures. The

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[28] I.R.C. §§ 106, 220 (2008) (providing for Archer Medical Savings Accounts).

[29] I.R.C. § 125 (2008) permits flexible spending plans that reimburse participants for out-of-pocket medical expenses incurred during the plan year provided that an election to defer a specified amount occurs prior to the beginning of a plan year and any funds in the plan not used during the year are forfeited to the employer. *See* BORIS I. BITTKER, MARTIN J. MCMAHON, JR., & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS 8–40 (3d ed. 2002).

[30] Pub. L. No. 93-344, § 3(3), 88 Stat. 297 (1974). Prior to 2008 the Treasury Department identified tax expenditures as deviations from a "normal" tax base. Since use of a "normal" tax base raised considerable controversy, in 2008 a new approach was followed by classifying tax expenditures as "Tax Subsidies" or "Tax-Induced Structural Distortions." A tax subsidy is "a specific tax provision that is deliberately inconsistent with an identifiable general rule of the present tax law . . . and that collects less revenue than does the general rule." JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2008–2012, JCS-2-08 at 5 (Oct. 31, 2008), *available at* 2008 WL 4874301 [hereinafter JOINT COMM. ON TAXATION]. Tax Subsidies are then divided into Tax Transfers (generally transfers to persons not having a tax liability), *id.* at 11–12; Social Spending, *id.* at 12–18; and Business Synthetic Spending, *id.* at 19–24. Sometimes the categories overlap. For example, the mortgage interest deduction on owner occupied housing could be classified as social spending if it is viewed as consumption or as business synthetic spending if it is viewed as a substitute for income producing investment. *Id.* at 13–14.

lost revenue over the five year period from 2008 to 2012 from tax expenditures affecting the Bailey's tax liability includes the following:

	2008–2012 (in billions of dollars)[31]
Employer-provided Health Insurance Premiums	$680.3
Deduction of Mortgage Interest on Owner Occupied Housing	443.6
Property Tax Deduction (homes)	112.0
Defined Benefit Pension Plans	212.9
Defined Contribution Pension Plans	341.4
Roth and Traditional IRAs	98.3
Nonrefundable Child Tax Credit	105.1
Hope and Lifetime Learning Credits (higher education)	22.6
	Total $2,016.2

These are enormous amounts and the Baileys take advantage of some of them but because of their limited income the Baileys don't get the same benefit as taxpayers with higher incomes in higher marginal tax brackets. Senator Schumer may keep the Baileys in mind but the bulk of the massive tax expenditures pass them by in favor of high income taxpayers.[32]

By injecting itself into these areas of personal living the Federal Government has taken on a major responsibility for housing, health care, education, retirement, and emergency aid. With this massive flow of money into these vital areas one must ask the question about who benefits most and about the impact of such money into the system on prices. Certainly prices for education, health care, and housing have seen incredible increases in recent years. Could it be that government assistance is pushing prices up and out of reach of the Baileys—the very people the programs are designed to assist?

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[31] Tax expenditure values are taken from various charts in JOINT COMM. ON TAXATION, *supra* note 30, at 48–57. Specifically, Employer-provided Health Insurance Premiums, *id.* at 56, Deduction of Mortgage Interest on Owner Occupied Housing, *id.* at 51, Property Tax Deduction (homes), *id.* at 52, Defined Benefit Pension Plans, *id.* at 57, Defined Contribution Pension Plans, *id.*, Roth and Traditional IRAs, *id.*, Nonrefundable Child Tax Credit, *id.* at 55; Hope and Lifetime Learning Credits (higher education), *id.* at 54.

[32] The perverse effect of various tax expenditures was illustrated in 1972 by the originator of the tax expenditure budget who compared two families—one had $200,000 in income and was in the 70% marginal rate and the other earned $10,000 and was in the 19% marginal rate. The first received $70 back from the government for each $100 of mortgage interest on their home while the other only $19. GRAETZ & SCHENK, *supra* note 23, at 58–59. Professor William Andrews, objecting to upside-down subsidies, argued that deductions should be considered as refinements of an ideal personal income tax, the purpose of which is to impose a "uniform graduated burden on aggregate consumption and accumulation." William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 311–313 (1972). Andrews finds many distinctions that are irrelevant to an ideal personal income tax and should be purged from the tax. *Id.* at 316.

We saw how saving 20% of their wages allowed the Baileys to fund a home purchase, education, weather some family emergencies, and have an adequate retirement. We ignored inflation, health care (assuming that was provided by employers and Medicare), taxes, and Social Security. We should now ask the question of the appropriate level of savings. Let's look at the Bailey's wage package (to include the value of major fringe benefits) in a relatively broad way.

Basic wage		$50,000
Family Health Insurance		12,000
Employer Social Security contribution		3,200
Employer Medicare contribution		688
	Total Wage Package[33]	**$65,888**
Less:	Health Insurance	$(12,000)
	Social Security	(6,400)
	Medicare	(1,375)
	Tithe (the Baileys attend church)[34]	(5,000)
	Net Income	**$41,113**

The Baileys have $41,113 to use for other spending. From that amount they will find that they have to dedicate a portion for medical expenses not covered by their employer health insurance such as physician and drug co-pays, glasses, and other medical supplies that could easily amount to over $1,000 per year. The Baileys must also determine how much they will save. In some respect they are saving $7,775 (11.8%) of their wage package for retirement in the form of Social Security and Medicare.

Since Social Security and Medicare payments are not available for home purchase, education, current health care, or emergencies, the Baileys must save in some other way. Since they have determined to save 20% of their income based on their "base" wage, they conclude that Social Security will provide some retirement income so they will save $3,600 per year in addition to the $6,400 paid to social security. This savings will be used to cover the down payment for the home, education, and emergencies.

[33] Health insurance, Social Security, and Medicare are included in the Bailey's wage package since if it were not provided by the employer or required by payroll taxes the employer would increase the Bailey's gross wage.

[34] SCHUMER, *supra* note 7, at 24.

> Socially, the Baileys are not anti-authority; in fact, they respect authority. They attend church regularly, though not every week. They accept the structure brought to their lives by religion, work and governmental institutions. They want these structures to be successful and strong, and they are leery of those who seem to always criticize them.

Id.

Saving $3,600 per year as set forth above would mean that the Baileys would delay the home purchase because they would need to wait longer to accumulate the down payment, which they would do in year seven. Continuing their saving at this rate and earning the 4% annual return they will be able to pay for some college but, by the time the six years of $25,000 is completed, they will have borrowed approximately $60,000 which they will pay off using their annual savings of $3,600 per year. Then, when the emergencies hit at age 50 and 60 and those expenses are paid, the Baileys will discover they owe $96,000 when they are age 65 and all they will have is the Social Security amount when they retire. That Social Security benefit, using a 2007 estimate, would be $1,607 per month or $19,283 per year. Social Security will replace 39% of the Bailey's pre-retirement income. Reliance on Social Security has left them with $96,000 in debt and only a $19,283 pension for life.

To replace their pre-retirement income at 80% they would need to save and invest $7,000 per year to pay off the housing down payment, college expenses, emergencies and $20,000 per year from age 65 to age 95 to supplement the nearly $20,000 per year Social Security benefit. This example is terribly over simplified—Social Security has benefits in addition to the retirement benefit and do-it-yourself pensions have many pitfalls as Teresa Ghilarducci clearly points out.[35] A particularly glaring oversight is that we have assumed zero inflation, an assumption that can have devastating effects on the Bailey's best planning.[36] But we have pointed out that the Baileys, at least while they have minor children in the family receive few immediate tax benefits, although with proper planning they will have invested in Roth-type tax advantaged investment accounts so that their retirement income will have a minimal tax burden and if they die before exhausting their savings their children will receive some benefit.

Finally, the Baileys began saving at age 20 and their emergencies occurred late in life. Had the emergencies occurred earlier or they began saving at age 30 instead of age 20 their lifetime savings would be considerably less. It is also possible that the Baileys might inherit money unexpectedly from their parents which would add to their family wealth.[37]

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[35] GHILARDUCCI, *supra* note 9, at 116–138 in a chapter entitled "Do-It-Yourself Pensions."

[36] Interestingly, Siegel reports the real rate of return on stocks of 6.8% per year over 204 years from 1802 through 2006. This growth offsets 2.5% inflation. Since World War II, during which the United States experienced all the inflation it experienced in 200 years, the average real rate of return was 6.9% per year which is virtually identical to the prior 125 years during which there was no inflation. SIEGEL, *supra* note 16, at 12–13.

[37] *See* Peter Ferrara, *Short-Circuiting the "Third Rail": Social Security Personal Accounts and the Traditional Family*, FAM. POL'Y REV. 75, 88 (Spring 2003). Ferrara points to the positive benefits of intergenerational wealth transfers:

> More than simply aiding the family financially, these cross-generational financial assets can help to bind the family more closely. Instead of becoming mere dependents or forgotten government beneficiaries, retired parents and

One other significant factor is inflation.[38] It was not considered in the example but a brief comment will demonstrate its devastating effects. If the Bailey's age 20 income were $20,000 and inflation during their lifetime were 4% per year and the Baileys were able to achieve wage increases at 2% above inflation then at age 65 the Bailey's income would be $275,000. Inflation alone would have increased the $20,000 income to $117,000 so the Bailey's real wage has slightly more than doubled. If they determine they would like to retire on 80% of pre-retirement income of $220,000 then by age 80, inflation would require an annual income of almost $400,000 to maintain that level of purchasing power. The point here is that few people can conceive of planning for the combined effects of investment return, inflation rates, levels of savings, and retirement needs without considerable assistance.[39]

Rahm Emanuel and Bruce Reed see the old America with its security and sense of responsibility as having disappeared during 1970s, 1980s, and 1990s as financial strains forced more and more women into the workplace and forced longer hours on most workers.[40] They claim that President Bush aggravated the problem.[41] Nevertheless America has changed:

> grandparents can continue to play a central, even leading role in helping and guiding the family. The family will collaborate more intimately, working together to preserve and manage its nest egg.

Id.

[38] Inflation is considered as a natural part of America's financial landscape and deflation the most feared result. Newt Gingrich favors "a balanced budget, limited government, low taxation, relatively stable inflation (1 to 3%), and low interest rates as the best way to promote prosperity." GINGRICH, WINNING THE FUTURE, *supra* note 5, at 145.

[39] A simple example of the impact of taxes and inflation on savings can be illustrated by a taxpayer that invests $10,000 for one-year at 5%. At the end of the year the account has a value of $10,500 and the individual, assuming a 25% marginal tax rate, owes $125 in Federal Tax. This leaves the taxpayer with $10,375. However, assuming 3% inflation it will take the taxpayer $10,300 to restore the purchasing power of $10,000 the year before. Thus the taxpayer has some gain from his investment but far less than the 5% nominal interest.

[40] EMANUEL & REED, *supra* note 1, at 37.

> When the economic woes of the 1970s brought a sudden halt to the steady rise in living standards they had grown used to in the 1950s and 1960s, families adapted by sending more women off to work. According to the Families and Work Institute, two-earner families now work an average of ninety-one hours a week—ten hours more than a quarter century ago. Like American business, families have downsized, waiting longer to have children and having fewer when they do.

Id.

[41] *Id.* at 40.

> Respond to the first widespread rip in the social contract, the disappearance of pensions, by making social Security's troubles worse. And as a final burden to middle-class aspirations, abandon the fiscal responsibility that sparked the longest economic boom in American history, and instead saddle us with enormous foreign debt.

Id.

> Yet for all practical purposes, the world we grew up in no longer exists. The generations before us built a land of opportunity and certainty, where a job could last a lifetime, one salary could support a family, a house came with only one mortgage, a pension could guarantee a secure retirement, and one generation's decades of hard work and sacrifice could give the next generation a better life. Those certainties were America's security blankets—and one by one, economic and social changes have taken them away.[42]

The example of the Bailey's lifetime saving plan only shows the power of consistent savings and compounding. Many of the events noted above could interrupt this simple plan. The 20% savings rate for the Baileys is somewhat higher than the current amount paid into Social Security and Medicare. While a 4% rate of return is lower than historically earned in the stock market, the effects of inflation have been ignored.

A serious question in these matters is whether the Baileys will have any choice in determining their future. The Social Security system takes the fund that the Baileys could save for their own future and replaces it with a schedule of benefits determined by Congress to meet the needs of a nation of nearly 300,000,000 people. The individual has lost control over his destiny. Presumably, left to themselves, individuals will not rationally plan for their futures and will spend their entire income leaving inadequate resources to meet the needs of themselves and their family. This theory is taken and incorporated into the Tax Code in numerous ways that prevent the individual from taking control of their lives.

The Tax Code is used as a method of exerting a paternalistic oversight of the population. The Social Security System is a classic example where workers are forced to contribute to a system that will work more or less independent of the workers' decisions to provide disability and death benefits for themselves and their family and a retirement benefit when the worker becomes of age. But, the benefit is expensive and numerous studies indicate the workers would be better off investing themselves.[43] But investing is not as simple as it sounds.

Any of the vital areas of life planning could be explored to demonstrate Congress' irrational control over tax incentives. Home ownership, health care, education, and retirement planning are all heavily controlled through the Tax Code. Within each area and between areas, provisions overlap and provide contradictory

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[42] *Id.* at 32 ("We console ourselves with high-definition, flat-screen color TVs, but all our dreams are still in black-and-white. Ozzie and Harriet don't live here anymore, and their children can't stop squabbling about what to do now that they're gone.").

[43] *See generally* Ferrara, *supra* note 37, at 76.

incentives.[44] Each area raises a complex set of decisions and limitations but all areas raise the question of why the American public is restricted by such a set of paternalistic rules when simple solutions could be affected. Here, we will explore the provisions dealing with health insurance.

The contradictory nature of tax legislation is seen in the history of I.R.C. § 162(l) which allowed self-employed individuals to deduct 60% of the amount paid in 1999 (prior to 1996 it was 25%) for health insurance for medical care for the taxpayer, his spouse, and dependents.[45] At that time the percentage was scheduled to increase gradually to 100%. The percentage and the phase-in period changed four times during the 1990s. When fully phased in, self-employed individuals were finally granted the same tax advantages for their health insurance coverage as employed individuals. An examination of health care provisions will show great disparity in the tax benefits received by differently situated individuals. The erratic nature of the relief reflected the distortion in the tax system by virtue of the efforts at deficit reduction which dominated tax policy during much of the 1990s.

A fundamental tax policy objective is that similarly-situated taxpayers receive the same tax treatment. Therefore, similarly situated taxpayers should receive the same level of tax support for medical costs. In this case, employed, self-employed, and unemployed persons of similar income levels should receive the same support for medical costs. Under I.R.C. § 162 an employer deducts the full cost of employee health insurance plans and under I.R.C. § 106 the employee excludes the value of employer-provided coverage under health plans from gross income. Thus, employed persons get the full benefit of the tax deduction for health insurance. Self-employed persons (e.g., sole proprietors, partners) were historically limited under I.R.C. § 162(l).

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[44] GRAETZ & SCHENK, *supra* note 23, at 756. Graetz and Schenk illustrate the conflicting nature of many tax policies:

> Legislation passed in 2006 permitted additional taxpayers to convert a regular IRA to a Roth IRA by removing the income limitation on conversions in 2010. This was done to move revenue (the tax paid on such conversions) into the five-year budget window so that the legislation would not cost more than allowed by budget reconciliation instructions. Obviously, only taxpayers who think they will save taxes by converting will do so. The additional revenue was used to pay for extensions of the 2003 rate cuts for capital gains and dividends. So Congress seems to have found its own version of the Golden Goose—a way to pay for tax cuts for the wealthy with more tax cuts for the wealthy.

Id.

[45] This problem is discussed in Gordon T. Butler, *The Line-Item Veto and the Tax Legislative Process: A Futile Effort at Deficit Reduction, But a Step Toward Tax Integrity*, 49 HASTINGS L.J. 1, 80–90 (1997).

Taxpayers who are not employed, or who are self employed, fare even worse. Without a deduction under I.R.C. § 162(l), taxpayers paying their own health insurance can only deduct the amount under I.R.C. § 213 as a medical expense. However, I.R.C. § 213 only permits a deduction to the extent medical expenses exceed 7.5% of adjusted gross income. This high threshold was intended to eliminate medical deductions except in extreme cases to help defray extraordinary medical costs. It affords little help for health insurance premiums because the premiums seldom exceed the threshold.

Employed persons get the benefit of deducting many routine costs through deductible medical insurance even though there is no serious medical condition or undue financial burden. Such a result is inconsistent with the theory of I.R.C. § 213. Furthermore, employees covered by cafeteria plans under I.R.C. § 125 can establish a healthcare flexible spending account and take most medical and dental expenses on a pre-tax basis. Taxpayers who receive employer-paid health insurance and persons who pay for their own care (including health insurance), whether self-employed or otherwise, are given unequal tax subsidies for their health care. The extent of confusion in health care has been described:

> Although enormously popular, the tax exclusion for employer-provided health insurance has been the "Titanic" of U.S. domestic policy. It is hard to find a domestic program that rivals the incompetence of U.S. health insurance. While spending per capita is more than twice the OECD [Organisation for Economic Cooperation and Development] average ($6401 versus $2759), we manage to leave about 47 million Americans without insurance. All of the systems of other OECD countries provide (near) universal access at aggregate costs—both as a percentage of GDP [gross domestic product] and per capita—below U.S. expenditures.[46]

A similar analysis can be made in other areas. Complexity abounds in the pension area not only in defined benefit plans and profit sharing plans but in the numerous provisions for private pension savings. I.R.C. § 401(k) plans, 403(b) plans, IRAs, Roth IRAs, pretax IRAs, Roth rollover, IRA rollover, Keogh plans, SIMPLEs (savings incentive match plan for employees), and SEPs (simplified employee pensions) all have their individual limitations and conditions. This paper will focus on retirement tax incentives and will naturally implicate social policy as well as tax policy. Hopefully the reader will conclude, as this author has,

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[46] GRAETZ & SCHENK, *supra* note 23, at 105–109 (citing MICHAEL J. GRAETZ & JERRY L. MASHAW, TRUE SECURITY: RETHINKING AMERICAN SOCIAL INSURANCES (1999)). They also point out that the tax expenditure in 2007 for the exclusion of employer sponsored health care was $145.3 billion for income tax purposes and $100.7 for Social Security payroll tax purposes. *Id.*

that greater freedom for the individual is a desirable and important policy goal and that much of the discussion on the topic is flawed.[47]

II. Retirement Planning Models

There are numerous vehicles that enable families to save for retirement. This section will summarize a number of those vehicles and point out some of the tax advantages associated with each one. We will begin with the most traditional method, the whole-life insurance policy.

