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One Fund Solution and the Pension Crisis

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ONE FUND SOLUTION AND THE PENSION CRISIS

GORDON BUTLER[*]

A good man leaves an inheritance for his children's children.[1]

ABSTRACT

The next forty years of economic life will be dominated by one underlying theme: dealing with the retirement income security of a growing, aging and longer-lived global population. This is a "can't run, can't hide" problem that will affect the lives of almost every human being on the planet . . . Whether you are light in your pension account, whether you have more money than Croesus, whether you live in the well-funded Netherlands, or whether you are a put-upon unambitious young male in Japan who sees no future for himself, you cannot escape this problem.[2]

Before you read very far you will realize that looming Baby-Boomer retirements are a ticking time bomb that threatens even those who have saved prudently for most of their lives. This is because many millions of others will enter retirement with virtually no private savings. The second group, which is far larger than the first, will face unmet needs that governments will find politically impossible to ignore. And to meet those needs, we will need lots of additional tax revenue, which can only come from those in a position to provide it. As Willie Sutton replied when asked why he robbed banks, "that's where the money is."[3]

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[1] *Proverbs* 13:22.

[2] RICHARD A. MARIN, GLOBAL PENSION CRISIS: UNFUNDED LIABILITIES AND HOW WE CAN FILL THE GAP 43 (2013). The abstract of a recent article about the pension system in Australia begins: "Dealing with the fiscal impacts of Australia's ageing population is potentially the most important issue for the next 30 years. The majority of the countries in the developed world are facing an ageing population due to sustained low fertility and increased life expectancy." Rhys Cormick & John McLaren, *The current retirement system in Australia needs to be more attuned to a mobile international workforce: A case for reform*, 29 AUSTRALIAN TAX F. 493 (2014).

[3] Robert H. Frank, *Foreword* to MARIN, *supra* note 2, at ix.

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INTRODUCTION

On the eve of President George W. Bush's inauguration in January 2001 the world was at peace and the federal deficit was predicted to produce a $5.6 trillion surplus over the next ten years. Indeed, Chairman Alan Greenspan of the Federal Reserve Board was fretting about the problems that would be caused if the national debt were paid off.[4] At that time, total federal debt was $5.6 trillion, and debt held by the public was $3.4 trillion. In 2009, President Obama found the federal debt nearly doubled at $10.0 trillion and debt held by the public at $5.8 trillion. In 2017, when the next President takes office, the federal debt is projected at $20.3 trillion with debt held by the public at $14.9 trillion. Overall federal debt will have grown by $14.7 trillion, and the debt held by the public will have grown by $11.5 trillion in the first sixteen years of the twenty-first century.[5]

The next President's most optimistic observation may be that the United States has survived sixteen years of fiscally irresponsible and excessive spending, wasteful and interminable wars, failed projects, and the inability to take modest steps to solve the nation's long-term deficit problem handicapping the nation with $17 trillion of debt. However, the next President may find solace from an unexpected source. The discovery of energy resources could tip the balance toward national solvency and reduce the cost of manufacturing in the United States provided government regulations do not hinder its development or use the new wealth for new programs, more wars, and/or for maintaining the wasteful and inefficient programs.[6] A further reason to be optimistic is the reassertion of the United States' historic abhorrence of debt.[7]

Retirement security is viewed as a three-legged stool in which the first leg is Social Security, the second, employer-sponsored pensions, and the third is personal savings.[8] Medicare is sometimes viewed as a fourth leg, and a "bridge job" is

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[4] C. EUGENE STEUERLE, DEAD MEN RULING: HOW TO RESTORE FISCAL FREEDOM AND RESCUE OUR FUTURE 63 (2014).

[5] *Historical Tables: Federal Debt at the End of Year 1940-2017*, OFFICE MGMT. & BUDGET, at tbl.7.1, https://www.whitehouse.gov/omb/budget/Historicals (last visited Apr. 24, 2016) (If the projections are correct, the average annual deficit over sixteen years was slightly over $700 billion per year.).

[6] *See, e.g.*, Carl J. Circo, *Using Mandates and Inventives to Promote Sustainable Construction and Green Building Projects in the Private Sector: A Call for More Stable Land Use Policy Initiatives*, 112 PENN. ST. L. REV. 731, 736-37 (2008).

[7] It has been a part of the American dream that our children would have a better world than we inherited. *See infra* note 13 and accompanying text.

[8] NANCY J. ALTMAN & ERIC R. KINGSON, SOCIAL SECURITY WORKS!: WHY SOCIAL SECURITY ISN'T GOING BROKE AND HOW EXPANDING IT WILL HELP US ALL 58-59 (2015).

sometimes referred to as a fifth leg.[9] Although a three-legged stool is inherently unstable, when any one of the legs are weakened the entire stool is in danger of collapsing. As a nation we find ourselves in an unstable situation due to our unwillingness to change the system. To use a children's fairy tale, everyone has become immune to the warnings of fiscal demise by modern day "Chicken Littles."

Providing for the pension and health care obligations, needs, and expectations of the elderly is threatening the economies of cities, states, and nations, as well as private businesses and individuals. Governments have not only been unable to adequately address these growing obligations, but have created new ones that expand government in such a way that all major life decisions are dominated by governmental bureaucracy and economic growth necessary to accommodate these obligations has been stunted.

America needs forward-thinking leaders who see into the second half of the twenty-first century and move the United States into a position of financial strength and solvency with personal responsibility and independence. Sylvester J. Schieber has noted the dilemma young people face:

> It looks like most of our children can just forget about a monthly employer pension. Many of the private pensions still standing are closed to new entrants, and the phenomenon has even spread to public pensions. Policy mavens in Washington are now suggesting that we need to raise the payroll tax cap and cut Social Security benefits. At the state and local level, public pension costs are edging out funding for educating our children and replacing crumbling infrastructure, in some cases inflicting near paralysis on other normal governmental functions . . . .[10]

This Article is a continuation of two previously published articles proposing a one-fund account to simplify retirement planning for individuals.[11] First, this Article outlines the parameters of the fiscal problem America faces and how its major entitlement program, Social Security, fits into that problem. This Article then focuses on the justifications given for taking twelve percent of an individual's lifetime earnings and eliminating their investment choices. The next section examines the failure of cities, states, and countries, as well as companies, in fulfilling their defined benefit pension funding obligations. Then Social Security and its faults are discussed followed by some possible solutions and alternative ways to provide benefits that incorporate decisions made by the taxpayer whose funds are being taken. The final section discusses how the One Fund Solution meets many, if not all, of the parameters for a successful retirement plan.

In reviewing the state of retirement security, Sylvester J. Schieber's comments that the "so-called" golden age of retirement in the 1970s may not have been so golden after all but merely reflected a desire that should be kept in mind:

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[9] SYLVESTER J. SCHIEBER, THE PREDICTABLE SURPRISE: THE UNRAVELING OF THE U.S. RETIREMENT SYSTEM 4 (2012).

[10] *Id.* at 6-7.

[11] *See* Gordon T. Butler, *American Paternalism and the One Fund Solution*, 9 WYO. L. REV. 485 (2009) [hereinafter Butler, *American Paternalism*]; Gordon T. Butler, *The One Fund Solution: "It's My Money and I Need It Now*!," 11 HOUS. BUS. & TAX L.J. 262 (2011) [hereinafter Butler, *It's My Money*].

> I do not believe that we should abandon the goal of a comfortable retirement supported by the combined efforts of government, employers, and ourselves. Retirement and our various retirement programs arose in response to economic and business necessities, as well as to a personal desire for a well-deserved rest after a lifetime of labor. None of those has gone away. We just have to figure out how to make our programs serve our interests instead of becoming slaves to them.[12]

Finally, a tradition needing no authority for its support is the great American tradition that tells us we should leave the next generation a world that is better off than the one we inherited.[13]

I. RETIREMENT'S THREE-LEGGED STOOL—SOCIAL SECURITY: THE WEAKENED FIRST LEG

Social Security stands for a simple proposition: no matter how life works out, whether prosperity or ruin, no one will be left penniless in old age or because of disability or being orphaned.[14]

Social Security is by far the most popular federal government program, the best funded federal program, and the strongest remaining piece of our badly frayed system of social benefits. It is also under relentless attack by those who would kill it.[15]

A. Social Security Benefits

Social Security retirement benefits are received in the form of a lifetime annuity that begins at full retirement age that is sixty-five for those born before 1938 and gradually increases to sixty-seven for those born after 1960. Workers qualify for Social Security benefits when they have forty full quarters of covered work in the system,[16] and have the option of taking a reduced benefit at age sixty-two or an enhanced benefit by delaying the start of benefits beyond normal retirement age up to age seventy, at which time benefits must start.[17] A beneficiary taking benefits prior to normal retirement age and earning more than a prescribed amount will have his or her benefit reduced by a percentage of earned income above that prescribed amount.

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[12] SCHIEBER, *supra* note 9, at xvii-xviii.

[13] *Id.* at xviii.

[14] David Cay Johnson, *Foreword* to ALTMAN & KINGSON, *supra* note 8, at xiii.

[15] *Id.* The authors describe Social Security as the largest children's program and largest disability program providing income security for millions of families. *Id.* at 16.

[16] On this "quarter system" one credit is received for each quarter worked if the person earned $1,200 (in 2014) during the quarter. *Survivors Planner: Planning for Survivors*, SOC. SECURITY ADMIN., http://www.ssa.gov/survivorplan/onyourown.htm (last visited Apr. 24, 2016) [hereinafter *Planning for Survivors*]. Survivor and disability benefits for younger workers and their families can be paid if he earned a minimum of six credits in the three years prior to his death. *Id.*

[17] The adjustment made to the benefit based on when the individual retires is "intended to be actually fair, so that a person's total lifetime benefits will have an approximately equal value regardless of the age at which he or she begins collecting them." ALTMAN & KINGSON, *supra* note 8, at 3.

The initial Social Security retirement benefit uses the worker's "average indexed monthly earnings" (AIME) over a thirty-five-year period,[18] and the "primary insurance amount" (PIA) to calculate the initial benefit by applying percentages to defined increments of the AIME.[19] The first increment (currently up to $816) is multiplied by 90%, the amount in the next increment ($816 up to $4,917) is multiplied by 32%, and the final increment up to the maximum AIME ($4,917 up to $8,890) is multiplied by 15%.[20] The result is a progressive formula providing a greater overall percentage of AIME to lower income workers than higher income workers.

The retirement benefit is perhaps the most important benefit because it provides insurance against "bad labor market outcomes" that carry over into retirement.[21] It contains a redistribution scheme by providing low-wage workers with an "adequate income" even when their working careers are unsuccessful.[22] The retirement benefit provides a retirement for those who are too short-sighted to provide for their own retirement thereby providing an acceptable mandatory minimum standard living for the elderly.[23]

The lifetime annuity also protects against the risk of outliving your retirement income.[24] In addition, it is unique in that once the initial benefit is determined it will annually be adjusted based on increases in the cost-of-living index (COLA) to keep pace with consumer prices and protect the retiree's purchasing power.[25]

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[18] The Congressional Budget Office describes the impact of the initial benefit as follows:

> For the purpose of calculating average earnings to determine the initial benefit, the amounts earned in earlier years are converted to current-year earnings in the economy as a whole. Because average national earnings are projected to grow faster than inflation that indexation will cause average initial benefits to grow in real (inflation-adjusted) terms and will keep the average replacement rate stable. (In later decades, the replacement rate will be slightly lower for workers with average earnings who claim benefits at age 65, mainly because of the scheduled increase in the full retirement age.)

CONG. BUDGET OFFICE, SOCIAL SECURITY POLICY OPTIONS 2010, at 3 (2010). In other words, "the procedure converts a worker's past earnings to approximately average-wage-indexed equivalent values near the time of his or her benefit eligibility." THE BD. OF TRS. OF THE FED. OLD-AGE & SURVIVORS INS. & FED. DISABILITY INS. TRUST FUNDS, THE 2014 ANNUAL REPORT 109 (2014) [hereinafter THE 2014 TRUSTEES REPORT].

[19] CONG. BUDGET OFFICE, *supra* note 18, at 8-9.

[20] *Id.* at 9.

[21] *See generally* EDWARD D. KLEINBARD, WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY (2015) (strongly supporting the function of government in providing social insurance against such adverse effects).

[22] SCHIEBER, *supra* note 9, at 120-21. This protection against a failure to provide sufficient income outside Social Security may be due to causes outside an individual's control but could just as likely represent poor choices in spending patterns.

[23] *Id.* at 121.

[24] *Id.* at 122.

[25] *Id.* at 121-22.

Another critical element of the retirement benefit is that the spouse of a beneficiary is entitled to a benefit at least equal to one-half the benefit of the primary wage earner.[26] The spouse is entitled to his or her own benefit if that benefit is greater than one-half of the primary beneficiary's benefit.[27] When the primary wage earner dies the surviving spouse takes the deceased spouses benefit if it is larger than their own benefit.[28]

1. Disability and Survivor Benefits Under Social Security

In addition to retirement benefits, Social Security provides survivor and disability benefits.[29] Survivor insurance is built into the current Social Security system and is funded by the Social Security taxes paid by the individual. Upon a beneficiary's death, benefits are paid to the surviving spouse, and in some cases a former spouse;[30] children under age eighteen,[31] and other dependents.[32]

The amount of any benefit is based on the decedent's "insured status,"[33] lifetime earnings, disability status (if applicable), and the maximum amount of benefits he

[26] *Id.* at 120.

[27] *Id.* at 120-21.

[28] As noted later in this Article, the non-working spouse's receipt of a 50% benefit creates a much larger return for those family units who are often higher income individuals. Some people think of the spousal benefit as a means of offsetting effects of the progressive objective of the benefit formula. *Id.* at 120-21.

[29] M. L. Reig, *The Unspoken Poor: Single Elderly Women Surviving in Rural America*, 9 ELDER L.J. 257, 260 (2001).

[30] Divorced widows or widowers may also be eligible. *See Social Security Survivor Benefits*, NAT'L CAREGIVERS LIBR., http://www.caregiverslibrary.org/caregivers-resources/grp-money-matters/hsgrp-social-security/social-security-survivor-benefits-article.aspx (last visited Apr. 24, 2016); LEXIS TAX ADVISOR–FEDERAL TOPICAL § 6A:5.06 (discussing the applicability of state law to determine whether there was a state marriage, common law marriage, or a deemed marriage). Furthermore, being a child of the deceased worker does not automatically make the individual a qualified child.

[31] Social Security is provided only to children under eighteen years old. ALTMAN & KINGSON, *supra* note 8, at 120-121 and 214; Amy Foster, SOCIAL SECURITY DISABILITY GUIDE FOR BEGINNERS, 41 (2016). *But see* Astrue v. Capato, 132 S. Ct. 2021, 2029 (2012) (stating children conceived after a parent's death are not entitled to survivor benefits if state law forbids it); LEXIS TAX ADVISOR, *supra* note 30 ("[A]n individual may be eligible for child's benefits if the individual is . . . (2) under age 19 and a full-time elementary or secondary student; (3) 16 years or older but became disabled prior to reaching age 22.").

[32] *See* 22 C.F.R. § 19.11–1 (2106). The beneficiary's age (spouse, child, or dependent) also affects the benefits a person can receive. For example, a spouse under the age of retirement will have their monthly benefit reduced based on a specified formula. "The formula for spousal benefits, based on the number of months entitlement before full retirement age, is: 25/36 of 1% for each month of the 36 months reduction; and 5/12 of 1% of each month of reduction in excess of 36 months." LEXIS TAX ADVISOR, *supra* note 30, at § 6A:5.06[b]. In the case of a qualified divorced spouse, the formula is very similar, but it has three additional requirements. *Id.* at § 6A:5.06[c].

[33] An individual can be "currently insured, fully insured, insured for disability, or transitionally insured." LEXIS TAX ADVISOR, *supra* note 30, at § 1N:8.06. A "currently insured" person must have "quarter coverage," by having a minimum level of earnings for six

would have received if he were still living.[34] Normally a beneficiary cannot receive more benefits than the deceased would have during his life, but the maximum family benefit is between 150 and 180% of the deceased's full retirement age benefit.[35] Survivor benefits, in the case of a wage earner's premature death, rarely occurs (less than .025%) and the progressive benefit structure has the effect of redistributing wealth.[36]

Social Security also provides disability insurance that extends earnings protection to people unable to support themselves by working.[37] While the definition of disability is stringent, people who qualify for disability often stay on disability until they qualify for early retirement benefits under Social Security.[38] Recently, there has been criticism of the disability benefit in that many people used disability as a means of extending their unemployment insurance. Although in need of considerable revision, disability insurance protects against a moderate risk of 2%.[39]

Beyond the benefit for the individual at retirement, the spousal, dependent, and disability benefits look like a game with innumerable twists and turns with various

calendar quarters out of the last thirteen quarters of his life. Meeting this requirement qualifies for coverage but does not affect the benefit amount, which is limited. *See Survivors Planner*: *How Much Would Your Survivors Receive?*, SOC. SECURITY ADMIN., http://www.ssa.gov/survivorplan/onyourown5.htm (last visited Apr. 24, 2016) [hereinafter *Survivors Receive*]; *Quarter of Coverage*, SOC. SEC. ADMIN., http://www.socialsecurity.gov/oact/cola/QC.html (last visited Apr. 24, 2016) [hereinafter *Quarter of Coverage*]. A person with "fully insured" status receives "virtually all of retirement and death benefits of the deceased." Reig, *supra* note 29. To be fully insured the decedent must have one quarter of coverage for *each year* which has elapsed since "1950 (or, after the year in which he or she became 21 if after 1950) and before the year he or she died or (if earlier) the year in which she or he attained age 62." *Short-range Projects for the Social Security Program*, SOC. SEC. ADMIN., https://www.ssa.gov/oact/NOTES/as115/as115_VI_H.html (last visited Apr. 24, 2016).

[34] *Survivors Receive*, *supra* note 33 (showing the amount a survivor may obtain based on the relevant factors, and explaining the maximum benefits a qualified beneficiary may receive cannot be greater than the amount the decedent would have received while he was living); *see also Survivors Planner: Survivors Benefits For Your Widow or Widower*, SOC. SECURITY ADMIN., http://www.ssa.gov/survivorplan/onyourown2.htm (last visited Apr. 24, 2015) [hereinafter *Widow or Widower*] (explaining the amount a spouse may obtain based on the stated factors).

[35] *Planning for Survivors*, *supra* note 16; *see also* 21 KIPLINGER'S RETIREMENT REPORT, YOUR QUESTIONS ANSWERED: FAMILY MAXIMUM SOCIAL SECURITY BENEFITS 14 (2014).

[36] SCHIEBER, *supra* note 9, at 119.

[37] *Id.*

[38] *Id.* at 119-20.

[39] Calculations similar to those for survivor benefits provide a progressive benefit structure for disabled workers. The benefit for disabled workers is based on their wage-indexed average earnings through the time of disability. *Id.* The disability benefit paid is progressive such that the replacement rate (the ratio of benefits received to a worker's past earnings) is higher for people with lower average earnings that for people with higher earnings. *Id.*

winners and losers.[40] For example, a sixty-two-year-old man with three children under eighteen can take an early-reduced retirement benefit and his three children can claim dependent benefits of an additional $1,800 per month.[41] A married couple could face up to 625 options for claiming benefits; divorced spouses also have numerous options for claiming benefits based on a former spouse's status.[42]

Notwithstanding numerous criticisms, Social Security is a valuable part of retirement planning. One study found Social Security comprised one-third of the assets of people between the ages of sixty three to sixty-seven in 2000; the remaining two thirds were equally divided between employer pensions and retirement savings.[43]

B. Social Security's Long-Term Financial Problems

Social Security is the largest single federal program and is often referred to as the most successful federal program.[44] It provides benefits to retired workers, their survivors and dependents, through Old-Age and Survivors Insurance (OASI), and to people with disabilities, through Disability Insurance (DI).[45] For people over the age of sixty-five, the benefits are a major source of income, 50% or more of total income for 67% of those families, and 90% or more of total income for almost a third of such families.[46]

Social Security is funded through two primary sources of dedicated tax revenues: payroll taxes and taxes on benefits. Approximately 97% of the revenues are from a payroll tax of 12.4% levied on earnings and split evenly by workers and their

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40 *Social Security pitfalls and windfalls: Playing the game right can add more to your monthly chec*k, CONSUMER REP. (Feb. 12, 2015, 5:00 PM) http://www.consumerreports.org/cro/news/2015/02/7-social-security-pitfalls-and-windfalls/index.htm.

41 *Id.*

42 *Id.*

43 SCHIEBER, *supra* note 9, at 125 (noting that the top and bottom 10% of wage earners provided unique situations and were not included in the study and concluding, "[a]nyone who contends that it is not a retirement program, albeit one with a number of unique features, is ignoring the facts").

44 STEUERLE, *supra* note 4, at 138. Marin, suggests that the Social Security program had its origin, not in the great depression of the 1930s but "in the English Poor Laws enacted in mother England in 1601 and brought over on the Mayflower in 1620 as part of the Puritan Ethic and Anglo history of caring for the poor, aged, and indigent. MARIN, *supra* note 2, at 58. This fervent sense of self-determination and independence that came with the Puritan Ethics made this the exception in social policy, not the norm." *Id.*

45 THE 2014 TRUSTEES REPORT, *supra* note 18, at 1.

46 *Id.* at 2. The report notes that OASI accounts for 82% of the benefits and DI for 18%. *Id.* AARP identifies the percentage of the population over sixty-five in each state that depends on Social Security for at least 90% of their income. *News From Your State*, AARP BULL., June 2014, at 36(C). The range is between 14.5% (Alaska) and 32.7% (Tennessee). *Id.* Eleven states in the Southeast (AL, AR, FL, GA, KY, LA, MS, NC, SC, TN, and WV) have between 27.2% and 32.7%, while nine states are below 20% (AK, CA, CT, HI, MD, NE, OR, WA, and WY). *Id.*

employers at 6.2% each.[47] The tax applies to taxable earnings up to a maximum of $117,000 in 2014, and up to $118,500 in 2015 pursuant to annual adjustments.[48] Social Security taxable wages constitute approximately 83% of covered earnings (i.e. wages and self-employment income).[49] Approximately 3% of the revenues come from taxes on Social Security benefits received by high-income beneficiaries.[50] The current 12.4% rate presents a stark contrast to the original 2% rate in the Social Security Act in 1935.[51]

Two trust funds have been created to receive tax payments and distribute payments to beneficiaries. One is for the OASI program, and the other one is for the DI program, although they have often been described collectively as the "OASDI trust funds."[52] Whenever tax revenues exceed expenditures, creating a surplus, the excess funds are loaned to the federal government to fund general operations and are considered a loan from the trust fund to the government, which will eventually be repaid with interest credited to the trust fund on a regular basis.[53]

In 2013, payments into the OASDI trust funds, exclusive of interest, totaled $752.8 billion while expenditures, benefits, railroad retirement financial exchange, and administrative expense, totaled $822.9 billion.[54] The $70.7 billion deficit was covered by the $102.8 billion in interest credited to the trust fund so that the trust fund grew by $32.1 billion to $2,764.4 billion.[55]

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[47] SCHIEBER, *supra* note 9, at 36. Noting that during the formative states in the development of Social Security:

> Everyone was convinced that a national program that did not include contributions from workers and their employers would almost certainly have to include means testing. Virtually all students of social insurance found means test demeaning and beneficiaries of traditional welfare programs that included such testing were commonly considered to be personal failure by the broad cross-section of society.

Id. The contributory nature of the system gave the beneficiaries a "right" to their benefit so that they could say, "I have paid for my benefits." *Id.* at 37. The failure to provide for one's retirement was viewed not as a personal failure, but as a failure of the industrial system.

[48] THE 2014 TRUSTEES REPORT, *supra* note 18.

[49] *Id.*

[50] SCHIEBER, *supra* note 9, at 36.

[51] The final provisions of the 1935 Social Security Act provided for a 1% tax on the first $3,000 of income on both the employee and the employer. That Act scheduled 0.5% increases in the payroll tax every three years until the rate reached 3% on each the employee and the employer in 1949. *Id.* at 40. In subsequent debates leading the 1939 Amendments over whether the system should be pre-funded or simply pay-as-you-go, the date of the scheduled increase was gradually pushed back until 1950 while benefit increases were incorporated into the system. *Id.* 56-57. These changes pushed the system toward pay-as-you-go and left it for future generations to worry about the funding and left some people concerned over leaving the public unawares of the ever-growing debt in excess of the acknowledged debt of the United States. *Id.*

[52] THE 2014 TRUSTEES REPORT, *supra* note 18, at 136.

[53] For 2013, the trust funds effective annual rate of interest was 3.8%. *Id.* at 7.

[54] *Id.*

[55] *Id.* at 22.

Since 2010, tax revenues into the trust fund have been insufficient to fund benefits so that payments into the fund from general tax revenues in the form of interest on the trust fund assets were needed to make up the shortfall.[56] These payments, although built into the system, reversed the dynamic in the federal budget in which excess Social Security revenues were used to decrease the deficit. The first decrease in the trust fund occurred unexpectedly in 2015.[57] Now repayment of those revenues will increase the deficit. The amount needed to repay trust funds will grow annually so that by 2033 the trust fund will be exhausted.

By 2035, the number of people over age sixty-five will have grown by 90% while those between twenty and sixty-four will have grown by only 10%.[58] In addition, the life expectancy of the older generation is increasing. Reflecting these changes, the Congressional Budget Office (CBO) estimates that the percentage of gross domestic product (GDP) dedicated to paying benefits will grow from 4.8% in 2010 to 6.2% in 2035, as the Baby-Boomer generation moves through retirement, and then decline over the next fifteen years to 5.95% in 2050.[59]

When making projections, the Trustees of the OASDI trust funds make certain assumptions regarding demographic, economic, and programmatic criteria. Recognizing that such assumptions are critical to any projection, the Trustees make projections using a "low-cost," "intermediate-cost," and "high-cost" scenario.[60] Unless otherwise indicated, the intermediate-cost scenario is presented because it represents the Trustees' best estimates of future experience.