A. Insurance Model—After Tax In and No Tax Out

In general there are two types of life insurance; term insurance and whole-life insurance. Term insurance provides a simple death benefit if you die while the insurance is in force. You pay an annual premium that is based on your age and health over the term of the insurance policy. There are many variations of term insurance but, in general, it is not a vehicle for saving for retirement. Premiums are paid with after-tax dollars but policy proceeds at death are excluded from tax.[48]

Whole-life insurance combines a death benefit with a savings feature, and for this reason the annual premium is considerably higher than the premium for a term insurance policy. The increased premium is used to build a "cash value" over the years. That cash value will pay a dividend each year which can be used to reduce the premium, or purchase additional life insurance, so that the final insurance value greatly exceeds the original face value of the policy. The policy is considered a life-time policy so that if the insured dies at any time the face value of the policy will be paid.

A special feature of the whole-life policy is that the cash value provides a source of money from which the policy holder can borrow to meet current needs. The borrowings can be repaid with interest at a determined rate but if they are

[47] The World Bank delineated three pillars: a publicly managed, unfunded, defined benefit pillar; a privately managed, funded, defined contribution pillar; and a voluntary private pillar. Orszag & Stiglitz, *supra* note 15, at 4 (citing World Bank, Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth (1994)). Orszag and Stiglitz address ten myths identified by the World Bank: (1) individual accounts raise national savings; (2) rates of return are higher under individual accounts; (3) declining rates of return on pay-as-you-go systems reflect fundamental problems; (4) investment of public trust funds in equities has no macroeconomic effects; (5) labor market incentives are better under individual accounts; (6) defined benefit plans necessarily provide more of an incentive to retire early; (7) competition ensures low administrative costs under individual accounts; (8) corrupt and inefficient governments provide a rationale for individual accounts; (9) bailout politics are worse under public defined benefit plans; and (10) investment of public trust funds is always squandered and mismanaged. Orszag & Stiglitz, *supra* note 15, at 8–40.

[48] I.R.C. § 101 (2008).

not paid then upon death of the insured the policy proceeds will be used to pay off any policy loans. This borrowing feature allows an elderly policy holder to withdraw an amount each year in the form of an annuity that will be repaid only when the policy matures at death. In this way the policy will provide a pension for the insured. Particularly attractive are the facts that the internal build up of investment earnings are excluded from income tax and that the payment of proceeds at death are tax free to the beneficiary so that when the policy loan is repaid there is no tax impact.[49]

A healthy 20-year-old desiring to purchase a $1 million whole-life policy with a projected 5% per annum internal build up would pay a premium of $5,700 per year. If the insured allowed the policy to build over 45 years, at age 65 the death benefit would be $2,044,851 and the cash value would be $1,054,096—more than enough to guarantee a lifetime $40,000 retirement benefit. This illustration does not account for the need for a down payment for a home, education or emergencies. However, if the Baileys are committed to saving $10,000 per year, the $4,300 remaining after paying the insurance premium would come close to funding those needs, although the Bailey's savings fund would fall to zero and they would have to borrow to fund the education needs and repay the loans with interest after the college period ends. While these projections seem attractive they would undergo considerable adjustment to account for inflation.

Individuals face many decisions related to education, health care, housing, and retirement. Traditionally, the individual provided for these uncertainties through the purchase of life insurance which provided a growing fund that was available to meet the uncertainties of life. These problems were addressed by an individual through discussions and dialogues with a life insurance salesman. The salesman would make projections of policy values using a sophisticated financial analysis and the individual would be instructed on how the buildup of cash values would be available to be borrowed for unexpected expenses, for college or retirement. The numerous tax advantages available for insurance accumulations would come into play to accelerate investment growth thereby making the compounding effects of interest benefit the individual. In this way the ordinary citizen encountered all the sophistication of a Wall Street banker, had financial security assured, and his personal investment decisions kept to a minimum.

Creation of a fund with life insurance characteristics could provide an alternative to the complexity experienced by taxpayers coping with the current system that combines Social Security, private pensions, and private savings. Funded with after-tax dollars, the tax benefits of life insurance policies could easily be extended to the single savings fund concept. Tax free build up and eventual tax free withdrawals could be provided. The tax expenditure for the exclusion of

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[49] I.R.C. §§ 101, 7702 (2008).

investment income on life insurance and annuity contracts totals $154.8 billion over five years (2008–2012). Analyzing these large existing tax expenditures could begin the analysis as to the source of funds to change current systems.

B. Social Security Model

In 1936, the Congress of the United States enacted the Social Security Act providing a vehicle for universal retirement income for nearly all citizens. The system is funded through a payroll tax on all earnings. Initially, the system provided for a 1% tax on an individual's gross earnings matched by 1% paid by employers, and a pension when a worker reached age 65. Since life expectancy for persons over 65 was relatively short the system was well funded and easily paid the benefits. As time passed the number of retirees grew and raising sufficient money to support the retirees became more burdensome.[50] During the 1970s, Congress amended the system so that the individual's initial benefit was indexed to wage increases, but, once the individual started collecting the benefit it was indexed to price increases (cost of living or "COLA").[51] It could be said that each generation would receive the benefit of their generation's productivity and that the purchasing power of the initial benefit would be maintained for life.[52]

Raising the initial benefit based on wage indexing reflects not only price inflation but also productivity increases. This method of calculating initial benefits was instituted in 1975. Because of wage indexing, a person retiring in 2020 will receive benefits 20% higher in real terms than a person retiring in 2003. Those retiring in 2040 will be 60% higher in real terms. Indexing for price inflation only assures each generation the same purchasing power as the previous generation.[53]

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[50] Fertility rates decreased in the 1960s and 1970s until the replacement rate stabilized around 2.1 in the late 1980s. This is called the "baby bust" that followed the baby boom. Other demographics affecting the future of Social Security are the longer life expectancy and a slowing of wage growth in the recent past. Ferrara, *supra* note 37, at 80–81.

[51] Daniel Shaviro sees the Social Security retirement benefit as containing three essential features: (i) forced savings, (ii) limiting portfolio choice, and (iii) a redistribution of income in that some people will receive back more than the value of their tax contributions and other will receive less. He describes the retirement system as a wage tax in which everyone pays during their working years in exchange for a wage subsidy upon retirement such that some participants will receive less than they put in and thus pay a net wage tax. SHAVIRO, *supra* note 11, at 3. Two other features provided by Social Security are survivor benefits and a form of security generally unavailable to most investors—a lifetime annuity with a fixed real payment. *Id.* at 3 n.1.

[52] First, in 1972 benefits were increased by 20% across the board and then, in an effort to block the political bidding wars that occurred biennially, indexed for inflation by making annual cost of living adjustments. In the late 1970s another tweaking of benefits tied the initial benefit to real wages, thereby assuring each new wave of retirees that their benefit would not have been undermined by inflationary pressures. "The 'replacement rate'—a measure of the share of preretirement earnings replaced by Social Security—jumped from 34 percent in 1970 to 54 percent in 1981." MILLER, *supra* note 10, at 200.

[53] *Id.* at 205–206.

A person's initial retirement benefit under Social Security is calculated in a way that results in lower income workers replacing a greater percentage of their pre-retirement income than higher paid workers. Taking a worker's highest 35 years of earnings, an "average indexed monthly earnings" ("AIME") is determined for each worker.[54] A worker's AIME is then divided into three levels with the lowest level multiplied by 90%, the next level by 32%, and the final level by 15%. Applying these percentages to the 2007 levels, a person with a $612 AIME would receive a benefit of $550 while a person with a $3,700 AIME would receive a benefit of $1,560.[55] After the initial benefit is calculated the annual benefit is indexed for price inflation so that so long as wage increases exceed cost of living increases each succeeding generation will have greater buying power from Social Security than the previous generation.[56]

Social Security is a pay-as-you-go ("PAYGO") system meaning current benefits are paid with current taxes.[57] In the 1980s it became increasingly apparent that the system could not be maintained indefinitely with the current payroll tax rates and benefit expectations. The Greenspan Commission was set up with the concurrence of Congress and the President and made recommendations for increased funding as well as a decrease in benefits. Funding was increased by assessing the tax against a higher and higher income base and is currently (2009) being assessed at a rate of 6.4% each for the employee and the employer on the first $106,500. On the benefit side, the age at which full social benefits could be

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[54] Covered earnings before age sixty are indexed for both real and inflationary wage growth until you reach age 60. SHAVIRO, *supra* note 11, at 13. Shaviro facetiously suggests that, if asked, you simply describe the Social Security benefit calculation as, "[t]ake the PIA on your AIME, adjust for your retirement age and spousal benefits, and then just index it." *Id.* The "PIA" is the basic benefit offered at normal retirement age.

[55] *See* GHILARDUCCI, *supra* note 9, at 139–143 for details of this example. Using these percentages gives the lower-paid workers a larger percent of their AIME. In 2007, a person with an AIME of $3,689 would receive an initial benefit equal to 90% of $612 ($550.80) plus 32% of the next $3,070 ($984.64) plus 15% of the next $166 ($24.90) for a total of $1,560.34 or a replacement of 42.3% of their AIME. A person with an AIME of only $612 would receive a monthly benefit of $550.80 which replaces 90% of his AIME. AIME is calculated on the basis of indexing that reflect wage rate increases that include productivity as well as cost of living increase.

[56] *Id.* at 142.

> Every retiree has living standards reflecting the achievements of her or his generation. That the Social Security initial benefit is indexed to wages, and the subsequent benefits are indexed to prices, both reflect a specific philosophical decision about the balance between retirees' standard of living and the standard of living of the workers who support them.

Id.

[57] Suggesting that Congress overrode President Roosevelt in structuring Social Security as a pay-as-you-go ("PAYGO") system, Browning states, "[p]erhaps we would make more progress in reforming the system if we acknowledged Charles Ponzi as the true 'father of Social Security.'" Edgar K. Browning, *The Anatomy of Social Security and Medicare*, INDEP. REV., Summer 2008, at 5, 26.

received will gradually increase to age 67 by 2027. The system provides reduced benefits for persons retiring after age 62 but before full retirement age. A surviving spouse who does not qualify for their own benefits will receive a 50% spousal benefit if it is taken when the surviving spouse reaches full retirement age. The spousal benefit illustrates the unusual set of incentives and distributional effects created by taxing individuals while determining benefits based on marital status.[58]

The Greenspan Commission recommendations also recognized that the payroll tax revenues would exceed the benefits paid out each year and that the excess would be placed in a government trust fund and reserved for a future time when the baby boom generation would cause annual revenue short falls.[59] Present projections are that revenue surpluses will continue until 2018 at which time the system will begin consuming the funds in the trust fund, but that the trust fund will be depleted by 2041 after which time revenues at current rates would only support about 78% of the benefits promised.[60] At that time a decision would have to be made whether to decrease benefits or pay for the short fall from general revenues. Over the past few years there has been a continued debate on how to best prepare for the shortfall and for the time when the system will call on the Federal Government to repay loans from the trust funds that have been used to fund government operations and reduce deficits ever since the trust funds were established.[61]

In 2005 President Bush proposed giving workers the option of diverting 4% of their 6.2% FICA payroll tax into a "personal savings account"—a plan

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[58] SHAVIRO, *supra* note 11, at 19; Orszag & Stiglitz, *supra* note 15, at 12. ("As Paul Samuelson showed 40 years ago, the real rate of return in a mature pay-as-you-go system is equal to the sum of the rate of growth in the labor force and the rate of growth in productivity.") (citing Paul Samuelson, *An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money*, 66 J. POL. ECON. 467 (1958)).

[59] Not everyone believes that the changes wrought by the Greenspan Commission were necessary. It is argued that the Social Security trust fund was created to provide tax revenues to reduce the soaring budget deficit created by the Reagan tax cuts of 1981 that heavily favored high income taxpayers. Under this argument the Social Security "crisis" was fabricated and used to cover the real purpose of funding the budget deficit. In other words, taxes on low and middle income workers were used to fund tax cuts for high income taxpayers. *See* RAVI BATRA, GREENSPAN'S FRAUD: HOW TWO DECADES OF HIS POLICIES HAVE UNDERMINED THE GLOBAL ECONOMY 11–45, 240–241 (2005).

[60] Browning estimates that revenues begin to fall short of payments as early as 2007 for Medicare and 2017 for Social Security, and the points when trust fund revenue is exhausted as 2019 for Medicare and 2041 for Social Security. Browning also estimates that maintaining these current programs would require reducing benefits by 50% or doubling payroll taxes by 2040. Browning, *supra* note 57, at 18–19.

[61] Browning sees the trust fund discussion as a distraction "that has permitted people to believe mistakenly that the future financing problems of Social Security and Medicare are smaller and further in the future than they actually are." *Id.* at 19.

the Democrats derogatively referred to as "privatization."[62] Funds in the private account could be invested in the stock market to produce an investment return estimated at 3% after inflation in exchange for a reduction in their projected Social Security benefit equal to the presumed value of the benefit replaced by the account.[63] The 3% assumption was seriously questioned.[64] Democrats in Congress refused to support the plan[65] seeing it as an attempt to "bury the New Deal and try life without a safety net."[66] In general, all discussions to save Social Security seek to preserve the system's solvency for the next 75 years—nearly two full work lives of 40 years each.[67]

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[62] Support for privatization efforts often comes from examining successes with that approach in other countries. In Chile workers could opt-out for a private account in lieu of the traditional Social Security system. In addition to paying 10% into a private account they were required to pay an additional 3% to finance life and disability insurance to cover the survivor's disability benefits of the old system. Ferrara, *supra* note 37, at 89–90.

[63] If investment in the stock market is desirable, why doesn't the government make the investment rather than individual account holders? Some traditionalists talk as though stock market profits are free and without risk. SHAVIRO, *supra* note 11, at 114. One issue is the reluctance to have the government deciding which companies to favor but the other is pointed out by Alan Greenspan who argues that swapping public debt for private debt in the trust fund would produce a benefit to the Social Security system only to the extent that it reduced the benefit to other recipients of that income. He states:

> But, if the social security trust funds achieved a higher rate of return investing in equities than in lower yielding U.S. Treasuries, private sector incomes generated by their asset portfolios, including retirement funds, would fall by the same amount, potentially jeopardizing their financial condition. This zero-sum result occurs because of the assumption that no new productive saving and investment has been induced by this portfolio reallocation process. . . . At best, the results of this restricted form of privatization are ambiguous. . . .

Orszag & Stiglitz, *supra* note 15, at 21 (citing Alan Greenspan, Chairman, Fed. Reserve Sys., Remarks at the Abraham Lincoln Award Ceremony of the Union of League of Philadelphia, Philadelphia, Penn., (December 6, 1996)).

[64] GHILARDUCCI, *supra* note 9, at 155.

[65] Ghilarducci refers to President Bush's 2004 retirement savings accounts (RSAs) proposal to consolidate retirement savings under the Tax Code and notes:

> Two things primarily characterized individual retirement accounts; they are based on financial market assets rather than an annuity as found in defined benefit pensions and in Social Security; and the employer has no responsibility for retirement income. Both add up to one result—that the elderly, when retired, will not be able to rely on pension income and will need other sources of reliable income. . . . More reliable is work. . . . Anyone who has to work more to reach the same income suffers a decline in living standards.

Id. at 23. She further asserts that "[m]ost preretirees are unaware that Social Security is their most secure source of retirement income." *Id.* at 29.

[66] EMANUEL & REED, *supra* note 1, at 85.

[67] Emanuel and Reed complain that President Bush has made solving the shortfall impossible:

> For the last six years, Washington has spent as if there's no tomorrow. The cost of making the Bush tax cuts permanent will be three times larger than the size of the Social Security shortfall over the next seventy-five years. In fact, just the cost of

C. *Defined Benefit Plan Model*

Beginning in the 1940s and continuing through the present time employers instituted defined benefit pension plans. Under the defined benefit plans employers would establish a pension plan under which employees would receive a lifetime annuity based on their average earning over a certain period prior to retirement and the number of years of service. Typically, an employee would qualify for a minimum pension payable when the employee turned 65 after a minimum number of years of service with the employer. For example, the maximum pension might be equal to 60% of the employee's final annual average compensation over five years provided the employee had 30 years of service by age 65. If the employee had only 20 years of service then the pension would be 40% of final annual average compensation. Some plans offer lump sum withdrawals that avoid the lifetime annuity. Employees electing the lump sum option often learn the error of their choice after the choice has become irreversible.

Under the Tax Code, contributions to qualified pension plans are deductible by the employer and not included currently in the taxable income of the employee provided that the employer meets the requirements of the Tax Code.[68] One of those requirements is that the employer not discriminate in favor of higher compensated individuals.[69] The bottom line for the IRS is that if the executives want tax advantaged pension plans the lower paid employees have to be included. This arrangement worked well through the 1980s. During that time it became common to refer to retirement planning as a three legged stool. These legs were Social Security, the company pension, and the employee's personal savings.

In 1974 Congress passed the Employee Retirement Income Security Act ("ERISA")[70] to provide Federal Government insurance for defined benefit plans and to force employers to take appropriate action to fund the plans. ERISA established the Pension Benefit Guarantee Corporation ("PBGC"), a quasi-governmental agency that provides insurance coverage for pensions up to certain limits depending on age and plan termination date but only for pensions that

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> the tax cuts for the top 1 percent of households, which equals about 0.6 percent of GDP, is larger than the entire Social Security deficit, according to the CBO. Medicare is by far the bigger fiscal time bomb, and Bush's prescription drug plan made Medicare's looming shortfall far worse. Congress and the president doled out pork, special favors, corporate tax breaks, and other new spending at a pace that would be unsustainable in the short run and catastrophic over the long haul. The best way to strengthen Social Security and Medicare is for Washington to stop spending the family fortune on everything else.

Id. at 87–88.

[68] *See generally* I.R.C. §§ 401–404; 410–416 (2008).

[69] I.R.C. § 401(a)(4), (5), (20).

[70] P.L. 93-406, 88 Stat. 829 (1974).

began at normal retirement age.[71] In many cases during economic downturns employers would scale back employment by offering enhanced retirement benefits to employees agreeing to retire before normal retirement age. These enhanced benefits were not insured by PBGC so that when certain employers went bankrupt employees found, to their chagrin, that the "enhanced" portion of the benefit was not protected. Bankruptcies in the steel and airline industries had a particularly hard impact on employees and on the funds held by PBGC to protect other plans.

Beginning in the 1980s, accelerating in the 1990s and continuing to the present time, employers began to discontinue or freeze their defined benefit plans preferring to offer defined contribution plans that shifted the risk of funding pensions from the employer to the employee. There are a number of reasons for the shift including the elimination of employer costs and to some extent a desire on the part of employees to control their own pensions. Employers also found that funding defined benefit pensions was extremely costly and attaining an appropriate investment return uncertain.

Defined benefit plans historically have also been combined with employer provided retiree health insurance. Defined benefit plans still dominate state and federal government employees and funds, such as the California Public Employees Retirement System ("CalPERS") that manages pensions and health care for 1.6 million California employees, retirees, and their families. In recent years CalPERS paid over $10 billion in retirement benefits and $7 billion in health care benefits from a trust fund of approximately $180 billion, as of December 2008.[72] Newt Gingrich notes that state and local unfunded retiree health and pension liabilities amount to $2 trillion and will come due with devastating effect.[73]

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[71] Guarantee limits for 2009 for a 65 year-old retiree are $54,000 for single life annuity $48,600 for a joint and 50% survivor annuity. Pension Benefit Guarantee Corporation, Maximum Monthly Guarantee Tables, http://www.pbgc.gov/workers-retirees/benefits-information/content/page789.html#top (last visited March 11, 2009).

[72] At its peak in October 2007 the assets were approximately $260 billion.

[73] GINGRICH, REAL CHANGE, *supra* note 5, at 31.

> Chris Edwards and Jagadeesh Gokhale, economists at the libertarian Cato Institute, have warned that there is a $2 trillion "fiscal hole" in unfunded retirement benefits and retirement health benefits for state and local workers. They warn that "the prospect of funding $2 trillion of obligations with higher taxes is frightening, especially when you consider that state politicians would be imposing them on the same income base as federal politicians trying to finance massive shortfalls in Social and Medicare."

Id. Gingrich also notes that state and local governments pay $3.91 per hour worked for health benefits while private sector pays $1.72; he concludes the only option is for state and local governments to reduce benefits and currently fund pension costs through private savings accounts—an option opposed by a left leaning Democratic Party. *Id.* at 31–32.

An example of a defined benefit plan is that provided to members of Congress. Members elected prior to 1984 were covered by the Civil Service Retirement System ("CSRS"), but, members elected since 1984 are covered by the Federal Employee's Retirement System ("FERS") under which members contribute 1.3% of their salary into the pension fund and 6.2% of their salary in Social Security taxes. Their pension will vest upon attaining five years of credited service with the option to retire at age 50, with 20 years of service, anytime after 25 years of service, or at age 65 with less than 20 years of service. The amount of the pension depends on the years of service and the average of the highest three years of salary. The starting amount of the retirement annuity cannot be more than 80% of the last salary received. As of 2006 the average pensions under the CSRS for 290 former members was $60,972 and under the CSRS and/or FERS for 123 former members was $35,952.[74]

From the standpoint of the tax expenditure budget the cost of defined benefit plans to the income tax is approximately $628 billion over five years. Defined benefit plans have begun to be replaced with defined contribution plans initiated in the late 1970s to supplement defined benefit plans.

D. Defined Contribution Model, the Congressional and Military Pension Plans [75]

Beginning in the late 1970s companies began sharing profits with employees on a broad basis. The company would make contributions to a trust and allocate portions of the trust to individual employees. When the Internal Revenue Service approved the creation of such plans, provided they did not discriminate in favor of higher paid employees, the defined contribution plan movement was born.

Today defined contribution plans come in several forms.[76] Employer sponsored plans under sections 401(k) and 403(b) are broadly popular and are presented as retirement plans. Under these plans employees make voluntary contributions to an employee trust fund that accommodates individual accounts

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[74] *See* About.com, U.S. Gov't Info., http://usgovinfo.about.com/library/weekly/aa031200a.htm (last visited January 22, 2009).

[75] Defined contribution plans are presented as the heart of privatization proposals. Shaviro includes five concepts included in most privatization plans in various combinations. These include a shift to a fully funded plan to increase national savings, a shift from a single benefit plan to one offering portfolio choice; elimination of income transfers except to the extent of privatizing existing benefits; a shift of administrative functions from government to regulated private enterprises; and allocation of income to individual accounts depending on investment choice. SHAVIRO, *supra* note 11, at 128.

[76] Defined contribution plans go under names such as Individual Retirement Accounts ("IRAs" which include standard pre-tax IRAs and post tax Roth IRAs), SIMPLEs (savings incentive match plan for employees), SEPs (simplified employee pensions), and I.R.C. § 401(k), 403(b), and 457 plans.

for each employee. The employer typically matches the employee contribution to some extent. Contributions to the plans are invested either in employer stock or in mutual funds determined by the employer sponsor with each employee allocating the funds in their respective accounts. At times employers contribute their stock to the plan and restrict the sale of such stock by the employee account holder.

Taxwise contributions to the plans are excluded from the employee's income in the current year as is any growth of the invested funds in the plan. Ultimately the funds will be taxed when withdrawn from the fund by the employee when the employee retires. Currently, in the year 2009, employees are permitted to contribute $16,500 to a fund per year and employees age 50 and over are entitled to contribute an additional $5,500 for a total of $22,000 per year.[77] Employers can make contributions and often do so in the form of an employer match. Employers often require the employee to make voluntary contributions in order to qualify for the employer match. However, in that employers are primarily interested in benefiting the higher paid employees, by not making the program mandatory the employer reduces cost when lower paid employees do not participate and claim the employer match.[78]

Withdrawals before the employee turns 59 and one-half are penalized with a 10% penalty on the tax due.[79] Withdrawals must begin in the year following the year in which the employee turns 70 and one-half unless the employee is still employed by the plan sponsor.[80] Withdrawals are permitted for hardships and a limited number of other reasons. When an employee changes employment he can roll the funds in the plan over into a new employer's 401(k) plan or into an Individual Retirement Account ("IRA").

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[77] IRA contribution limits for 2009 are $5,000 for those under age 50 and $6,000 for others. These amounts will be indexed for inflation in 2010. I.R.C. § 219(b).

[78] GHILARDUCCI, *supra* note 9, at 1130–32. The author presents the argument that I.R.C. § 401(k) participants are planners and more productive employees than non-participants and thus the I.R.C. § 401(k) rewards the most productive workers. *Id.* at 132. Enron presented a particularly stark picture of employees unable to sell Enron stock contributed by Enron to the employee's account although the employee could sell Enron stock purchased with employee contributions. When Enron stock plummeted on disclosures of massive fraud employees who held large blocks of Enron stock in their I.R.C. § 401(k) accounts lost most of the value of their accounts and some retirees were forced to return to work.

[79] I.R.C. § 72(t) (2008). This section imposes a penalty for early withdrawal from qualified retirement plans. Exceptions are provided for withdrawals after age 59 and one-half; to a beneficiary after the death of the employee; for disability; following separation from employment after age 55; for life time annuities; and for some distributions from some plans for medical expenses, health insurance premiums, and first home purchases. *Id.*

[80] *Id.* Subject to specified conditions, exceptions from the 10% penalty are provided for education, health insurance, disability, retirement annuities, first time home purchases, and other similar uses. There are also restrictions on borrowing against pension assets. I.R.C. § 72(p).

Individual retirement accounts are another form of a defined contribution plan except that it is not employer sponsored.[81] In an IRA the employee is permitted to make annual contributions up to a certain amount each year. Depending on the person's income and whether the person or their spouse is covered by an employer sponsored plan the contributions may be tax deductible. In either case, whether deductible or not, the contributions once made are invested and grow without current taxation until the funds in the IRA are withdrawn. The same rules governing withdrawals from 401(k) plans cover IRAs. Investment rules under the Tax Code permit the owner of the account to broadly control the investment choices in the IRA. Generally contributions to IRAs cannot exceed earned income in a given year although special rules permit contribution by non-working spouses.[82]

A variation of I.R.C. 401(k)/403(b) and IRAs is the Roth version in which the person contributing the funds does not receive a tax deduction or exclusion for the funds contributed.[83] In effect the funds are taxed to the individual in the year they are earned and contributed to the plan. However because they are deemed to be after tax funds they will not be taxed when they are withdrawn. The rules require that they remain in the plan for at least five years and the owner cannot withdraw them without penalty before reaching the age of 59 and one-half. However, there are no mandatory withdrawals.

Amounts left in the defined contribution plans go to the designated beneficiary upon the death of the owner. Special tax rules apply regarding the withdrawal of the funds by the beneficiary. Depending on the circumstances upon the death of the owner, the beneficiary may be permitted to spread the withdrawal of funds over the beneficiary's lifetime thereby deferring the taxation of funds in the account until withdrawn.

Common criticism of defined contribution plans is that the tax benefits of the plans favor high income taxpayers who receive the greatest tax benefit.[84] It is argued that these accounts do not spur new savings but merely a transfer of existing savings from taxable to tax deferred accounts. It is also claimed that these accounts reduce the amount available to the owner at retirement because the companies managing the funds charge higher fees than are common in defined benefit plans which manage large funds for a single employer. Another criticism is that since the account holder is generally inexperienced in selecting and balancing

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[81] *See generally* I.R.C. §§ 408, 219.

[82] I.R.C. § 219(c).

[83] *See generally* I.R.C. § 408A.

[84] Ghilarducci describes the three "I's" for the defined contribution model as: Inefficiency (the nation is not getting the most retirement income security out of each dollar saved for retirement); Inadequate retirement savings; and Inequality of income and risk-bearing between employers and workers, as well as between upper- and middle-class workers. GHILARDUCCI, *supra* note 9, at 116.

mutual fund investments, the optimum investment returns are not achieved. Further, because participation is voluntary these plans do not have anywhere near the 100% participation of defined benefit plans. Indeed it often occurs that when an employee changes employers and the funds are transferred to the new plan the employee does not roll over 100% of the funds. They use the funds for current needs, thereby undermining their retirement savings plan.[85]

E. Education Funds

The Tax Code has a myriad of exclusions, deductions, and credits providing educational assistance to taxpayers and their dependents.[86] Of particular importance to the Baileys in their investment planning are the Coverdale education savings accounts[87] and the state sponsored qualified tuition programs. Coverdale education savings accounts permit the taxpayer to contribute up to $2,000 per child per year to a trust for use in providing the child qualified educational expenses. Contributions are not tax deductible, must be in cash, and cannot be made after the child reaches his 18th birthday. Funds in the trust are invested and accumulate without current taxation and, if used for qualified educational expenses, will not be taxed upon distribution. Uniquely, funds in a Coverdale education savings account can be used for education below the college level.[88]

State sponsored qualified tuition programs come in two varieties. First are the programs that permit taxpayers to purchase tuition credits on behalf of a designated beneficiary. Tuition credits are purchased at a discount for use at a future date when the beneficiary attends college or university. When used for educational purposes any increase in the value of the tuition credit is not taxed.

The second type of qualified tuition program is the investment type program in which funds are deposited with the State sponsor and invested in pre-designated accounts. In this type of plan there is a prohibition against the person

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[85] Defined contribution plans under I.R.C. §§ 401(k) and 403(b) are currently being studied by Congress to better structure the American retirement system. *See* Sam Young, *Retirement Reforms Examined by House Committees* 122 TAX NOTES 1060 (2009).

[86] *See* I.R.C. § 25A (2008) (Hope Scholarships and Lifetime Learning Credits); I.R.C. § 108(f)(1) (2008) (loan forgiveness); I.R.C. § 117 (2008) (scholarship exclusion); I.R.C. § 127 (2008) (employer provided educational assistance); I.R.C. § 135 (2008) (exclusion of interest on U.S. savings bonds); I.R.C. § 219 (individual retirement accounts); I.R.C. § 221 (2008) (deductions for interest on educational loans); I.R.C. § 222 (2008) (tuition tax deduction); I.R.C. § 529 (qualified state tuition programs); I.R.C. § 530 (Coverdale education savings accounts).

[87] Coverdale education savings accounts were originally modeled after individual retirement accounts and were originally given the title education IRA.

[88] Education groups and in particular the National Education Association have opposed any and all programs, including tax incentive programs, that would provide any assistance below the college level to non-public schools.

or beneficiary providing any investment direction after the funds are deposited.[89] Direction, of course, is made to some extent in the choice of which State program to invest in and often states will provide several investment choices. Furthermore, account holders are permitted to roll the funds in one plan over to a different plan once within a 12-month period.[90] By rolling over the funds to another state the owner has renewed the ability to select among different investment funds. Many states offer funds directed toward entering college in specified years as well as funds directed toward types of investments such as bonds, stocks, aggressive stocks, blend or balanced funds, and other combinations.

Notably, while the Coverdale education savings accounts are limited to annual contributions of $2,000 the qualified tuition programs are limited only by the general standard of the amounts necessary to provide for the qualified higher education expenses of the beneficiary.[91] This amount could be several hundred thousand dollars such that the buildup of earnings will never be taxed provided they are used for "qualified higher educational expenses." Unused funds can be rolled over to successive beneficiaries.[92] Reform of the tax provisions for education is overdue and being called for by politicians.[93]

F. Health Care Funds

Investment accounts for health care are limited to flexible spending accounts and medical savings accounts.[94] Flexible spending accounts allow an employee to contribute an amount to an account to be used by the employee for medical

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[89] I.R.C. § 529(b)(4).

[90] I.R.C. § 529(c)(3)(C)(iii).

[91] I.R.C. § 529(b)(6).

[92] Abuse of the rollover provisions is the subject of regulations proposed by the Treasury and Internal Revenue Service and is described in Wendy C. Gerzaog, *College Savings Plans: Not Just for Education*, 122 TAX NOTES 1267 (2009).

[93] Advocating universal college education, Emanuel and Reed note a 2006 study by the Federal Reserve that found the average net worth of a high school drop out to be $20,000 as compared to the average family headed by a college graduate which was $226,000. EMANUEL & REED, *supra* note 1, at 70. They call for reform of confusing and contradictory education tax incentives:

> The main reason young people don't go to college—or don't finish—is cost. For starters, we need to get rid of the red tape in their way. The tax code is littered with well-intentioned but confusing and often contradictory education provisions, with different rules, definitions, and limits. We should simply the tax code by replacing the five major existing education tax incentives—the Hope Scholarship, the Lifetime Learning Credit, the deduction for higher-education expenses, the exclusion of employer-provided education benefits, and the exclusion for qualified tuition reductions—with a single $3,000-a-year refundable credit for four years of college and two years of graduate school. If we want young people to go to college, they shouldn't have to stop first at H&R Block.

Id. at 72.

[94] I.R.C. § 125 (flexible spending accounts); I.R.C. § 220 (Archer Medical Savings Accounts).

expenses during the plan year. Contributions are excluded from the employee's gross income for Federal income tax purposes but not for purposes of payroll taxes. Amounts authorized by the employee to be contributed to the plan must be made available by the employer for use by the employee on day one of the plan year even though the contribution will be collected from the employee's pay over the entire plan year. Amounts not used during the plan year are forfeited to the employer and cannot be carried forward to future years. Employees who over contribute must use the money or lose it.[95]

Archer Medical Savings Accounts ("MSAs") are accounts for use by individuals who are covered by "high deductible health plans." Such individuals are provided a deduction for a percentage (65% in the case of individual policies and 75% in the case of family policies) of the annual deductible amount under the high deductible health plan.[96] MSA trusts are exempt from tax, and distributions from MSAs are excluded from gross income provided the money is used for medical purposes.

Because MSAs offer individuals the potential for self insuring, there is a fear that if they are generally available, the young and most healthy individuals will self select out of traditional health insurance policies leaving traditional policies with high-risk/high-cost participants thereby undermining the actuarial projections for such plans. Therefore the availability of MSAs has been highly restricted.

G. Guaranteed Retirement Account Model

Professor Ghilarducci proposes that the Federal Government adopt guaranteed retirement accounts as a supplement to Social Security in a way that will provide a secure retirement for all Americans. Ghilarducci builds her analysis on several basic beliefs. The first is that the traditional three-legged stool of Social Security, defined benefit plan, and personal savings has provided a secure retirement system. She believes that Social Security is likely secure through 2052, that a secure retirement without the need to work is a symbol of a prosperous and healthy society, that the decline of defined benefit plans has been accelerated

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[95] Addressing the use of pre-tax reimbursement accounts for health costs, Gingrich points out that when the contributions to such accounts were allowed to be carried over from year to year that several companies experimented with providing participants with information and incentives to control the decisions on health care. As a result, costs incurred dropped up to 45% in the face of projected cost increases. The use of Health Savings Accounts (HSA) also produced significant results in cost containment. This is particularly true because four out of five people do not have major health problems before age 65. Gingrich points out that an 18 year-old that maintains his health could have $250,000 in his HAS by age 65. Other savings could be realized in health care by providing electronic availability of health information together with an emphasis on wellness and prevention, including health care. GINGRICH, WINNING THE FUTURE, *supra* note 5, at 121.