The Trustees use several tests to evaluate the status of the system. One such test, the Short-Range Actuarial Estimate, seeks to measure financial adequacy by looking at the trust fund ratio over a ten-year period (e.g. 2014 through 2023).[61] The trust fund ratio is the projected trust fund reserves at the beginning of each period to the projected program cost for that year. Maintaining a ratio of 100% is a good

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[56] *Id.* (Trust fund revenues, exclusive of interest, have been insufficient to pay benefits since 2010.).

[57] Jed Graham, *Social Security Trust Fund Fell, First Time Since 1983*, INV. BUS. DAILY (Jan. 21, 2016), http://www.investors.com/politics/capital-hill/social-security-trust-fund-ends-32-year-streak/.

[58] CONG. BUDGET OFFICE, *supra* note 18, at 4.

[59] *Id.* After 2050, it is anticipated that the trajectory will resume its upward climb reaching 6.3% in 2080. *Id.* Another common measure is the ratio of workers to beneficiary, which fell below 3:1 in 2010 and will decline to 2.1:1 by 2035. THE 2014 TRUSTEES REPORT, *supra* note 18, at 113-14 (indicating that the ratio was stable at 3.2 to 3.4 to 1 from 1974 until 2008 when this measure began to decline due to the economic recession and the beginning of the demographic shift caused by the baby boomers).

[60] THE 2014 TRUSTEES REPORT, *supra* note 18, at 8 tbl.II.C1 (showing long-range values of key assumptions for the 75-year projection period). Factors affecting the low-cost, intermediate cost, and high-cost assumptions include, among others, fertility rates (children per woman) are 2.3, 2.0, and 1.7, respectively; net immigration (in thousands) are 1,430, 1,125, and 830, respectively; average wage in covered employment from 2025 to 2088 are 5.16, 3.83, and 2.52, respectively; and Consumer Price Index (for 2020 and later) are 3.40, 2.70, and 2.0, respectively. *Id.*

[61] *Id.* at 9.

indication that the program can meet its obligations over the succeeding year.[62] Based on these criteria, the asset reserves of the OASI trust fund and the combined OASI and DI trust funds exceed the 100 % criteria over the ten-year period.

The DI trust fund individually has a ratio of 0.62% and, as of 2014, was projected to be depleted in 2016.[63] Thus, a challenge to the political powers to patch or resolve the disability program will occur in the context of the 2016 presidential election year.[64] In anticipation of the disability trust fund's depletion, the Obama Administration initially proposed transferring $350 billion in Social Security revenues into the DI trust fund over five years so it will be solvent until 2033, thereby delaying reform for a generation. However, in the 2015 budget deal, a Republican controlled Congress and a Democratic President temporarily avoided the crisis by reallocating 0.57 percentage points of the Social Security tax to the DI Trust from 2016-2018 without raising the total payroll tax.[65] The current crisis is a result of the expansion of the criteria in 1984, which ultimately doubled the percentage of the working age population on disability. Once on disability, few people ever return to active full-time work since qualifying entitles one up to $15,000 in cash and $9,000 in Medicare benefits with the option to earn more than $13,000 without losing benefits.[66]

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62 *Id.*

63 *Id.* at 9. The DI trust fund is expected to be exhausted in 2016 and the OASI trust fund in 2034. After the DI reserves are exhausted, the income would only support expenditures at a level of 81% declining to 80% by 2088. In 1994, when the DI trust fund was nearly exhausted, funds were redirected from the OASI trust fund to make up the difference. *Id.* at 23. Such action, it is suggested, would likely delay much needed reforms to the DI program. *Id.*; *see also* Lanhee J. Chen, *A Capsizing Disability-Insurance Program*, WALL ST. J. (Jan. 21, 2015), http://www.wsj.com/articles/lanhee-j-chen-a-capsizing-disability-insurance-program-1421802230 (predicting that Congress will take a short-term view in 2016 to shore-up the system and suggesting ways to tighten up the criteria for disability and eliminate barriers for workers to leave disability and return to work).

64 *See Disabling a Budget Con*, WALL ST. J. (Jan. 16, 2015), http://www.wsj.com/articles/disabling-a-budget-con-1421367558 (noting that disability income used to be a last-resort insurance and is now a "middle-age retirement"). In 1990, one dollar in ten social security dollars went to disability but now it is one in five. Disability roles doubled between 1990 and 2008 and spiked an additional twenty-one by 2012. A recent rule change in Congress would prohibit moving money from one trust fund to the next and perhaps force Congress to address the underlying problem and fix the eligibility requirements for disability. A similar article that acknowledges the need and opportunity for reform in 2016 suggests any reform would take years before the benefit was realized and that Social Security would likely have to be reformed at the same time but laments the fact that politicians will likely do nothing. *See Disability insurance*, *Not working,* ECONOMIST (Jan. 24, 2015), http://www.economist.com/news/united-states/21640367-many-disabled-people-can-work-washington-prevents-them-ruinous-cost-not-working.

65 Kat Lucero & Stephen K. Cooper, *Congress Passes 2-Year Federal Budget*, 149 TAX NOTES 642, 642 (2015) (the additional 0.57% increases raises the Disability program share to 2.27% from 1.8%). The two-year budget contained a revenue raiser in reducing the required pension contribution rates. *Id.*

66 Andrew G. Biggs, *Averting the Disability-Insurance Meltdown: The out-of-control $150 billion program is in urgent need of reform*, WALL ST. J. (Feb. 23, 2015, 6:19 PM), http://www.wsj.com/articles/andrew-g-biggs-averting-the-disability-insurance-meltdown-1424733559.

To assess the actuarial status of the system over the seventy-five-year time period, the Trustees use three tests: (1) annual cash-flow measures, including income rates, costs rates, and balances; (2) trust fund ratios; and (3) summary measures, such as actuarial balances and open group unfunded obligations.[67] These are expressed in percentages of taxable payroll or GDP and in dollars. An additional indication of the long-term status of the system is the infinite horizon values.[68]

According to the first measure, the annual cash-flow, under the intermediate assumption, the combined OASDI trust fund remains positive until it is exhausted in 2032.[69] After 2032 continuing income could only support expenditures at a level of 77% decreasing to 72% by 2088.[70]

According to the second measure, the trust fund ratios, the OASI, DI, and combined OASDI all peaked in 2014 and are projected to be depleted in 2034, 2016, and 2033 respectively.[71]

The third measure, referred to as the summary measures, is the actuarial balance, which includes the beginning period asset reserves, all costs and income during the period, and the cost of reaching the reserve objective at the end of the period. Thus, the actuarial balance, or deficit if negative, is essentially, "the difference between the present values of income and cost from 1937 through the end of the valuation period."[72] It is expressed as a percentage of the taxable payroll needed over the valuation period to bring the balance to zero.

Under the intermediate-cost assumption the actuarial deficit for the combined OASI and DI trust funds is 2.88% of taxable payroll.[73] The Trustees estimate the total unfunded liability to be $10.6 trillion through 2088 representing 2.73% of

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67 THE 2014 TRUSTEES REPORT, *supra* note 18, at 10.

68 *Id.* at 10, 49. An additional test is the long-range close actuarial balance which requires: (1) the trust fund satisfies the short-range financial adequacy and (2) the trust fund ration stays above zero through the seventy-five-year projection period assuring that benefits would be payable on a timely basis. The OASDI and individual OASI and DI trust funds all fail this test under the intermediate-cost assumption. *Id.* at 10-11.

69 *Id.* at 11.

70 *Id.* at 11. The combined OASDI trust funds reserves will increase through 2019 because the interest credited to the trust funds will make total revenues exceed total costs. *Id.* at 3. After 2019, total costs will exceed total revenues and the combined trust funds will be gradually depleted until they are exhausted in 2033. *See id.* at 24. The exhaustion of each trust fund occurs at different times. Finally, the ratio of workers per beneficiary remained stable at 3.2 to 3.4 from 1974 through 2008 when, because of the economic recession and beginning of the "demographic" shift drove the ratio down, the ratio fell to 2.8. It will continue down to 2.1 over the next 20 years. *Id.* at 13. The 2014 Trustees Report details the short-range estimates under all three cost assumptions by year. *Id.* at 39-48. As expected, the high-cost assumption has the trust funds being exhausted in 2028, while the low-cost assumption does not have the trust funds being exhausted through 2090 and actually increasing at that point. *Id.* at 18-19, fig.II.D7.

71 *Id.* at 15.

72 *Id.* at 16.

73 *Id.* at 16; *see also* ALTMAN & KINGSON, *supra* note 8, at 217 (recognizing that closing this deficit would require increasing the tax rate from 6.2% to 7.64% on both the employee and the employer, making the total tax roughly 15.28% of covered payroll).

taxable payroll and 1.0% of GDP for the seventy-five-year period.[74] The actuarial deficit is higher than the unfunded liability because the former includes the cost of having an ending period trust fund ratio of 100%.[75] These figures over the seventy-five-year period do not necessarily produce "sustainable solvency" for the system, which is "achieved when the projected trust fund ratio is positive throughout the 75-year projection period and is either stable or rising at the end of the period."[76]

To correct this imbalance the Trustees project the following options: [77]

> For the combined OASI and DI trust funds to remain fully solvent throughout the 75-year projection period: (1) revenues would have to increase by an amount equivalent to an immediate and permanent payroll tax rate increase of 2.83 percentage points (from its current level of 12.40 percent to 15.23 percent; a relative increase of 22.8 percent); scheduled benefits during the period would have to be reduced by an amount equivalent to an immediate and permanent reduction of 17.4 percent applied to all current and future beneficiaries, or a 20.8 percent if the reduction were applied only to those who become initially eligible for benefits in 2014 or later; or (3) some combination of these approaches would have to be adopted.[78]

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[74] THE 2014 TRUSTEES REPORT, *supra* note 18, at 16.

[75] *Id.* at 17.

[76] *Id.* at 17 n.1.

[77] Because of various demographic assumptions the projections in the 2014 Trustees Report may differ from those used by the CBO in its report on the future budget outlook. Under the CBO's extended baseline, it would take an additional 4% of payroll (or a combination of tax increase or benefit cuts) to bring the system into actuarial balance through 2088. CONG. BUDGET OFFICE, CBO'S 2014 LONG-TERM BUDGET OUTLOOK 50 (2014) [hereinafter CBO 2014 REPORT]. That is equivalent to 1.4% of GDP through that period. *Id.* at 49-50. To be consistent with the Social Security Trustees Report, which shows a smaller short fall, it is pointed out that the CBO believes life expectancy will increase at a faster rate than the Trustees, the incidence of disability will be higher under the CBO estimate, and the interest rate used for the discounting would be slightly lower. *Id.* at 50 n.13 (referencing and comparing estimates from the THE 2013 TRUSTEES REPORT, infra note 84). No significant changes to Social Security are reflected in the CBO's 2015 Report, and changes are unlikely to occur until the new administration takes office in January 2017. For example, the increased payroll tax percentage to meet the seventy-five-year Social Security shortfall increases to 4.4% increase but continues to be equivalent to a 1.4% of GDP. CONG. BUDGET OFFICE, CBO'S 2015 LONG-TERM BUDGET OUTLOOK 53-54 (2015) [hereinafter CBO 2015 REPORT].

[78] THE 2014 TRUSTEES REPORT, *supra* note 18, at 23. To make the program "permanently" sustainable would require increasing the payroll tax by 4.1%. *Id.* at 69. Any estimate of future solvency requires assumptions about future demographic conditions that may or may not prove accurate in actual practice. Included are assumptions about fertility, mortality, immigration, marriage, divorce, productivity, inflation, average earnings, unemployment, real interest rates, disability incidence, and termination. Related to these assumptions are independent factors such as total population, life expectancy, labor force participation, gross domestic product, and program-specific factors. *Id.* at 75. If the needed changes are delayed until the trust funds are exhausted in 2033, it would be necessary to increase the payroll tax rate by 4.2% to 16.6% in 2033, which would then increase to 17.7% by 2088. *Id.* at 24.

The actuarial deficit calculated in 2013 through 2087 was 2.72% of payroll and had the only change for 2014 been an increase of one more year to the valuation date the actuarial deficit calculated in 2014 would have been 2.78% rather than the 2.88% noted above. The addition of 0.1% was the result of changes in methods, assumptions, and starting values combined. Had such assumptions not occurred in 2014, the "open group" unfunded obligation would have been \$10.1 trillion in 2014 rather than \$10.6 trillion.[79] Looking beyond the seventy-five-year period to the infinite horizon reflects an estimated unfunded obligation equivalent to 4.1% of taxable payroll or 1.4% of GDP, which is \$24.9 trillion.[80] Thus, there is a significant cost of delay.[81]

One final measure is the "closed-group" unfunded obligation that was reported in the Trustees' 2013 Report, but not in the 2014 Report. The closed-group unfunded obligation is the shortfall the system would incur if Social Security were closed to anyone under the age of fifteen.[82] The calculation considers only the income and costs associated with persons aged fifteen years and older on the date the calculation is made and does not permit new entrants.[83] The closed group unfunded obligation for past and current participants is \$23.7 trillion, whereas the unfunded obligation for the infinite horizon for all participants is \$23.1 trillion.[84] Thus future participants will pay \$0.6 trillion into the system more than they receive out of the system. The report summarizes the implications:

> This accounting demonstrates that some generations are scheduled to receive benefits with a present valued exceeding the present value of their dedicated tax income, while other generations are scheduled to receive benefits with a present value less than the present value of their dedicated tax income whether past general fund reimbursements are included or not. Making social Security solvent over the infinite horizon requires some combination in increased revenue or reduced benefits for current and

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79 *Id.* at 16, 68-69. The actuarial balance is a percentage of the taxable payroll over the seventy-five-year period to indicate the size of the surplus or shortfall. *Id.* at 49. Similarly, "[t]he open group unfunded obligation indicates the size of any shortfall in present-value dollars" and does not take into account the ending period trust fund balance. *Id.*

80 *Id.* at 18, 69, 191-92. The trustees further note that a more accurate measure is 4.3% of payroll because the 4.1% infinite horizon is an actuarial deficit that does not reflect "a behavioral response to tax rate changes." *Id.* at 191 n.1. "In particular, the calculation assumes that an increase in payroll taxes results in a small shift of wages and salaries to forms of employee compensation that are not subject to payroll tax." *Id.*; *see also* Mark J. Warshawsky, *The 2014 Social Security and Medicare Trustee Reports*, 144 TAX NOTES 967, 968, 969 (2014) (summarizing information from THE 2014 TRUSTEES REPORT, *supra* note 18).

81 THE 2014 TRUSTEES REPORT, *supra* note 18, at 68.

82 CBO 2014 REPORT, *supra* note 77, at 50-51.

83 *Id.*

84 THE BD. OF TR., FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND FEDERAL DISABILITY INSURANCE TRUST FUNDS, THE 2013 ANNUAL REPORT 69 (2013) [hereinafter THE 2013 TRUSTEES REPORT].

> future participants amounting to $23.1 trillion in present value, 4.0 percent of future taxable payroll, or 1.4 percent of GDP.[85]

The 2013 Report further compares the unfunded obligation through 2087 ($9.6 trillion) with the unfunded obligation through the infinite horizon ($23.1 trillion).[86] The $13.5 trillion difference reflects the significant financing gap for the years after 2087.[87] It could be concluded that continuing the present program would cost $9.6 trillion over the next seventy-five-year period whereas closing the program to persons under fifteen would cost $24.3 trillion until the death of the last person currently fifteen years or older. It is much easier to just kick the can down the street.

C. Federal Government's Long-Term Fiscal Problems

Any discussion about Social Security, Medicare, Medicaid, and the Affordable Care Act must include consideration of the impact these programs are projected to have on the overall federal budget. The changes to correct the system would be small if the impact were small, but the growth of the national debt and the inability to project anything but deficits into the future threatens the fiscal soundness of the nation and the well-being of every citizen. Correcting the system will require drastic change.

The total federal debt held by the public is 74% of GDP, is the highest it has been in our nation's history, except for a brief period around World War II, and it is almost twice the percentage as the end of 2008.[88] While the percentage is expected to decrease slightly over the next couple of years, it will eventually grow again such that by 2024 it will reach 78% of GDP and by 2039 it will reach 106% of GDP.[89] While the projections do not incorporate the impact of higher debt levels on the overall economy, they are significant and would severely limit the economic well being of the country.[90] The CBO's projected impact of continued spending and taxing under current law (the "Extended Baseline")[91] is illustrated in the following summary:

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85 *Id.*

86 *Id.*

87 *Id.* at 68.

88 CBO 2014 REPORT, *supra* note 77, at 1.

89 *Id.* at 10.

90 *Id.* at 13. The 2014 CBO Report summarizes the effects as:

> The high and rising amounts of federal debt held by the public that CBO projects for the coming decades under the extended baseline would have significant negative consequences for the economy in the long term and would impose significant constraints on future budget policy, in particular, the projected amounts of debt would reduce the amounts of national savings and income in the long term; increase the government's interest payments thereby putting more pressure on the rest of the budget; limit lawmaker's flexibility to respond to unforeseen events; and increase the likelihood of fiscal crisis.

Id. Chapter 6 of the report expands on these results under various scenarios. *Id.* at 69-86.

91 *Id.* at 10.

Table 1

Note: All Numbers are Percentages of Gross Domestic Product (% of GDP)	2014	2024	2039
Spending Category			
Social Security	4.9%	5.6%	6.3%
Medicare (Net of Offsetting Receipts)	3.0%	3.2%	4.6%
Medicaid, CHIP, and exchange Subsidies	1.9%	2.7%	3.4%
Other Mandatory	2.5%	2.2%	1.7%
Discretionary	6.8%	5.1%	5.2%
Net Interest	1.3%	3.3%	4.7%
Total Spending	20.4%	22.1%	25.9%
Total Revenues	17.6%	18.3%	19.4%
Deficit	-2.8%	-3.7%	-6.4%
Debt Held by the Public at the End of the Year	74%	78%	106%[92]

Projected Spending and Revenues in Selected Years
Under CBO's Extended Baseline[93]

Notably, the growth in expenditures as well as taxes as a percent of GDP over the next twenty-five years greatly exceeds past growth averages. For example, total federal spending would increase to 26% of GDP while it was 21% in 2013 and 20.5% on average over the past forty years.[94] This represents an increase to 14%

[92] Buttonwood, *Land of the falling yield: The return of an old relationship between asset prices*, ECONOMIST 79 (June 7, 2014), http://www.economist.com/news/finance-and-economics/21603448-return-old-relationship-between-asset-prices-land-falling-yield (noting that Japan's government debt is currently 230% of GDP and has been at such levels for some time without overwhelming the economy).

[93] CBO 2014 REPORT, *supra* note 77, at 10. The 2014 CBO Report states:

> CBO's base line projections are not a forecast of future outcomes. They are constructed in accordance with provisions set forth in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. As those laws specify, CBO constructs its baseline projections under the assumption that current laws will generally remain unchanged; the projections can therefore serve as a benchmark against which potential changes in law can be measured. However, even if federal laws remained unchanged for the next decade actual budgetary outcomes could differ from CBO's base line projections, perhaps significantly, because of unanticipated changes in economic conditions and other factors that affect federal spending and revenues. CBO's updated baseline projections incorporate the effects of legislation and administrative actions through April 1, 2014.

Id. at 10; *see also* CONG. BUDGET OFFICE, UPDATED BUDGET PROJECTIONS 2014-2024, at 2 (2014), http://cbo.gov/publication/45229.

[94] CBO 2014 REPORT, *supra* note 77, at 3; *see also* CONG. BUDGET OFFICE, THE BUDGET AND ECONOMIC OUTLOOK 2016 TO 2026, at 4 (2016) (projecting that a 2016 deficit will be $544 billion which is $105 billion more than the deficit recorded in 2015, and explaining that the deficit represents 2.9% of GDP and the expected shortfall for 2016 will mark the first time that the deficit has risen in relation to the size of the economy since peaking at 9.8% in 2009). The estimated cumulative deficit from 2017 to 2026 is $9,378 billion. *Id.* at 2. Further, in 2026

from an average of 7% over the past forty years for Social Security and the government's major health programs.[95] The government's net interest payments would increase to 4.7% of GDP compared to an average of 2% over the past forty years.[96]

The growing costs of both Social Security and Medicare have a significant impact on the long-term federal deficit. In 2014, the total contributions from general revenues will be $80 billion for Social Security, $25 billion for Medicare Hospitalization Insurance (known as Part A), and $248 billion for Supplementary Medical Insurance (known as Part B).[97] The total, $352 billion or 2% of GDP, will more than double to 4.4% by 2040.[98]

At the same time there will be increased demands on the federal budget including increasing debt service as interest rates rise. At that point, payroll tax increases may be unpalatable and the only decision will be whether to cut Social Security benefits or Medicare benefits.[99] Notwithstanding the looming crisis, a number of people advocate increasing benefits in various ways.[100]

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the ratio of debt held by the public to GDP is estimated to be 86% ($23,817 to $27,660 (in millions)). *Id.* at 2; *see also* Jed Graham, *Deficit To Hit $544 Billion This Year CBO Forecasts,* INV. BUS. DAILY, Jan. 20, 2016, at A1.

95 CBO 2014 REPORT, *supra* note 77, at 3.

96 *Id.*

97 SOC. SEC. & MEDICARE BDS. OF TR., STATUS OF THE SOCIAL SECURITY AND MEDICARE PROGRAMS: A SUMMARY OF THE 2014 ANNUAL REPORT 7 (2014), https://www.ssa.gov/oact/TRSUM/tr14summary.pdf.

98 *Id.* at 974. The relative size of any changes will be determined by the timing of such changes. Without changes, it is estimated, in 2010, that benefits under current formulas would have to be cut by 20% in 2040 to have benefits paid and equal taxes received. CONG. BUDGET OFFICE, *supra* note 18, at ix. That number would rise to a 24% cut by 2084. *Id.* at 6.

99 It is suggested that, because the CBO finds the health care cost to dominate the future deficit requirement, Social Security and health care can be addressed separately. One observation is that:

> Under the CBO projections, health care is clearly the heart of the adverse outlook. Some people view these projections as an indicator that Social Security is not causing our financial dilemma and that we can address its financing imbalance in the narrow context of its own operations. But this is akin to the homeowner behind on his mortgage payments who asks his banker to finance a new car. While the banker sees a creditor already in over his head wanting to take on more debt, the applicant insists that his mortgage is the problem and the new car a separate issue.

SCHIEBER, *supra* note 9, at 311-12.

100 *Id.* at 313 (citing surveys showing a high percentage of respondents believe various benefits should be added or increased such as extending benefits to children of deceased or disabled parents from nineteen years to twenty-two years; increasing the benefit by fifty dollars per month for retirees age eighty-five; improve benefits of widowed spouses; make benefits for early retirees at least the at the poverty level; and giving service credits for persons taking time off to care for children). Often those who seek to increase benefits tend to ignore the impact of private employer plans (both defined benefit and defined contribution plans) on retiree security. *Id.* When the benefits under private employer plans are combined with benefits under Social Security retirees in the United States compare favorably with retirees in other developed economies. *Id.* at 315-16. However, when the focus is on lower

The most important causes of the projected growth in Social Security and the major health care programs through 2039 are aging (55%); Excess Cost Growth (24%); and Expansion of Medicaid and Exchange subsidies (21%).[101] Using the figures in Table 1, between 2014 and 2039, Social Security will grow by 29%; Medicare by 53%; Medicaid, CHIP, and exchange subsidies by 79%; and interest payments by 262%.[102] As long as the deficit percentage of GDP exceeds the rate of growth of the economy, the percentage of GDP dedicated to national debt will continue to grow with the likelihood that interest will grow accordingly.

While the CBO projections do not incorporate the impact of higher debt levels on the overall economy, this level of growth of debt will restrain future budget policy and severely limit the economic well being of the country and its ability to respond to future crises.[103] One prominent study suggested that debt level exceeding 90% of GDP posed particular problems.[104]

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earners there is concern that the favorable comparison does not hold true so that an across the board reduction in social security benefits would impact the lower earners more than higher earners. *Id.* at 317.

[101] CBO 2014 REPORT, *supra* note 77, at 23. Within the major health care programs alone the impact of aging is less through 2039. The causes are aging (39%); Excess Cost Growth (33%); and Expansion of Medicaid and Exchange subsidies (28%). *Id.*

[102] ALTMAN & KINGSON, *supra* note 8, at 18. The authors suggest the problem is not spending on seniors but the result of rising health care costs, both public and private and the tax cuts benefitting the very well-off. The authors further state that changes to Social Security will reflect our "priorities, what kind of a society we want for ourselves, our children, and our grandchildren." *Id.* at 19.

[103] CBO 2014 REPORT, *supra* note 77, at 13. The 2014 CBO Report summarizes the effects as:

> The high and rising amounts of federal debt held by the public that CBO projects for the coming decades under the extended baseline would have significant negative consequences for the economy in the long term and would impose significant constraints on future budget policy, in particular, the projected amounts of debt would reduce the amounts of national savings and income in the long term; increase the government's interest payments thereby putting more pressure on the rest of the budget; limit lawmaker's flexibility to respond to unforeseen events; and increase the likelihood of fiscal crisis.

Id. Chapter 6 of the Report expands on these results under various scenarios. *Id.* at 69-86. Loss of flexibility in dealing with domestic and international problems while carrying a high level of debt is particularly worrisome. The CBO recognizes that the ability to address the recession of 2008 and 2009 was available because the debt was lower. To this point, the CBO states:

> Several years ago, when federal debt was below 40 percent of GDP, the government had some flexibility to respond to the financial crisis and sever recession by increasing spending and cutting taxes to stimulate economic activity, providing public funding to stabilize the financial sector, and continuing to pay for other programs even as tax revenues dropped sharply because of the decline in output and income. As a result, federal debt almost doubled as a percentage of GDP. If federal debt stayed at its current percentage of GDP or increased further, the government would find it more difficult to undertake similar policies under similar conditions in the future. As a result, future recessions and financial crises could have larger negative effects on the economy and on peoples' well-being. Moreover, the reduced financial flexibility and

1. Intergenerational Inequality

Another recent analysis points to the fiscal imbalance in spending which overemphasizes spending on the elderly compared to an under emphasis on the young. Federal spending consumed by the elderly is $26,355 per person compared to $3,822 being invested per child.[105] Taking it a step further, between 2012 and 2022 federal spending will increase by $1.19 trillion of which $780 billion (66%) will be spent on programs benefitting the elderly,[106] while $29 billion (2.22%) will be spent on children.[107]

Most of the future spending priorities are mandatory and will prevent addressing spending alternatives. As stated: "Whatever the merits of Keynesian and supply-side economics, these schools of thought gave our legislators a license to pass the cost of tax cuts and increased spending to future generations."[108] Ending open-ended and

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> increased dependence on foreign investors that accompany high and rising debt could weaken U.S. leadership in the international arena.