[96] I.R.C. § 220(b)(2).

by the introduction of defined contribution plans, and that defined contribution plans are an inadequate substitute for defined benefit plans.

Her objection to defined contribution plans centers first on the fact that participation is voluntary such that only a small percentage of people are covered; the plans have a much higher administrative cost than defined benefit plans; that retirement is undermined because participants withdraw funds during the accumulation period and take lump sum distributions at retirement instead of exercising the annuity option; that these plans favor highly compensated individuals who often only use them as tax shelters for existing savings resulting in an excessive tax expenditure and loss of federal tax revenue; and that employer's contributions to their employees' retirement security has been greatly reduced.[97]

Guaranteed retirement accounts are proposed as a supplement to Social Security and are funded by payroll taxes equal to 5% of payroll, up to the ceiling for Social Security, to be split between employee and employer, but, unlike Social Security, additional voluntary contributions can be made that will increase the ultimate retirement payout.[98] Unlike defined contribution plans contributions are not excluded from gross income but to avoid an undue burden of low-income workers a $600 refundable tax credit is given to every worker regardless of income.[99]

Funds collected in the guaranteed retirement accounts will be invested in the financial markets by public employees overseen by a board appointed by Congress and the President.[100] The government will guarantee an inflation adjusted return of 3% reflecting the historic long term growth of the economy but if the actual investment return is greater the board can, after providing for the ability to back up the minimum guarantee in times of economic downturn, allocate a higher return to the accounts. In this way, the government and the worker will share the investment risk of the accounts.[101]

Upon retirement or thereafter the worker can convert all or part of their account to an inflation adjusted lifetime annuity. The annuity is preferred to assure the retiree will not outlive the available funds. Any amounts remaining in the fund

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[97] GHILARDUCCI, *supra* note 9, at 118–30.

[98] *Id.* at 264.

[99] *Id.*

[100] *Id.*

[101] *Id.* at 265 (indicating that if the economy does better than 3% the Board of Trustees can allocate the increased economic performance among the accounts). These accounts are largely modeled after the approach of the Teachers Insurance Annuity and College Retirement Equities Fund (TIAA-CREF) which represents university professors and offers a guaranteed return of 3% but, if investment yields exceed 3%, will allocate the additional earnings to the accounts. TIAA-CREF is a nonprofit organization. *Id.* at 272.

at death will be used to provide survivor benefits. The objective of guaranteed retirement accounts is to provide a retirement income that does not require a significant drop in the retiree's standard of living. In this regard it is estimated that the combined income from Social Security and a life-time annuity through the guaranteed retirement account would replace 64% of the pre-retirement earnings of a high earner ($61,914); 71% of an average earner ($38,696); and 86% of a low earner ($17,413).[102] To meet these replacement percentages it is necessary to restrict access to the funds so that they are not available for "all sorts of other needs including health care, job changes, buying a home, education, and other expenses unrelated to retirement or disability . . . ."[103] These accounts will shift the numerous risks of retirement savings to the Federal Government:

> An individual must not bear all the risks of losing his or her job and losing all pension benefits; nor the risk of living longer than anticipated; nor the risk of financial market fluctuation; nor the risk that inflation will diminish the buying power of the investments income. Individuals must not bear risks because they cannot control these risks. Employers and the government can bear these risks more effectively and at lower cost.[104]

A significant risk is undertaken by the government when it undertakes to protect accounts against inflation. Even in periods when investment return is undermined by inflation, as in the 1970s, the tax revenues kept pace with inflation. Because the proposed $600 refundable tax credit replaces the benefits for the defined contribution plan the loss to tax expenditures will be dramatically reduced. However, if the dramatic shift away from defined contribution plans is resisted politically, Ghilarducci proposes an alternative plan that would retain a progressive tax response that would use a $400 refundable tax credit and cap defined benefit tax breaks at $5,000.

Ghilarducci sees retirement planning as a form of paternalism in which the government can decide the degree of support and, for her, a secure option to retire or work as the individual may choose is the optimum result. For her:

> Whether an economy can support non-workers depends more on productivity growth and the size of and strength of the tax base rather than on the ratio of workers to beneficiaries. Whether a society chooses to support non-working older people depends on economic power, mostly on the power in the labor market. Pension policy is ultimately labor policy.[105]

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[102] GHILARDUCCI, *supra* note 9, at 266.

[103] *Id.* at 267.

[104] *Id.*

[105] *Id.* at 282–83.

H. The Plan

Sociologist Charles Murray looks at the massive redistribution of income in America and concludes that there is a better way to spend this money.[106] He believes that enormous wealth generated by our society can more efficiently be utilized to alleviate poverty, secure a comfortable retirement, provide adequate health care, and revitalize civil society. Murray's "ideal" solution is to recognize that the trillion dollars in wealth transfers cannot solve the problem and leave the money in the hands of those who originated the wealth to use it as they deem necessary.[107] Recognizing that this "ideal" solution is not acceptable to 90% of the population, Murray has proposed an alternative which I have dubbed the "Guaranteed Income Solution" and which Murray calls simply "The Plan."[108]

Under The Plan each individual citizen age 21 and older would receive an annual grant of $10,000 to be deposited monthly into the citizen's United States bank account.[109] A married couple would receive two annual grants for a total of $20,000 per year. Grants will be adjusted for inflation either by linking it to a wage or inflation index or simply allowing Congress to adjust the amount periodically. The annual grant will be offset, to some extent, by a 20% surtax on incomes between $25,000 and $50,000. For example, someone making $30,000 per year would have a $1,000 surtax (20% of $5,000) and someone making $50,000 per year or more would pay the maximum surtax of $5,000 (20% of $25,000). For a married couple the surtax would apply to each individual's earned income, if any.

The Plan is calculated to replace income transfer programs totaling, in 2002, $1.385 trillion which includes replacement of Social Security, Medicare, Medicaid, unemployment compensation, food stamps, and certain corporate welfare programs as detailed by Murray.[110] Murray estimates the net cost (after the surtax) will be approximately $1,740 trillion. The gap between the cost of the

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[106] MURRAY, *supra* note 8, at 5 ("The argument starts by accepting that the American government will continue to spend a huge amount of money on income transfers. It then contends that we should take all of that money and give it back to the American people in cash grants.").

[107] The large wealth transfers by governments assume that government can allocate wealth effectively. According to Murray this assumption began in small ethnically homogeneous societies like Scandinavia and the Netherlands that had traditions of work, thrift, neighborliness, and social consensus. These traditions broke down as the welfare state removed the penalty for failing to acquire these qualities. At first it was the large societies with diverse populations where an underclass developed that lacked these qualities. Thus, according to Murray the welfare state carries the seeds of its own destruction and the process plays out over decades such that the Western world can see that it is within decades of financial and social bankruptcy. *Id.* at 1–4.

[108] *Id.* at 4.

[109] *Id.* at 24.

[110] *Id.* at 25, app. at 130–39.

program and the savings from program elimination will be eliminated in that the costs of the replaced programs would increase at a faster rate than The Plan. He also claims that his calculations err on the high side.[111]

Retirement and health care deserve special consideration. For retirement, Murray uses the example of a worker who will make $20,000 per year for his lifetime. Under the current system the employee's and the employer's annual contribution would be $2,480 and would provide an annual retirement benefit of $10,992. If the employee made a similar contribution to an investment account paying a real annual rate of return of 4% the employee's retirement account would total $300,153, enough to provide a lifetime annuity of $24,350 which, combined with the annual grant, would provide a total retirement of $34,350.[112]

Health care is a significant element of The Plan.[113] Each person will have to provide their own health care but they will be granted resources with which to make that provision. Murray points out that "routine" medical care costs have been falling while costs for medical care at the front lines of medical science have escalated. He believes that a major problem in the health care system is that individuals do not make the cost-benefit analysis that would ultimately reduce costs. Under his proposal people would have the benefit of choosing the medical insurance they desire and would have the funds available from the grant to support that choice. One of the most expensive, and least cost effective treatments, is end of life care ("EOL"). An individual could purchase a policy with limited EOL at a reduced cost if he so chose. At least the government would not make the choice.

Murray suggests three reforms that will accommodate The Plan. First, health insurance companies would consider the population as a whole as the pool and individuals age 21 and older would be required to purchase a policy that would

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[111] MURRAY, *supra* note 8, at 21. The Plan would allow some restrictions on the use of the money. According to Murray the cost of The Plan beginning in around 2011 would be less than the current cost for the social programs. By 2020 he expects The Plan will save a half trillion dollars over the projected cost of existing programs.

[112] *Id*. at 25–26. Murray points out that the retirement annuity would be less than $25,000 so that the surtax would not be triggered. Apparently, the annuity constitutes "earned" income for purposes of the surtax. As always the devil is in the details. Murray goes to great length to support the "anemic" 4% real rate of return on stocks over 45 years arguing that if the market does not achieve this level the government would be unable to fund existing programs. *Id.* at 35.

[113] For Medicare the problem is more difficult than Social Security as costs are to rise faster than revenues. Costs will rise from 2.5% of GDP to 5% by 2030 and Medicare's share of federal spending will rise from 12% to 24%. To keep the Medicare trust fund solvent would require a doubling of the Medicare portion of the payroll tax from 2.9% to 5.8%. Medical spending increases will outstrip any increases that Social Security will provided seniors. MILLER, *supra* note 10, at 208. But it is argued that insolvency is only one of the four "I's" associated with Medicare's problems: inadequate, inefficient, and inequitable. *Id.* at 209 (referring to points made by Robert Reischauer of the Urban Institute).

cover chronic conditions. Murray estimates that if an individual committed to a lifetime policy a premium of $2,800 for males and $3,500 for females, which would include pharmaceutical coverage, a $2,500 deductible could be obtained. Additional insurance could be purchased if desired. The second reform is to make employer provided health care taxable and the third is to allow legally binding medical malpractice waivers for routine procedures. The second reform facilitates individual choice in policies above the required minimum and the third will allow the creation of an inexpensive network of neighborhood medical centers to handle routine matters.[114]

The Plan will require that $3,000 of the $10,000 be used to purchase health insurance. While it might be unfair to young healthy individuals with a healthy lifestyle and family history of few chronic conditions, it is the only way to keep the costs of insurance under control and at a minimum.[115] In this way the annual grant would be $7,000. Murray also suggests that it may be politically necessary to commit an additional $2,000 of the annual grant (called "Plan B") as a contribution toward retirement which would leave an annual grant of $5,000. Murray recommends against Plan B because he believes that the grant should allow the young to save for other things such as an education or to pursue a dream.

Murray does not believe that The Plan will undermine initiative and it will not promote the lethargy he sees in the European nations as a result of the extensive welfare systems that sees work as a hindrance to self-fulfillment rather than a path toward that goal.[116] The Plan, he asserts, is consistent with three basic elements of human nature: humans as individuals tend to act in ways that advance their own interests, humans tend to have a desire for approbation from other human beings, and humans tend to take on responsibility to the extent that circumstances require them to do so.[117]

I. The Two Percent Solution

Journalist Matthew Miller recognized that the need to solve the Social Security and Medicare (and Medicaid) projected shortfalls would necessitate the solution to social problems that kept large segments of society from becoming productive.

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[114] MURRAY, *supra* note 8, at 43–50.

[115] *Id.* at 50 (suggesting that insurance companies might be permitted to vary premiums for smokers or persons engaged in hang-gliding).

[116] *Id.* at 83–87 (outlining Europe's loss of meaning and purpose and predicting the loss of greatness resulting from the welfare state). Murray dubs the term "European Syndrome" to describe the acceptance that "the purpose of life is to while away the time as pleasantly as possible, and the purpose of government to enable people to so with as little effort as possible." *Id.* at 84.

[117] *Id.* at 91.

Looking at the percentage of the GDP that was being consumed by the Federal Government he focused on the fact that the then current (2002) percentage was 20% whereas the percentage under President Reagan had been as high as 22%. He proposed funding "major" reforms to education, health care, and campaign finance and implementation of a plan to support a living wage all of which could be achieved by adding 2% to the Federal Government's budget to pay for such reforms.

Addressing the Social Security shortfall, Miller claims a simple fix will solve the funding problems. That fix is to change the index under which initial Social Security benefits are determined from the wage index to the price index. This simple change will mean that the purchasing power of each new generation of retirees will be the same whereas under the current system, each generation of retirees is better off because of the productivity improvements generated by that generation.[118]

J. Other Plans

There are other solutions that have been proposed by competent and recognized sources. Ghilarducci references a number of them.[119] Each plan raises the issues discussed above and provides suggested solutions. A plan proposed by the "Hamilton Project" suggests that employers automatically enroll their employees in 401(k) plans and invest all retirement funds in "life cycle" mutual funds that adjust the ratio of stocks to bonds depending on the age of the participant so that the fund investments become more secure as the employee ages.[120]

Emanuel and Reed recognize that major companies are replacing their defined benefit plans with 401(k) plans and believe that, if Social Security remains strong and people contribute to the 401(k) plans, a sound retirement can be assured. They acknowledge only 50% of employees participate; that the average balance for people between the ages of 55 and 60 is $15,000;[121] that an endless array of investments and investment advisors make investment more like a lottery than a plan for the future; and the need to limit the downside for individuals planning their own retirement. They suggest automatic enrollment and the combining of all tax incentives into a single "Universal Pension" to include the option to direct tax refunds to the account at the point of a "savable moment."[122] Finally,

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118 *See supra* note 52 and accompanying text (commenting on the impact of wage indexing in the description of Social Security).

119 GHILARDUCCI, *supra* note 9, at 383–87.

120 *Id.* at 286. Peter Orszag, appointed Director of the Office of Management and Budget by President Obama, along with other economists was involved in the Hamilton Project.

121 EMANUEL & REED, *supra* note 1, at 89.

122 *Id.* at 93.

to provide an incentive for low income individuals Emanuel and Reed propose a 50% match on contributions up to $2,000 for individuals making $30,000 or less or $60,000 for couples.[123]

Professor Shaviro provides a "modest" proposal for Social Security reform. His reform would provide mandatory contributions from earnings with a cap on covered earning. The funds would be placed in an individual account that could be invested in a conservative stock or bond fund with limited administrative costs. Contributions by married couples would be split 50–50 between their respective accounts. The unique feature of this proposal is that it provides for a limited "adjustment" of all accounts upon retirement so that accounts above an "average value" would contribute to those with below-average assets. This "progressive redistribution" captures to some extent the redistributive effects of the current Social Security system. Options upon retirement would provide a combination of annuities with the possibility of a guaranteed term and the possibility of passing the balance to a survivor.[124]

These and other interesting and important proposals have been made from time to time. The One Fund Solution described next incorporates many of the proposals already discussed. By building on the whole-life insurance model it offers more flexibility than other proposals.

K. The One Fund Solution

The simplest plan to understand is the whole-life insurance model. The policy owner invests a certain amount every year and the benefits are invested by a competent insurance company that is guided by actuarially sound principles and a long term investment time horizon. The policy owner can understand that the cash buildup can be borrowed and if not repaid will affect the policy values. Life insurance premiums are paid with after-tax funds, but the proceeds of the policy will be paid at death, free of income tax. It is also easily understood that the cash value can be used to fund an annuity to provide a retirement income with any balance being left for the beneficiary of the policy. In all cases the investment decisions and sound financial condition of the insurance company is directed by professionals overseen by experienced regulatory authorities.

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[123] A simple example of Emanuel & Reed's basic principle of saving, "Start early and keep at it" is: "If the employer matches her contribution, a person who starts setting aside 1 percent of her $30,000 salary at twenty-five and keeps doing it until she is sixty-five can expect to have a nest egg of around $200,000." *Id*. at 93. The saving contribution would be $600 per year over 40 years at an expected compounded rate of 9 percent per annum. Congress temporarily enacted a similar program in 2001. *See* GRAETZ & SCHENK, *supra* note 23, at 757.

[124] SHAVIRO, *supra* note 11, at 152–57.

The One Fund Solution captures the freedom and flexibility of whole-life insurance with a governmentally administered fund, required contributions, and restrictions on withdrawals but is large enough to fund the major investment needs of a life time at an adequate level. The One Fund Solution reflects a combination of features present in the plans described above. The One Fund Solution recognizes the long recognized principle that government's involvement in so many areas of individual choice is for the purpose of enabling the least privileged in society to participate in society and have an opportunity to work their way economically into the middle class or higher. However, an equally well recognized principle is that $100s of billions in tax expenditures each year provide the greatest benefit to those taxpayers in the highest marginal brackets. The guaranteed retirement account proposal described above recognized the basic unfairness of current tax expenditures when it proposed a $600 refundable tax credit to replace the tax benefits for defined benefit plans. The One Fund would carry that proposal a step further and recommend the gradual elimination of all such "upside" down tax expenditures in favor of supporting a single whole-life insurance type fund offering flexibility and equality to all participants.

The One Fund recognizes that personal wealth is built up over a lifetime and that savings objectives focus on uses prior to retirement. The One Fund would ultimately supplant tax expenditures for retirement, housing, education, health care, and emergencies, freeing up tax revenues to support the conversion to the One Fund. The objective of the One Fund would be to replace Social Security and Medicare as they exist today. Because of the accumulated interests and expectations of individuals in the existing plans a complex set of rules would be needed to accommodate those changes over a significant period of time.

Because of the ultimate demands on the One Fund, significant funding will be required and that funding should begin when the individual begins gainful employment. The objective is to create a tax-advantaged fund that will support the normal financial needs of an individual or family at the level somewhat above the middle class. If that level is a family with an expected $60,000 pre-retirement income and it is desired to provide a retirement benefit replacing 80% of that amount, the account would need to grow sufficiently to provide a lifetime annuity of $48,000 annually or $4,000 per month. One estimate is that the necessary amount would be $920,000. Contributions of $10,000 per year from age 20 to 65 with an investment return of 3% per year would fund that annuity. If the required contribution were 20%, the annual contribution on $60,000 would be $12,000 per year and the additional funds could be used to provide other needs such as education or health care.