Id. at 14. The inability to address financial crises can be costly for many countries. *See id.* (citing Carmen M. Reinhart & Kenneth S. Rogoff, *The Aftermath of Financial Crises*, 99 AM. ECON. REV. 466 (2009)); Carmen M. Reinhart & Vincent R. Reinhart, *After the Fall, Macroeconomic Challenges: The Decade Ahead*, FED. RES. BANK KAN. CITY JACKSON HOLE SYMP. (2010), https://www.kansascityfed.org/publicat/sympos/2010/Reinhart_final.pdf; *see also* Luc Laeven & Fabian Valencia, *Systemic Banking Cries Database: An Update*, (Int'l Monetary Fund, Working Paper No. 12/63, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12163.pdf.

104 CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009). *But see Free Exchange, the 90% question,* ECONOMIST, Apr. 20, 2013, at 82 (noting that the Reinhart-Rogoff study is challenged as to the drop in GDP growth after debt exceeds 90% of GDP).

105 Charles McElwee, *Nation's financial peril will be physical peril soon*, PUTNAM METRO (Sept. 28, 2015), http://www.metroputnam.com/article/20140928/ARTICLE/140929375/ (citing STEUERLE, *supra* note 4).

106 For example, Social Security, Medicare, and Medicaid other than for children.

107 *See* STEUERLE, *supra* note 4 (finding deficits as a symptom of a broader disease, which is "the effort by both parties to control the future"). Steuerle's thesis is:

> Both parties have conspired to create and expand a series of public programs that automatically grow so fast that they claim every dollar of additional tax revenue that the government generates each year. They also conspire to lock in tax cuts that leave the government unable to pay its bills. The resulting squeeze deprives current and future generations of the leeway to choose their own priorities, allocate their own resources, and reach for their own stars. Those generations are left largely to maintain yesterday's priorities.

Id. at 4; *see* Martin A. Sullivan, *Treat All Parts of The Budget Equally*, 144 TAX NOTES 312, 314 (2015) (describing Steuerle's book and his solution which is to free up assets by limiting automatic growth of entitlement spending, as well as tax expenditures, by reforming the budget process).

108 Sullivan, *supra* note 107, at 313.

automatic spending for retirement and healthcare could change the current downward trend for spending on infrastructure, education, and research.[109]

> Altman and Kingson explain that although Social Security's primary goals are not alleviating poverty or income inequality, the program does more to rectify income inequality and prevent poverty among older Americans than any other program, public or private, while also providing crucial protections for orphans and the disabled. More important, they prove that the widely made claims that Social Security adds to the federal governments perennial budget deficits have no basis in fact.[110]

Notwithstanding the Altman and Kingson arguments, maintaining the current Social Security system with the growing intergenerational inequality will strain and even curtail the federal government's ability to address other pressing needs including those needs of the youngest members of society.

2. Standard Solutions to Social Security Financing

Fixing Social Security can be a simple process. Increase revenues or decrease benefits. The time when the economy could outgrow the entitlement crisis is past.[111] However, Social Security is not referred to as the "third rail of American politics" for nothing. Whenever you bring Social Security reform up, there are strong emotional responses by large numbers of voters ready to penalize any politician bold enough to propose any changes. Changes are talked about in general terms with little prospect of effecting change before the problem reaches a level of crisis. With that in mind, it is necessary to acknowledge that Social Security has a long history of change that resembles a lobster in the soup pot. At first the water is cool, but gradually the water is heated to a boil and the lobster realizes its predicament and is cooked.

For the first couple of years after its adoption in 1935, the rate of Social Security contribution was 1% on a tax base of $3,000 by the employee and the employer.[112] The contribution level was to increase to 3% by 1939, but was delayed until 1950.[113] Subsequent increases raised the contribution level to 4.4% on a tax base of $6,600 by 1967 and to 4.8% on a tax base of $7,800 by 1969, resulting in covered payroll being 82% of total United States earnings.[114]

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[109] *Id.* at 314.

[110] ALTMAN & KINGSON, *supra* note 8, at xiii.

[111] Amity Shlaes & Ike Brannon, *Get Real: We Can't Grow Out of Entitlement Mess*, INV. BUS. DAILY (Dec. 30, 2015), http://www.investors.com/politics/brain-trust/entitlements-must-be-reformed-we-cant-outgrow-their-costs/. Shlaes and Brannon point out that federal government payments to individuals grew from 5% of GDP in 1964 (before Medicare and Medicaid), to 10% in 1980 before President Ronald Reagan took office, to 15% today. *Id.* They believe the time has come to address the entitlement question since failure to do so will likely block other spending options. They suggest starting by delinking pensions from economic growth. *Id.*

[112] GEOFFREY KOLLMAN, SOCIAL SECURITY: SUMMARY OF MAJOR CHANGES IN THE CASH BENEFITS PROGRAM 1 (2000), https://www.ssa.gov/history/reports/crsleghist2.html.

[113] *Id.* at 3.

[114] SCHIEBER, *supra* note 9, at 72.

Congress gradually and periodically increased the benefit and expanded the coverage as prompted by then Commissioner of Social Security, Robert M. Ball.[115] In 1965, Medicare added a medical benefit for seniors and thereafter Commissioner Ball continued his efforts to increase benefits for all current and future retirees.[116] Following significant increases in 1969, 1971, and 1972, a beneficiary went from receiving a $500 benefit in 1969 to receiving $759 in 1972 (a 52% increase) while the cost of living index rose by only 20%.[117]

In 1972, the indexing of benefits was instituted so that benefits were indexed based on increases in the consumer price index.[118] Benefit increases continued until the 1977 amendments, which reduced benefits for the first time so that, by 2010 retirees classified as low earners would receive 33% less, average earners 25% less, and maximum earner s 31% less than a comparable worker in 1977.[119] The slow pace of benefit increases came to an end.[120]

As the working age population was increasing relative to the number of retirees and wage growth exceeded the growth of benefits, it appeared any funding insufficiency could be easily accommodated with a modest tax increase. Prominent economist Paul A. Samuelson found the beauty of Social Security in the fact that it was actuarially unsound so that everyone could get benefits far in excess of any amount they paid into the system, a phenomenon he would explain stems:

> [F]rom the fact that the national product is growing at compound interest and can be expected to do for as far ahead as the eye cannot see. Always there are more youths than old folks in a growing population. More important, with real incomes going up at some 3 percent per year, the taxable base on which benefits rest in any period are much greater than the taxes paid historically by the generation now retired. Social security is squarely based on what has been called the eighth wonder of the world—compound interest. A growing nation is the greatest Ponzi game ever contrived.[121]

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[115] *Id.*

[116] *Id.* Wilber Cohen, the first member of the Social Security Board, and Robert Ball, Social Security Commissioner from 1962 to 1973, envisioned a grand plan of "cradle to grave" social insurance. Cohen recognized that the grand plan could only be taken in small steps because it could not be consumed in a single bite. *Id.* at 71-72.

[117] *Id.* at 73.

[118] The 1972 changes applied the indexing to the initial benefit, which itself automatically reflected inflationary wage growth and productivity increases and a double benefit was created which was soon recognized as a catastrophic mistake which was rectified in 1977 legislation that decoupled the wage indexing from the benefit indexing. *Id.* at 76.

[119] *Id.* at 78.

[120] *Id.* at 76.

[121] *Id.* at 74 (citing Paul A. Samuelson, *Social Security*, NEWSWEEK, Feb. 12, 1967, at 88). Samuelson had previously published a very influential article suggesting that a pay-as-you-go system could be sustained so long as the workforce grows over time relative to the retiree population. *See* Paul A. Samuelson, *An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money*, 66 J. POL. ECON. 467 (1958).

Notwithstanding such optimism, the inevitable funding crisis arrived in the early 1980s and a bipartisan commission chaired by Alan Greenspan was formed to make appropriate recommendations.[122] The result was to increase the retirement age gradually from sixty-five to sixty-seven over an extended period of time, slightly reduce benefits, and increase taxes so the system would be solvent for a seventy-five-year period.[123] The projections proved to be inaccurate and the solvency period was reduced to approach fifty years.[124]

Nevertheless, the Commission's changes combined with the large population of Baby Boomers in the workforce caused significant surpluses to accumulate, and a debate developed over whether to keep the surplus or go back to a pay-as-you-go system, which would eliminate any surpluses.[125] Ultimately, the surplus was kept and loaned to the government who used it to reduce the deficit.[126] Some observers concluded that the surplus permitted excessive and wasteful federal spending referring to it as "thievery or embezzlement."[127] Today the numbers are reversed as large numbers of Baby Boomers are retiring and thereby accelerating the growth of the dependent population, eliminating the surplus, and creating a deficit requiring actual transfers from general revenues to make required benefit payments. Such transfers will continue, at least until the accumulated surpluses and the accrued interest is exhausted.[128]

Because initial benefits are based on past earnings and are indexed to the average growth of wages reflecting productivity increases that grow faster than the cost of

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[122] *See* GREENSPAN COMM'N, REPORT OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM (1983).

[123] SCHIEBER, *supra* note 9, at 86. The President, the Speaker of the House of Representative, and the Senate Majority Leader each appointed one-third of the Commission to be known as the Greenspan Commission. The changes effected by the Greenspan Commission, as well as subsequent changes which began taxing up to 85% of Social Security benefits, have been severely criticized as benefits cuts up to 7% over a lifetime. ALTMAN & KINGSON, *supra* note 8, at 60-61; *see also* RAVI BATRA, GREENSPAN'S FRAUD: HOW TWO DECADES OF HIS POLICIES HAVE UNDERMINED THE GLOBAL ECONOMY 11-46 (2005).

[124] SCHIEBER, *supra* note 9, at 85-86 (noting that in 1983 the system was projected to be solvent through 2063 but the projection was reduced to 2049 in the 1985 trustee's report and to 2029 1n the 1995 trustee's report).

[125] *See, e.g.*, Kilolo Kijakazi & Wendell Primus, *Would Using the Budget Surplus for Tax Cuts or Entitlement Expansions Affect Long-Term Social Security Solvency*, CTR. ON BUDGET POL'Y & PRIORITIES (Mar. 13, 1998), http://www.cbpp.org/archives/313socsec.htm.

[126] SCHIEBER, *supra* note 9, at 96.

[127] A commission created by President Bush concluded that the 1983 funding legislation that resulted in surpluses which could theoretically be used to increase national savings:

> [T]aught the nation a clear lesson about how unlikely this is as a practice. The Social Security surpluses have enabled the government to finance other government spending, rather than raising current year taxes and effectively saving Social Security funds for the future.

Id.

[128] As a result of the unemployment during 2007 and 2008 Social Security experienced its first annual deficit since the passage of the 1983 amendments. SCHIEBER, *supra* note 9, at 100.

living, future beneficiaries will have greater purchasing power than current ones. The following table demonstrates the increased purchasing power in 2061 (in 2011 dollars) for low, medium, and maximum earners.

Table 2

Age 65 SS Benefit[129]	2011	2061 (in 2011 dollars)	Increased Purchasing Power
Low Earner	$ 10,232	$ 17,080	$ 6,848 (67%)
Medium Earner[130]	$ 16,860	$ 28,143	$ 11,283 (67%)
Maximum Earner	$ 26,573	$ 45,466	$ 18,893 (71%)

A 2010 report suggested indexing initial benefits to prices rather than wages so the average benefit would be one-third lower by 2060 and one-half lower by 2080.[131] Further, by reducing COLAs after benefits commence would also reduce benefits. Under current adjustments, 25% of benefit payments by 2040 will be the result of COLA adjustments.[132]

While future retirees' benefits will have greater purchasing power, the contribution levels will also increase. Therefore, a single male turning sixty-five in 2014 whose lifetime earnings were 60% of average, between $25,000 and $30,000, will receive lifetime benefits worth only $0.91 for every dollar of payroll taxes paid on his behalf accumulated with interest.[133] Medium earners and maximum earners would receive benefits worth $0.67 and $0.46 per dollar invested respectively.[134]

Considering the poor investment that Social Security has become, Schieber asks:

> Given that many low earners today are getting back less than the value of lifetime contributions on their earnings and higher earners are doing worse—and that every additional dollar we put into the system will make the outcome worse—how much more money do we want to pump into this system? With total obligations for benefits in excess of $20 trillion that have already been earned by people who are now alive we cannot walk away from the program but we can choose to constrain the future losses.[135]

Not only has Social Security become a poor investment for most people but it also is not sufficient for most people to retire. Considering the lifetime cost of health

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[129] *Id.* at 114.

[130] ALTMAN & KINGSON, *supra* note 8, at xv (suggesting the average benefit is roughly equal to the gross pay of someone working full time at the federal minimum wage).

[131] CONG. BUDGET OFFICE, *supra* note 18, at 5.

[132] *Id.* at 4. After 2050, it is anticipated that the trajectory will resume its upward climb reaching 6.3% in 2080. *Id.*

[133] SCHIEBER, *supra* note 9, at 283.

[134] *Id.*

[135] *Id.* at 241.

care and retirement savings, an average earner can expect to dedicate 31% of their lifetime earnings to these two costs alone.[136]

Benefits received by early participants in Social Security were far larger than could be justified based on their contributions to the system. One analysis compared the present value of the benefits received for a given level of contributions made to the system to the present value of a private insurance annuity that could be purchased with those contributions. To the extent that the present value of the benefits received exceeded the present value of the private insurance annuity, the beneficiary received a "windfall." The analysis considered people retiring in 1940, 1970, and 1980 whose income level, compared to those retiring in the respective year, was (i) 40% of such average income (the "low earner"), (ii) 100% of such average income (the "average earner") (iii) was 1.6 times such average income (the "high earner"), and (iv) the maximum income for the year (the "maximum earner").[137] The table below demonstrates the windfall received for retirees in three cohorts. These windfalls may help explain the popularity of the Social Security system and how, at one time, it could be said that: "The way our Social Security system was structured, we could give away literally trillions of dollars in unearned benefits and yet almost all the windfall recipients had the sense that they had paid for what they received."[138]

Windfalls received by retirees in three different age cohorts in constant 2009 dollars:[139]

Table 3

Income Level	1940	1970	1980
Low Earner	$ 38,000	$ 115,000	$ 73,000
Average Earner	$ 50,000	$ 146,000	$ 106,000
High Earner	$ 59,000	$ 160,000	$ 126,000
Maximum Earner	$ 77,000	$ 159,000	$ 126,000

The windfall has largely dried up such that it can now be said:

> From 2,000 onward, on average, the "return" for workers in each retiring cohort will be less than it would be from a funded pension program invested solely in government bonds. Having spent younger worker's contributions on inflated "start-up" benefits for earlier retirees meant the program had to forego the interest income on those contributions. So as an investment vehicle, Social Security could not match a funded system no matter how conservative the funded system's investments.[140]

136 *See infra* tbl.6, n.749 and accompanying text.

137 SCHIEBER, *supra* note 9, at 64-65.

138 *Id.* at 65.

139 *Id.* at 66. Another commentator estimated that in 1980 a two-earner couple making the average, who retired at sixty-five, would have paid $219,000 of Social Security and Medicare taxes in their lifetimes, but would receive $635,000 worth of benefits, and a similarly situated one-earner couple would have paid $110,000 in taxes and would receive $547,000 in benefits. STEUERLE, *supra* note 4, at 50 n.6 (citing C. EUGENE STEUERLE CALEB QUAKENBUSH, SOCIAL SECURITY AND MEDICARE TAXES AND BENEFITS OVER A LIFETIME: 2013 UPDATE 2013).

140 SCHIEBER, *supra* note 9, at 65.

To some extent the windfall continues in spousal benefits where a non-working spouse, who never contributed to the Social Security system, qualifies for a benefit equal to one-half the working spouse's benefit, or when a working spouse's benefit is less than one-half of the higher earning spouse's benefit.[141] In either case if the higher earning spouse dies first then the lower earning spouse will receive a benefit equal to that earned by the higher earning spouse.

The spousal benefit makes a marked difference in the overall return received by family units. Since the 1960s, there has been a rapid increase in the employment of women in the workforce.[142] To some extent, women entered the workforce to supplement family income when wages were depressed because of the large number of Baby Boomers entering the workforce.[143] This additional wave of female workers created significant wealth and swelled tax revenues during those years.[144] Thus the spousal benefit may be less significant today than in the past, but neutral observers might still find it unfair and open the door to an avenue of change.

In a 2000 survey, Social Security assets were approximately 48% of total dedicated retirement assets for respondents ages sixty-three to sixty-seven.[145]

Table 4

Earnings Level	Single male	Single female	One-earner couple	Two-earner Couple
Very low	1.25	1.41	2.47	1.41
Low	0.91	1.02	1.81	1.03
Medium	0.67	0.76	1.36	0.77
High	0.56	0.63	1.12	0.64
Maximum	0.46	0.52	0.92	0.52

Expected Value of Social Security Benefits Relative to Accumulated Lifetime Contributions with Interest for Hypothetical Workers Born in 1949, Retiring at Age 65,by Earnings Level[146]

The Table assumes that a hypothetical twenty-one-year-old began working in 1970, worked continually through 2013, and began retirement at age sixty-five in 2014. The very-low single male earner will receive benefits 1.25 times the value of his contributions (and his employer's contribution on his behalf) accumulated at trust fund interest rates. The chart confirms that, except for "one-earner couple"

141 *Id.*

142 *See generally* Lisa Quast, *Causes and Consequences of The Increasing Numbers Of Women In The Workforce*, FORBES (Feb. 14, 2011, 12:03 PM), http://www.forbes.com/sites/lisaquast/2011/02/14/causes-and-consequences-of-the-increasing-numbers-of-women-in-the-workforce/#55c29c71c76d.

143 SCHIEBER, *supra* note 9, at 372.

144 *Id.* at 371-73.

145 *Id.* at 281.

146 *Id.* at 283 tbl.24.2. The payroll taxes are accumulated over a lifetime at the applicable rates and are credited with interest at the rates that the bonds in the Social Security trust fund earned interest. *Id.* at 282. In calculating the benefits, the actuaries considered the comprehensive package of benefits including retirement, disability, and survivor benefits. *Id.*

households, all medium, high, and maximum earning households receive a negative return on their Social Security contributions.[147]

Converting the percentages from the previous chart into dollars (without accounting for the value of the survivorship or disability benefits), the single male medium earner at age sixty-five will have $353,800 from his lifetime (from age twenty-two) payroll taxes accumulated at the trust fund interest rates. The benefits received by this same taxpayer using a present value of expected benefits would be $273,049 for a net loss of $80,751. If the medium earner were a single female, the lifetime benefit would be $304,767 for a net lifetime loss of $49,033. If the medium earner were a one-earner couple, the lifetime benefit would be $554,229 for a lifetime gain of $200,429. Similar analysis can be done for the two-earner couple and for a very low, high, and maximum earner.[148]

The spousal benefit might have made sense when most families had one member in the workforce; however, today most families have two wage earners so that the lower wage earner is paying into the system, but will likely receive no greater benefit than if he or she stayed out of the workforce.[149] One solution to this problem could be providing a joint and survivor annuity that reflects the value that each spouse paid into the system.[150] The myriad of family situations makes equalizing the benefits based on lifetime contributions a complicated task.[151]

Raising the age at which workers qualify for benefits would be an obvious way to reduce costs but such a proposal is one of the most politically sensitive areas of discussion in any Social Security proposal.[152] Fifty years ago men worked five years longer and women seven years longer than current workers, and that was at a time

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[147] *Id.* at 93, 282.

[148] *Id.* at 284-85 tbl.24.3 (providing the results of the full analysis by the author).

[149] The pattern of Social Security was set with the 1939 amendments. Social Security has not kept up with the changing times. In 1950, less than 40% of the women between twenty and sixty-four were in the workforce. *Id.* at 367. By the beginning of the twenty-first century nearly 75% were working outside the home including a majority of those with children under school age. *Id.* The age when one starts work has changed, as has the age of retirement. *Id.* at 366-69.

[150] *Id.* at 340.

[151] STEUERLE, *supra* note 4, at 144. Steuerle recognizes that, at the margins, Social Security has performed poorly and states:

> A well-designed minimum benefit and perhaps a minimum credit for child-bearing years would greatly help achieved the goal of a minimum standard of living in old age. Meanwhile, we should also reform current spousal and survivor benefits that discriminate unjustifiably against many groups: single heads of household (who pay for but do not get spousal and survivor benefits); those who have children before age 40 (who pay for but do not get the children's benefits provided to the men and occasionally women who have children at a late age to supplement their retirement benefits); and those who divorce before ten years of marriage (who can lose hundreds of thousands of dollars in spousal and survivor benefits because they failed to delay their divorce by as little as one day or until the marriage lasted ten years and additional spousal and survivor benefits become available).

Id. at 144-45.

[152] SCHIEBER, *supra* note 9, at 326.

when work was more physically demanding and life expectancy was shorter than today.[153] There is evidence that both men and women are beginning to work longer hours, which may be explained by the shift over the past two decades from defined benefit plans to defined contribution plans.[154]

Today's expectation of retirement grew out of an era when life spans were shorter, the working age population was growing, and companies were able to finance defined benefit plans and retiree health care plans from current income.[155] Although the retirement age has crept up slightly, there are tremendous advantages for individuals to continue working an extra year or so, which would lighten the burden on other workers and reduce the time for which an individual's savings would have to cover.[156] One way to encourage the elderly to continue working and enhance the equity of the system is to exempt the earnings from Social Security taxation when the person arrived at either full retirement age, or age seventy, when the enhanced benefit reaches its maximum.

Other areas of change could come from changing elements in the Social Security calculation, such as reducing the wage indexing of initial benefits for determining AIME, or adjusting the bend points and percentages used in the PIA to reduce some benefits. The payroll tax cap could also be raised to 90% of covered earnings, trust funds could be invested in the stock market, or other taxes, such as the estate tax receipts, could be dedicated to Social Security.[157]

Any changes to the system will create winners and losers. Recent proposals have been reluctant to impact persons aged fifty-five and above. The idea is that they have planned on the current system and it would be unfair to change it in a way that it would be too late to make up the difference. Since most everyone in the system benefits by the excessive benefits, they could be asked to participate in the fixes that affect all participants.[158] By failing to act in a timely fashion the youngest cohort of Baby Boomers will turn age fifty-five by 2019, which is fast approaching. We are

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[153] *Id.*

[154] *Id.* at 326 (noting this shift in the type of retirement plan means that, rather than depending on the employer to take care of the annuity, the employee will have to do it themselves).

[155] *Id.* at 326.

[156] *Id.* at 373.

[157] *Id.* at 318. The options considered in the 2010 Report did not include the possibility of private accounts, options to draw general revenues into the system, or investment of Social Security moneys in securities other than government debt. CONG. BUDGET OFFICE, *supra* note 18, at 8-10. Although Sylvester Schieber supported private accounts when he served on an advisory council in the 1990s, he has come to a different conclusion today:

> But realistically, I have come to believe that we ought to drop the subject. The conversation about individual accounts had been so poisoned by the accompanying political discourse that all rationality has been lost. Further argument on the subject simply delays our progress in tackling an urgent problem.

SCHIEBER, *supra* note 9, at 330.

[158] SCHIEBER, *supra* note 9, at 344 (suggesting that those nearing retirement and retired should bear some of the cost of reform).

nearly, if not already, at the point when any change will totally exempt the entire Baby Boomer generation.[159]

It is generally recognized that Social Security cannot be considered the sole source of income during the retirement years, at least, for most people desiring to live in a manner commensurate with their standard of living during their working years. Thus, Social Security must be considered in the context of private retirement savings and overall healthcare needs.[160] For example, a typical family of four with an average income of $50,000 has a surplus of only $9,400 after payment of Federal Taxes ($3,600); state/local taxes ($1,400); property taxes ($2,000); food costs ($7,800); utility, phone, cable, internet expenses ($3,800); mortgage payment ($13,000); and health care costs ($9,000).[161]

That $9,400 must pay for everything else, including charitable contributions, movies, restaurants, family vacations, car expenses, childcare, braces for kids, tutoring or counseling, and saving for college and for retirement. Today, many young families have the additional cost of paying student loans that burden the family for twenty-five or more years after graduation.[162] Furthermore, employee compensation is reduced by the employer costs of Social Security, retirement plan contributions, and healthcare costs all of which affect the employee's take-home pay. Considering these demands it is no wonder that many individuals have very little extra savings for retirement and rely almost exclusively on Social Security for most of their retirement income.[163]

The American dream, coined by James Truslow Adams is the "dream of a land in which life should be better and richer and fuller for every man, with opportunity for each according to his ability or achievement."[164] The American dream also includes the desire that each generation would leave the world a better place and that our

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159 ALTMAN & KINGSON, *supra* note 8, at 181 (suggesting that exempting reflects a strategy to undermine the system by passing the burden on to today's young people and children). These authors see a vast conspiracy to undermine Social Security that has been going on for decades. They devote a chapter to this conspiracy entitled "There They Go Again: Why Supporters of Social Security Must Remain Vigilant." *Id.* at 185-99.

160 SCHIEBER, *supra* note 9, at 370.

161 Howard Gold, *Social Security can't save us from the poor house,* MARKETWATCH (Apr. 4, 2014), http://www.marketwatch.com/story/social-security-cant-save-us-from-the-poorhouse-2014-04-04 (reproducing data attributed to "Bankrate, National Associations of Realtors, Maliman, and Whitefenceindex.com.").

162 The College Board reports that between 2009 and 2013 Private Non-Profit average tuition and fees (in 2013 dollars) rose from $26,356 to $29,593 (a 12% increase) while that for Public institutions rose from $7,008 to $8,821 (a 26% increase). COLL. BD., TRENDS IN COLLEGE PRICING, at tbl.2B (2013), http://trends.collegeboard.org/sites/default/files/college-pricing-2013-full-report.pdf. Accompanying these tuition increases, student debt from 2009 to 2013 for graduates receiving a bachelor's grew at Private Non-Profit institutions from $18,000 to $19,500 (an 8% increase) and at Public institutions from $11,700 to $14,300 (a 22% increase). *Graduating to Debt: Why student loan debt is on the rise*, ONINVESTING (2014) (referring to the College Board 2014).

163 *See infra* note 741 and accompanying text.

164 SCHIEBER, *supra* note 9, at 365 n.3 (citing JAMES TRUNSLOW ADAMS, THE AMERICAN EPIC 404 (New York: Blue Ribbon Books, Inc. 1931)).

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children would have a better start than we did. Social Security leaves no inheritance for the heirs of the deceased beneficiary. It is noted that: "Psychologists tell us that, as humans age, they are wired to want to leave a legacy. A Greek proverb says the societies become great when old men plant trees whose shade they know they will never sit in."[165]

Social Security has grown from a simple pension system in which pay-as-you-go was an easy funding device that was deceptively simple. There were many contributors but few beneficiaries. However, underneath the surface a huge unfunded federal liability was growing that today is creating significant long-term budgetary problems in which any solution will involve considerable complexity as the change filters through a diverse population with diverse family situations.

3. The Easy Solution—Not So Easy

Making Social Security sustainable for the long run is often seen as a problem involving relatively simple mathematics. You can raise taxes, cut benefits, or a combination of the two. But the discussion does not remain simple when it expands to all kinds of retirement benefits that are supported by the government tax system. The discussion might suggest that reducing other retirement subsidies or tax expenditures should be done to save Social Security. High-end taxpayers may not give up their very lush benefits easily to fund the changes to save Social Security. In reality, it is a question of who is going to suffer to make the system work and none of the players are particularly interested in helping the solution.

At some point, the demands of the retirement crisis will significantly impinge on other government spending and the country will look to raise taxes. When this happens, it may be that the large and untaxed 401(k), IRA, and other large retirement assets may be the target of greater taxation. Some people think the efforts are already under way when they look at the problems in Greece, Spain, Portugal, and Italy where overspending and over borrowing has become a problem for which these countries are looking to Germany to bail them out. Of course, Germany may be strong today, but, as noted above, it has its own looming unfunded pension problem.[166]

Those political activists seeking to bring federal spending into balance should not expect revolutionary change. The move to greater spending and greater deficits and debt seem irreversible. It has been observed:

> The fact that even Ronald Reagan could not "curb the size and influence of the federal establishment," as he promised in his 1981 inaugural address, indicates that the battle between liberals and conservatives over

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[165] Paul Taylor, *Mending the Safety Net*, AARP BULL., Oct. 2014, at 18, 20.

[166] MARIN, *supra* note 2, at 46. Marin states:

> I contend that if you plumb the depths of Angela Merkel's consciousness, you will find an acute awareness that the problem Germany faces with regard to its own looming pension crisis . . . and their severely underfunded status and aging population make Merkel very unwilling to tackle the problems of Southern Europe . . . who ALSO have their own pension crises looming behind the current overborrowing crisis. And the other pillar of the European Union, France, is . . . in even worse shape than Germany and entirely unable to shoulder this burden.

Id. at 46-47.

> the welfare state is fundamentally asymmetric. What's at stake in their political contest is not whether the permanent liberal project of expanding the welfare state will or won't go forward, but whether it will proceed rapidly or slowly. Liberal victories advance liberalism; conservative "victories" postpone liberalism.[167]

Several balanced proposals have been put forward, but have not received serious attention in Congress. The Simpson-Bowles Proposal, which was sponsored by a committee appointed by President Obama, did not receive any serious consideration either at the White House or in Congress although it received an inordinate amount of press coverage.[168]

In the face of severe deficits and growing debt, there are proposals being made that would expand Social Security in significant ways both to expand the coverage and to raise the funds necessary to pay for them.[169]

Social Security has just passed its 80th birthday and seems more ingrained in the American system than ever before. Yet, in spite of the many defects and inequalities built into the system, and the many proposals for change, the dependence of so many people on the system is likely to militate against any significant change. At some point the weakness of this first leg of retirement planning will need to be reformed.

II. JUSTIFYING SOCIAL SECURITY

A. Stay the Course with the Present Social Security Structure

New York University Law Professor Daniel Shaviro sees the Social Security issue as one between the existing system and a system modeled after private insurance. He generously refers to the issue as whether Social Security should be more "market-based."[170] Expanding on that issue, Professor Shaviro states:

> What makes it non-obvious whether Social Security and Medicare should be more market-based . . . is the fact that these programs specifically address problems of market failure and defective consumer choice. Accordingly, . . . one needs to assess the issue of more versus less market-based design in terms of how it would affect achieving the underlying objectives that one has already agreed markets do not provide. In addition, one has to ask how political choice problems would change within the

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[167] WILLIAM VOEGELI, NEVER ENOUGH, AMERICA'S LIMITLESS WELFARE STATE 212 (2010).

[168] *See, e.g.*, Brain Faler, *The ghost of Simpson-Bowles*, POLITICO (Oct. 25, 2014), http://www.politico.com/story/2014/10/the-ghost-of-simpson-bowles-haunts-2014-112199.

[169] ALTMAN & KINGSON, *supra* note 8, at 107-08.

[170] Daniel Shaviro, *Should Social Security and Medicare Be More Market-Based?*, 21 ELDER L.J. 87, 90 (2013) (stating, more specifically, "that of whether the retirement programs should be made more market-based, with differences from privately offered insurance being mainly limited to the fact that the government mandates, regulates and subsidizes retirees' private coverage").

> new structure, rather than presuming that they would go away, given that the government will be heavily involved in any event.[171]

Although Social Security and Medicare have insurance like characteristics, Shaviro says the two programs are quite distinct:

> [T]hey are deliberately designed to limit people's ability to make their own choices—in particular, with regard to how much or little to save for retirement; how to invest these savings; and how to structure the eventual payout. While limiting choice may sound bad, . . . it turns out to be well justified in this context. Both paternalism (however dubious an approach in many contexts) and externality problems provide convincing grounds for imposing the life cycle planning equivalent of requiring people "to eat their spinach."[172]

Shaviro describes Social Security as a "widely accepted conceptual structure that reflects the deliberate linkage between its taxing wages and its offering retirement benefits that creates a sense of 'earned entitlement' even if the taxes one pays are not present value-equivalent to the benefits one eventually receives."[173] This arrangement is justified based on two analogies. The first, by economist Paul Samuelson, set out in his 1958 article,[174] and the second, by Professor Shaviro, in his book on Social Security published in 2000.[175] Samuelson posits that, with the demise of a social structure where children cared for parents in old age, a stable system was created in which one generation supported the prior generation with the expectation that they will be similarly supported by the succeeding generation.[176] While the first generation gets a "free ride" because they pay so little into the system, each succeeding generation will support the prior generation and receive support from the next succeeding generation. The system works and is stable so long as the generations continue. The last generation, of course, is cheated; although, this will not occur as long as the nation endures.

Shaviro draws three conclusions from Samuelson's model. First, there is no inherent reason the program would be unsustainable since the model simply posits that the money paid into the system by the succeeding generation will be taken out by the first generation.[177] This merely says that what is taken in is given to the senior

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[171] *Id.* at 90 (asserting that proponents of market-based approaches have conceded that markets cannot entirely handle the core problems that make the programs necessary—leaving them in a posture of merely "haggling about the price.")

[172] *Id.* at 92.

[173] *Id.* at 93.

[174] Paul A. Samuelson, *An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money*, 66 J. POL. ECON. 467 (1958); *see also* Shaviro, *supra* note 170, at 93 n.21; SCHIEBER, *supra* note 9, at 10-11.

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

[176] Samuelson, *supra* note 174, at 480.

[177] Shaviro, *supra* note 170, at 93-94.

generation. So long as payroll tax funding is constant relative to wage levels, benefits will not explode and will likely not grow faster than the economy.[178]

The second conclusion is from the standpoint of the working-age participant. This "pay-as-you-go" system with fixed payroll tax funding creates an implicit financial instrument with no rate of return, because each generation takes out of the system the same amount that it put into the system.[179] However, if the population of the junior generation increases or wages grow beyond what was true of the prior generation, an investment return will be realized by the senior generation.[180] Samuelson's model posited a situation in which participation in Social Security was the only investment option but suggested that a return in excess of that provided by the capital market could be realized if the population or wages grew significantly.[181] If his suggestion is correct, it supports the idea that ever-increasing benefits not funded in advance could be continued until the last generation in the program.[182]

As Shaviro notes, Social Security sustainability in practice has suffered from adverse conditions inconsistent with Samuelson's model.[183] Birth rates have fallen, life expectancies have increased, and wage growth has slowed in the past several years putting pressure on the effectiveness of Samuelson's "ever increasing benefits" analysis. Nevertheless, Shaviro finds the analysis constructive since any imbalance in the system can be addressed "so long as the needed changes to taxes and/or benefits were adopted in a timely fashion."[184]

The third conclusion, involves the political economy of obtaining approval from one generation to pay taxes with the promise of ultimately receiving a return in retirement based on assumed fixed parameters.[185] The idea was to overcome the selfish impulses by approving a system with an assumed fixed payroll tax rate and a pure pay-as-you-go benefit payout.

While recognizing that the program has continued for over fifty years since Samuelson's model, and many changes have occurred, including the clear separation of the payroll tax rate from the benefit formula, Shaviro notes: "Yet the two sides of the ledger will only be in balance, either for a given year or over the long term if

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178 *Id.* 95-96.

179 *Id.* at 96.

180 *Id.* at 97.

181 *Id.* at 97-98 (citing Henry J. Aaron, *The Social Insurance Paradox,* 32 CAN. J. ECON. & POL. SCI. 371 (1966)). In his article, Aaron provides an algorithm proving that "social insurance can increase the welfare of each person if the sum of rates of growth of population and real wages exceeds the rate of interest." Aaron, *supra*, at 372. He calls his theorem the "social insurance paradox" such that he can assert that "if no reserve is accumulated in the financing of old age pensions, each person will receive a larger pension than he has paid for . . . ." *Id.* at 372. Of course, if the combined rate of population growth plus the wage growth fall below the prevailing interest rate the system will leave everyone with a smaller pension than was paid for. *Id.* at 374.

182 Shaviro, *supra* note 170, at 97.

183 *Id.* at 99-100.

184 *Id.*

185 *Id.* at 100-01.

Congress adjusts them suitably and without undue lag, as demographic events alter the fiscal relationship between the two sides of the ledger."[186]

Shaviro suggests Social Security is sustainable, even with a lack of pre-funding, so long as benefits do not grow too fast relative to the size of the economy, because "simply increasing taxes relative to benefits over the long term" can fund system benefits.[187] Although the terms of the "ever increasing benefit" analysis has in practice encountered certain "risk factors" (e.g. adverse demographic growth and wage growth), Shaviro does not see any "inherent" reason the system should not continue to be sustainable so long as adjustments to taxes and/or benefits are made in a timely fashion.[188] However, the policy of one generation paying for the next has become weaker as the fiscal situation has deteriorated. The large senior age cohort has created a "third rail" of politics in Social Security and Medicare that makes solving the fiscal problem of who will pay either in the form of higher taxes or lower benefits politically difficult.[189]

The second model Shaviro uses to help conceptualize Social Security comes from his earlier book, *Making Sense of Social Security Reform*, which does not focus on the system but instead focuses on the individual in the system.[190] Here, he outlines Social Security as a three-part system in which the benefit (B) is equal to the taxes paid (T) plus the return on taxes paid (rT) plus an amount (X) needed to adjust the system into balance.[191] The formula (B = T + rT + X) allows Social Security to be viewed as distinct programs wrapped together.[192]

"T" is viewed as an amount of forced savings to acquire a benefit that is simply a fixed lifetime annuity that cannot be transferred or assigned. "rT" represents a restricted portfolio choice over which the participant has no opportunity to choose between alternate investments.[193] "X" is either a positive, if someone benefits from a wealth transfer, or a negative, if one's benefit is reduced.[194] The redistributive feature represented by "X" is a "modestly progressive" and seldom-understood factor that favors one-earner married couples over two-earner couples and single individuals.[195]

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186 *Id.* at 98.

187 *Id.*

188 *Id.* at 100.

189 *Id.* at 100-01.

190 *Id.*

191 *Id.* at 102.

192 *Id.*

193 *Id.*

194 *Id.* at 102-04.

195 *Id.* at 104 (raising questions as to whether the transfers are good policy, whether the transfers should be done within or outside the system, and whether the relationship between taxes paid and benefits received should be more transparent). Descriptions of Social Security as a plan of forced savings and as a redistributive program are elaborated in an earlier book, see SHAVIRO, *supra* note 175, at 29-32.

In recognizing that the sytem is financially challenged, Shaviro states that making Social Security self-financing is simply a matter of arithmetic:[196] "All it takes is some combination of increasing its tax financing and/or reducing projected future benefits. One of the most important issues raised here is what mix between changes to these two sides of the ledger should be utilized."[197]

Suggested changes include increasing the retirement age and indexing benefits to increases in life expectancies, making the benefits less generous to high-income earners, or changing the inflation index for benefits.[198] Regardless, making the system more progressive by reducing the benefits to higher earners seems inevitable. Such a change might escape economic inefficiences if the system is simply viewed as a tax on work, but would likely create further obscurities in the tax/benefit relationship and raise issues of political economy as higher earners may be less inclined to continue supporting the system. This problem was recognized by Social Security architects, as Shaviro notes:

> Social Security architects, such as Wilbur Cohen and Robert M. Ball, famously argued that "a program for the poor will end up being a poor program," and that universality was thererfore needed to keep the program politically strong. If this is correct, a more progressive benefit skew might endanger poor retirees' benefits over time.[199]

A strong political consideration is that any change in benefits may affect current retirees and those close to retirement who have planned on certain levels of benefits. However, such benefits are not legal obligations and may be legally changed by Congress.[200] Recent discussions have sought to reassure such persons by stipulating that changes (i.e. reducing benefits) would not affect those fifty-five years or older. On the other hand, Social Security benefits and taxes are often considered independently such that raising taxes means greater "forced" savings having the same effect as a benefit reduction.[201] Under the current system taxes could be raised by raising the rate of tax or by lifting the ceiling on the tax base that is subject to the tax. Raising the rate affects all taxpayers but lifting the ceiling will affect higher income taxpayers who may not need the increased benefit but may see the increased redistributional effects and be less willing to support the system.[202]

Finally, Shaviro believes that the label, as well as, the substance of any change implementeed should be evaluated. In one plan he mentions, taxes were increased by making health benefits received by an employee subject to the Social Security tax.

[196] Shaviro, *supra* note 170, at 105. Other commentators describe the needed adjustments at "slight increases." ALTMAN & KINGSON, *supra* note 8, at xii.

[197] Shaviro, *supra* note 170, at 105.

[198] *Id.* at 105-06.

[199] *Id.* at 107 (citing EDWARD D. BERKOWITZ, ROBERT BALL AND THE POLITICS OF SOCIAL SECURITY 4 (2005)).

[200] *Id.* at 107-08.

[201] *Id.*

[202] *Id.* at 107-09. Shaviro finds the current system of placing a ceiling on the tax base subject to the Social Security tax reflects a "high political economy value" on limiting the actual and apparent redistribution effects. *Id*. at 108-109.

Such a change allows one to argue that at least the observed rate of tax was not increased when in fact the tax revenue increased primarily among those lower income persons who are below the wage ceiling.[203]

B. Arguments for Forced Savings

That some element of forced savings should be instituted is supported by three arguments—*paternalism, market failure, and externalities*. Paternalism suggests that optimal lifetime behavior requires people be forced to save for, and throughout, retirement based on their own self-interest.[204] The theory of declining marginal utility from consumption within a time period leads to the conclusion that smoothing out consumption between periods should be a common objective regardless of your income level. Thus, forced saving for retirement is consistent with one's ability to maintain a constant level of consumption throughout retirement making Social Security's lifetime annuity highly desirable even though it might mean that person's wealth is exhausted at the time of death with no intergenerational transfer.[205] Finally, looking to psychological studies, some people concentrate more on present consumption and therefore act in such a way as to undermine their ability to maintain their level of consumption in future years.[206] Some level of forced savings should be required and failing to do so would be a mistake.[207]

Market failure is the second argument for forced savings. Here, the idea is that the government can do a better job of addressing the failures of the market than private firms. Further, by using income tax and transfer payments the government can provide better insurance against individual career or planning failure that does not provide adequate retirement than can private firms. The government guarantee provides everyone at least a minimal level of living. Thus, under the economic principle of the declining marginal utility of money, the amount taken from a high income individual and given to a low income individual has greater utility (e.g. value) to the low income person than the utility lost by the high income person thereby creating net social utility.[208]

Private firms are unable to provide this type of insurance because it can create an incentive for someone to intentionally have a low income and collect from the insurance company. It also allows for adverse selection in which the purchaser of a

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203 *Id.* at 109-10.

204 *Id.* at 122.

205 *Id.* at 123.

206 *Id.* at 125.

207 *Id.* at 124-25.

208 Declining marginal utility is a concept that economists consider so obvious that needs no proof. *See* 7 FRED GOTTHEIL, PRINCIPLES OF ECONOMICS 108-12 (2013). Nevertheless, the concept is the primary justification for the graduated income tax notwithstanding that no one is able to quantify utility or any decline in utility. However, no one is able to determine the appropriate tax rate that equalizes the economic sacrifice between taxpayers. Thus, when someone states that it is important for the wealthy to pay his or her fair share of taxes, it is impossible to determine his or her fair share. Such comments also misuse the term "wealthy," since the income tax taxes income and not wealth. Perhaps the best one can say is that your fair share is what Congress determines is your fair share. *See infra* note 703 and accompanying text.

life annuity has better information than the insurer on his or her own health and life expectancy. Only a stable government requiring the entire population to participate in the program can provide this type of insurance.[209] Shaviro argues that the government must, to some extent, have a fixed demographic; although, if demand is sufficiently large, it may be possible for private firms to provide the required annuities on somewhat more actuarially fair terms than is presently available.[210] Fiscal and altruistic externalities support forced savings, arguing that, when individuals fail to save or insure against the exigencies of retirement, they become a burden on the national, state, or local treasuries.[211] It is also unsettling to others who observe the elderly suffering in old age because of a failure to save adequately for retirement. These concerns are alleviated by a forced savings plan.[212]

Portfolio choice is the final argument Shaviro addresses, which, for Social Security, is no portfolio choice. He posits that departures from optimal investor behavior present errors and negative externalities that could be prevented by paternalism.[213] Optimal investor behavior varies depending on the investor's degree of risk aversion, which in turn reflects the declining marginal utility of money.[214] Optimal investor behavior requires broad diversification of investments that are often unavailable to the private investor such that Shaviro sees this criticism of Social Security as speculation.[215] Investor error is expected and likely to lead to bad results, thereby raising questions of negative fiscal and altruistic externalities.[216] Since most private saving account "PSA" proposals restrict investment options during accumulation and retirement, Shaviro characterizes the argument about investment choice as merely a "haggling about the price" and deems PSAs as unrelated to future Social Security sustainability.[217]

C. Arguments Favoring Investor Participation

Three basic arguments are presented in favor of allowing participants to trade their future benefits for an investment in a diversified stock or bond portfolio. First, Social Security is the bottom tier of anyone's retirement, and everyone investing this basic amount exhibits an inordinate amount of risk aversion.[218] Someone who prefers more risk could invest other monies in risky assets to make the overall risk

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[209] Shaviro, *supra* note 170, at 125-27.

[210] *Id.* at 127.

[211] *Id.* at 128.

[212] While arguing that Social Security is an insurance program rather than a welfare program proponents of Social Security expansion stress the needs of "older women, people of color, the LGBT community, low-wage workers, many early retirees, and the oldest old." ALTMAN & KINGSON, *supra* note 8, at 49.

[213] Shaviro, *supra* note 170, at 134.

[214] *Id.* at 134.

[215] *Id.* at 135.

[216] *Id.* at 135-36.

[217] *Id.* at 136.

[218] *Id.* at 137.

consistent with that person's objectives. Second, the private sector trend of shifting from defined benefit plans to defined contribution plans, where one's retirement success depends on the success of investment decisions, should be extended to Social Security.[219] Resistance to this trend generally is strongest among collective bargaining units (primarily in the public sector), who point out that the private sector trend is being initiated by the employer and not the employees.[220] Therefore, Shaviro argues that diversification would require that one's retirement is not entirely dependent on the financial markets and that some "defined benefit" is preserved.[221] Finally, the volatility of the financial markets in the past few years suggests that returns on such investments are not as assured as some have asserted; and, since people are risk adverse, they should not invest in risky investments until such time as they are assured of some base of retirement savings.[222]

Characterizing a flat rate payroll tax as a form of "forced savings" might suggest some element of investor participation. However, the dedicated payroll tax was implemented for a different purpose which was to insure that people would feel they had paid for the benefits and politicians would be reluctant to interfere with them in the future.[223] There is only a general relationship between the payment of taxes and benefits, but not on a dollar for dollar basis. In fact, the system has a significant wealth distributional effect such that lower income individuals receive a higher percentage of their preretirement income (the so-called "replacement rate") than higher income individuals.[224] The ceiling on the earnings covered by the Social Security tax can be justified on the grounds that the purpose of the program is to insure that every person has a minimum amount at retirement and persons with incomes higher than a certain level will likely have additional savings of their own.[225]

Creating a distinct relationship between taxes and benefits could make Social Security more efficient by making the relationship more transparent in that a person

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[219] *Id.* at 137-38.

[220] *Id.* at 138.

[221] *Id.* at 138.

[222] *Id.* at 139-40 (noting that even people who do not hold stock already bear some of the risk associated with market performance through the market's macroeconomic impact).

[223] *Id.* at 140. In response to an inquiry from a reporter challenging the economic incentives in the system, President Roosevelt stated:

> I guess you are right on the economics, but those taxes were never a problem of economics. They are politics all the way through. We put those payroll tax contributions there so as to give the contributor a legal, moral, and political right to collect their pensions . . . . With those taxes in there, no damn politician can ever scrap my social security program."

SCHIEBER, *supra* note 9, at 66; *see also* SHAVIRO, *supra* note 175, at 117 (noting that with Medicare only part A was given a dedicated tax because of the "popularity of Social Security's program design" but unlike social security, the more you pay does not correlate to greater benefits but since this relationship is "sufficiently obscure to the general public" the dedicated finance might protect this program as well as Social Security).

[224] Shaviro, *supra* note 170, at 140-41.

[225] *Id.* at 141-42.

who views the tax as a burden on labor can more easily see how the extra work could result in an additional benefit.[226] But Shaviro suggests the lack of transparency is no accident, and notes the political economy argument that a "program for the poor" is often a program because it can easily be cut when voters refuse to support it.[227] The opacity also served to allow the first generation, which suffered during the Great Depression, to do very well with little or no payment into the system, although such a transfer may be justified.[228]

Finally, even though Social Security does not provide a benefit of inheritability, consumer failure, market failure, or altruistic or fiscal externalities would not be alleviated by a provision for inheritability.[229] Shaviro, having made a strong case for Social Security, challenges anyone desiring to replace it with PSAs must be prepared to address the following criteria:

1. Since $100 can be invested in treasury bonds, other bonds, or stock, each investment is said to be "equally valuable," although risk and expected return may be different. Noting that the Social Security benefit (T + rT + X) is one such investment, choosing something other than Social Security should reflect a basis for concluding a riskier portfolio is better." If the riskier portfolio is preferable overall, PSAs are unnecessary and the government could make the alternative investments.[230]
2. Since PSAs will also offer limited investment choice, proponents are merely "haggling about the price" such that proponents must demonstrate the merits of "greater choice" in relationship to Social Security's accepted purposes.[231]
3. If desirable, a PSA system could be made "progressive" by transferring funds from higher income PSA owners to lower PSA owners.[232]
4. PSAs make the marginal relationship between contributions and benefits transparent and encourage work, an effect that could also be achieved under Social Security.[233]
5. Actuarial conventions make PSAs look attractive by, among other things, under-estimating the cost of implicit government guarantees

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226 *Id.* at 143.

227 *Id.*

228 *Id.* at 143-44. Other reasons include the Samuelson thesis discussed earlier, the extreme poverty caused by the depression, and a belief in the progressivity provided by rising lifetime incomes. *Id.*

229 *Id.* at 145-46.

230 *Id.* at 112-13 (noting that this approach seemed viable in the 1990s when the internet bubble caused large market returns making stocks look "artificially reliable," but the stock market performance in the years subsequent have dampened enthusiasm for this approach).

231 *Id.* at 113-14.

232 *Id.* at 114 (citing SHAVIRO, *supra* note 175, at 152-56).

233 *Id.* at 102-04.

or overemphasizing their safeguards against future government interference.[234]

6. Shifting money into PSAs will reduce any Social Security surpluses and limit government's ability to use those funds for other programs. Since the surpluses have been largely eliminated, general revenues are needed to pay current benefits and PSAs will increase that need.[235]

Eliminating investor participation based on the Samuelson/Aaron analysis is not as clear as it seems. That analysis can be simplified by positing a society in which there are 1,000 participants at every age so that there are 1,000 one-year-olds, 1,000 ten-year-olds, 1,000 sixty-six-year olds and so forth. Assume everyone enters the workforce at age twenty and leaves at age sixty-five and dies at age eighty. If everyone between age twenty and sixty-five produces $400 worth of goods then those 45,000 persons will produce $18,000,000. If we divide the product between all persons twenty and older (age eighty), 60,000 people would each receive $300.00. If the population increases or if the workers become more productive, there is more to distribute and everyone is better off. Of course, if the population begins to decline or becomes less productive then everyone will have a reduced standard of living.

However, reality sets in, because the individual impact varies due to differences in longevity, waves of population growth and decline, earnings, and an infinite variety of other conditions all of which can be addressed by policy makers (called "ethical observers" by Samuelson) who select the winners and losers.[236] Nevertheless, this ideal suggests, as does Samuelson, that the system could generally be sustainable.