Taxation of the One Fund would mirror the insurance model and Roth IRA model which are funded with after tax income with all withdrawals being tax free. As was seen in the case of the Baileys no income tax was due during the years they were raising their family, so the loss of tax incentives on contributions is irrelevant to the Baileys. Later when funds are withdrawn they may be in a higher tax bracket so that the tax-free nature of the withdrawals could be a significant benefit. Currently, the employer's Social Security contributions are excluded from the gross income of the employee and benefits are taxed depending on the recipient's overall income tax situation.[125]

The One Fund proposal could be efficiently administered by the Social Security Administration. The guaranteed retirement account proposed an increase of 5% in the payroll tax suggesting that an individual being required to save 20% of their income is not unreasonable. The example of the Baileys and several studies would also support the 20% level. To permit the fund to grow and provide meaningful support for the worker, voluntary contributions by the employee would be permitted. Additional contributions by the employer would be taxed as income to the employee, and could be used to fund various benefits through the fund such as health care or disability insurance.

Because this is a proposal to support a middle class life style and because withdrawals are tax free there would be limitations placed on the amount of the annual contribution as well as the overall size of the fund. Consistent with current savings plans, annual contributions to the plan could be limited to $40,000. Someone earning $100,000 per year would be required to contribute $20,000, but the worker or the employer could contribute an additional $20,000 which could be used for health insurance or other approved uses. Required contributions would be discontinued when fund values reached $1 million but voluntary contributions would be permitted until the fund value reached $2 million. After the fund reaches $2 million no further contributions would be permitted, and any withdrawals above $2 million would be taxed at ordinary income tax rates.[126]

Funds left at the time of the participant's death can be distributed as directed by the participant or transferred to a One Fund for designated beneficiaries up to the $2 million limit on contributions to any individual's One Fund. The value of an individual One Fund account will be exempt from any estate taxes on death.[127]

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[125] I.R.C. § 86 (2008).

[126] To some extent the $2 million figure is a figure that represents current thinking about the level of estate assets that would exempt someone from the federal estate tax. This level divides the "upper middle class" from the "wealthy" and if the One Fund Solution is fully implemented one would expect the accumulation of intergenerational wealth. Under the federal estate tax a credit is given to each taxpayer equal to the tax on an estate of a designated amount. For 2006–2008 the amount of the credit was the tax on a $2 million estate. For 2009 the credit was the tax on an estate of $3.5 million. I.R.C. § 2010(c) (2008). The estate tax is repealed for 2010 but reinstated in 2011 with a credit equal to the tax on a $1 million estate. A married couple has a credit for the husband's and the wife's estate which provides estate planning opportunities.

[127] It would be appropriate to limit other deductions from the estate tax to make transfers through the One Fund the principal method of transferring tax-free wealth.

By transferring the One Fund to a child at death the next generation would begin life with an endowment. Setting limitations on contributions and tax-free distributions insures some degree of equality in the receipt of tax advantages. It is important that Congress resist calls to add benefits that favor high income tax payers.[128]

Investment return is controversial. It is a simple matter to demonstrate the superiority of private accounts by using a high enough projected return on investment. Murray suggests that over the worst 45 year period on record the real rate of return was 4%. Others have suggested higher rates. An important consideration is whether, in dealing with accounts to be administered on a population wide basis, it is necessary that everyone make every investment decision. The guaranteed retirement account proposed allowing the government to invest the funds and allocate the investment profits among participants with the Federal Government guaranteeing a minimum return of 3% above inflation. This proposal is attractive except for the provision allowing the government to control investments in the market.[129]

Investment of money in One Fund accounts should be subject to strict rules. Notwithstanding arguments to the contrary this author believes that individuals prefer to let professionals make the investment decisions.[130] Given the option of a

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[128] In proposing The Plan, Charles Murray suggested that the Constitution be amended to prohibit Congress from creating any wealth redistribution programs. MURRAY, *supra* note 8, at 11.

[129] Shaviro questions the wisdom of allowing the government to make investment decisions with Social Security funds:

> Thus, even if Congress created an independent "Social Security Reserve Board" it might well get in the habit of issuing narrow directives. Perhaps it would start by barring investments in tobacco companies and gun manufacturers. Then, mirroring what has happened in state-run funds and those in other countries, Congress might start mandating, say, investment in low-income housing, local infrastructure, or companies that promise to build manufacturing plants in Rust Belt states that hold key presidential primaries. . . . In a thorough study of investment performance by state and local governments' retirement systems, published well before the current Social Security debate, Roberta Romano concludes that "there are no practical solutions to the problem of political influence on public pension funds" so long as (like Social Security) they are defined-benefit plans. Others are less pessimistic but agree that the problem of political meddling is real.

SHAVIRO, *supra* note 11, at 122 (quoting Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 796 (1993)) (citations omitted).

[130] Shaviro disagrees stating:

> Despite the paternalism and moral hazard arguments for limiting portfolio choice, I personally find the extent and manner in which the system denies it hard to defend. Are Americans unable to make even such limited investment decisions as whether to accept a bit of well-diversified risk in exchange for a higher expected return? Why try to prevent people (in practice, only those who don't save enough on the outside) from trading the Social Security retirement package for something

secure account with a guaranteed return they would select that account over more volatile accounts with uncertain returns. Offering a government bond fund with a guaranteed return of 3% above inflation would be highly attractive and should be the default fund as well as the fund holding a minimum level of investment in every account.[131] The minimum level could be the first $100,000 plus 40% of the balance in any account up to $1 million. Thereafter, the participant can allocate the remaining funds among approved funds. In that the One Fund is the worker's "safety net," investment options approved and monitored by the administrator should be relatively conservative.[132]

The magic of compound interest is performed over a long term.[133] For this reason individuals begin saving when they begin working and continue until the $1 million level is reached. At such time as the value of the fund reaches certain predetermined levels the individual will be permitted to withdraw funds for use in the purchase of a residence, education, special health care needs, or bona fide or designated emergencies. Funds withdrawn for a particular purpose will not be taxed but the $2 million limit will be reduced by the amount of any tax free withdrawals.

Funds in the One Fund are exempt from the claims of creditors except to the extent determined pursuant to a valid domestic relations order for the benefit of dependent children. As proposed, it will be unnecessary for amounts in a One Fund account to be subject to claims of a divorced or surviving spouse since each person would have their own One Fund account.[134] The One Fund

> of equal actuarial value, perhaps selected from a short list of what are considered prudent options?

Id. at 103.

[131] The return on long-term government bonds has not kept up with the impact of inflation since World War II. The real rate of return during the period 1946 to 2006 for stocks was 6.9% but for long-term government bonds was 1.6%. However, Siegel predicts that future real rates of return will be about 2% with inflation at between 2% to 3% for nominal interest rates of 4% and 5%. This is lower than the 3.5% real rate of return on such bonds over the past 205 years. SIEGEL, *supra* note 16, at 16–17.

[132] Commentators desiring the privatization of the Social Security system emphasize the long-term real returns on equities will argue that the longer money is invested the less the risk and greater the return. However, the One Fund Solution with its guaranteed real rate of return with tax exempt distributions provides a risk-free return consistent with the paternalistic approach suggested. Besides, additional funds could be contributed and invested for the long-term.

[133] Albert Einstein is reputed for his comment that compound interest is the eighth wonder of the world meaning that small changes in rate will produce large changes in outcomes when compounded over long periods of time. Browning, *supra* note 57, at 10.

[134] Earnings-sharing proposals have been set forth as a way to reduce benefit costs and inequities by crediting each spouse with one-half of the couples combined earnings. Such proposals may result in costs savings for the Social Security system but would have the effect of facilitating property settlements upon divorce. SHAVIRO, *supra* note 11, at 112–13 (citing C. EUGENE STEUERLE & JON

Solution would provide that fund contributions and earnings made or accrued during marriage would be allocated equally between the accounts of the married persons.[135] This proposal essentially treats the earnings of married couples in a manner similar to how they are treated in a community property state.

Funding health care requires special consideration. Charles Murray found in formulating The Plan that a high deductible health insurance plan could be obtained if the individual committed to a lifetime premium. He estimated the cost at $3,000 per year. If such a plan were provided through the One Fund the government could commit to refundable tax credits for low income participants to assist in the funding of health insurance until asset values in the One Fund could support the individual's insurance. It is not the purpose of the One Fund Solution to replace all wealth transfers, as Murray's The Plan is proposing, but it should be an objective that as individual wealth accumulates the individual will be in a position to fund their own benefits. The One Fund Solution is sufficiently flexible to permit employer contributions for the purpose of providing health and medical insurance.

The One Fund is established to reflect the shared responsibility of the individual to provide for their own welfare and the government's role in paternalism. Governments step in and take over responsibility for individuals when they fail to provide for themselves. It has been the practice of governments once engaged in an area to dominate that area and squeeze out private decisions. So it has become in the prime areas of life planning. Government's problem is that it cannot say "NO" to any perceived need.[136] With the One Fund individuals

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M. BAKIJA, RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY: RIGHT AND WRONG APPROACHES TO REFORM, 214 (1994); HENRY J. AARON & ROBERT D. REISCHAUER, COUNTDOWN TO REFORM: THE GREAT SOCIAL SECURITY DEBATE, 98 (1998)).

[135] *Id.* at 124. Shaviro notes:

> On spousal benefits, some traditionalists have commendably taken the lead in proposing reform without just trying to cut benefits by the back door. Unfortunately, the tendency of the current system to discourage clear thinking about the tax-benefit relationship impedes addressing the forced-saving needs of stay-at-home spouses without making what are perhaps excessive transfers to one-earner couples. Traditional Social Security is in principle flexible enough to do better in its treatment of household issues, but this will require clear thinking about the difficult choices that are involved.

Id.

[136] Gingrich confirms this analysis:

> When there is a permanent deficit there is no reason for any politician to say no to any interest group. If government spending is simply an open-ended credit card with no consequences, why not pander to every group and say yes to every request? That is, in fact, how we ended up with the current absurdly bloated, undisciplined federal government. If deficits do not matter and spending is open ended, the most rational strategy for every bureaucracy is to simply ask for more money. If, however, there is a commitment to balancing the budget, then each agency has to

can re-take responsibility for their own life decisions, fund their own priorities, and refuse expenses that are not cost effective. They will be spending their own money.[137] The individual will decide between the extent of end of life care and an inheritance for the next generation. Government's role will be to allow the One Fund Solution to be the exclusive tax-supported solution to government support in these areas. Murray suggested that The Plan might only work if a constitutional amendment prohibited the government from reentering the fields which The Plan supplanted. A constitutional amendment may also be necessary to limit government's role in all family planning challenges except for provisions of the One Fund Solution that treat all citizens equally.

Once fully implemented the One Fund should replace tax expenditures estimated to be over $700 billion over five years. As such funds are gradually freed up, subject to appropriate transition rules, they can be used to offset the immense legacy costs associated with unfunded governmental obligations for Social Security and Medicare.[138] One unintentional benefit of the One Fund is that as funds in the guaranteed government bond fund grow, more and more of the Federal debt will be held by United States citizens. Because the bond interest is inflation adjusted, there may also be an incentive for Congress and the Federal Reserve to restore fiscal discipline to the government. With a guaranteed inflation adjusted rate, seniors will no longer be squeezed by Federal Reserve rate cuts that reduce the income generated by secure FDIC guaranteed investments.

Because of the projected size of the unfunded Social Security and Medicare/Medicaid problem built over the baby boom generation it is unlikely that any solution will be fully in place in the near future. In fact, proposed "fixes" for Social Security solvency commonly focus on a 75 year horizon suggesting that full implementation of the One Fund Solution will be a multigenerational project.

> find better ways to do things and more innovative ways to get things done. If you want innovation, better outcomes at lower costs, greater productivity, and a spirit of entrepreneurial public management, the balanced budget creates much more pressure for real innovation.

GINGRICH, WINNING THE FUTURE, *supra* note 5, at 144.

[137] People come to rely on such assistance and then fail to provide it for themselves. Since government finds it impossible to say "no" to any request for assistance the cost effectiveness of any solution is ignored. Since there is never "enough" to satisfy the need, programs grow, costs inflate, efficiency is lost, and individual needs are only partially met. The solution to government's cost containment problem is to place a certain amount of decision making and risk of poor decisions on the individual whose fate is determined by those decisions. The whole-life insurance model lets the individual decide which needs have priority.

[138] STAFF OF JOINT COMM. ON TAXATION, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2008–2012, (Comm. Print 2008). Retirement tax expenditures include (in billions) Keogh-type plans $71; defined benefit plans $212.9; defined contribution $341.4; traditional IRAs $78; Roth IRAs 20.3; and credits for certain IRA deferrals $4.1.

IV. FINDING THE RIGHT SOLUTION

The search for a solution for the social safety net results from the general acknowledgement that the Federal Government will be unable to finance the promised benefits under Social Security and Medicare.[139] The Social Security "trust" fund described above should have insured payment of benefits through 2041, but has become the subject of jokes among Washington politicians. Surveys alleging that young people have greater confidence in the existence of UFOs than in the likelihood that they will receive Social Security[140] were widely quoted by President Bush, but the reliability of such surveys has been seriously questioned.[141] One presidential expression of the problem is the following:

> On April 5, 2005, President Bush posed for a photo beside a file cabinet that holds the $1.7 trillion in Treasury bonds that constitute the Social Security Trust Fund and commented that those securities "were not real assets." Later in a speech he said, "There is no trust fund, just IOUs."[142]

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[139] That Social Security is a poor investment is generally acknowledged. However, what is not known generally is that it does not achieve its primary purpose of eliminating poverty in the over-65 population. It does not according to Murray who points out that nearly one out of every ten people age 65 and older fall below the poverty line. The primary reason is that many people (e.g., divorced women who stayed at home) did not work long enough to qualify for Social Security. This is remedied by The Plan which is universal and not dependent on working. MURRAY, *supra* note 8, at 24.

[140] Miller notes the problem faced by young workers expecting some payout:

> By the early 1980s, owing to the growing payroll tax bite, that average couple had to scrape by on four times what they paid in, but in absolute dollars those retirees (many still collecting) enjoy the biggest windfalls Social Security will ever bestow. How big? On average, on lifetime payroll contributions of $65,000, they receive an astonishing $280,000 in benefits, for a net lifetime "profit" of about $215,000 (in 2003 dollars). People retiring in 2000 will still receive 1.2 to 1.4 times their contributions. But many boomers retiring in 2010, and the bulk of the Generation X'ers who come after, will face lifetime *losses*.

MILLER, *supra* note 10, at 201 (emphasis in original).

[141] GHILARDUCCI, *supra*, note 9, at 151.

[142] *Id.* at 151. Miller provides the following:

> Remember how awful it was when you realized there wasn't a Tooth Fairy or a Santa Claus? Well, brace yourself for another rude awakening: The Social Security trust fund is an accounting fiction. While it's true that about $100 billion more comes in today via Social Security taxes than gets paid out in benefits, that "surplus" is immediately invested in Treasury bonds, in effect loaning the money to Uncle Sam to mask the deep deficits in the rest of the budget. The so-called surpluses building up in the trust fund are thus nothing but IOUs. Making good on them as the boomers retire won't be pretty, since by that time we'll be paying out far more in Social Security than payroll taxes bring in. The tragedy is that today's "surpluses" were designed by congressional reformers in 1983 to add to national savings, in

In contrast to this view of the trust fund is the view that the trust fund is a solemn compact between the politicians and the average American worker. By passing the legislation the lawmakers are saying, "You pay higher taxes now in exchange for guaranteed benefits at the time you retire."[143] Any reservations those who voted for the change had were abandoned when the legislation was approved. This position sees Social Security as the "bedrock" of the American retirement system.[144]

Some commentators seriously contest the 2041 date and suggest that more reasonable estimates of economic growth should keep the system solvent through 2052.[145] It is also considered possible to increase the Social Security payroll tax by 2.5% to assure solvency for 75 years.[146] What is unsettling is that responsible

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> hopes of boosting economic growth before the big bills came due. Instead, they became an easy way to evade hard choices in the rest of the budget. For the record, the head-in-the-sand crowd insists these trust funds (there's one for Medicare, too) are as "real" as any private retirement account holding Treasury bonds. Maybe it's time we switched to a clear label: the "Pass the Huge Tax Hike to the Kids" Funds.

MILLER, *supra* note 10, at 201. Newt Gingrich is particularly irreverent about the Social Security trust fund which will be needed in 2017:

> But the government has no cash in reserve to repay any of those bonds. So guess who will pay for them? That's right: you, the taxpayer.
>
> From 2017 [to] 2042, in order for Social Security to continue to be able to pay all promised benefits, taxpayers will have to cough up an additional $6.5 trillion to pay off all the trust fund bonds. . . .
>
> This additional, enormous taxpayer liability happened because Social Security never saved and invested any of its "surpluses[.]" . . . Instead, the program loaned the surpluses to the federal government, which used the money to pay for everything from "bridges to nowhere" to welfare to foreign aid. In short, the Social Security surpluses went to the general fund to pay for anything and everything the government pays for.

GINGRICH, REAL CHANGE, *supra* note 5 at 148. They are, of course correct, but, why say it that way? In reality the taxpayers are merely repaying the debt incurred years ago so Congress could continue spending without raising taxes. It was Gingrich and the others in Congress who set up the trust fund concept which they now use to taunt the American people. That the government has to repay borrowed money should be no surprise.

143 BATRA, *supra* note 59, at 22.

144 *Id.* at 15.