If the system is sustainable, the next step is to make appropriate allocations to achieve some "equitable" or "optimal" state. Recognizing that free markets might reach a "Pareto efficiency,"[237] achieving an "ethically optimal" distribution would require governmental interference with the market results by using taxes, subsidies, fiat, or other such action.[238] To achieve the ethically optimal distribution mankind enters into a Hobbes-Rousseau social contract instructing the young that if they

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[234] *Id.* at 114-15.

[235] *Id.* at 115-16 (noting that Social Security surpluses caused increased government spending in the past is no longer the case as the process is now reversed and payments are now needed for interest on the trust fund).

[236] Samuelson, *supra* note 174, at 480. These conditions must be addressed by policy makers and the views of economists can be helpful for as Samuelson states:

> We economists have been told . . . to economize . . . in the sense that we want what there is to go as far as possible. But it is also the task of political economy to point out where common rules in the form of self-imposed fiats can attain higher positions on the social welfare functions prescribed for us by ethical observers.

Id.

[237] Pareto efficiency, or Pareto optimality, is a state of allocation of resources in which it is impossible to make any one individual better off without making at least one individual worse off. *Id.* at 479-80.

[238] *Id.* at 479.

support the aged then the unborn will be charged with supporting them.[239] Although social coercion is used on the young, "the young never suffer, since their successors come under the same requirement. Everybody ends better off. It is as simple as that."[240]

The end result of the Samuelson/Aaron analysis is a series of governmental interferences which are not necessarily preferable to the choices made by investor participation. With investor participation the "ethically optimal" distribution would reflect at least some element of self interest.

D. Acknowledged Faults

Shaviro acknowledges a number of caveats that have a tendency to weaken his argument, which supports the current system, including the following:

1. Social Security provides greater security against loss than private investments, assuming that the government is solvent and politically stable.[241]
2. If payroll taxes and benefits to be received were allocated on an "actuarially fair individual basis," a PSA structure would be preferable to the current system.[242]
3. Social Security lacks transparency between the taxes paid and benefits received. Few understand the wide disparity of benefits between individuals because of marital status.[243] There is also a lack of transparency when it comes to the national debt, where the unfunded liability of Social Security is not listed as a separate item.
4. If a failure to leave an inheritance constituted an irrational decision then consumer failure might be implicated and should be addressed by Social Security.[244]
5. Medicare over emphasizes relatively routine care relative to high-end catastrophic coverage.[245]
6. The political situation has acknowledged the unsustainability of Social Security for over a quarter century, but, in spite of considerable dialogue and acknowledgement, the political situation has been unable to take action and has allowed the problem to grow worse and more costly to repair.

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239 *Id.* at 479-80.

240 *Id.* at 479. In this way, Samuelson asserts it is "easy" to set the rules to get to an optimum solution that is better than everyone insisting on a "*quid pro quo*" where we end up with each person being worse off. *Id.*

241 Shaviro, *supra* note 170, at 140-41.

242 *Id.* at 140-41.

243 *Id.* at 145. The opacity of the system obscures the disparity between household types such as between one and two wage earner couples and between single individuals and one wage earner couples that cannot easily be justified on the basis of distributional grounds or grounds that the biases are offset in other areas of the fiscal system. *Id.*

244 *Id.* at 146.

245 *Id.* at 92.

7. Immigration could upset the system.[246]

Part II has set forth Professor Shaviro's arguments supporting the present Social Security system but has also acknowledged some of its weaknesses. The next section will demonstrate the inability of state and local governments as well as private employers to fulfill pension promises. That the federal government can succeed where so many other entities have failed reduces the case for Social Security to the public's reliance on the federal government's power to control the supply of money.

III. ABANDONING LEG TWO: DEFINED BENEFIT PLANS

A prime advantage of having Social Security sponsored by the federal government is the perception of long-term solvency and stability. The dramatic drops in the stock market in 2000 and 2008 have enhanced this perception, leaving the impression that the only stability retirees have is Social Security. However, there is evidence of long-term stability in the returns on stocks. From 1980 to 2014, a period of thirty-four years, the Dow Jones Industrial Average grew from 1,000 to over 17,000— a return of approximately 8% per annum.[247] During the same period, the gross federal debt (including debt held by the public as well as debt held in government accounts) grew from nearly $1.0 trillion to just under $18 trillion with deficits projected as far into the future as can be estimated.[248]

The long-term solvency and stability of the United States government and whether it will continue funding unsustainable programs is in question. The wisdom of continuing the Social Security program in its current state becomes questionable when one looks around the world at the ability of governments as well as private companies to sustain defined benefit plans. The next few sections look at the ability of cities, states, countries, and corporations to sustain defined benefit plans. In a sense, these plans have traditionally been the second leg of the three-legged retirement security plan in the United States.

A. The Municipal Bankruptcy: Detroit

Detroit is a city that watched its tax base decline as a result of business relocation, citizen flight, and growing obligations for pension and retiree healthcare costs that rely on current taxes to fund them.

In July 2013, Detroit filed for Chapter 9 bankruptcy in what was the largest-ever municipal bankruptcy with debt totaling about $18 billion.[249] The $18 billion debt included unfunded pension liabilities of approximately $2 billion owed to city

[246] *Id.* at 99.

[247] *Dow Jones Industrial Average, Jan. 1, 1980 – Dec. 8, 2014*, MARKETWATCH, http://www.marketwatch.com/investing/index/djia/charts?symb=DJIA&countrycode=US&time=100&startdate=1%2F4%2F1980&enddate=12%2F8% 2F2014&freq=1&compidx=none&compind=none&comptemptext=Enter+Symbol%28s%29&comp=none&uf=7168&ma=1&maval=50&lf=1&lf2=4&lf3=0&type=2&size=2&style=1013 (last visited Mar. 8, 2016).

[248] *Historical Tables*, *supra* note 5; CBO 2014 REPORT, *supra* note 77, at 2 & 3.

[249] Ashley Woods, *A Guide To Detroit's Chapter 9 Default And How Bankruptcy Could Change The City*, HUFFINGTON POST (July 24, 2013), http://www.huffingtonpost.com/2013/07/24/detroit-bankruptcy-chapter-9_n_3640734.html.

retirees and employees in the General Retirement System ("GRS") and $1.25 billion owed to the Police and Firefighter Pension System ("PFRS").[250] The other major creditors are holders of bonds issued by the city for various purposes that include funding the escalating costs of pension and retiree health care.[251]

1. Urban Flight and the Anemic Tax Base

Critics point to the Detroit riots in 1967 and the recession in the early 1980s that impacted the auto industry and its component suppliers, resulting in significant losses of tax revenues to the city as the beginning of Detroit's decline.[252] The city responded to the loss of tax revenues with tax increases, which caused many corporations, residents, and non-resident workers to move out of the city into the suburbs.[253] Detroit was left with the highest combined property and income tax for the state of Michigan; and, as a consequence, in 2012, the State of Michigan drastically cut its revenue sharing to the city.[254] Mismanagement also played a part in Detroit's decline.[255]

2. Adverse Demographic Shifts

Pay-as-you-go pension systems are heavily impacted by decreases in the taxpayer base and increases in the longevity of beneficiaries. Detroit was impacted by both demographic effects, seeing its ratio of employees to pensioners fall from two to one in 1960 to one to one in 1991 to one to two in 2012.[256] The life

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[250] Lawrence J. McQuillan, *Detroit bankruptcy reveals 401(k)'s virtues: Column*, USA TODAY (Aug. 18, 2014), http://www.usa today. com/story/opinion/2014/08/18/detroit-bankurptcy-trial-pension-column/14228253/; Andrea Riquier, *Detroit Bankruptcy Deal Largely Spares Pensions*, INV. BUS. DAILY, Apr. 28, 2014, at A1 (noting that, prior to the bankruptcy, the unfunded liability was listed as approximately one-fourth of the $3.5 liability determined by the Emergency Financial Manager Kevyn Orr).

[251] *See* Christine Sgarlata Chung, *Zombieland/The Detroit Bankruptcy: Why Debts Associated with Pensions, Benefits, and Municipal Securities Never Die . . . and How They Are Killing Cities Like Detroit*, 41 FORDHAM URB. L.J. 771, 778 (2014) ("[f]inally, there are the city's creditors/lenders, including general obligation bondholders, some of whom were promised that the city's taxing power and/or dedicated revenue streams would be available for repayment, but who now are being told that they should expect substantial losses. Put simply, Detroit is faced with toxic stew of competing rights and obligations, and it cannot simply tax, cut or borrow its way out of economic distress.").

[252] Nathan Borney & John Gallagher, *How Detroit Went Broke*, SUNDAY FREE PRESS, Sept. 15, 2013, at 12A.

[253] *Id.*

[254] Chung, *supra* note 251, at 793.

[255] The City's mismanagement is epitomized by its mayor from 2002 to 2008, Kwame Kilpatrick, who is now in prison. *See Can Detroit recover? Chapter 9 draws to an end*, ECONOMIST, Nov. 15, 2014, at 36.

[256] The employee to pensioner ratio in Detroit in 1960 was 26,386 employees to 10,629 pensioners; in 1991 it was 18,548 employees to 18,615 pensioners; and in 2012 it was 10,525 employees to 21,113 pensioners. Borney & Gallagher, *supra* note 252, at 14A.

expectancy for men was 66.6 years in 1960, but it increased to 76.2 years by 2010.[257] During this same time frame, Detroit's population decreased by 57%.[258] These changes, coupled with pensioners' unwillingness to reduce benefits while looking for cost of living increases, made the pension system unsustainable. Further, in 1997, when the Michigan moved from a defined benefit plan to a defined contribution plan, Detroit failed to follow suit and its legacy costs continued to increase.[259]

3. Inaccurate Projections of Financial Returns

Pension management requires making complex financial projections of receipts from the City and/or workers, returns on pension fund investments, and benefit estimates. If a high investment return is estimated, the fund can be balanced with lower contributions from the City and the workers. In administering Detroit's two pension plans, the pension board members were union officials who employed static return percentage (most recently 7.9% annual rate of return) far exceeding the actual returns realized on the pension funds.[260] Allegedly, political pressure on plan administrators to use artificially enhanced investment return estimates reduced the City's annual contribution.[261] With the adverse forces described above in play, this

[257] U.S. DEP'T OF HEALTH & HUMAN SERVICES, HEALTH, UNITED STATES, 2015 (2015), http://www.cdc.gov/nchs/data/hus/hus15.pdf.

[258] FAZLEY SIDDIQ, FIFTY YEARS OF GROWTH AND DECLINE OF LARGE COUNTIES IN THE UNITED STATES 1960-2010, at 14, 18-20 (2013).

[259] Borney & Gallagher, *supra* note 252, at 14A.

[260] Estimates made on assumptions of return as high as 8% have been seen as unrealistic. William K. Tabb, *If Detroit Is Dead, Some Things Need to be Said At the Funeral*, 37 QUEENS COL. J. URB. AFF. 1, 8 (2015). It has also been observed:

> That is, the pension obligations of the city constitute an expense equal to almost 200% of the city's total payroll. Most departments and operations of the city of Detroit are understaffed and layoffs have occurred. Currently in the cases of both plans, active members constitute less than 40% of the members. That is, over 60% of the members of these funds are not contributing to annuity funds which are invested in the capital markets to grow the amount of money available to fund the plans' obligations. *Moreover, the market values of the assets held by such funds were significantly lower than the value of those assets assumed in the actuarial analysis of the funds.*

Mark P. Franke, *The Detroit Pensions Bankruptcy Trust: A Proposal for the Resolution of Detroit's Pensions Obligations under Chapter 9 of the Bankruptcy Code*, 23 BANKR. L. & PRAC. 2, art. 5 (2014) (emphasis added) (internal citations omitted).

[261] Fraud, waste, abuse, and corruption in the city's two pension funds and all employee benefit programs were also alleged. The emergency manager ordered an investigation into possible violations. Press Release, Federal Bureau of Investigation, Detroit Division, Jury Convicts Former Detroit City Treasurer, Pensions Officials of Conspiring to Defraud Pensioners Through Bribery (Dec. 8, 2014), https://www.fbi.gov/detroit/ press-releases/2014/jury-convicts-former-detroit-city-treasurer-pension-officials-of-conspiring-to-defraud-pensioners-through-bribery. An executive responsible for $200 million in real estate investments pleaded guilty earlier this year to conspiring to bribe a city treasurer. *Id.* The former city treasurer also is under indictment. *Id.* In addition, a federal grand jury indicted a former general counsel for Detroit's police and fire pension fund. *Id.* The government claims that people that had business with the city pension extorted thousands of dollars in the form of payments to individual trustees. *Id.*

situation could not go on forever and plan administrators sought to alleviate the problem by investing large sums into alternative high-risk investments, which, unfortunately, did not provide the return hoped for.[262]

4. The Approved Workout Plan

On November 7, 2014, Bankruptcy Judge Steven Rhodes issued an oral opinion confirming the City's eighth amended plan of adjustment.[263] The opinion approved a reduction in both pensions and the amount to be paid to bond holders.[264] The City's art collection held by the Detroit Institute of Art ("DIA") was an asset sought by creditors, which the City desperately wanted to protect.[265] The plan reflected compromises and settlements of various claims, which the court found reasonable, fair, equitable, nondiscriminatory, and feasible.

The pension settlement was part of what was called the "Grand Bargain," a collection of settlements among parties interested in the two pension plans and a desire to protect the City's art.[266] The settlements include the pension settlement, the state contribution, and the DIA. The Grand Bargain allows an unfunded accrued actuarial liability (the "UAAL") in the amount of $1.879 billion for GRS and $1.25 billion for PFRS.[267] Under the Grand Bargain, the art will be preserved for the City and the City's two pension plans will receive $816 million over twenty years to be paid by the State of Michigan, the Detroit Institute of Arts, and a number of charitable foundations and individuals.[268]

Under the Grand Bargain GRS pensioners' benefits are reduced by 4.5% and the cost of living adjustment (COLA) is eliminated while the PFRS pensioners' receive

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262 This type of hedge fund investing, coupled with other alternative investments such as venture capital and private equity has steadily increased in the last thirty years and now account for 20% of public pension fund allocations. Detroit also made very speculative and ultimately disastrous derivative deals in relation to their debt offerings in connection with its special financing offer, which was basically a Band-Aid over a large wound. *See* THOMAS SUGRUE, THE ORIGINS OF THE URBAN CRISIS: RACE AND INEQUALITY IN POSTWAR DETROIT xx (2014) ("In 2005 [Mayor Kwame] Kilpatrick approved the largest municipal restructuring to date. A 'veritable army' of financial professionals from the nation's top investment banks and insurance companies put together a $1.44 billion deal to fund the city's unfunded pensions liability using innovative but complex and highly risky derivatives and credit default swaps . . . But just a few years later, the deal, like many of the high-risk credit deals that proliferated in the 1990s and 2000s, unraveled.").

263 Oral Opinion on the Record at 1, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Nov. 7, 2014), http://www.mieb.uscourts.gov/sites/default/files/notices/Oral_Opinion_on_Detroit_Plan_Confirmation_Judge_Rhodes_FINAL_for_Release.pdf [hereinafter Detroit Oral Opinion].

264 *Id.* at 4-6.

265 *Id.* at 12-13.

266 *Id.* at 3.

267 *Id.* at 4 (finding through June 30, 2023 the pension plans will use a 6.75% discount rate to value liabilities and a 6.75% assumed investment return rate to estimate future growth of assets).

268 *Id.*; *see also Can Detroit recover? Chapter 9 draws to an end*, *supra* note 255.

no benefit cut; however, their COLA is reduced from 2.52% to 1%.[269] In approving the plan the court determined that federal bankruptcy power was sufficient to impair municipal pension rights even with state constitution protection.[270]

The pension settlement also relates to a voluntary savings plan called the Annuity Savings Fund that was comingled with the GRS and was credited with excessive interest accruals.[271] The settlement provided that, subject to certain caps, excess interest accrued between 2003 and 2013 would be repaid to the GRS, amortized at 6.75% over the participant's life expectancy and deducted from the participant's monthly pension check.[272] This part of the settlement is estimated to recoup $190 million into the GRS.[273]

To settle the claims consistent with Michigan Constitution article IX, section 24, which prohibits the impairment of municipal pensions, the State of Michigan will make an immediate payment of $194.8 million to settle pension claims.[274] The DIA Settlement involves the transfer of the City's art to a permanent trust in exchange for contributions to be paid over a twenty-year period into the GRS and the PFRS in the

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269 Detroit Oral Opinion, *supra* note 263, at 4-5. The pension plans were frozen as of July 1, 2014 and current employees will get a less generous hybrid pension plan. Each pension claimant will receive an adjusted pension amount. Projected funding targets for 2023 are 70% for GRS and 78% for PFRS with full funding by 2053. The plan was approved by 73% for GRS and 82% for PFRS. *Id.* This settlement was a victory for current pensioners since they were initially offered a plan, called the "Hybrid Plan," that would rectify the pension situation by immediately reducing the benefits for GRS pensioners by 35% and eliminating their cost of living increases and by reducing benefits for PFRS pensioners by 10% but maintaining their cost of living increases. McQuillan, *supra* note 250; *see also* Chris Isidore & Melanie Hicken, *Detroit vote: Key to comeback*, CNN MONEY (May 6, 2014), http://money.cnn.com/2014/05/06/news/ economy/detroit-bankruptcy-vote/. Additional cuts are proposed to health care benefits promised to retirees. *Id.*; *see also* Andrea Riquier, *Detroit's Pensions Largely Avoid Cuts In City Bankruptcy: Precedent For Future Flops?,* INV. BUS. DAILY, Apr. 29, 1014, at A1. Voting on the proposal took place in July 2014, and both the General Pensioners (73% of retirees and employees with pension benefits who voted supported the plan) and Police and Firefighter Pensioners (82% those eligible for a police or fire pension who voted supported the plan) approved the plan. David Sirota, *Detroit's latest pension disgrace*, SALON (July 24, 2014), http://www.salon.com/2014/07/24/ detroits_pension_disgrace_a_gaudy_new_stadium_at_retirees_expense_partner/ (last visited 7/29/2014).

270 Detroit Oral Opinion, *supra* note 263, at 5. The court rejected challenges to the settlement under the Michigan constitution as well as arguments that the art at the DIA should be available for sale to fund the pension obligations. In fact, the court felt that the pension reduction were "minor" compared to any foreseeable result at the time the bankruptcy was filed and was only possible because of the Grand Bargain. *Id.* at 6-7.

271 *Id.* at 8.

272 *Id.* The recoupment is limited to 20% cap of the highest value of the participant's ASF account or of the participant's annual pension. The settlement of the ASF claim will net approximately $190 million for the GRS. *Id.*

273 *Id.*

274 Elizabeth Pratt, *Legislation Related to the Detroit Bankruptcy*, ST. NOTES, Summer 2014, at 1, http://www.senate.michigan.gov/sfa/Publications/Notes/2014Notes/NotesSum14lp.pdf.

amounts of $100 million from contributions guaranteed by the DIA and $366 million from various local and national charitable foundations.[275]

The overall bankruptcy settlement included six settlements beyond the Grand Bargain.[276] The parties settled a claim for other post-employment benefits (OPEB), which includes healthcare and life insurance benefits.[277] The allowed amount of OPEB claims was $4.3 billion of which $2.1 billion was for GRS retirees and $2.2 billion for PFRS retirees.[278] In settlement of these claims, the City established two associations to administer the claims and provided funding to the level of 10% of what the claims asserted.[279] The remaining five settlements reflected recoveries ranging from 13% to 74% of the amount claimed.[280] Overall, the City was able to reduce its unsecured liabilities by $7 billion out of the $18 billion owed by going into bankruptcy.[281]

In settling the claim, the City was given approval to borrow $325 million in exit financing.[282] However, the court admonished the City's labor unions, retirees, and the State of Michigan to take actions to make sure this never happened again. Finally, the court also admonished the Governor regarding the composition of the Financial Review Commission responsible for ensuring the long-term feasibility of the plan and the City's fiscal health that is composed of seven members, two of which are elected City officeholders.[283] The court's concern was that these two members have an interest in advocating for the City's position rather than providing oversight.[284] That meant only seven members are independent, thereby requiring five out of remaining seven members to overturn any action proposed by the City.[285]

The Detroit bankruptcy raised two important issues that were settled without the requirement of a court decision, aside from whether the settlement was fair and in

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[275] Detroit Oral Opinion, *supra* note 263, at 12. The Court also found in its discussion regarding the settlement being in the best interests of the creditors that "[t]o sell the DIA art would be to forfeit Detroit's future" and that the City made the right decision in refusing to sell the art. *Id.* at 24; *see also* Sirota, *supra* note 269 (noting that the $816 million represents the present value of Detroit's world-class collection of the Detroit Institute of Arts, which the City has indicated would be placed in a separate trust, and finding concerning that, at the same time pensioners were seeing their pensions cut ("slash" according to Sirota), billionaire owners of the Detroit Red Wings, the Ilitch family, unveiled details of an already approved taxpayer-financed stadium for the professional hockey team).

[276] Detroit Oral Opinion, *supra* note 263, at 2.

[277] *Id.* at 14.

[278] *Id.* The City claimed the OPEB liability was $3.8 billion and the retirees asserted it was $5 billion with the difference resulting from certain actuarial assumptions and discount rates. *Id.*

[279] *Id.*

[280] *Id.* at 15-20.

[281] *Can Detroit recover? Chapter 9 draws to an end*, *supra* note 255.

[282] Detroit Oral Opinion, *supra* note 263, at 37.

[283] *Id.* at 43.

[284] *Id.*

[285] *Id.* at 42-43.

the best interests of the creditors. These issues were the extent and application of the constitutional provision prohibiting the impairment of municipal pensions, and whether art is subject to a trust that prohibits the City from selling it to pay debts. These issues await another day, but Detroit is out of bankruptcy and the only clear winners are those providing services to the bankruptcy who have received $126 million thus far, and are estimated to receive a total of $150 million, which is in excess of the GM bankruptcy ($110 million) and the Chrysler bankruptcy ($77 million), but no way near the Lehman Brothers Holdings Inc. bankruptcy ($2.2 billion).[286]

B. The States: New Jersey, California, Illinois[287]

Just as Detroit's fiscal insolvency led to bankruptcy, many states are in a similar position as a result of irresponsible borrowing, unfunded pensions, and healthcare liabilities. Unlike municipalities, bankruptcy courts are not available to states.[288]

In a recent report using 2012 data, the fifty states were ranked according to the state's "financial health based on a variety of measures, such as cash on hand to pay its current bills, budget surpluses or deficits, unfunded liabilities and ability to provide adequate public services."[289] The report notes that, although the Great Recession[290] is now history, states still struggle with the repercussions of the economic downturn and balancing budgets continues to be a problem for the states due, in part, to rising healthcare costs and the cost of funding state and local pension.[291] New Jersey, Illinois, and California are three states ranked among the

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[286] Matthew Dolan, *Cost of Detroit's Historic Bankruptcy Reaches $126 Million*, WALL ST. J. (Sept. 12, 2014), http://www.wsj.com/articles/cost-of-detroits-historic-bankruptcy-reach-126-million-1410557043 (noting that such fees are for lawyers, accountants, financial advisers, and experts on everything from police work and pension funds to art appraisals and public relations). The Bankruptcy Judge's oral opinion noted that the fees in this case would exceed $100 million. Detroit Oral Opinion, *supra* note 263, at 27.

[287] Frank, *supra* note 3, at x.

[288] Jack M. Beermann, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 7 (2013).

[289] John Merline, *New Jersey Dead Last In U.S. For Fiscal Solvency, Study Finds*, INV. BUS. DAILY, Jan. 17, 2014, at A1. "Cash solvency" looks to how much cash a state can easily access to pay near-term bill. "Budget solvency" is mainly a measure of a state's per-capita budget surpluses or deficits. "Long-term solvency" looks at a state's ability to pay its long-term obligations, such as guaranteed pension benefits and infrastructure maintenance. *Id.* "Service solvency" examines whether a state has sufficient resources to provide its residents with an adequate level of services, such as public safety and education. *Id.* The article was based on a study from the Mercatus Center at George Mason University. Sarah Arnett, State Fiscal Condition: Ranking the 50 States (Mercatus Ctr., George Mason Univ., Working Paper No. 14-02, 2014).

[290] "The 'Great Recession' is a term used to describe the nationwide United States recession that lasted from December 2007 to June 2009 . . . ." Arnett, *supra* note 289, at n.1 (citing *US Business Cycle Expansions and Contractions*, NAT'L BUREAU ECON. RES., http://www.nber.org/cycles.html).

[291] Arnett, *supra* note 289, at 3.

five lowest and have recently been in the news for their pension difficulties.[292] Their ranking is as follows:

Table 5

Name of State	Rank by Cash Solvency[293]	Rank by Budget Solvency	Rank by Long-Run Solvency	Rank by Service-Level Solvency	Overall Rank: Fiscal Condition	Fiscal Condition Index[294]
California	48 (-2.58)	45 (-1.37)	46 (-2.67)	31 (-0.96)	46	-2.01
Illinois	50 (-2.66)	46 (-1.37)	49 (-4.81)	29 (-0.50)	48	-2.42
New Jersey	36 (-1.72)	50 (-2.84)	50 (-5.12)	39 (-1.99)	50	-2.81

Ranking by Fiscal Condition (Fiscal Year 2012)

In describing the results, the report suggests the bottom performers were especially hit hard in two categories: Budget Solvency and Long-Run Solvency.[295] These states' status reflects years of poor financial management, adverse economic conditions, and/or a combination of both.

New Jersey and Illinois are similar in that; (1) tax revenues have not kept up with spending, (2) budget practices only appear to balance the budget, (3) bonds are issued without the means of paying for them, and (4) pension liabilities underfunded by billions of dollars.[296] Calculating unfunded liabilities is always difficult, in that the choice of an appropriate discount rate will often determine whether the fund is in deficit or surplus.[297] It also seems that in times of economic downturns, states will underfund pension obligations and use the funds for other purposes.[298]

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[292] *Id.* at 3. For a broader list of states that are in the winner and in the loser category, see MARIN, *supra* note 2, at 13 (identifying the winner states as Delaware, Idaho, North Carolina, Oregon, Utah, Vermont, and Wisconsin, and the loser states as Arkansas, Connecticut, California, Hawaii, Louisiana, Mississippi, Montana, New Hampshire, New Mexico, and Rhode Island.) The winners made provision for retirement and post retirement medical needs of workers and the general population while the losers did not and are now faced with playing catch up through tax increases and service cuts. *Id.*

[293] Note: Solvency indices are in parenthesis next to the rank whereas the index of fiscal condition is in the separate last column. For each index the all state mean is 0.00. The top rated state in each category are as follows: Cash Solvency: Alaska (15.25); Budget Solvency: Alaska (7.76); Long-Run Solvency: Nebraska (8.77); Service-Level Solvency: Nevada (6.93); and Fiscal Condition: Alaska (8.80). Arnett, *supra* note 289, at 34-40.

[294] Arnett's *State Fiscal Condition* identifies the fiscal condition index as "the sum of the cash, budget, long-run, and service-level solvency indices weighted as follows: (0.35 x cash solvency score) + (0.35 x budget solvency score) + (0.2 x long-run solvency score) + (0.1 x service-level solvency score)." *Id.* at 38.

[295] *Id.* at 34-40.

[296] *Id.* at 24.

[297] Arnett describes the method of selecting an appropriate discount rate as follows:

> The method used to calculate a state's unfunded pension liabilities is a point of much discussion. The controversy centers on how to determine the appropriate discount rate, which is the interest rate used to determine the future value of pension assets. The

1. New Jersey

On September 25, 2014, a specially appointed commission to study the status of New Jersey's pension and health benefit systems issued the "NJ Status Report."[299] The Report outlined New Jersey's fifteen-year history of underfunding its state and local pensions. New Jersey's 2014 budget called for $700 million in pension spending and $2.8 billion in health benefit spending, for current employees and retirees, out of its $33 billion state budget.[300] Fully funding New Jersey's pension obligation would require an additional $3 billion.[301] Looking at the long-range prospects the unfunded pension liability is at $37 billion and the unfunded post-employment health benefit liability is at $53 billion.[302]

> unfunded pension liabilities presented in this section of the paper come from state estimates. State pension plans currently use their own rate-of-return and discount-rate assumptions, resulting in underestimated liabilities that are different to compare between states. To address this difficulty, Moody's Investors Service, a credit rating agency, proposed that state pension plans use a common rate of return/discount rate base on a high-grade bond index. Changing the discount rate in accordance with Moody's proposal would result in higher estimated unfunded liabilities that most estimates currently report. For example, using Moody's new methodology, Illinois's estimated unfunded pension liability would be over $200 billion. When New Jersey's unfunded pension liability is calculated using a method consistent with private-sector accounting standards, the state's unfunded liabilities rise to over $273 billion. For the purposes of calculating the long-run solvency index, this paper uses the total long-term liabilities figure reported in state CAFRs [Comprehensive Annual Financial Reports produced by state and local governments], which includes pension liabilities.

Id. at n.18 (internal citations omitted). Another method that understates pension liabilities occurs when an out of date table of mortuary experience is used which underestimates the anticipated life expectancy. *See* Jean Lotus, *Police and fire pension funds report $200,000 shortfall: Actuarial change leads to property tax boost to cover pensions*, FOREST PARK REV. 2 (Sept. 9, 2014), http://www.forestparkreview.com/News/Articles/9-9-2014/Police-and-fire-pension-funds-report-$200,000-shortfall-/ (reporting that Forest Park, Illinois used GAM-1971, a 1971 actuarial table, rather than RP-2000, a 2000 actuarial table, that showed an additional four years of life expectancy thereby increasing the amount of the unfunded liability).

[298] Arnett, *supra* note 289, at 16.

[299] TRUTH & CONSEQUENCE: STATUS REPORT OF THE NEW JERSEY PENSION AND HEALTH BENEFIT STUDY COMMISSION (Sept. 25, 2014), http://www.state.nj.us/treasury/pdf/NJPHBSC.pdf [hereinafter NJ STATUS REPORT]. Governor Christie in Executive Order No. 161, signed on August 1, 2014, appointed a ten member commission to examine the status of the pension and health care systems of the State of New Jersey. The status report is factual and explanatory in nature and a final report will offer solutions. *Id.* at 2.

[300] *Id.* at 3.

[301] *Id.* (stating the unfunded liability is for the pension funding only since the health care is financed on a pay-as-you-go basis).

[302] *Id.* at 4 (the combined $81 billion is almost three times the state's annual budget). The funded pension liability is $44 billion making the pension funded at the level of 54%. *Id.* The unfunded liability is defined as the "present value of: 1) the cost of providing pension benefits to current retirees and 2) the pension benefits earned through that date by current employees." *Id.* at 5. In making the calculation, a 7.9% expected rate of return was used which is a number

The states underfunding is blamed on the drag on plan asset values caused by the 2000-2002 downturn, the Great Recession of 2008-2009, as well as, elected officials of both political parties making long-term commitments for benefits based on assumptions that were unduly optimistic.[303] Reforms initiated by Governor Chris Christie in 2010 and 2011 helped by reducing benefits for new employees, increasing contributions, and temporarily suspending the cost of living adjustment; however, many saw them as a political compromise and not a permanent solution.[304] It remains to be seen whether Governor Christie will again seek to curb pension and health care costs or even make the promised contributions given current budget constraints.[305]

2. Illinois

One recent report identified Illinois as the worst state in terms of pension funding with their plans only 39% funded, followed by Kentucky at 48%; Connecticut at 49%; and New Jersey at 54%.[306]

Officially, in 2011 the combined unfunded pension liability for Illinois' five state-run pension plans was $83 billion, using an expected return of 8% to value the

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used by other states. *Id.* A lower rate of return would increase the amount of the unfunded liability.

[303] *Id.* at 6. Local governments in New Jersey participate in the same plans but their plans have funded ratio of 75% compared to the state's funded ration of 54%. *Id.*

[304] *Id.* at 7. The changes in 2010 and 2011 are currently being challenged in litigation. *Id.* Suspending COLAs reduced the unfunded liability by $11.5 billion. *Id.* Health care is particular problem because the plans provide little incentive for employees to reduce costs, and, when the "Cadillac Tax" under the Affordable Care Act becomes effective in 2018, New Jersey will likely see an excise tax imposed in the amount of $58 million rising to $284 million in 2022. *Id.* at 7-8. Citing Pew Charitable Trust data, the Report points out that the annual cost of individual health insurance coverage in New Jersey is $9,096 compared to a public and private national average cost of $5,884 and for family coverage $19,488 in New Jersey compared to $16,351 for the national average. Only Alaska and New Hampshire had higher costs. *Id.* at 24.

[305] Elise Young & Terrence Dopp, *Christie Pension Fixes Range From Unlikely to Unpalatable*, BLOOMBERG (Aug. 4, 2014), http://www.bloomberg.com/news/articles/2014-08-04/christie-pension-fixes-range-from-unlikely-to-unpalatable. The article also notes that West Virginia adopted a defined contribution plan in 1991, but changed back to a defined benefit plan in 2005 because they found it was cheaper to administer over the long run. *Id.*

[306] NJ STATUS REPORT, *supra* note 299, at 6. Regarding Kentucky's problems, see CHRIS TOBE WITH KEN TOBE, KENTUCKY FRIED PENSIONS: EXPANDED WORSE THAN DETROIT EDITION 9 (2d ed. 2013) (noting: "[T]he two states most corrupt in their funding practices are also corrupt in their investment practices. In the cases of Illinois and Kentucky the plans seem to be linked in a strange quid pro quo in which the retirement systems look the other way at their underfunded plans, while the legislature and governors look the other way and turn a blind eye to the investment corruption. As put by Matt Taibbi in Rolling Stone 'With public budgets carefully scrutinized by everyone . . . the black box of pension funds makes it the only public treasure left that's easy to steal.'"); *see also* Timothy W. Martin, *Despite Cuts, More Pension Woes*, WALL ST. J. (Jan. 27, 2016), http://www.wsj.com/articles/kentuckys-governor-matt-bevin-prepares-another-pension-overhaul-1453842769 (describing the efforts of Kentucky's new governor to overhaul Kentucky's state pension system).

funds.[307] Moody's Investment Service, a bond-rating agency, found the short fall to be $135 billion, using a 5.67% discount rate.[308] For 2012, Moody's used a discount rate of 4.1% under the agency's new methodology, at which time the unfunded liability approached $200 billion.[309] To cover its annual pension obligations, Illinois has issued bonds, which now constitute 60% of Illinois' outstanding debt.[310] Illinois is using long-term borrowing to cover current obligations and squeezing other spending to accommodate its pension underfunding.[311]

In 2012, Illinois attempted to control retiree healthcare costs by eliminating the statutory standards for determining the state's contribution to health insurance premiums for certain retirees, and instead placed responsibility for allocating the health insurance premiums to the director of a public agency.[312] The beneficiaries challenged the legislation, alleging, among other things, the legislature's action violated the pension protection clause of the Illinois Constitution of 1970.[313] In July 2014, the Illinois Supreme Court ruled that the health insurance benefit was a "benefit of membership" under the plain and ordinary meaning of the constitutional provision, and was therefore within that provision's protections.[314] The case was remanded for the plaintiffs to proceed with their claims.[315]

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[307] Ted Dabrowski, *Illinois Pension Debt to Double as New Moody's Methodology Kicks In*, ILL. POL'Y INSTIT. BLOG (June 17, 2013), http://www.ilinoispolicy.org/illinois-pension -debt-to-double-as-new-moodys-methodology-kicks-in/.

[308] *Id.*

[309] *Id.* (finding the Illinois state pension system is squeezing out everything from prisons to education and state pensions are grossly underfunded with unfunded liabilities of $100 billion and assets of 39%). Illinois has all the problems common to other pension systems and is trying all the common solutions from raising taxes to extending age limit, and eliminating retiree health care. *Squeezed*, ECONOMIST (Jan. 26, 2013), http://www.economist.com/news/united-states/21570733-illinois-lawmakers-fail-tackle-states-pension-crisis-squeezed.

[310] Dabrowski, *supra* note 307.

[311] Arnett, *supra* note 289, at 21–22 (estimating that the unfunded liability approaches $200 million using Moody's Investors Service proposed state discount rate); *see also* Dabrowski, *supra* note 307; *Money to Burn,* ECONOMIST (May 4, 2013), http://www.economist.com/news/finance-and-economics/21577088-muddle-headed-world-american-public-pension-accounting-money-burn.

[312] *Retiree Health Insurance Ruling to Increase State Costs by $128 Million*, INST. ILL. FISCAL SUSTAINABILITY (July 17, 2014), https://www.civicfed.org/iifs/blog/retiree-health-insurance-ruling-increase-state-costs-128-million.

[313] Kanerva v. Weems, 13 N.E.3d 1228, 1239 (Ill. 2014); ILL. CONST. 1970, art. XIII, § 5 ("Membership in any pension or retirement system of the state . . . shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.").

[314] *Weems*, 13 N.E.3d at 1239. In its examination of the floor debate on the pension protection clause during the drafting of the state constitution in 1970, the opinion says:

> The intent of the pension protection clause was "to guarantee that retirement rights enjoyed by public employees would be afforded contractual status and insulated from diminishment or impairment by the General Assembly. In light of the constitutional debates, we have concluded that the provision was aimed at protecting the right to

In December 2013, while the healthcare litigation mentioned above was ongoing, the Illinois Legislature passed a pension reform law that decreased cost-of-living adjustments, capped pensionable salaries, and raised retirement ages while decreasing employee contributions by one percentage point.[316] The legislation was immediately challenged under the Illinois Constitution and the reforms were placed on hold pending the outcome of the litigation.[317] During the 2014 gubernatorial election, Governor Pat Quinn and the Republican gubernatorial candidate, Bruce Rauner, avoided definitive pension proposals while waiting for the outcome of litigation. Governor Rauner won the election and plans to propose replacing the defined benefit plan with a defined contribution plan that would reduce current costs, but would do nothing to address the burden of paying for the accrued unfunded liabilities of the old plan.[318]After the November election, the Sangamon County Circuit Court overturned the 2012 health care reforms and the case proceeded to the Illinois Supreme Court, which upheld the circuit court, finding a violation of the pension protection clause of the Illinois Constitution.[319] Governor Rauner's efforts to

> receive the promised retirement benefits, not the adequacy of the funding to pay for them."

Id. at 1242. Interestingly, the court noted language in the debates that recognized the importance of providing pension assurance to "those persons who have worked for often substandard wages over a long period of time could at least expect to live in some kind of dignity during their golden years." *Id.* The court cited two other cases reaching opposite conclusions based on similar constitutional language. Everson v. State of Hawaii, 122 Haw. 402, 228 P.3d 282 (Haw. 2010) (holding health care benefits covered by the provision); *In re* Lippman, 487 N.E.2d 897 (1985) (holding that health benefits were not covered and the provision only extended benefits directly related to the terms of the retirement annuity). The *Everson* court found the decision in *In re Lippman* unpersuasive, and the *Weems* court agreed. *Weems*, 13 N.E.3d at 1243; *see also* Paul Merrion, *Pension reform dealt blow by Illinois Supreme Court*, CRAINS (July 3, 2014), http://www.chicagobusiness.com/article/20140703/NEWS02/140709930/pension-reform-dealt-blow-by-illinois-supreme-court# (emphasizing Justice Burke's dissent stating that the court did not decide that the 2012 law was an unconstitutional diminishment or impairment of the constitutional rights).

315 *Weems*, 13 N.E.3d at 1230. Justice Burke dissented, pointing out that the clause in the constitution was titled "Pension and Retirement Rights," which implied that only pensions were covered and that there was no discussion at the time the provision was adopted about health care benefits. *Id.* at 1245,1247 (Burke, J., dissenting). The dissent also objected that the remanding of the case did not definitively answer the issued raised by the appeal. *Id.* at 1251-52.

316 Charles Chieppo, *The Real Culprits in Illinois' Pension Disaster*, GOVERNING STATES & LOCALITIES (Dec. 2, 2014), http://www.governing.com/blogs/bfc/col-real-culprits-illinois-pension-underfunding-voters.html. The changes were intended to save $145 billion and fully fund the state pension system by 2044. *Id.*

317 *Id.*

318 Steven Malanga, *A Pyrrhic Pension Victory: Illinois public workers may pay dearly for a court decision to overturn retirement reforms*, CITY J. (Dec. 2, 2014), http://www.city-journal.org/html/pyrrhic-pension-victory-11470.html.

319 *In re* Pension Reform Litig., 32 N.E.3d 1, 4 (Ill. 2015). The Illinois constitution provides:

balance the Illinois budget caused deadlock in the state capital.[320] Indeed, the failure to approve a budget has delayed state aid to colleges and universities for low-income students forcing them to fail to return to school.[321]

Not only is the State of Illinois having problems, but the city of Chicago is as well. Although not in bankruptcy, Chicago has a more serious pension problem than Detroit. Detroit's aggregate unfunded public-worker pension liabilities are estimated at $4,100 per resident, while Chicago's is at $18,200.[322] Chicago also faces the problem of decreasing population that has gone from 3.6 million in 1950 to 2.7 million today with 200,000 leaving in the first ten years of this century.[323]As reforms have taken shape, unions have threatened suit to stop the legislation from taking effect and suggest that Chicago instead borrow and raise taxes to fund the pensions.[324] Prior Chicago administrations used one-off sources of cash, such as selling the right to collect parking fees until 2084.[325] More recently, newly re-elected

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> Membership in any pension or retirement system of the State, any unit of local government or school district, or any agency or instrumentality thereof, shall be an enforceable contractual relationship, the benefits of which shall not be diminished or impaired.

ILL. CONST. 1970, art. XIII, §5. The court in *In re Pension Reform Litigation* found that the term "benefits" in the pension protection clause *does not* "only include the right to receive payments in the amount determined by the most recent calculation" and that a retiree "has a right in the existing formula by which his benefits are calculated as of the time he began employment and any beneficial modifications made during the course of his employment." *In re* Pension Reform Litig., 32 N.E.3d at 21-21 (citing Fields v. Elected Officials' Retirement Plan, 320 P.3d 1160, 1165-68 (Ariz. 2014).

[320] Aaron M. Renn, *It's Reform or Misrule In Basket Case That's Illinois*, INV. BUS. DAILY, Jan. 4, 2016, at A13 (describing the budget stalemate between Illinois' Republican Governor and Democratic Legislature). "Short-term solutions and tax increases will never solve Illinois's problems: unsustainable public pensions and health care benefits, coupled with a complete lack of fiscal responsibility. But Democrats and their union backers say they have ruled out the substantive changes necessary to shore up the state's financial future." Emily Zanotti, *The Man Stopping Illinois From Digging a Deeper Hole,* WALL ST. J. (Feb. 6, 2016), http://www.wsj.com/articles/the-man-stopping-illinois-from-digging-a-deeper-fiscal-hole-1454715881.

[321] Douglas Belkin, *Illinois Budget Deadlock hits College Enrollments*, WALL ST. J., Jan. 19, 2016, at A2.

[322] *Chicago: Rahmbo's toughest mission*, ECONOMIST, June 14, 2014, at 25 (referencing Civic Federation; Morningstar). Mayor Rahm Emanuel was encouraged by a pension reform bill that required a 29% increase in contributions from existing city-government employees for a "smaller" pension and raises an additional 50 million dollars in taxes. *Id.* Emanuel still has to address the issue with teachers and with police and firefighters. *Id.* The latter groups comprise approximately 39 million employees and retirees. *Id.*

[323] *Id.*

[324] *Id*.

[325] *Id.*; *see also* Charles Chieppo, *Can Chicago Ever Dig Itself out of Its Pension Hole?*, GOVERNING STATES & LOCALITIES (Nov. 4, 2014), www.governing.com/blogs/bfc/col-chicago-public-pensions-cut-benefits-increase-contributions.html (noting that Chicago's pension contribution in 2013 was $476 million and is scheduled to double by 2016 and escalate thereafter but even in 2016 the contribution would be barely half of the $2.2 billion

Mayor Rahm Emmanuel suggested allowing gambling casinos in the city with revenue dedicated to paying the City's pension obligation as a way to address the pension problem.[326]

3. California

California, unlike New Jersey or Illinois, has seen its fiscal condition improving slightly as a balanced budget was proposed for the 2013-2014 fiscal year with a $1.2 billion surplus after years of billion-dollar deficits and sever political gridlock.[327] California has been the victim of many unrealistic expectations about the sustainability of pension benefits, such as assuming liability greater than funding available, and the lack of adequate contingency planning.[328] Estimating the size of California's unfunded pension obligations is often in the eye of the beholder, but one bipartisan study estimated the unfunded liabilities of the ten largest public pension plans, encompassing over 90% of the assets and participants in public pension plans, at $240 billion.[329] The two largest public pension funds in the United States are in California: the California Public Employees Retirement System (CalPERS), which is estimated to be 61% funded, and California State Teachers Retirement System (CalSTRS), which is estimated to be 58% funded.[330]

In 1998, CalSTRS was fully funded for the first time primarily due to a thriving stock market, increased state contributions, and a robust economy from the dot-com

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payment the city should make under the Governing Accounting Standards Board requirements). Chicago is likely a Detroit in the making.

[326] Allysia Finley, *Rahm Emmanuel Rolls the Dice to Pay Chicago's Pension Bills*, WALL ST. J., June 6, 2015, at A9. The Chicago schools started 2016 with a $480 million shortfall driven by pension payments and a decline in state funding. Illinois Governor Rauner is calling for a state takeover of the Chicago and legislation that would allow the school district to file for bankruptcy. Mark Peters & Kris Maher, *Schools in Detroit, Chicago Seek State Help*, WALL ST. J., Jan. 21, 2016, at A3.

[327] Arnett, *supra* note 289, at 24-25; *see also* Beermann, *supra* note 288, at 3 (discussing the pension crisis in California).

[328] David Crane, *Dow 28,000,000: The Unbelievable Expectations of California's Pension System*, WALL ST. J. (May 19, 2010, 12:01 AM), http://online.wsj.com/news/articles/SB10001424052748703315404575250822189252384 (written by an advisor to former Governor Schwarzenegger).

[329] LITTLE HOOVER COMM'N, PUBLIC PENSIONS FOR RETIREMENT SECURITY ii, 3, 4, 21 (2011). California's state retirement system has eighty-five separately managed "defined-benefit" plans and forty-six "defined contribution" plans covering a total membership of 4.4 million workers and retirees in California. *Id.* at 3. By 2015 California's largest cities could be devoting one-third of their budgets to pension costs. *Id.* at 21. Beermann cites studies showing the estimated unfunded liability of public pensions as high as $4.6 trillion while another study estimates it as low as $647 billion. *See* Beermann, *supra* note 288, at 11-12 and studies cited therein.

[330] LITTLE HOOVER COMM'N, *supra* note 329, at 4. CalPERS covers over one-half of all California government workers and CalSTRS provides uniform benefits for all K-12 teachers and administrators and community college faculty, was started in 1913, and is under strict state control. *Id.* at 4-5.

boom.[331] Seeking a political advantage from the positive developments, the Legislature and Governor enhanced teachers' pension benefits believing that stock market gains would absorb the increased cost.[332] The retirement of teachers who worked twenty-five years was calculated based on their highest single year of salary rather than a three year average of the top three.[333] Longevity bonuses and supplemental retirement accounts were also created, and, at the same time, state contributions were reduced while teachers and school system payments went unchanged.[334] In 2001, the dot-com bubble burst, which led to a $20 billion shortfall and the Legislature, relying on a 40% chance of covering it with market gains, did nothing.[335] Then, with the 2008 recession, the funding levels plummeted to a level many considered unhealthy.[336]

CalSTRS is on the road to insolvency[337] and the government can no longer rely on stock market returns to close the deficit.[338] Tax hikes or cuts in government services will have to be used to compensate. In the fiscal year ending in June 2014, payments into CalSTRS by school employees, school districts, and the state were $6 billion, creating the need for additional $4.5 billion if investment returns do not meet expectations.[339] While California expects to have a budget surplus this fiscal year, lawmakers also have other expenditures to consider.[340]

CalPERS, the nation's largest public employee pension fund, administers health and retirement benefits for more than 3,000 city, state, and local agencies with over 1.6 million retirement system members and 1.4 million health plan members.[341] Like CalSTRS teachers, CalPERS members received generous plan increases in 1999 that could allow workers as young as fifty-years-old to retire with lifetime pensions up to

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331 Chris Megerian, *No Easy Fix for California's Teacher Pension* Crisis, L.A. TIMES (Feb. 20, 2014, 4:45 PM), http://www.latimes.com/local/la-me-teacher-pensions-20140221-story.html#page=1.

332 *Id.*

333 *Id.* (referring to a sixty-two-year-old teacher who retired in 2013 with twenty-five years of service receiving a monthly pension of $3,980).

334 *Id.* State contributions into the pension fund were reduced from 2.6% to 2% of the statewide teacher payroll. *Id.* Teachers continued to pay in 8% of their salaries, as they have since 1972. *Id.* Schools have contributed 8.25% of their payrolls since 1990. *Id.*

335 *Id.*

336 *Id.*

337 *Id.*

338 David Crane, *Teachers' pension crisis: How it happened*, SAN DIEGO UNION-TRIB. (Mar. 8, 2014), http://www.utsandiego.com/news/2014/mar/08/david-crane-calstrs-funding-nightmare/.

339 Megerian, *supra* note 331.

340 Crane, *supra* note 338. With the recent stock market surge, pension plans are finding some relief while unions are thinking about how to raise pensions with the increased returns. Steven Greenhut, *Pension funds cheer good news. So why do they need us?,* PUB. SECTOR INC. (Aug. 4, 2014).

341 *Facts at a Glance,* CALPERS, www.CalPers.ca.gov/eip-docs/about/facts/facts-at0a-glance.pdf (last visited Dec. 6, 2014).

90% of final year salaries.[342] This bill was the largest issuance of non-voter-approved debt in California's history, and CalPERS assured (some say misled) the Legislature that investment returns would cover the cost of the pension enhancements.[343]

In 2012, California Governor Jerry Brown signed into law the California Public Employees' Pension Reform Act of 2013.[344] The law was essentially aimed at reducing pension payments for newly hired workers, but was somewhat undermined when CalPERS's board approved nearly one hundred different types of extra pay that count towards pensions (referred to as "pension-spiking") for workers hired since 2013.[345] A 2014 bill aimed to fund CalSTRS over a thirty-two year period by increasing school district contributions.[346]

Reforms in California are hindered by politics and judicial decision. In 2014, San Jose Mayor Chuck Reed proposed amending the California Constitution to permit government employers to change pension and healthcare benefits earned by public employees going forward and, when pension and healthcare retirement benefits are underfunded and are impeding the government from providing essential services, to reduce pension payments, increase employee contributions, decrease cost of living

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342 Crane, *supra* note 338. SB 400 signed into law in 1999 by then Governor Gray Davis increased pension benefits retroactively and prospectively for all public sector employees. *Id.*

343 *Id.* Allegedly, CalPERS "failed to disclose . . . that (1) the state budget was on the hook for shortfalls . . . , (2) those assumed investment returns implicitly projected the Dow Jones would reach roughly 25,000 by 2009 and 28,000,000 by 2099 . . . , (3) shortfalls could turn out to be hundreds of billions of dollars, (4) CalPERS's own employees would benefit from the pension increases and (5) members of Calpers's board had received contributions from the public employee unions who would benefit from the legislation." *Id.*

344 Assemb. B. 340, 2012 Assemb., (Cal. 2013) (making several changes to pension benefits that may be offered to new employees, hired on or after January 1, 2013, affecting contribution rates and funding in California public retirement systems, and these changes include, among others, a new maximum, a lower-cost pension formula that increased the age and service requirements for retirement and a cap on pensionable compensation, as well as increasing the period used to calculate final average compensation to three years). The bill also included pension-spiking reform for new and existing employees. *See generally* CALPERS, SUMMARY OF PUBLIC EMPLOYEES' PENSION REFORM ACT OF 2013 AND RELATED CHANGES TO THE PUBLIC EMPLOYEES' RETIREMENT LAW (2012), https://www.calpers.ca.gov/docs/forms-publications/summary-pension-act.pdf.