145 GHILARDUCCI, *supra* note 9, at 148.

146 Ghilarducci states:

> (Raising the FICA tax rate is not unreasonable since it has not changed in fourteen years. Moreover, during the fourteen-year period before it was last changed in 1990, FICA was increased six times, from 7% in 1977 to 12.4% in 1990.) Presidents Carter, Reagan, and Bush senior oversaw FICA tax rate increases. Since FICA has been raised twenty-two times in the sixty-seven years since Social Security was established, increasing the FICA tax on pay is a routine part of maintaining the system. It can be argued that raising the FICA tax now is politically difficult

government officials as high as the President should think so little of the Federal Government's obligations.[147]

Social Security can be made solvent by either (i) raising the payroll tax; (ii) reducing benefits, for instance by extending the retirement age;[148] or (iii) increasing the rate of return on the trust fund assets or privatizing a portion of the payroll tax.[149] A proposal called "progressive price indexing" uses wage indexing to drastically reduce benefits for average and higher income workers. It would flatten the progressive nature of the system and provide a high replacement for lower income workers.[150] Progressive price indexing would force average and high

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> because there is a surplus of more than $1.5 trillion in the Social Security Trust Fund, and the trust fund is projected to grow in absolute value until 2017, when the size of the trust fund will be overtaken by the liabilities in Social Security.

Id. at 152. To support her position that the United States can afford to fund Social Security, Ghilarducci points out that the United States will only spend 7% of its GDP on Social Security in 2050 while Italy is projected to spend 20%, Canada 8.7%, and France and Germany between 14% and 18% while England will spend only 4%. *Id.* at 153.

[147] For Shaviro the importance of the trust fund lies only in the willingness of future politicians to respect it and to allow its existence to restrain their decision making. SHAVIRO, *supra* note 11, at 7.

[148] Ghilarducci recognizes the push to extend retirement age:

> The World Bank's report on pensions in 1994 became a manifesto for more individual responsibility in retirement planning, for changing social norms to reward and make legitimate longer work lives, to penalize "early" retirement, and for private individual pension accounts to replace national Social Security and company plans. In short, one clear expressed global agenda is to retrench—to get the elderly to work more.

GHILARDUCCI, *supra* note 9, at 192. Ferrara points to *Flemming v. Nestor*, 363 U.S. 603, 616 (1960) (holding that individuals have no property rights in Social Security benefits and that Congress can change them at will to meet the needs of flexibility and boldness). Ferrara, *supra* note 37, at 78. Justice Black, dissenting, looked at the program as insurance and therefore subject to contract principles. *Flemming*, 363 U.S. at 624 (Black, J., dissenting).

[149] Ghilarducci recognizes seven issues that are constantly raised when Social Security Reform is being considered: (1) How much should the elderly work; (2) What should the Federal Government do when employer pension plans fail?; (3) Will increased longevity cause insolvency?; (4) Does Social Security squelch initiative to save for one's own retirement?; (5) Can Social Security (and tax-favored retirement systems) mitigate rising income and wealth inequality?; (6) Does a crisis require major reform?; and (7) Are advanced-funded programs or pay-as-you-go programs more affordable? GHILARDUCCI, *supra* note 9, at 172.

[150] *Id.* at 157. The effective rate of the Social Security portion of the payroll tax is complicated by iterations between the employer portion which is deductible by employer and not included in the employee's income while the employee portion is deductible by the employer and taxed to the employee. Shaviro suggests the combined effect is an 11.5% tax up to the ceiling but for the purpose of thinking about the overall impact on your earning it is a combined 14.2% (7.65% multiplied by 2) reflecting a minor adjustment for the exclusion of the employer's share from your earnings. He also points out that the payroll tax does not apply to all fringe benefits and certain forms of compensation. SHAVIRO, *supra* note 11, at 10–11 n.3.

income workers to increase their personal investing to compensate for loss of Social Security.[151] Another commentator has suggested that the Social Security shortfall could be eliminated by simply indexing the determination of the initial benefit to the cost of living rather than to wage increases.[152]

American culture has always respected personal responsibility, self-reliance, and the ability to overcome life's difficulties through perseverance and the pursuit of the good in an honorable way. Self-respect derives from these qualities. Our discussion of American Paternalism and numerous tax motivated solutions to life's problems has demonstrated an incredible complexity which, coupled with government mandated inflation and an incomprehensible tax system, undermines these fundamental American values. Ghilarducci concludes:

> In most, if not all, nations, social spending programs aim to prevent poverty and enable workers to retire, even if a worker is still capable of working. Governmental policymakers and economists recognize that people are unable to make, or hopelessly ineffective at making, decisions affecting their lives over a long time horizon.[153]

What is particularly alarming is that at the beginning of 2009 with a new president being sworn into office the nation looks to the government to solve an overwhelming economic crisis that was generated by that very government's irresponsible economic policies. A new economic stimulus is becoming the cure for problems caused by previous economic stimuli. Solving such crisis with continued borrowing could create intergenerational conflict because the government's ability to fairly balance interests is being seriously questioned.[154] It is therefore necessary

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[151] Shaviro sees every income cohort in the Social Security system as suffering a net loss in the system with lower cohorts losing less than higher cohorts. It is merely a transfer from younger persons to older persons that is distributed progressively based on income. *Id.* at 69.

[152] MILLER, *supra* note 10, at 205–08. *See* GHILARDUCCI, *supra* note 9, at 168 (identifying and describing a number of ways to fine-tune the existing system to extend the solvency of Social Security and estimating the effect of each on such extension).

[153] GHILARDUCCI, *supra* note 9, at 56.

[154] Governmental solutions produce unequal and often inequitable effects. For example, the government has no ability to offset the moral hazard of people working less if their income is assured or for adverse self-selection. Thus any effort by the government must be limited. SHAVIRO, *supra* note 11, at 53–55. Shaviro further explains:

> [The government's ability to successfully alter or reform Social Security and maintain a sense of generational fairness] strongly depends upon the fact that so long as society keeps getting wealthier, the age group (elderly people) with the greatest political power is also generally the poorest on a lifetime basis. The current system might look less appealing if we asked: How would it respond to different contingencies, such as an economic downturn that left young people worse off that the elderly? This could happen, for example, if a recession hit the labor market harder than the stock market.

to limit the governmental role in personal financial responsibility and limit that role to areas in which the government has the ability to act efficiently and effectively.

The focus here is individual financial security and the first question is how much of an individual's income should be saved to meet that goal of financial security. From the earlier discussion of the Baileys it was suggested that 20% seems to be an acceptable goal. Recognizing this goal it seems the height of incredulity to suggest that the 15.3% payroll tax should not be considered individual savings. Ghilarducci agrees with the 20% suggestion:

> Without Social Security and employer-provided pensions, a worker who chooses to be, or must be, a "do-it-yourself pension" planner, needs to save about 20% of every paycheck in an account earning at least 4% after inflation and investment fees for an entire working life. It is a tall order to fill; most people don't fill it and couldn't fill it without being forced to save.[155]

A rule of thumb might be that a person would need approximately $230,000 in a lump sum at retirement to generate a pension of $1,000 per month.[156] Thus, a $1 million retirement nest egg would purchase a $4,347 per month ($53,174 per year) lifetime annuity.[157] However, the retiree must keep in mind that with inflation at 4% per annum the retirees earning power would decrease about 25% by age 75, and 50% by age 85.[158]

The second question is what is meant by financial security and this question seems best answered by focusing on financial independence. That is the ability to make decisions about life without complete dependence on one's ability to earn a living. Since few people begin life with such an ability it is appropriate to ask at what age someone should ideally be in such a financial position. This raises

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> Under such circumstance, transfers from the elderly to the young, or at least reduced transfers in the other direction might be appropriate. But the adoption of such transfers through Social Security would be impeded not only by the power of the AARP, but also by an ideology that holds that benefits currently promised to the elderly can be increased but not reduced.

Id. at 71.

155 GHILARDUCCI, *supra* note 9, at 56. She further observes a rule of thumb by pension experts is that you must save between 7% and 15% of every paycheck during your thirties and forties if you will be able to maintain your pre-retirement standard of living in retirement depending on the assumed rate of return, wage increases, inflation and Social Security benefit. *Id.* at 120.

156 *Id.* at 121 (reflecting the estimate that a $1,000 per month Social Security benefit is valued at approximately at $240,000).

157 This number seems low in that corporate bonds generally pay 5% or more long-term and this would generate $50,000 per year without consuming principal.

158 *Id.* at 121.

the question of the age of retirement although, by retirement, we should not think solely of the ability to while away one's life on the sea shore without any productive activity.[159] Retirement may mean continued work or the start of a new career or vocation. Many Americans believe that the ability to be productive is the essence of life. However, the fact that healthy men and women who are able to continue working may plan to retire at some point is also generally accepted in American society.[160]

Ghilarducci uniquely and poetically ties retirement to human dignity in a way we should all keep in mind: "The financial ability to withdraw voluntarily from the labor force, the ability to rest, and, even to recuperate before dying, is, to workers, a fundamental part of dignified living and a marker for achieving middle class status."[161] Ghilarducci states further: "Retirement with dignity and security after a lifetime of hard work is a cherished feature of a civilized society."[162] For Ghilarducci this promise is being lost in the United States because of the shift away from defined benefit plans in favor of defined contribution plans which, in her mind, have been proven as a failed experiment.[163]

At what age or after how long a period of labor should this ideal be achievable.[164] Many pension plans target age 65 and 30 years of service as the target for "full" retirement. Government and military look to 20 or 30 years of

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[159] Charles Murray calls this the European Syndrome. MURRAY, *supra* note 8, at 84–87 ("The European Syndrome is dismissive of all the ways in which work can become vocation and vocation can become a central source of satisfaction in life.").

[160] GHILARDUCCI, *supra* note 9, at 1 (noting that in 2000 the life expectancy of a man at age 65 was 14 years and a woman was 18 years).

[161] *Id.* at 2. Further she states:

> Retirement is a result of economic prosperity. And the choice to retire should be an achievable goal of everyone's financial life. A fundamental desire of everyone is to be able to make choices about how to spend our time. As we grow older time grow more precious. Making our pensions secure is the only way to secure the capacity to choose what to do with the time remaining to us.

Id. at 25.

[162] *Id.* at 260.

[163] This objective is becoming less and less a reality in the United States primarily because of the uncertainty generated by the demise of the defined benefit plan in favor of the defined contribution plan which relies on uncertain market returns. Ghilarducci concludes: "The nation's experience with voluntary, individual, tax-subsidized retirement accounts administered by commercial money managers, has failed." *Id.* at 261.

[164] The proposal is to allow people to choose their age of retirement but such decisions could be threatened from unexpected sources. The aging of the population in Western countries and the desire for early retirement could be threatened by a downward pressure on equity prices as baby boomers seek to sell their investments to fund their retirement. Siegel proposes a "Global Solution" to what he calls the "age wave" with the developing countries providing goods to the developed countries in exchange for "assets" furnished by the developed countries. From his analysis, it is necessary for the developing world to maintain a growth rate of 6% to 8% to allow the baby boomers to maintain their retirement age of 62. SIEGEL, *supra* note 16, at 133–38.

service and age 55 as the targets for retirement.[165] Social Security targets age 66 currently (increasing gradually to age 67 in 2027) for full retirement with early retirement at a decreased benefit at age 62 and delayed retirement with increased benefits at age 70.[166]

Contributions to the One Fund begin at age 18 although many young people attend college and begin their careers later. But, for someone beginning at age 18, by age 68 they would have accumulated 50 years of compounding on their One Fund contributions. That's great for the magic of compounding, but 50 years is a long time to pursue financial security. Ideally, that should occur much earlier—age 60, or even 55, should be considered a real target for an enlightened, progressive, growing society.[167] Sociologists suggest that length of expected retirement across socioeconomic groups is about equal at 13 years so that a system is necessary to allow people to retire at different ages.[168] Newt Gingrich suggests changes that encourage the poor to build wealth by beginning to save early in life and benefit from the principle of compound interest.[169] He would advise the young: "The key

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[165] The twentieth century saw a gradual increase in expected retirement time for both men and women. Nevertheless, beginning in 1999 expected retirement time began to slip back somewhat as people began to use their increased longevity to continue gainful employment. GHILARDUCCI, *supra* note 9, at 11.

[166] *Id.* at 282–83. Ghilarducci states:

> Whether an economy can support nonworkers depends more on productivity growth and the size and strength of the tax base rather than on the ratio of workers to beneficiaries. Whether a society chooses to support nonworking older people depends on economic power, mostly on the power in the labor market. Pension policy is ultimately labor policy. Economists Steven Nyce and Sylvester Schieber argue that older people should work more because a future smaller U.S. workforce will slow GDP growth (assuming everyone else is working) and lower consumption, which is something we all do not want to happen.

Id.

[167] If this objective cannot be met in the immediate generation it should become more achievable under the One Fund for succeeding generations that begin life with, or at least expect to receive, some contribution to their One Fund through inheritance.

[168] *Id.* at 13–15.

[169] GINGRICH, REAL CHANGE, *supra* note 5, at 64. Gingrich states:

> The poor especially need the power of compound interest over time to help them grow out of poverty and into prosperity. The earlier you start working and saving, the more likely you are to rise. The earlier you learn how to make a living and how to spend less than you earn, the more likely you are to move out of poverty.

Id. He also sees the importance of change in education:

> There is ample evidence of what works in education, but the bureaucracies have systematically ignored all of it. Innovations that work included merit-based pay, increasing teacher-student rations, revamping union rules to reward the best teachers, bonuses and incentives for new teachers, charter schools, and offering parents a coupon giving them the opportunity to send their children to the school that works best for them. I've even suggested rewarding students in the poorest neighborhoods by paying them if they get a B or better in math and science.

Id. at 57–58.

characteristics of great success are starting early, working hard, learning every day, and being prepared to bounce back from failure and to enthusiastically work your way through setbacks and frustrations."[170]

Ghilarducci believes a system of combined Social Security and defined benefit pensions as being efficient and affordable and preferable to a defined contribution plan because the former will cover everyone and the latter only those who volunteer.[171] Workers need to be forced to save and insure against the coming possible "superannuation."[172] Social Security and employer pensions spread the risk over large groups in an efficient and workable manner.[173] She sees arguments that the system is seriously threatened by the shift to defined contribution plans and longer life expectancy as false, arguing that the large tax expenditure supporting defined contribution plans unfairly favor higher paid workers and suggesting that increased life expectancies may result from earlier retirement.[174] Finally, she argues that similarly situated retirees with a guaranteed amount of income feel more secure and are generally more content with their situation than retirees with merely an equivalent lump sum at their disposal.[175] Defined benefit plans are preferable in a society in which frequent job changes occurs.[176]

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[170] *Id.* at 64.

[171] GHILARDUCCI, *supra* note 9, at 13–17 (arguing that the combination is both efficient and affordable).

[172] *Id.* at 24 ("'[S]uperannuation' [is] a rarely used word of many syllables that simply and sadly refers to the awkward stage of life when people either cannot work or no one wants them to work.").

[173] An important complicating factor is that a public program can control risk in a way that private programs cannot. A public program can obtain any portfolio profile it desires, whereas a private plan cannot. For example, recent contributions have significantly more risk than contributions years in the past. Orszag & Stiglitz, *supra* note 15, at 13.

[174] The pension system is seen as being threatened by the general beliefs that (i) life expectancy is increasing so that we should work longer, (ii) labor shortages will develop as the population ages, and (iii) pensions are unaffordable. GHILARDUCCI, *supra* note 9, at 17. She presents the example of an upside down tax incentive by comparing a $20,000 a year worker taxed at 15% saving $2,000 (10%) and getting a $300 tax break with a $200,000 a year worker taxed at 35% saving $20,000 (10%) and getting a $7,000 tax break. *Id.* at 21.

[175] This is also borne out by the finding from the survey that having a supplement to Medicare or Medicaid—even for retirees who are healthy—substantially increases their satisfaction. *Id.* at 72.

[176] *Id.* at 74. The author compares two employees and concludes that an "average" employee with the defined contribution would accumulate $59,000—enough to pay an annuity of $6,000—while the same employee accumulating 2% per year of final average pay making the same moves as the 401(k) employee would accumulate a pension of $35,364. The author acknowledges that if the employee was an "ideal" 401(k) participant and had rolled-over his entire accumulation each time he changed jobs he would have accumulated $647,379—enough to buy an annuity worth $51,790 for life. Of course when the 401(k) participant changes jobs the money that is not rolled-over is used for current purposes that may improve the quality of the participant's life. This ideal participant is one that never misses a payment, never borrows from the plan, and never withdraws any amount from the plan. See *id.* at 78, for a chart setting forth the details of the comparison between a "real life" average 401(k) participant and an "ideal" 401(k) participant.

In promoting her guaranteed retirement account, Ghilarducci argues her preference for defined benefit plans over defined contribution plans. Her primary argument is that they cover all employees and are better and more efficiently managed.[177] Defined contribution plans suffer from non-professional management and high costs.[178] Current problems with defined benefit plans stem from under-funding which she attributes to the actions of the PBGC that permitted pension funds to use a double digit return to project future values.[179] Further, the under-funding of the PBGC is the result of unusual bankruptcies in the airline and steel industries.[180] Finally, calling herself an "institutionalist" as opposed to a neoclassical economist, she believes that governments, unions, and firms are better able to make group decisions than individuals in the group.[181]

Defined contribution plans also suffer from certain leakages such as hardship and other special withdrawals so that the average defined contribution plan has a balance of around $50,000—enough to fund a 20 year payout of $300 per month

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[177] Self-annuitizers face inflation risks against which the increasing cost of living will progressively undermine the buying power of the retiree's income. Investment risk includes the risk of a less than optimum portfolio mix of bonds and stocks thereby incurring greater risk for a given return on investment. Investment funds may provide life-cycle funds that eliminate some of the risk but even here all life-cycle funds vary in their investment strategies. Providing educational assistance in the area of personal financial management to participants does not seem to change the investment allocations of participants. GHILARDUCCI, *supra* note 9, at 127, 309 n.15 (citing Steven Venti, *Choice, Behavior, and Retirement Saving*, in OXFORD HANDBOOK OF PENSIONS AND RETIREMENT INCOME, 603–617 (Gordon L. Clark, Alicia H. Munnell, & Michael Orszag, eds., 2005)).

[178] Workers are unsuited and unable to earn the maximum return on their pension savings when individual accounts are the vehicle to do so because of high and hidden investment management fees, the lack of investment experience and the difficulty of saving enough to eliminate the downside risk of not having enough to retire on. GHILARDUCCI, *supra* note 9, at 129.

[179] *Id.* at 97–98, 109–110. That defined benefit pensions are subject to considerable uncertainty is reflected in the impact of the economic downturn in 2008 on pension assets. One study reported that, of 772 of the S&P 1500 companies that have defined benefit plans, plan assets represented only 75% of pension obligations. Further, at a time (Sept. 30, 2008) when the non-finance companies in the S&P 500 companies reported a near record $647.8 billion in cash, escalating demands for that cash included $70–$100 billion need to cover investment losses in pension plans. Norm Alster, *Corporations Face Cash Squeeze from Credit, Profits, Pensions*, INVESTOR'S BUS. DAILY, Jan. 26, 2009 at A1.

[180] GHILARDUCCI, *supra* note 9, at 105.

[181] *Id.* at 85. Ghilarducci states that:

> Institutionalists emphasize human limitations to process information, limitation that make it unrealistic for people to make rational decisions. That perception implies that decisions can be better made, or only made, by a union and a firm, together, to provide employee benefits, such as defined benefit pension and health insurance, both providing for worker's long-term needs. Perhaps this may justify what could be considered derisively as the "paternalistic" view of unions and firms.

Id.

at a 4% investment return.[182] Believing that permitting lump sum withdrawals undermines pension security,[183] Ghilarducci proposes that any pension reform should be judged by the following standard:

> Any pension reform should be evaluated according to: whether the reform encourages better and more stable funding; whether the reform is fair to workers, retirees, executives, shareholders, customers, and taxpayers; whether the reform encourages the formation of "real" pensions—where "real" implies an definite stream of lifetime income; and whether the reform helps firms adjust to business cycles and industrial trauma.[184]

The One Fund Solution meets these standards by requiring significant contributions throughout life, offers guaranteed inflation adjusted investment options, and is the sole vehicle for government supported/tax favored savings. All taxpayers are treated equally with taxpayers desiring greater returns or larger portfolio's being required to do so without taxpayer subsidies. But the One Fund goes beyond these standards by offering flexibility to the participants in investment choices and the ability to use the fund for lifetime needs subject to regulations that prevent jeopardizing long-term security. Further, it limits the government's involvement in guaranteeing or underwriting investment risk. Where outside services are provided through the One Fund such as investment options, health care, disability, education needs, and related services, government does what government should do best by insuring adequate disclosure and the ability of approved vendors to provide the service offered in a responsible manner.[185]

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[182] *Id.* at 102, 306 n.46, 107–08.

[183] The PBGC regulations do not restrict the lump sum distributions from defined benefit plans. These distributions are favored mainly by executives but have the effect of draining fund assets which are not generally acquired to fund lump sum distributions. *Id.* at 114. By taking a lump sum rather than a retirement annuity you forego any "subsidy" that you would obtain if you were in an actuarial defined group of similar retirees. A self-annuitizer is also likely to underestimate your longevity. Psychologically it is interesting that people are willing to share risks in auto, house, and medical insurance, but not in pension risk. *Id.* at 124.

[184] *Id.* at 114.

[185] MURRAY, *supra* note 8, at 127. Murray states:

> If constructed with great care, it is possible to have a government that administers a competent army, competent police, and competent courts. Even accomplishing this much is not easy. Every step beyond these simplest, most basic tasks is fraught with increasing difficulty. By the time the government begins trying to administer to complex human needs, it is far out of its depth. Individuals and groups acting privately, with no choice but to behave in ways that elicit voluntary cooperation, do these jobs better. The limited competence of government is inherent. At some point in this century, that too will become a consensus understanding.

Id.

Resolving the retirement dilemma should not be independent of solving the health care problem. At one point employers provided pensions and health care as a package and, for seniors the two problems interact every day. Social Security ties into Medicare in that Medicare Part B is deducted monthly from Social Security payments. Murray suggested that high deductible health care insurance could be obtained for a relatively modest cost when coupled with a commitment to continue the policy over one's life.[186] This at least would address the possibility of catastrophic illness.[187] However, it is suggested that achieving real health care reform requires stressing prevention, wellness, early detection, and self-management as well as shifting health care decisions from bureaucratic systems back to the patient.[188]

Education makes demands on life savings that can be accommodated through the One Fund. Tax subsidies provide assistance on a modest level that could be duplicated through the One Fund without seriously undermining long term security. Housing is often acquired through savings when people are in their 20s. During these early earning years the One Fund balance may not be sufficient to

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[186] Gingrich provides a list of citizenship rights which includes basic health rights. You have a right not to die from medical error, be protected from contracting illnesses in the health care facility, to own your own medical record, be part of a low-cost health insurance with vouchers for those who cannot afford the insurance, to know quality and cost before making a medical decision, and to know your treatment options. Every person has the responsibility to have health insurance but he would require the posting of a bond by "libertarians" who do not wish to participate in the plan. He goes further and asserts that everyone is expected to be engaged in maintaining their own health, contribute something toward the cost of medical care, and make reasonable cost-benefit decisions. GINGRICH, WINNING THE FUTURE, *supra* note 5, at 123–26.

[187] The Plan recognizes an important connection between health care and retirement savings. Murray notes the expense of medical care escalates because of three characteristics in the current health care system. Routine health care needs are paid by insurance so that the individual receiving the service is unaware of the cost and not responsible for its payment. Second, many costs are incurred "just-to-be-sure" the condition does not exist. These expensive tests have only a marginal benefit yet are extremely expensive and are paid by insurance. Finally, end of life care is a large part of the medical costs but often only extends life a couple of months. These problems can be overcome by having medical and related cost decisions be made by the person receiving the care. His three reforms are noted in the text.

[188] GINGRICH, REAL CHANGE, *supra* note 5, at 240. Gingrich states:

> The deepest and most destructive impact of the third-party bureaucratic system on health is that it shifts responsibility and authority away from the individual and onto other people. In a third-party bureaucratic system, the buyer (the insurance company) pays for the receiver (the patient) and someone else (the doctor) provides a good or service. The patient is essentially passive, and becomes dependent on the insurance bureaucracy to decide how he can get care. Then he becomes dependent on the doctor to provide the service the bureaucracy has agreed to pay for. He gets into the habit of waiting for someone besides himself to do something to make him healthy. To make this problem even worse, the doctor who is being paid to take care of the patient grows to expect him to be hopelessly passive.

Id.

fund a loan for a down payment. While the One Fund is not a "bank" account and withdrawals are strictly regulated to minimize any impact on long term security, some accommodation of first time home buyers may be possible depending on fund balances and age of participants. Education is now built on the willingness of young men and women to borrow large amounts of money. A goal of the One Fund should be to alleviate that need.

The key item of discussion when talking about private accounts is the rate of return on the funds invested.[189] Newt Gingrich in his advocacy strongly asserts the low real rate of return on money invested in Social Security, which he argues is only 1 to 1.5%, and contrasts it with the argued long-term real rate of return on stocks of over 7%, and the real return on bonds of around 3.5%.[190] He would subscribe to a plan proposed by Representative Ryan and Senator Sununu that would allow people to invest 50% of their Social Security contribution in private accounts with a Federal guarantee that the fund would yield no less than would be the case under Social Security.[191] This plan essentially leaves the investment

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[189] Newt Gingrich points out that the basic argument is that Social Security is no longer a good deal for young Americans since the long-term real rate of return on corporate stocks is at least 7.0 to 7.5%. *Id.* at 34 (citing PETER FERRARA & MICHAEL TANNER, A NEW DEAL FOR SOCIAL SECURITY 72–73 (1998)). Arguably, large company stocks have returned a real rate of return on the New York Stock Exchange of 7.5% since 1926. *Id.* at 33 (citing IBBOTSON ASSOCS., STOCKS, BONDS, BILLS AND INFLATION YEARBOOK (2003)). The real rate of return on corporate bonds is 3.5% so that a portfolio of half bonds and half stocks would be 5% and a portfolio of two-thirds stocks and one-third bonds would produce a return of 5.75%. Compare these results to the real rate of return on Social Security of 1 to 1.5%, although some studies suggest that it is less than 1%. *Id.* at 33–34, 223 nn.15–17 (citing WILLIAM W. BEACH & GARETH G. DAVIS, SOCIAL SECURITY'S RATE OF RETURN: A REPORT OF THE HERITAGE CENTER FOR DATA ANALYSIS, No. CDA98-01 (January 15, 1998)).

[190] GINGRICH, REAL CHANGE, *supra* note 5, at 150. Shaviro cites estimates that Social Security offers an average internal rate of return of 2.4% for people born between 1945–1949; less than 1% for those born after 1965; and approximately 0% for those born after 1995. SHAVIRO, *supra* note 11, at 33. Browning provides data emphasizing that the "return" on Social Security taxes paid by individuals has and will decrease as time passes regardless of family and income status in which one finds oneself although the highest return goes to the low wage earner in a one-earner couple (dropping from 6.1% in 1995 and 4.9% in 2008 to 4% in 2068) and the lowest return goes to the high income single male (dropping from 1.5% in 1995 and 0.8% in 2008 to 0.2% in 2068). Browning, *supra* note 57, at 9.

[191] This plan reflects input from the "chief actuary of Social Security" and a principle at State Street Global Advisors. It would create intergenerational wealth and make the Social Security system not only solvent but produce surpluses. In fact, it would force the Federal Government:

> [T]o stop spending the annual Social Security Raid, it would have to be honest about the budget and the larger financial picture, because it would force Congress to no longer hide deficit spending in Social Security IOUs that it cannot finance. That would force Congress to prioritize or cut spending.

GINGRICH, REAL CHANGE, *supra* note 5, at 158.

decisions to the individual but the risk of loss with the government.[192] Such private accounts would resolve the Social Security funding problem[193] and create an ownership interest in society which he exuberantly praises:

> Just think about what sweeping changes our society would experience if workers at all income levels could accumulate several hundred thousand dollars in their own personal accounts by retirement. All workers would be accumulating a substantial, direct ownership stake in America's businesses and industries, and they would all prosper while dramatically increasing the capital available to the American economy. This would be a historic breakthrough in the personal prosperity of working people.[194]

As noted previously, Murray provides support for at least a 4% real rate of return over a 45 year period.[195] But while long-term averages are comforting and reflect some degree of reliance on the integrity of the stock market, individual experience may be somewhat unnerving. For example, the Dow Jones Industrial Average ("DJIA") peaked just over 1,000 in 1966 before falling below that number. Thereafter, it did not return permanently to that level until 1983; seventeen years later. While some dividend income may have cushioned the investment return,

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[192] Gingrich, using a plan proposed by Representative Ryan and Senator Sununu, calculates that if a husband making $40,000 per year and a wife making $30,000 per year were permitted to invest 50% of their current Social Security contributions in private accounts with a 50/50 stock bond ratio earning average returns over their entire careers they would accumulate approximately $668,178—enough to pay twice what social security would pay. Making a 67/33 stock bond ratio accumulates approximately $829,848 and if they were allowed to shift 80% of their contributions they would accumulate $1.2 million. A similar calculation produced even better benefits for a low income individual who would be permitted to invest a greater percent of their contributions to a private account. The Ryan/Sununu plan also contained a Social Security safety net with full Federal guarantee such that if the return on accounts fell below what Social Security would pay then the government would make up the difference. Since few people would fall below the level of protection the guarantee would be of minimal expense to the government.

[193] Estimating the cost of the Ryan/Sununu proposal, the Social Security chief actuary estimated that the reform plan would begin paying surpluses by 2030 and would meet all obligations through 2077 and beyond. GINGRICH, WINNING THE FUTURE, *supra* note 5, at 39; *see also id.* at 223 n.30 (detailing the Ryan/Sununu bill); *id.* at 223 n.31 (citing STEPHEN GOSS, ESTIMATED FINANCIAL EFFECTS OF THE PROGRESSIVE PERSONAL ACCOUNT PLAN (Dec. 1, 2003); STEPHEN GOSS, ADDITIONAL ESTIMATED FINANCIAL EFFECTS OF THE PROGRESSIVE PERSONAL ACCOUNT PLAN (April 6, 2004)).

[194] GINGRICH, REAL CHANGE, *supra* note 5, at 153.

[195] MURRAY, *supra* note 8, at 35. Murray argues that the 4% real growth return on stocks is essential for another reason. If it does not occur over the next 45 years the government would not be able to make good on its promises under Social Security in which case it may not make any difference whether The Plan was in effect except that with The Plan you would have an opportunity to make your own decisions on how to protect your retirement account. *Id.*

inflation would have left you worse off in 1982 than you were in 1966.[196] Likewise for the period 1998 to 2008 where the DJIA closed around 8600 in both years.

The meaning of these swings can be offset to some extent by investment strategies. But for the individual that turned 55 in 1998, planning to work for another ten years and retire in 2008 at age 65, the challenge is daunting. Not only were investment returns uncertain in that the swing of returns was great depending on the particular year being considered but these were the individual's highest years for personal earnings as well as savings. Keep in mind that any investment made at age 55 only accumulates a compounded return for ten years before the owner must decided whether to retire at age 65. An example may help understand recent stock market returns.

TIAA-CREF, one of the oldest organizations providing retirement services, is dedicated to providing financial services to persons in the field of education. They are known for their conservative investment strategies. They offer a number of funds in their retirement portfolio including a stock and bond fund and a guaranteed investment account. Looking at the ten year compounded annual rate of return on these funds reveals the following: stock fund -1.01%;[197] bond fund 5%; guaranteed retirement annuity (restricted withdrawals over ten years but benefiting from professional management) 6.12%. A combination of these funds could have produced a return that exceeded the stock market return although during the period returns varied and the one, three, and five year returns during this period were lower than the ten year return. It should be noted that the Stock Fund was created in 1952 and reports its rate of return since inception through 2008 at 9.38%—well above inflation.

Most workers would not be in a position to manage their investments with the degree of confidence and objective and detached sophistication of professional investors so that restricting investment choices and providing a guaranteed fund remains highly desirable for funds that are accumulating for specific purposes.[198]

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[196] The real return on stocks was an abnormally low -0.4% during the period 1966 to 1981 and an abnormally high 13.6% during the period 1982 to 1999. SIEGEL, *supra* note 16, at 13.

[197] It is interesting to compare the Vanguard Total Stock Market Index fund for the same ten year period. It reported a return of -0.66%. Vanguard's Total Bond Market Index reported a return of 5.37% over the same period.

[198] Murray disagrees and asks the question:

> The broader question is whether ordinary people can be expected to plan for their own retirements and invest their money wisely, to which my short answer is: Why not? The large retirement income that I produced from a working income of $20,000 a year is based on the same amount that people at that income level are currently required by law to save for retirement. Accumulating that sum does not require people to make sophisticated investment choices; it is based on the result if they buy a fund based on a broad market index and leave it alone during a hypothesized worst investment period in American history. For that matter,

Such uncertainty leads others to advocate defined benefit plans and guaranteed funds managed by professionals. The One Fund provides a balance between these positions that leaves some degree of decision making and responsibility with the One Fund participant.

Transition costs from the present retirement system to the One Fund Solution would be significant and time consuming. Murray faced the problem of transition costs when he proposed The Plan. He noted that the switch would affect different people depending on their age and position. He proposed that the present value of the benefits lost by switching to The Plan could be made up by providing affected persons with a lump sum payment equal to the lost benefits.[199] He surmised that the only people that would need to be paid off under The Plan would be couples older than their mid-thirties making more than $50,000 each. These couples would expect two social security payments plus Medicare when they retire at normal retirement age.

Such a solution would be applicable to a transition to the One Fund. A present value calculation could be made either on the basis of individual contributions to the Social Security and Medicare trust funds together with some growth rate to determine the present value.[200] An alternative would be to use a present value analysis of expected benefits less future contributions and taking into account benefits to be assumed under the One Fund such as the guaranteed account and tax free withdrawals. Individual determinations would be made and the amount credited to the individual's One Fund account subject to appropriate limitations. Such calculations are performed regularly by the financial services community and much of the information necessary to make such calculations is generated annually by the Social Security Administration and mailed to every Social Security participant.

> obtaining a 4 percent return does not require investing exclusively in equities. The CBO [Congressional Budget Office] analysis of the President's Commission to Strengthen Social Security projects an average real return of 5.2 percent from a portfolio consisting of 50 percent equities, 20 percent treasury bonds, and 30 percent corporate bonds.

MURRAY, *supra* note 8, at 31.

[199] *Id.* at 165–167.

[200] The higher the discount rate the lower the present value. It could be argued that the discount rate should be the expected return from Social Security (*e.g.*, 1.5%) or it could be the investment return on the guaranteed fund (*e.g.*, 3% after inflation) or some other rate on special bonds to be place in the individual's One Fund account. The discount rate could also reflect the tax exemption of distributions from the One Fund. The appropriate discount rate may be different for high and low wage workers but, in any event is controversial. *See* SHAVIRO, *supra* note 11, at 34–35.

Paying the "legacy" costs associated with Social Security and Medicare are significant.[201] The shortfalls and the trust fund weakness is a fact of life that must be addressed with hard choices. It has been pointed out:

> The trick in switching mid-stream from today's "pay-as-you-go" system to a pre-funded private retirement system is that one generation has to pay twice: first for the retirement of its parents, and then for its own, since younger folks in a private scheme will start paying for themselves. Usually such plans require at least a trillion dollars in these "transitions" costs. Conservatives either can't do the math or simply won't admit that they can't have Bush's tax cuts and also fund their transition to partial private accounts. Democrats fairly blast Republicans here for continued fiscal recklessness and for peddling the worst kind of accounting hoaxes to mask what they are up to.[202]

Under the One Fund enormous tax expenditures supporting existing programs would be freed up as time passes, vested benefits are paid, and existing plans dissipate and expire. A further important source of revenue will be the reinstitution of the estate tax after 2010 on large estates. It is reasonable to tax these estates because the accumulation of a large estate generally includes assets that have not previously been taxed under the normal income tax rates. Nevertheless there is a cost associated with the transition and that cost will be incurred even if the existing plans are continued. The One Fund would allow the shifting to a sustainable funded plan in which the government's roll would be to administer and provide inflation adjusted 3% bonds but not assume risk of investment losses.