345 Tim Reid, *California Governor decries Calpers vote on pensions*, REUTERS (Aug. 20, 2014), http://www.reuters.com/article/2014/08/20/us-usa-pensions-calpers-idUSKBN0GK23220140820. California Governor Jerry Brown opposed this vote since the action would increase the costs of state pensions which are calculated on the total amount of pensioners' monthly income. *Id.; see also* Steven Greenhut, *California Embraces Pension-Spiking Bonanza*, HUM. EVENTS (Aug. 27, 2014), http://humanevents.come/2014/08/27/californai-embraces-pensin-spiking-bonanza/ (providing pension-spiking techniques such as including extra pay for clerical workers for typing and taking dictation, extra pay for police officers taking physical fitness programs, maintaining licenses required for the job and other similar items to employees hired after January 1, 2013 thereby undermining the recent legislation).

346 Victor Nava, *California's Pension Reforms Don't Go Far Enough*, ORANGE CNTY. REG., (July 29, 2014) (lamenting that the reform did not address the overly optimistic assumed rate of return on investments).

adjustments, or increase retirement age.[347] The initiative was scheduled for the November 4, 2014 ballot but was withdrawn by its sponsor after the Attorney General of California, Kamala Harris, released the ballot language and summary of the bill. Reed thought that the language misrepresented the bill by focusing on the pension takeaways rather than the positive side of the initiative.[348] Litigation is ongoing and the initiative may be reset for the 2016 election.[349]

The 2014 pension reform initiative was aimed at the so-called "California Rule," a judicially created rule significantly restricting California's ability to initiate decreases in public sector pensions.[350] In a series of cases beginning in 1917, California courts began a process to secure state pensions, even those not yet earned, by linking pensions to unbreakable contracts.[351] By 1955, in the *Allen v. City of Long Beach* decision, the final link in the "California Rule" fell into place when the court held that "changes in a pension plan which result in a disadvantage to employees should be accompanied by comparable new advantages."[352] One commentator, who concluded that the California Rule is inconsistent with both contract law and economic theory,[353] describes the most significant criticism:

> California courts have put in place a highly restrictive legal rule that binds the legislature without the court ever finding clear and unambiguous evidence of legislative intent to create a contract. This break with traditional contract clause analysis is potentially the most troubling in that

[347] *California Pension Reform Initiative*, BALLOTPEDIA (2014) http://ballotpedia.org/California-Pension-Reform-Initiative-%282014%29#text-of-measure (last visited Apr. 26, 2016).

[348] *Id.*

[349] *Id.*; *see also* Tim Reid, *Democrats Feud Over California Pension Reform Measure*, REUTERS (Feb. 4, 2014), http://www.reuters.com/article/2014/02/04/us-usa-california-pensions-idUSBREA131EH20140204; Editorial, *CalPERS About to Undo Pension Reform*, L.A. DAILY NEWS (Aug. 14, 2014), http://www.dailynews.com/opinion/20140814/calpers-about-to-undo-pension-reform-editorial.

[350] LEGISLATIVE ANALYST'S OFFICE, PUBLIC PENSION AND RETIREE HEALTH BENEFITS: AN INITIAL RESPONSE TO THE GOVERNOR'S PROPOSAL 18 (2011).

[351] O'Dea v. Cook, 169 P. 366 (Cal. 1917); *see also* Amy B. Monahan, *Statutes as Contracts? The "California Rule" and Its Impact on Public Pension Reform*, 97 IOWA L. REV. 1029, 1052 (2011) (describing *O'Dea v. Cook* as the first step of departure from the traditional position that pensions were gratuities that the legislature could amend as it saw fit). Through the court's dicta that pensions, "as a form of compensation" became "in a sense a part of the general contract of employment," *O'Dea* was the first court "to suggest that pension statutes might create contracts; however, the court developed this idea without authority for the position and without an examination of legislative intent." *Id.* at 1053, 1076. Later courts would build on that dictum.

[352] Allen v. City of Long Beach, 287 P.2d 765, 767 (Cal. 1955). *Allen* has been described as a "bombshell" in that it ignored any inquiry into legislative intent to create a contract it impliedly held that reasonable modifications could be made to pensions so long as any detrimental change was offset by a comparative new advantage. Monahan, *supra* note 351, at 1060.

[353] Monahan, *supra* note 351, at 1029, 1044, 1075-82.

> it infringes on the power of the legislative branch without apparent authority.[354]

A "flawed legal theory" creates a "flawed economic theory." Locking one part of a compensation package (i.e. pension accruals) in place[355] while other areas of compensation can be bargained for or eliminated creates a distorted economic plan.[356] The California Rule has also been criticized because the court found a contractual relationship contrary to the well-established "presumption that statutes do not create contractual rights absent clear and unambiguous evidence that the legislature intended to bind itself."[357]

States protect pension plan participants from significant modifications to their plans under both constitutional and contract law theories.[358] While there are distinct protections under state provisions as compared to federal law, "the considerations state judges use to decide whether to protect pensions under state law are very similar to the considerations they use to determine whether a reform violates the U.S. Constitution's Contract Clause."[359] Present and future pension promises are contractually protected under the California Rule from the first day of hire.[360] Illinois and Michigan, along with five other states, have state constitutional protection

[354] *Id.* at 1070.

[355] *Id.* at 1079. There is some authority in California that prior to retirement an employee does not have an absolute right to a particular pension but only to a substantial or reasonable pension. Beermann questions how far this "flexibility" would go. Beermann, *supra* note 288, at 41, and cases cited therein.

[356] Monahan states, "Yet California courts have held that even though the state can terminate a worker, lower her salary, or reduce her other benefits, the state cannot decrease the worker's rate of pension accrual as long as she is employed." Monahan, *supra* note 351, at 1033.

[357] *Id.* at 1032 n.5 (citing Nat'l R.R. Passenger v. Atchison, Topeka & Santa Fe Ry. Co., 470 U.S. 451, 465-66 (1985)). Beermann does not accept this criticism because he believes that pensions are different than other contracts since persons who accept employment with the government usually have options, which they give up to accept the employment thinking the pension is a firm commitment. Beermann, *supra* note 288, at 58-59. Another commentator, while finding nothing invalid about the California Rule, states: "But the rule is unsound as a policy matter, insofar as it locks governments and public employees into compensation structures different than what they would otherwise negotiate, and makes it harder for states to reform their pension systems." ALEXANDER VOLOKH, OVERPROTECTING PUBLIC EMPLOYEES PENSIONS: THE CONTRACT CLAUSE AND THE CALIFORNIA RULE 4 (2013), http://reason.org/files/overprotecting_pensions_california_rule.pdf. Volokh would agree with Monahan that there was no explicit promise that the state would not change the pension. He notes cases that have struck down changes to a COLA. *Id.* at 5.

[358] Beermann, *supra* note 288, at 36 n.118 (citing Amy Monahan, *Public Pension Plan Reform: The Legal Framework*, 5 EDUC. FIN. & POL'Y 617 (2010)).

[359] "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10, cl. 1; *see also* Beermann, *supra* note 288, at 36 n.116.

[360] Beermann, *supra* note 288, at 37 n.119 (citing Monahan, *supra* note 351, at 1032). Monahan references twelve other states which have followed the California Rule, as announced including Alaska, Colorado, Idaho, Kansas, Massachusetts, Nebraska, Nevada, Oklahoma, Oregon, Pennsylvania, Vermont, and Washington. *Id.* at 1071.

although Illinois protects present and future benefits while Michigan protects only accrued benefits.[361] Some state courts find protection under the Contracts Clause of the United States Constitution once a contractual relationship is found under state law.[362] Federal bankruptcy, while available to municipalities, is not available to states.[363]

4. Future of State Pensions

Illinois, New Jersey, and California allow public employees in their fifties to retire with 90% of final pay, which is often increased by excessive pension spiking; this is unsustainable.[364] The major problem with public retirement plans is the lack of transparency and enforcement.[365] The Governmental Accounting Standards Board has set standards, but there is no enforcement mechanism when the states do not comply. One federal proposal was to eliminate the tax exemptions on bonds issued by non-compliant states. However:

> The record of private plans suggests that consistent and uniform disclosure encourages more rigorous oversight by stakeholders. It is time the federal government intervened to make sure the residents of state and local jurisdictions are fully aware of the pension obligations their local governments are creating for them. Beyond that, the states and local governments are going to have to adjust their commitments to levels that their taxpaying citizens can afford and will support.[366]

States are being forced to allocate large portions of their limited revenues to satisfy high pension costs at the expense of education and other essential state

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[361] Liz Farmer, *How Are Pensions Protected State-by-State*, GOVERNING (Jan. 28, 2014), http://www.governing.com/finance101/gov-pension-protections-state-by-state.html; *see also* Beermann, *supra* note 288, at 37-38.

[362] A question might arise as to when the contract is effective. Some courts look to a "vesting" requirement while more generous courts might find a contract upon the employee "accepting" employment thereby limiting the State's ability to amend the contract without consideration or employee consent. Other states view the employee as having a reliance interest after working for an extended period of time, which may limit the benefit to those in effect during his employment. Beermann, *supra* note 288, at 38-41, and cases cited therein.

[363] Under federal bankruptcy law, current and retired municipal workers' pensions can be reduced or eliminated if the balance of equities favors revision or rejection. This is seen in *In re City of Stockton*, 478 B.R. 8, 14 (E.D. Cal. 2012), where the bankruptcy court denied the retirees' request for an injunction to restore their benefits to pre-bankruptcy levels, mainly on the ground that the court had neither the power nor the jurisdiction to grant such an injunction. The bankruptcy court in the *Stockton* also observed that the Contract Clause is no impediment to adjustment of municipal contracts pursuant to bankruptcy because the Contract Clause does not apply to federal law. Beermann, *supra* note 288, at 69-72 n.265. CalPERS opposed the decision, believing it was their fiduciary duty to do so. *CalpERS Performs Its Fiduciary Duty*, WALL ST. J. (Feb. 24, 2015), http://www.wsj.com/articles/calpers-performs-its-fiduciary-duty-letters-to-the-editor-1424717233.

[364] SCHIEBER, *supra* note 9, at 354.

[365] *Id.*

[366] *Id.* at 355.

funded programs. California once had "one of the most comprehensive and inexpensive higher education systems in the nation," but is "now finding it impossible . . . to continue to offer sufficient community college slots for students."[367] According to Beermann, the pension crisis differs from other deficit spending because there is a human element involved; people depend on the mostly modest benefits in their retirement and have made career and personal decisions based on these promises. The apparent fairness of proposed reductions should thus be dependent on a multitude of considerations, including:

> [T]he magnitude of the contributions made by retirees and employees to the retirement system; the degree to which pensions were spiked in ways not related to the true earnings of the employees; the degree to which employees accepted lower current wages in exchange for generous retirement benefits; and the other ways in which employees structured their finances and their personal and professional lives around their pension expectations.[368]

Reform centered on closing loopholes, such as elements that allow for inflated pension benefit calculations (overtime, artificial promotions, etc.) are more likely to be accepted.[369]

Government pensioners are only beginning to sense that their pensions may not be as secure as once thought. Prior to the 2012 presidential elections, candidate Mitt Romney was unexpectedly recorded saying he would not get the votes of 47% of the citizens who do not pay taxes.[370] However, it was pointed out that this so-called "tax-gap" is not the deepest divide in the electorate. Indeed, the deepest divide is the divide between those who have defined benefit pensions with a fixed annuity at retirement and those who do not. In the early 1980s, 62% of American workers were covered by some kind of defined benefit plan.[371] Around that time, IRAs and 401(k) plans were introduced with interest rates in the double digits and the great stock market rally was beginning.[372] Today, interest rates are close to zero and although the stock market is at new highs (17,000), that high is a mere recovery from setbacks in 2000 (11,700) and 2006 (14,100) caused by incredibly low interest rates and Federal Reserve Bank quantitative easing, both of which are likely to end.[373] In any

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367 Beermann, *supra* note 288, at 84.

368 *Id.* at 86.

369 *Id.* at 84-66.

370 Jim Rutenberg & Ashley Parker, *Romney Says Remarks on Voters Help Clarify Position*, N.Y. TIMES (Sept. 18, 2012), http://www.nytimes.com/2012/09/19/us/politics/in-leaked-video-romney-says-middle-east-peace-process-likely-to-remain-unsolved-problem.html?_r=0.

371 ALICIA H. MUNNELL, CTR. FOR RET. RESEARCH AT BOS. COLL., 2010 SCF SUGGESTS EVEN GREATER RETIREMENT RISKS 3 (2012).

372 SCHIEBER, *supra* note 9, at 358.

373 The Federal Reserve's third round of quantitative easing ended in late 2014 and the first rate hike in nearly a decade occurred in late 2015. Patrick Gillespie, *Finally! Fed raises interest rates*, CNN (Dec. 6, 2015, 3:23 PM), http://money.cnn.com/2015/12/16/news/economy/federal-reserve-interest-rate-hike/. In making the minimal 0.25% increase in the federal funds rate, the Federal Reserve suggested there would likely be four additional quarter

event, the pension divide will likely close as those expecting lifetime annuities from public pensions are eventually forced to face the reality of underfunding. The market recoveries after 2000 and 2008 have not improved funding levels of public pension plans. Many plans were almost fully funded by 1999, but the funding gap grew to $670 billion by 2013 and $1.0 trillion by the end of 2015.[374] Investment return is not likely to close the gap.[375] The conclusion of a 2012 article remains true today: "The reality is that a big public-pension crash, which will eventually occur no matter who wins the [2012 or, now, the 2016] election, will make clear that the government employees won't get what is promised. It will reveal the truth: We are all in the same boat fiscally and even financially."[376]

5. Impact of the Employer Retirement Income Security Act ("ERISA")

Public pension plans are exempt from most ERISA rules, although they are subject to some IRS requirements.[377] In a comparison of wages plus benefits, multiple researchers concluded that, although wages were comparable between public sector workers and private sector workers after controlling for differences in the nature of their work, when benefits were factored in on the basis of equitable valuations that public sector workers compensation was almost one-third higher.[378] Stories abound about public servants padding their final year of service to qualify for

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point increases in 2016, but weaker economic data and financial-market volatility in January 2016 following their rate increase caught the Federal Reserve off-guard and caused them to signal they would likely delay any further increases. Jed Graham, *Fed Signals Policy Pause After Dec. Hike Fallout*, INV. BUS. DAILY, Jan. 28, 2016, at A1. Further, the Federal Reserve action in December 2015 has been confirmed as a bad idea as evidenced by the collapsing oil and commodity prices, a cratering Chinese economy, and slowdowns in Japan, Brazil, Russia, and other European countries as well as the United States. *Take Fed Hikes Off the Table*, INV. BUS. DAILY, Feb. 1, 2016, at A16. After pumping $2.5 trillion into the financial system, the Federal Reserve is facing new challenges in trying to pull the cash out and returning to a more normal interest rate. Katy Burne, *Fed Risks New Distortions When It Raises Interest Rates*, WALL ST. J., Dec. 16, 2015, at A7; Greg Ip, *Fed's Message Is Key To Soothing Markets*, WALL ST. J., Jan. 26, 2016, at C1 (characterizing the Federal Reserve's inability to control the long term economic conditions as the "leader of a mob it inspires but doesn't control."). "This creates a dilemma: Even when the Fed sets interest rates correctly for the needs of the economy, markets routinely overreact, frustrating its plans." *Id.*

374 Steven Malanga, *Bear Mauls Gov't Pensions Even A bull Couldn't Heal*, INV. BUS. DAILY, Jan. 22, 2016, at A13.

375 *Id.* (noting that the biggest obstacle to real reform is the notion that a few good years of investment return coupled with some additional contributions will solve most pension underfunding).

376 Amity Shlaes, *War on Pensions Will Make Election Battle Look Tame*, INV. BUS. DAILY, Sept. 28, 2012, at A15; *see also* Gerald Skoning, *Welcome to Illinois, the Deadbeat State*, WALL ST. J., Dec. 10, 2014, at A19 (decrying the debt of state and local governments as well as the United States government and hoping newly elected republicans can help rectify the situation).

377 SCHIEBER, *supra* note 9, at 216.

378 *Id.* 220 n.14 (citing Andrew G. Biggs, *Are Government Workers Underpaid? No.*, AMERICAN (June 9, 2010), http://www.american.com/archive/2010/june-2010/are-government-workers-underpaid-no).

much higher pensions, and many policy makers in government condone such behavior.[379]

Using the modern finance theorem the value of an enterprise or activity is independent of how it is financed.[380] Applying that theorem to the valuation of state pension liabilities would reject the standard 8% valuation discount typically used to value pensions assets in favor of a more realistic rate of 4% reflecting a relatively risk free investment such as government bonds.[381] With current government bonds paying practically nothing, it is difficult to conclude that such a rate is risk free while the government makes every effort to have a 2% inflation rate. One study calculated a $1 trillion deficit using traditional methods, but a $3.2 trillion deficit using a treasury rate and $1.3 trillion deficit using municipal bond rates.[382]

Illinois and New Jersey experimented with issuing bonds to the public with the expectation that the money could be invested at a greater than the interest rates they would have to pay on the bonds they issued.[383] New Jersey issued $2.7 billion in pension obligation bonds in 1997 which had to be paid from general revenues when the market crashed in 2000 and 2002 while Illinois issued $10 billion in general obligation pension bonds in 2003 with a thirty-year maturity, expecting to invest the money at the same rate their actuaries were using to discount the state's pension obligations (8.5%).[384] When the expected 8.5% return was not realized the bonds had to be paid along with the state's unfunded obligations.[385]

The levels of protection given to public pensions vary with some protections based on contract or property rights, while other pensions, like those in New York and Illinois, are irrevocably fixed as of the date the employee enters the pension plan.[386]

The federal government has three primary pension plans in effect: the Civil Service Retirement System (CSRS); the Federal Employee Retirement System (FERS); and the Military Retirement System (MRS). The CSRS was merged into the FERS for new employees in 1984, but the benefits under the old plan continue to

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379 *Id.* at 223. One report noted that nineteen Miami firefighters had salaries and benefits of $300,000 and another 161 made $200,000.

380 *Id.*

381 *Id.*

382 *Id.* at 324. One study in 2010, assuming that plans would realize annual returns of 8% and that contributions would cover normal costs, predicted that Illinois' public plans would deplete their assets in 2018; Connecticut, Indiana, and New Jersey will follow suit by 2019; and Hawaii, Louisiana, and Oklahoma in 2020. *Id.* (citing Joshua D. Rauh, Are State Public Pensions Sustainable? 26-27 (May 15, 2010) (unpublished), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1596679). Of all states, only Alaska, Florida, Nevada, New York, and North Carolina would still have funds beyond 2047. *Id.* Indiana and New Jersey adopted legislation in 2011 to slow the growth of pension obligations. *Id.* at 224-25 (internal citation omitted).

383 SCHIEBER, *supra* note 9, at 227.

384 *Id.* at 228.

385 *Id.* at 225-27.

386 *Id.* at 229; *see also id.* at 231-32 (describing the actions of New Jersey Governor Chris Christie and the ensuing law suit challenging pension adjustments).

accrue and there seems to be little cost savings from the change.[387] As of October 2008, the unfunded liability for the three systems was approximately $1.578 trillion.[388]

C. Demographic Problems Worldwide Strain Pension Funding

Richard A. Marin did an interesting analysis of the status of pension funding around the world in his recent book on the pension crisis.[389] Marin begins his analysis by estimating the extent of worldwide wealth and retirement assets. He estimates worldwide GDP at approximately $70 trillion and worldwide wealth at $132 trillion.[390] Taking the analysis a step further he estimates that, of the worldwide wealth, approximately $50.4 trillion is allocated to retirement assets.[391] Worldwide the assets allocated to retirement are 72% of global GDP.[392] In gross, these numbers may sound like a solid base to build worldwide retirement; however, Marin takes the analysis one step further to demonstrate how various countries compare to each other.

First, he looks at fourteen countries that account for $40 trillion of retirement assets that equate to 58% of the GDP of those countries.[393] The spread of pension assets to GDP among the countries is disturbing with the United Kingdom at 112%; the United States at 108%; Australia at 101%; Canada at 84%; Japan at 62%; Germany at 15%; and France at 7%.[394] The adequacy of any level of retirement assets as a percentage of GDP will depend on the years of retirement and the discount rate used to value the cost of retirement. The length of retirement is a function of the average age of retirement and longevity of the taxpayers in a particular country. Looking to four of the countries noted above the average period of retirement are: the United States at thirteen years; Japan at sixteen years; Germany at nineteen years; and France at twenty-two years.[395] These are the time periods that must be funded with retirement assets.

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387 *Id.* at 233-34.

388 *Id.* at 232-36.

389 MARIN, *supra* note 2. Marin is the Clinical Professor of Asset Management at The Johnson Graduate School of Management at Cornell University. He has extensive finance and management experience with several Wall Street firms, with hedge funds, and with several firms that he founded. *Id.* at xv.

390 *Id.* at 21. Global wealth includes private wealth, pension funds, mutual fund, insurance companies, and sovereign wealth funds. *Id.*

391 *Id.* at 22-23.

392 *Id.* at 23.

393 *Id.* at 24.

394 *Id.* at 24 ex.2.1. The other countries are Ireland at 55%; Switzerland at 118%; Netherlands at 156%; Brazil at 14%; China at 18%; Chile at 61%; and South Africa at 64%. *Id.*

395 *Id.* at 27 ex.2.2 (noting the average age of retirement, life expectancy, and retirement period are: for the United States 65, 78, 13; for Japan 68, 84, 16; for Germany 61, 80, 19; and for France 59, 81, 22 respectively). The table lists the information on all fourteen countries in the study. *Id.* at 27 ex.2.2. The United States has a shorter retirement period than the non-United States Anglo countries and Japan on the list primarily due to its shorter life

Funding long-term commitments is tied to the growth of GDP, which is positively impacted by the growth of population.[396] Historically, GDP in the West has been growing at a rate of 3% long-term, but that appears to be slowing while that of emerging markets is increasing.[397] The GDP multipliers comparing the growth from 2010 to 2050 for the United States, France, Germany, and Japan are 1.4, 1.7, 2.1, and 1.6, respectively, while those for Brazil, China, and Chile are 2.9, 6.9, and 4.9, respectively.[398] France, Germany, and Japan will see their working age population decline by 2050 while that of the United States will grow slightly due primarily to immigration.[399] With a few exceptions, countries in Central and South America, the Middle East, and Africa will experience dramatic population growth and the accompanying GDP growth over the period 2010-2050.[400] The dependency ratio, defined as the percent of the population in retirement, will increase by 2050 in the United States to 35%; to 45% in France; to 58% in Germany; and to 75% in Japan.[401] In Japan, one worker will support three retirees.[402]

Using the foregoing factors, Marin estimates a worldwide pension-funding gap of 141% of worldwide GDP through 2050, representing $98 trillion.[403] For individual countries, he estimates a pension-funding gap for the United States of $7.3 trillion, for France of $7.8 trillion, for Germany of $11.4 trillion, and for Japan of $17.2

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expectancy. The shorter life expectancy may be due to a larger immigrant population in the United States, which have not benefited from the better health care. *Id.* at 28.

396 *Id.* at 28-29 (pointing to the fifty-year decline in population in Japan, which appears directly correlated to the decline in GDP).

397 Max Roser, *GDP Growth Over the Last Centuries*, OUR WORLD DATA, http://ourworldindata.org/data/growth-and-distribution-of-prosperity/gdp-growth-over-the-last-centuries/#world-maps-of-real-annual-gdp-growth-max-roserref (last visited Apr. 2, 2016).

398 MARIN, *supra* note 2, at 31 fig.2.6. Partly as a result of China's one child policy, its aging population will likely limit China's ability to grow its economy. *See* Ciaran McEnvoy, *China Will Ease 'Hukou,,' 1-Child Policy Restrictions*, INV. BUS. DAILY, Nov. 18, 2013, at A1.

399 The world population in 2010 included a "dependency ratio" of sixteen people aged sixty-five and over for every one hundred adults aged twenty-five to sixty-four–about the same as in 1980. *Age Invaders*, ECONOMIST (Apr. 26, 2014), http://www.economist.com/news/briefing/21601248-generation-old-people-about-change-global-economy-they-will-not-all-do-so ("A generation of old people is about to change global economy. They will not all do so in the same way."). By 2035, the number will have risen to twenty-six overall but vary between countries. *Id.* Germany will go from thirty-eight to sixty-six people aged sixty-five and over for every 100 people between ages twenty-five to sixty-four; Japan will go from forty-three to sixty-nine; and the United States will rise from about twenty-four to forty-four. *Id.*; *see also* U.S. CENSUS BUREAU, AGE AND SEX COMPOSITION 2010, C201OBR-03, at 2 (2011) (providing United States dependency ratio for 2010).

400 MARIN, *supra* note 2, at 33-38, fig.2.7.

401 *Id.* at 37 Ex.2.8.

402 *Id.*

403 *Id.* at 39.

trillion.[404] Marin also shows that the twenty-year gap in the United States could be closed by increasing taxes to collect an additional 3% of GDP while closing the gaps in France, Germany, and Japan would require an additional tax of 19%, 23%, and 23% respectively.[405]

The problem of aging is worldwide. The global population of persons aged sixty-five or more is estimated to grow from 600 million to 1.1 billion over the next twenty years.[406] The impact of aging is likely to divide the population in unexpected ways. In America, 65% of men age sixty-two to seventy-four with a professional degree are in the workforce compared to 32% of those with only a high-school certificate.[407] In the twentieth century, greater longevity meant more years in retirement rather than more years at work. This shift has led many observers to expect slower economic growth and a "secular stagnation" in which swelling ranks of pensioners will bust government budgets.[408] Policy changes may be part of the problem since older policies that pushed people into retirement have been abandoned.[409] Also at the same time, life expectancy is increasing, and defined benefit pension plans are being replaced with less generous defined contribution plans forcing seniors desiring a comfortable retirement to work longer.[410]

A population that is aging, but not growing, suggests three possible outcomes. First, it will result in lower GDP unless incentives are created to keep older workers in the workforce or productivity increases to offset the loss of GDP.[411] There has been a trend for older and more educated workers to stay in the workforce longer than in the past. Second, the aging population may create incentives to innovation that will reduce the cost of aging.[412] Third, if highly skilled and educated seniors remain in the workforce longer than in the past, the higher income will result in greater savings and Social Security contributions by this group of workers.[413] Considering these possible outcomes, policy responses could include the following:

> Age should no longer determine the appropriate end of a working life, mandatory retirement ages and pension rules that discourage people from working longer should go. Welfare should reflect the greater opportunities to the higher skilled pensions should become more progressive (i.e., less

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[404] *Id.* at 40 Ex.2.12. The estimates of the long-term pension need is based on taking 60% of the final earnings level in the individual country reflecting general global retirement expectations. *Id.* at 38, 175.