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[201] Miller commenting on the unfunded liability:

> If government accounted for future benefit commitments as businesses must, these programs would show $25 trillion in unfunded liabilities. That means $25 trillion in promised benefits for which no money has been set aside. The pledge to honor them amounts to a promise to raise taxes on our children. If payroll taxes were raised to meet these costs, they would have to roughly double to 32 percent in 2030, an unthinkable and economically devastating burden. This won't happen, of course: Its obvious insanity means that long before then we'll have to rethink how these benefits are designed and financed.

MILLER, *supra* note 10, at 58–59.

[202] *Id.* at 277. Transition costs are a major reason that the system is not reformed but Browning points out that a refusal to pay these costs will ultimately mean that our children and grandchildren will be consigned to a lower standard of living. Browning, *supra* note 57, at 25. Furthermore, Browning identifies as a hidden cost of Social Security taxes a 10% reduction in GDP (0.3% annually) resulting from reduced savings and work incentives from the taxes. *Id.* at 26. Thus estimates of real return on an individual's Social Security contributions are incomplete. *Id.* at 12–16. That a switch from a pay-as-you-go system to private accounts incurs transition costs that must be borne by the current generation is not difficult to understand: "If the economy is dynamically efficient, one cannot improve the welfare of later generations without making intervening generations worse off. Reform of pension systems must thus address equity issued both within and across generations." Orszag & Stiglitz, *supra* note 15, at 13.

Finding the political will to change may also present problems.[203] In 2003, Matthew Miller proposed four areas in need of serious reform if America was to be in a position of addressing the retirement of the baby boomer generation. If implemented, his two-percent solution would mean that everyone working full time would be able to provide for their family, that every citizen should have basic health coverage, that poor children should have good schools, and that every citizen should be able to voice their opinions. Goals that he thought achievable were not met because of political consideration he outlined in his book. Money is a moving force in politics that distorts every effort at reform.[204]

Miller is skeptical of any reform[205] and sees the political future as determined by the government's commitment to be the "seniors-only" ATM machine.[206] If major programs were means-tested the cost would be reduced dramatically. With over $200 billion a year going to Americans with incomes over $50,000, it would

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[203] The political will to institute change is a perennial problem. Resisting the impulse to undo tax reform was seen in Republican efforts to undo the achievements of the tax reform of 1986 which reduced the income tax brackets to two and eliminated the capital gains differential. Both achievements were undermined within ten years by Republican majorities in Congress with the concurrence of a Democratic president. The author herein recognized the tendency of politicians to complicate simple tax proposals and argued against the adopting a value-added tax for the United States and argues herein for a transfer of control of life savings back to individuals. *See* Gordon T. Butler, *The Value-Added Tax: A New $40 Billion Tax for the United States?*, 50 TEX. L. REV. 267, 307 (1972). The Value Added Tax continues to be a hot topic whenever the government is seeking new revenue sources. *See* Alan D. Viard, *Border Tax Adjustments Won't Stimulate Exports*, 122 TAX NOTES 1139 (2009); David D. Stewart, *Specialists Offer Ideas for Design of U.S. VAT*, 122 TAX NOTES 1074 (2009).

[204] Miller suggests that money skews politics: "(1) it puts sensible policy options off-limits; (2) turns politicians' attention to wealthier Americans and business interests; (3) allows politicians to shake down business for campaign cash; and (4) discourages promising candidates from running for office." MILLER, *supra* note 10, at 45.

[205] *Id.* at 47–48. Miller states:

> The upshot of the forces we've discussed—electoral parity, Democratic timidity, Republican indifference, media stenography, and the warping effect of campaign cash—is a debased political culture in which potential answers to our major domestic problems cannot find expression. . . . Since our leaders can't or won't talk about what it would take to make serious progress on health or schools or wages or campaign reform, they pretend they're serious as a way of communicating their good intentions and letting us know which "side" they're on. . . . Public life becomes a complex and mystifying con—not a search for solutions, but the pretense of a search for solutions as a means of jockeying for power.

Id.

[206] *Id.* at 57. Miller states:

> The reality dawning as we look over the horizon is that virtually all of government spending has been pre-committed to the seniors-only ATM, leaving future voters effectively disenfranchised. This can't be acceptable. We need to tackle the challenges that accompany the aging of America now to avoid a showdown later.

Id.

appear on first look that means-testing would be appropriate. But liberals resist means testing because political support would be lost if wealthier Americans did not benefit.[207] Miller approaches the political question by obtaining acceptance of the proposition that some minimal level of governmental assistance is necessary because of the presence of "luck" in the determination of one's station and success in life.[208]

Newt Gingrich acknowledges the Republican failure at governing, but predicts the Democrats, after winning in 2008, will be unable to bring change because they refuse to acknowledge that government sponsored programs are invariably riddled with incompetence, inefficiency, waste, fraud, and illegality.[209]

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[207] *Id.* at 62. Miller suggests:

> First, we already means-test programs to some extent, both through progressive benefit formulas (like Social Security's) and by treating most benefits as taxable income. Looking ahead, they say, the universal nature of programs like Social Security and Medicare, into which everyone pays and knows they'll get out what they're supposed to, is precisely what assures their political viability. Alter this by explicitly scaling back benefits for well-off Americans and you'll stigmatize these programs as "welfare." Wealthier Americans will decide there's nothing in it for them, and will vote to opt out of the system. Before long, the whole notion of social insurance, and the transfers to needier citizens that take place within it, will erode. "Bribing" better off citizens to maintain their support, the argument goes, is a reasonable price to pay for the social good these programs bring.

Id.

[208] *Id.* at 71. Shaviro believes that the underfunding of Social Security is the only reason politicians even speak about Social Security reform. The relationship between taxes and benefits is muddled, inexact, and confusing. The relationship has been described as:

> The original rationale for muddying the relationship between Social Security taxes and benefits was to increase the potential to engage in hidden, but it was thought desirable, progressive redistribution. This was and is typically put in terms of giving the middle class a stake in government transfer programs if they are to be politically feasible; let the redistributive element stand alone and it will be politically vulnerable. To be effective, however, this requires not only combining multiple purposes within a single program, but obscuring the real relationship between these purposes.

SHAVIRO, *supra* note 11, at 20.

[209] Gingrich states:

> It is hard to overestimate the human cost that failed government has on the prosperity and well-being of the American people. Unionized bureaucracies and underperforming government institutions fight hardest to avoid change precisely where change is most needed because they recognize change as a threat to their power. They prefer failure with power to success without power. We have seen the cost of bad government most recently in the aftermath of Hurricane Katrina and more starkly in the state of Michigan and its once great city of Detroit.

GINGRICH, REAL CHANGE, *supra* note 5, at 43.

Nevertheless Gingrich is optimistic and believes that to make real change[210] happen requires a high degree of cheerful[211] perseverance.[212]

We may also find some consolation by comparing the situation in the United States with that of other developed nations. Comparing the United States to the rest of the world with respect to its future pensions and health care liabilities it is projected that in 2050 the United States will use 5.5% of GDP on pensions and health care while Italy will use 18.5%.[213] The United States' projection is lower because of higher birth rates and immigration rates.[214]

V. CONCLUSION

The theme of 2009 is change. This article has looked at numerous proposals for change. Senator Chuck Schumer set out eleven ambitious goals and specific policies that appeal to the middle class all to be achieved within two years of the Democrats taking control of Congress in 2006, none of which addressed the looming retirement crises.[215] Emanuel and Reed call for a new social contract that

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[210] Gingrich remarks:

> Eisenhower learned one lesson that strikes many people as counterintuitive: "Whenever I run into a problem I can't solve, I always make it bigger," he asserted. "I can never solve it by trying to make it smaller, but if I make it big enough I can begin to see the outlines of a solution."

Id. at 84.

[211] Gingrich states, "I learned the value of cheerful persistence in part from studying Eisenhower and Reagan. They both had wonderful smiles and a remarkable ability to work through opposition, frustration, and exhaustion. So did Franklin Delano Roosevelt." *Id.* at 89.

[212] *Id.* at 262–266. Gingrich describes 10 points about change learned through welfare reform in the 1990s. These include: (1) Successful reform always starts with a big idea. (2) Decide whether to repair or replace. (3) Great change never starts with government. (4) Cheerful persistence is necessary to successfully deliver large-scale reform in a free society. (5) Collaboration is critical. (6) Real change always requires winning the argument. (7) Words matter. (8) Real change must be consistent with broad American values. (9) Opponents of reform must be forced to carry the burden of their positions. (10) Real change must be citizen-centered. *Id.*

[213] The problems will be faced not only by the United States but by the entire developed world as people live longer, enjoy better health due to medical innovations, have a high quality of life, and have smaller families that will shrink the population drastically in Western European countries and in Japan. MILLER, *supra* note 10, at 59. The United States is seen as better able to address the problem with its large and innovative population. The problem is solvable but will require raising taxes and cutting benefits, or some combination thereof. *Id.* It will also require promoting economic growth. *Id.*

[214] GHILARDUCCI, *supra* note 9, at 193. The author points out that the United States has more men over 65 working than most other industrialized countries. *Id.*

[215] He calls his solution the "50% solution" reflecting his view that the middle class are not 100% dissatisfied with the present situation but only 50% dissatisfied. His eleven goals include 50% reductions in (i) property taxes that fund education, (ii) illegal immigration, (iii) our dependence on foreign oil, (iv) cancer mortality, (v) childhood obesity, (vi) abortions, (vii) child access to internet

includes a call for patriotism[216] and incentives to build middle-class wealth.[217] Their guiding principle is "You do your part, and your government, your company, and your country will do theirs."[218] They believe they can save $1.8 trillion over the next ten years.[219] Unlike the Bush administration's tax cuts,[220] they provide

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pornography, and (viii) tax evasion together with 50% increases in (ix) reading and math scores, (x) number of college graduates, and (xi) our ability to fight terrorism. Interestingly, retirement security and fiscal responsibility are not among his eleven goals. SCHUMER, *supra* note 7, at vi–ix.

[216] Emmanuel and Reed state: "America faces three great, urgent challenges. We need a new social contract for economic growth that enables Americans to get ahead again. We need a new strategy to make America safe again. And we need a new sense of patriotism and responsibility that unites us in common purpose again." EMANUEL & REED, *supra* note 1, at 49–50.

[217] Emanuel and Reed's plan provides the following: (1) A new social contract—universal citizen service, universal college access, universal retirement savings, and universal children's health care—that makes clear what you can do for your country and what your country can do for you. (2) A return to fiscal responsibility and an end to corporate welfare as we know it. (3) Tax reform to help those who aren't wealthy build wealth. (4) A new strategy to use all America's strengths to win the war on terror. (5) A hybrid economy that cuts America's gasoline consumption in half over the next decade. *Id.* at 52–53.

[218] *Id.* at 51–52.

[219] *Id.* at 118. Referring to a study by Paul Weinstein of the Progressive Institute, their threefold program would "[g]et rid of programs and privileges we don't need anymore; close loopholes that let some distort the market; and put the economy back on a path of sustained, broad-based economic growth." *Id.* They also want to limit corporate welfare and return to annual spending caps and pay-as-you-go rules that produced the surpluses at the end of the Clinton administration. *Id.* at 119. The pay-as-you-go rules require Congress to pay for any tax cuts or spending increases with off-setting tax increases or spending cuts. *Id.* Other suggestions include the use of capital budgeting and elimination of gerrymandering of Congressional districts, drastically curtailing lobbying by former members of Congress for five years after leaving Congress, and limiting the number of federal appointees from 3,000 to 1,500. *Id.* at 128.

[220] The debate in Washington over the last 30 years has been about taxes and the Republican has found tax cuts for the wealthy as the solution for all economic ills. Emanuel and Reed assert that:

> President Bush likewise changed the rationale for his tax cuts, but he never changed the policy. In 2000 when the economy was booming, Bush proposed tax cuts to get rid of the budget surplus and—unfortunately for the nation—succeeded beyond his wildest dreams. A year later, with the economy in recession, he promised the same tax cuts as stimulus. After the 9/11 attacks made clear that for years to come, the U.S. would be spending a fortune to fight the war on terror, Bush proposed more tax cuts as a return to normality. In 2003, as he headed for war in Iraq and a record deficit at home, he proposed still another round of tax cuts to ease the burden of wealth on the wealthy.
>
> When Republicans talk about taxes, any resemblance to the actual economy is coincidental and unintentional. That's because the Republican case for tax cuts is a theological argument, not an economic one. Conservatives have to make taxes a theological debate because the supply-side theory is the economic equivalent of intelligent design: They don't have any evidence to teach it in the classroom. Perhaps the conservative movement's greatest political coup over the last quarter century was to pull off the notion that cutting taxes for the wealthy corresponds to any economic theory at all.

EMANUEL & REED, *supra* note 1, at 131–32.

incentives for the "pillars of middle-class life: raising a family, buying a home, paying for college, and saving for retirement."[221] They contend that the Tax Code does not promote economic growth but simply favors those with influence.[222]

Newt Gingrich sees Social Security reform as a litmus test for voters.[223] But solutions to the crisis in America are not all economic. Actor Chuck Norris identifies eight areas of weakness in the American culture. These are our lack of a national legacy, no control over spending, insufficient border control, loss of a moral compass, failure to value human life, failure to provide our children with a future, loss of family values, and physical and mental laziness.[224] For Norris the renewal is spiritual and Americans need to be willing to sacrifice to pass on a tradition of freedom to the next generation.[225]

Charles Murray believes his proposal, The Plan, will regenerate the spirit of the community to solve its own welfare problems in a manner of volunteerism that was prevalent before the social net was built. Voluntary actions are more efficient and will give individuals the ability to share in the life of others in need. This has been lost in the bureaucratic provision of services.[226] He still believes in "the pursuit of happiness" and distinguishes it from "pleasure" by defining "happiness" as "lasting and justified satisfaction with one's life as a whole."[227] Such a distinction

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[221] *Id.* at 130.

[222] *Id.* at 137.

[223] NEWT GINGRICH, WINNING THE FUTURE, *supra* note 5, at 25 (stating that politicians see Social Security as untouchable but the rewards to the participant are so great that reform should be a litmus test). He sets out the example of an average American couple who invest in personal accounts throughout their careers, each start out earning $20,000 a year or less. By age forty, the husband is earning $40,000 and the wife is earning $30,000 so that by retirement they accumulate $829,800 in their personal investment accounts—enough to pay them double what Social Security promises. *Id.* at 222 n.1. He details the example stating:

> The calculation assumes that the husband is age forty and earning $40,000 and his wife earns $30,000. They both entered the work force at age twenty-three and the husband earned $20,200 and the wife earned $15,150 their first year for work and receive average salary increases throughout their working lives. The calculation also assumes that they had been investing two-thirds of their personal investment accounts in stocks and one third in bonds that earned standard, long-term, market returns over their working years. This study was done by Peter Ferrara of the Institute for Policy Innovation.

Id.; *see also* Ferrara, *supra* note 37.

[224] NORRIS, *supra* note 12, at 1–13.

[225] *Id.* at 186–189.

[226] MURRAY, *supra* note 8, at 111–124. One major problem is that "bureaucracies must by their nature be morally indifferent." Volunteers can address moral shortcomings in a way the bureaucrats cannot.

[227] *Id.* at 87.

is important in the terms "lasting and justified" which will require the exercise of one's abilities and the practice of virtue. Murray suggests happiness requires five basic materials. Two of the five are passive (material resources and safety) and three are active (meaningful relationships, vocation, and self-respect).[228]

In this regard, the One Fund Solution, like The Plan, is a way to renew American life by eliminating the deadly bureaucracy that consumed resources and controlled lives.[229] Let the individual have some control over their long-term financial planning and we may be surprised at the degree of responsibility that is exhibited. Choice is a time honored American virtue that is returned to the individual with the One Fund Solution.[230] Removing the government from everyday decisions of life should allow Americans to once again reach the dreams of individual achievement that moves all of us to a higher calling.[231]

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[228] *Id.* at 88–89.

[229] Murray's philosophy behind The Plan has nothing to do with retirement, health care, poverty, or the underclass, but is instead focused on the quality of life in a country of plenty and security. Reflecting on the European welfare state Murray suggests that it represents a particular way of looking at life and one which America should not emulate. He sees having short work weeks and frequent vacations along with impediments to changing jobs or starting a business as preventing work from becoming a vocation with the personal satisfaction that it generates. It reduces the marriage rate by lessening the economic incentives for marriage, objectifies children as a mere expense rather than an expression of the marriage, and presents the family choice as "children or a vacation home." European secularization also diminishes the interest in religion. Churches are empty. As he sees it:

> All of Europe combined has neither the military force nor the political will to defend itself. The only thing Europe has left is economic size, and even that is growing at a slower pace that elsewhere. When life becomes an extended picnic, with nothing of importance to do, ideas of greatness become an irritant.

Id. at 86.

[230] *Id.* at 127. Murray states:

> What was clear to the Founders will once again become clear to a future generation: The greatness of the American project was that it set out to let everyone live life as each person saw fit, as long as each accorded the same freedom to everyone else . . . . Sometime in the twenty-first century it will become possible to take up the task again, more expansively than the Founders could have dreamed but seeking the same end: taking our lives back into our own hands—*ours* as individuals, *ours* as families, and *ours* as communities.

Id.

[231] Gingrich laments:

> One of the great disappointments of my life has been the hijacking of the great space adventure by the NASA bureaucracy. Space should be an area in which American innovation, creativity, and entrepreneurship are producing constant breakthroughs that increase our economic capability, improve our quality of life, and raise our prestige among the world. Instead space has been hijacked by dull, inefficient, and unimaginative bureaucracies and transformed into an expensive, risk-adverse, and sad undertaking. This outcome is a surprising failure and a great disappointment for those of us who grew up in the early days of the great space adventure.

GINGRICH, REAL CHANGE, *supra* note 5, at 185.