[405] *Id.* at 41 Ex. 2.13.

[406] *Global Ageing: A billion shades of grey*, ECONOMIST, Apr. 26, 2014, at 13.

[407] *Id.* It is important to note that the divide being discussed is not between the young workers and the old idle pensioners, but between the well-educated Baby Boomers putting off retirement while many less-skilled younger people have dropped out of the work force. *Id.*

[408] *Id.*

[409] *Id.*

[410] *See id.*

[411] *Age Invaders*, *supra* note 399, at 24.

[412] *Id.* at 24.

[413] *Id.* at 25.

> generous to the rich). At the same time, this trend underlines the importance of increasing public investment in education at all states of life so that more people acquire the skills they need to thrive in the modern labour market.[414]

Adverse demographic changes would create problems for any long-term solution to Social Security financing.[415] Recall Aaron's social insurance paradox that the Social Security benefits of all participants will increase if the combined rate of growth for population and productivity equals or exceeds the current rate of interest. A caveat of Aaron's analysis is that the paradox may not hold if the provision of social insurance causes a reduction in the rate of private savings.[416] Aging skilled professionals staying in the workforce may to some extent offset this last caveat.

In the United States, workers can retire at age sixty-two with a reduced amount of Social Security benefits, which will be further reduced if the person continues to work prior to reaching full retirement, currently sixty-six.[417] The system then encourages people to continue working by increasing the full retirement amount by 8% per year until age seventy when the person is required to start Social Security.[418] One disincentive to continue work after age seventy is that the person will continue paying Social Security taxes but their benefit will be modestly increased if the person's AIME increases.

In the United States, the demographic divide is dramatic. While the younger generation is becoming a non-Caucasian majority, a record share of the population is going gray. Primarily due to Social Security and Medicare programs, older adults are no longer the poorest age cohort of society, having been replaced by young adults and their children.[419] The economic well-being of today's youth is impacted by "a witches' brew of deep recessions, sluggish recoveries, rising inequality, a shrinking middle class, automation, globalization and soaring student debt."[420] The federal government spends nearly $7 per capita on programs targeted at people sixty-five and over versus $1 for every child, all the while accumulating trillions of dollars in debt for the young people to pay off.[421]

Marin suggests part of the solution to the pensions crisis lies in the emerging markets:

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414 *See Global Ageing: A billion shades of grey, supra* note 406.

415 SHAVIRO, *supra* note 175, at 99-100.

416 Aaron, *supra* note 181, at 347.

417 In 1956, the government established an early retirement age of sixty-two for women, and, in 1961, applied the early retirement age of sixty-two to men. This led the way for private employers to follow suit. Early out plans in the 1980s and 1990s helped open the way for younger workers. SCHIEBER, *supra* note 9, at 176.

418 Taylor, *supra* note 165, at 18.

419 *Id.*

420 *Id.*

421 Taylor notes that the median net worth of persons in the millennial generation is $3,700 compared to $170,500 for people 65+ and that federal spending is $3,800 per child compared to $26,400 per person 65+. *Id.* at 20.

> The emerging markets will be less impacted directly and the more the emerging countries grow, the more the problem will fade away for them and perhaps, eventually, the whole world. Their growth is already strong, and those where population growth is still strong will find themselves growing out of the problem and, of course, learning from the mistakes of the developed countries . . . [T]his may be the first time in history where the growth of countries with higher population growth rates and younger populations will create a more stable economic environment rather than a bigger drain on productivity.[422]

Marin also observes the impact of pension burdens on countries with low population growth:

> The degree of this [pension] burden is clearly a function of economic growth, and we know that economic growth is very much correlated to population growth. Therefore, it is likely that in low population growth countries, where the burden is heaviest, growth will not likely provide a solution, and, indeed, the pension-funding burden will likely further impede growth.[423]

Efforts are underway in many countries facing demographic situations to grow a workforce capable of supporting the growing over-sixty-five population. In Japan, where the population is predicted to shrink by one-third over the next fifty years, the government is not only seeking to convince women to have more children (to increase the current level of 1.41 children per woman to 2.07), but is also considering allowing more immigration into Japan.[424] If Prime Minister Abe's efforts to get Japanese women into the workplace is successful, it could raise female labor participation to that of men, add 8 million people to the workforce, increase GDP by as much as 15%, and increase consumer demand. In order to accomplish this, Abe is focusing efforts on expanding hours for kindergartens and arranging for breast-feeding outside the home.[425]

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[422] MARIN, *supra* note 2, at 44.

[423] *Id.* at 175.

[424] *The Incredible Shrinking Country,* ECONOMIST (May 31, 2014), http://www.economist.com/news/asia/21603076-first-time-proper-debate-starting-about-immigration-incredible-shrinking-country (noting that traditionally Japan had a highly restrictive immigration policy).

[425] *Holding Back Half the Nation*, ECONOMIST, Mar. 29, 2014, at 23. A recent survey of pregnant women in Japan reported that 21% claimed they were mistreated in the workplace because of their pregnancy, although 74% reported receiving some sort of consideration because of their pregnancy. Of the 61% who left their jobs because of pregnancy, 55% said they wanted to focus on taking care of their baby. Jun Hongo, *Survey: One in Five Women Experienced 'Maternity Harassment*,' WALL ST. J., Feb. 24, 2015, http://blogs.wsj.com/japanrealtime/2015/02/24/survey-one-in-five-women-experienced-maternity-harassment/; *see also* Michael Auslin*, Japan's Gamble on 'Womenomics,'* WALL ST. J., Feb. 27, 2015, at A11 (noting that Japan's Health and Welfare Ministry predicts Japan's 127 million population will shrink to 87 million by 2060 thereby inverting the entitlements pyramid leaving one worker supporting more than one retiree).

Japan is not alone. Many countries are creating incentives to encourage higher birth rates, particularly in Europe but also in some Asian countries. The normal replacement rate is 2.1 children per woman; however, some commentators are questioning that figure, arguing it could be lower in countries with "better-educated" people since they are more productive and healthier, retire later, and live longer, thereby making a greater contribution to the dependent population.[426] Furthermore, longer working lives could increase youth unemployment.[427]

Parts of the world other than Japan, such as Germany, China, and Iran have also experienced differing impacts on their aging economy due to birth rates. Germany, which is going through a great reduction in its native population, has encouraged significant immigration from Turkey to supply its need for workers.[428] China, with its one-child policy, has found that the dramatic decrease in population is causing the need for additional workers to maintain its growing economy.[429] Iran instituted policies in the 1980s and 1990s to reduce the population but is now making the following changes since the population is dropping faster than expected:

> Rhyming public-health slogans that used to extol "Fewer kids, better life" have recently been removed. Instead, billboards depict large, happy families juxtaposed with sad little ones. Budgets for subsidized condoms and family planning have been cut; paternity and maternity leave, already generous, has increased. Parliament has passed a bill that aims to raise Iran's birth rate. If it is enacted, vasectomies and tubectomies, which were free until two years ago, will be treated like abortions, punishable by a jail term of up to five years and payment of *diyeh*, or blood money.[430]

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426 *Why Shrinking Populations May be No Bad Thing,* ECONOMIST, May 31, 2014, at 53.

427 MARIN, *supra* note 2, at 47-48 (noting that youth unemployment in France is 22%, in the United Kingdom is 21.8%, in Hungry is 26.1%, in Italy is 28.2%, and in Spain is 47.8%, as listed for 2012).

428 Germany has opened its borders to up to one million refugees from Syria and, although assimilation creates some problems, refugee children are filling seats in the schools that are vacant because of falling numbers of native children in many districts. *Educating Refugees: Learning the Hard Way*, ECONOMIST, Jan. 2, 2016, at 41-42. The same is true of Sweden, who is also experiencing a declining native population. *Id.*

429 *See* MARIN, *supra* note 2, at 42 ("China, with the backfiring of its incredibly impactful one-child policy (perhaps the most effective and far-reaching single public policy ever instituted in the history of mankind) is not far behind [the European Union and Japan] in seeing its growth engine screech to a halt from its administered demographic shift."). Marin further observes: "no single policy in the history of mankind has done more to alter the course of history than the one-child policy in China. In one generation . . . the largest and fastest growing population on Earth has not only been halted, it has actually been permanently altered such that the prevailing cultural belief in China is that the only path to prosperity . . . lies in a one-child household. This behemoth peaks and starts its downward move in the next 10 to 15 years . . . ." *Id.* at 52. Marin provides extensive details of the population in China through 2100. *Id.* at 53-57, tbl.3.2.

430 *See Make More Babies*, ECONOMIST, June 7, 2014, at 53 (recognizing that the culture may have changed since the revolution—women are now more educated and marriage has lost it luster and the divorce rate is climbing, all of which may undermine the government's effort to encourage larger families).

Thus, a country's decision to create incentives for women to enter the work force and to have or not have children may well have dramatic consequences on the country's fiscal future as well as its culture, home life, and families.[431]

D. Protesting Plan Changes and Constitutional Litigation

Litigation will be instituted by unions and other affected parties in connection with the Detroit bankruptcy and with attempts to control costs of pensions in California, Illinois, and New Jersey. Such litigation involves contract rights as well as protections under federal and state constitutions. Political conflict is also involved as officials seeking to make such changes are challenged when running for election.

The 2014 election cycle demonstrates the difficulty politicians face when seeking to change pension plans to reflect economic realities. In 2011, Wisconsin Governor Scott Walker attempted to limit union collective-bargaining rights over benefits for state employees.[432] Democrats in the Wisconsin Senate, who left the state to prevent a vote on the proposed legislation, first confronted Walker.[433] At the same time, state employees mounted protests in the state capital, including a takeover of the state house all of which obtained daily and extensive national attention.[434] When Walker secured passage of legislation without the need of the self-exiled Democratic senators, they returned, but the legislation was already signed.

The next step in the battle was to challenge the legislation in the Wisconsin Supreme Court, where the legislation was approved, but only by a single vote from a justice that was elected shortly before the legislation reached the court.[435] The justice's election was challenged by unions and affected state employees.[436] Finally, the disaffected parties sought to recall the Governor in a statewide election, which proved unsuccessful, possibly because the electorate did not think the allegations against the Governor were sufficient for a recall.[437]

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[431] Schrieber describes the dramatic increase in labor force participation by women in the baby boom generation in the United States. SCHIEBER, *supra* note 9, at 178-79.

[432] Stephanie Condo, *Wisconsin Gov. Scott Walker Signs Anti-union Bill—but Democrats Say They are the Political Victors*, CBS NEWS (Mar. 11, 2011), http://www.cbsnews.com/news/wisconsin-gov-scott-walker-signs-anti-union-bill-but-democrats-say-theyre-the-political-victors/.

[433] Bill Glauber et al., *Democrats Flee State to Avoid Vote on Budget Bill*, J. SENTINEL (Feb. 17, 2011) http://www.jsonline.com/news/statepolitics/116381289.html.

[434] *Id.*; *see also* Bill Glauber et al., *supra* note 433.

[435] Mike Lowe, *Wisconsin Supreme Court Uphold Act 10 Union Law. "It Will Affect All of Us,"* FOX 6 NOW (July 31, 2014, 10:20 PM), http://fox6now.com/2014/07/31/wisconsin-supreme-court-upholds-2011-union-law/.

[436] Madison Teachers, Inc. v. Walker, 839 N.W.2d 388 (Wis. 2013); *see also* Jason Stein, *Supreme Court upholds Scott Walker's Act 10 union law*, J. SENTINEL (Aug. 1, 2014), http://www.jsonline.com/news/statepolitics/supreme-court-to-rule-thursday-on-union-law-voter-id-b99321110z1-269292661.html.

[437] *See, e.g.*, John Nichols, *Recall Campaign Against Scott Walker Fails*, NATION (June 6, 2012), http://www.thenation.com/article/recall-campaign-against-scott-walker-fails/.

In 2014, Governor Walker stood for reelection in a contest that drew national attention in which unions spent enormous sums in an attempt to defeat him.[438] During the campaign, Milwaukee County Democratic district attorney, John Chisholm, targeted Walker's supporters using a "John Doe" process to launch sweeping and virtually unsupervised investigations of those supporters while imposing gag orders to prevent investigated people from defending themselves, or rebutting politically motivated leaks.[439] Chisholm was searching for evidence of '"coordination' between Walker's campaign and conservative issue advocacy groups" and although his tactics were generally condemned, they nevertheless had the effect of chilling political speech by those favoring Governor Walker.[440]

Walker won reelection with 52.3% of the vote and a spread of 5.7% over his opponent, Mary Burke, a former Secretary of Commerce with executive experience in her family business and a Harvard MBA.[441] The campaign received national attention.[442]

In Rhode Island, Gina Raimondo, the state treasurer, who survived a well-funded union backlash after she used her office to generate public opinion to support her reforms to public pensions, won the Democratic gubernatorial primary. The reforms lifted the retirement age from sixty-two to sixty-seven and froze cost-of-living adjustments for current pension recipients until pension funds are determined 80% solvent.[443] The same intensity was put into the general election, which Raimondo won with 40.78% of the vote compared to 36.33% for her Republican opponents.[444]

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[438] Daniel Bice, *Union Bosses, Wealthy Donors Spend Big for Mary Burke, Scott Walker*, J. SENTINEL (Oct. 26, 2014),

http://www.jsonline.com/watchdog/noquarter/union-bosses-wealthy-donors-spend-big-for-mary-burke-scott-walker-b99377685z1-280475452.html.

[439] George F. Will, *The Nastiest Political Tactic this Year*, WASH. POST (Oct. 2, 2014), http://www.washingtonpost.com/opinions/george-will-in-wisconsin-done-in-by-john-doe/2014/10/24/b30ee2ec-5ad8-11e4-b812-38518ae74c67_story.html?hpid=z2.

[440] *Id.*; *see also* Guy Benson, *Nail-biter: Democrats Go All In to Defeat Walker, Polls Show Tied Race*, TOWNHALL.COM (Oct. 26, 2014), http://townhall.com/tipsheet/guybenson/2014/10/24/nailbiter-democrats-go-all-in-to-defeat-walker-polls-show-tied-race-n1909725?utm_source=thdaily&utm_medium=email&utm_campaign=nl (suggesting that allegations of "coordination" between Walker's campaign and outside donor sources that is "chilling" conservative voices could also be alleged against Democratic candidate's activities with the unions in Wisconsin).

[441] *See Wisconsin Governor—Walker v. Burke*, REAL CLEAR POLITICS, http://www.realclearpolitics.com/elections/live_results/2014/governor/ri.html (last visited Jan. 3, 2015) (regarding election results).

[442] Benson, *supra* note 440.

[443] Matt Miller, *Gina Raimondo's Primary Win in R.I. Could Transform Debate on Progressivism*, WASH. POST (Sept. 11, 2014), http://www.washintonpost.com/opinions/matt-miller-gina-raimondos-win-in-ri-could-transform-debate-on-progressiveism. Miller reports that Raimondo is a Harvard, Yale, and Oxford educated former venture capitalist. *Id.; see also* NJ STATUS REPORT, *supra* note 299, at 21 (noting that Rhode Island made some interesting changes to their pension plans).

[444] *See Wisconsin Governor—Walker v. Burk*, *supra* note 441.

Raimondo is Harvard educated, an Oxford Rhodes Scholar, and a graduate of Yale Law School.[445] Prior to being elected state treasurer, she was a venture capitalist and started the first venture capital firm in Rhode Island. Her approach to pension reform is business oriented and some find it a template that may work on a national level: "Her pension-reform campaign was fascinating for its blunt talk of trade-offs, of sacrifices today for investments in tomorrow. She framed the cutbacks as progressive-as the only responsible liberalism-because without them education, infrastructure, transportation and more would suffer."[446]

The 2014, Illinois gubernatorial race avoided outright discussion of Illinois' pension problem.[447] When Republican Bruce Rauner won the election he was immediately faced with the expiration of a temporary 2% increase in the state income tax that will aggravate the state's fiscal problems particularly since Rauner must work with a Democratic legislature.[448] It is reported that Rauner, who railed against pension inefficiencies, now declares "that it is most important to 'protect what is done—don't change history. Don't modify or reduce anybody's pension who has retired, or has paid into a system and they've accrued benefits.'"[449] Still, dealing with the problem may make Illinois the first state to find out whether courts will force cuts in pensions to avoid pushing the state into a "death-spiral" that occurs as people leave the state as the state is forced to cut vital services and raise taxes.[450]

E. Private Employer Pensions: Problems with General Motors

The growth of private pensions was, in large measure, a result of government regulation and the implementation of Social Security. This is particularly true of the impact of the income tax, which allowed contributions to a trust to be deducted by the employer and not taxed to the employee until many years later when the money was withdrawn from the trust.[451] Initially, there was no funding requirement and the regulations were mostly interested in preventing discrimination in favor of highly compensated individuals and the loss of tax revenues, but later it became necessary to focus on funding the promises.[452] Furthermore, tax deferral of pension contributions has in recent years become a topic of debate, as Congress needed additional revenue.[453]

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[445] Frank Bruni, *A Democrat to Watch in 2015: Gina Raimondo's Approach to Income Inequality*, N.Y. TIMES (Dec. 30, 2014), http://www.nytimes.com/2014/12/31/opinion/frank-bruni-gina-raimondos-approach-to-income-inequality.html?_r=0.

[446] *Id.*

[447] Mark Peters, *Illinois Faces Big Revenue Hit in 2015*, U.S. NEWS (Dec. 30, 2014), http://www.wsj.com/articles/illinois-faces-big-revenue -hit-in 2015-1419967717.

[448] *Id.* The temporary increase had been from 3% to 5% but would fall to 3.75%.

[449] *Public Pensions, America's Greece?*, ECONOMIST, Dec. 20, 2015, at 37.

[450] *See id.* at 38 (referring to attorney James Spiotto's argument that a point can be reached when a state is unable rather than unwilling to pay pensions and a court finds the well being of citizens overrides any state constitutional protections).

[451] SCHIEBER, *supra* note 9, at 130.

[452] *Id.* at 130-31.

[453] *Id.* at 130.

The move toward adoption of private pension plans was also promoted by the institution of Social Security plans because an employer could supplement the Social Security payment with its own pension plan to provide workers with a reasonable retirement income without having to fund the entire cost. Of course, the employer could take credit for the benefit provided by the employer's portion of the payroll tax as well.[454] Government restrictions on wages during World War II excluded pensions and other benefits from the restriction thereby creating additional incentives to create such plans to attract employees during the War.[455] Later during the 1950s and 1960s, unions began negotiating for pensions for their workers.[456]

Private pensions face three types of risks. First is the agency risk of plan managers improperly handling plan assets. Second is the forfeiture risk of the employees leaving employment prior to vesting. Third is the default risk that plan sponsors would fail or be unable to make plan contributions which was a particular problem since creating a plan based on years of service and final annual pay meant there would be a substantial unfunded benefit for persons with existing years of service.[457]

In the early 1970s, Senators Jacob Javits and Harrison Williams, who published a report focused on the flaws in the private pension system, intensified congressional focus.[458] Although their statistics were inaccurate, they were more concerned with stirring up public sentiment than accurate numbers.[459] The same was true with a CBS ninety-minute documentary focusing only on the flaws in the system.[460] The report and documentary had the desired effect and the public was outraged.[461] The eventual result was Employee Retirement Income Security Act (ERISA).[462] In 1978, President Carter recommended a savings account to be administered by Social Security in which 3% of compensation would be put into a Mandatory Universal Pension system.[463]

There are three clear principles that apply not only to private pensions, but also to public pensions, that anyone should keep in mind when planning retirement security. First, the cost of a pension is not the benefits currently being paid but the benefits that are being accrued by current workers. Second, this current expense should be covered by a cash contribution to an independent fiduciary to secure their ultimate payment to the employee rather than rely on the ultimate success of the plan sponsor.

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454 *Id.* at 133.

455 *Id.*

456 *Id.* at 134-35.

457 *Id.* at 136-37. Ford Motor Company started its pension plan with an immediate obligation of $200 million for existing workers and nothing in the trust fund. The result was that employers and unions agreed to fund the initial obligation over 30 years. *Id.* at 138.

458 *Id.* at 142.

459 *Id.* at 143.

460 *Id.*

461 *Id.* at 143-44.

462 *Id.* at 144.

463 *Id.* at 150.

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Third, the plan participants had to have a vested right to a payout from the system.[464] Although these basic principles have been recognized as early as the 1920s, they were not acted upon so that years later it could be said:

> Both business and union members on President Kennedy's Advisory Committee on Labor-Management Policy felt that government had no business interfering in labor contracts, but officials at the Treasury Department were coming to believe that government had a prominent and legitimate interest in regulating employer-sponsored retirement plans. In the mid-1950s, Walter Blum began to develop a concept that ultimately became known as "tax expenditures." Writing in the Joint Economic Committee's 1955 study *Federal Tax Policy for Economic Growth and Stability*, Blum argued that if the government "decided to subsidize a certain activity, we should be hesitant about administering the subsidy by way of a tax preference. Subsidies in this form vary directly in amount with the tax brackets of the recipients; they are invariably hidden in the technicalities of the tax law; they do not show up in the budget; their cost frequently is difficult to calculate; and the accomplishments are even more difficult to assess."[465]

From the end of World War II in 1945 through the early 1990s, private employers were providing even more generous pension benefits.[466] In order to protect worker's pensions, Congress—in 1974—passed ERISA to provide a regulatory framework to make benefits available to workers and created the Pension Benefit Guarantee Corporation (PBGC) to protect employee expectations if the employer went bankrupt.[467] Initially the funding requirements were flexible, but the unusually large returns in the 1990s made many plans appear fully funded so that Congress instituted funding limitations as a way to raise revenues without raising tax rates.[468] As the nation entered the new millennium, the unusually high rates of return in the 1990s disappeared making many plans appear unsustainable.[469] Congress, in 2004, reversed some of the funding limitations, but the reversal came too late to help the Baby Boomers that were preparing for retirement.[470]

Since the late 1970s, another phenomenon was occurring, which was the introduction of defined contribution plans, but that trend changed and was even reversed as employers began to convert the defined benefit plans into hybrid plans

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464 *Id.* at 26-27.

465 *Id.* at 141 n.14 (citing *The Effects of Special Provisions in the Income Tax on Taxpayer Morale, in Joint Econ. Comm. Fed. Tax Pol'y for Econ. Growth & Stability*, 84th Cong., 250-51 (1955) (statement of Walter J. Blum)).

466 An early reason for providing pensions was that they were seen, in the banking industry, as being less expensive than fidelity bonds. *Id.* at 130.

467 *Id.* at 13.

468 Apparently, avoiding tax rate increases became more important than securing retirement funding. *Id.* at 14. It is also noted that during this period lawmakers gave union pension plans waivers on funding requirements. *Id.*

469 *Id.*

470 *Id.* at 15.

that provided a cash balance.[471] By 2008, the conversions, which were primarily a large plan phenomena, covered 2,984 plans representing 10.3% of total plans and 31.3% of defined benefit participants as reported by the PBGC.[472] Smaller plans began to reflect the need for change by freezing accruals under existing plans and denying new entrants. By 2007 the PBGC reported that 18% of covered plans were under a hard freeze representing 7.6% of all plan participants.[473]

During the 1980s and 1990s, the funding of private pensions was discouraged or stopped by administrative regulations. In 2008, the Pension Protection Act took effect with the goal of reaching 100% of unfunded accrued liabilities over a seven-year period.[474] These new rules came at an inauspicious time considering the economic turmoil of the 2007-2010 period. Companies were required to make enormous extra contributions in this tumultuous economic environment.[475] The resulting changes were seen as unfair to some workers, but many plans that did not change witnessed their unfunded pension obligations force them into bankruptcy.[476]

Toward the end of the twentieth century, the employer based pension was deteriorating and people were convinced they were better off relying on the new 401(k) defined contribution investment vehicle, which had been showing consistent double digit gains during the 1990's stock market boom.[477] Furthermore, the end of the 1990s foreshadowed more problems:

> By the end of the 1990s, some defined benefit plan sponsors had been on contribution holidays for 10 or 15 years. Even back in 1967, when Pal Samuelson was writing about Social Security being "the greatest Ponzi scheme ever contrived," the Social Security system at least required contributions. Pension operations in the 1990s seemed to be one-upping Samuelson's assessment of Social Security. But along the way, we had forgotten that saving for retirement requires some actual saving. Samuelson's assessment of Social Security would prove wrong when economic and demographic fundamentals changed. And the employer pension system would also run into problems when economic fundamentals changed at the beginning of the new millennium.[478]

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[471] *Id.* at 192.

[472] *Id.* at 195. In 1983, there were 175,000 private defined benefit plans covering 29.9 million active workers, but by 2007 those numbers had declined to 49,000 plans covering 19.4 million workers. *Id.* at 7.

[473] *Id.* at 195. Other definitions of "freeze" can be found but the trend is among major employers is to freeze various pension plans in one way or another. *Id.* Among 723 companies that made the Fortune 1000 list every year from 2004 through 2010, 242 did not sponsor a defined benefit plan during the period and, among the 481 that did, one terminated its plan in 2009 and eight others did the same in 2010. *Id.* at 196.

[474] *Id.* at 199.

[475] *Id.* at 198-99.

[476] *Id.* at 199.

[477] *Id.* at 180.

[478] *Id.* at 181.

Private pension plans are not uniquely American. In fact, it is reported that globally, defined benefit plans, although often grossly underfunded, have $23 trillion of liabilities to current and future pensioners[479] and are estimated to grow by 4% with each extra year added to one's life expectancy.[480] Several private companies have structured new financial instruments to absorb a portion of the longevity risk thereby making some pension plans safer recognizing the risks to the pension plans.[481]

During the 1980s, reducing corporate tax deductions associated with such plans continually reduced funding requirements for private pensions in order to raise tax revenue.[482] Such reductions in funding put benefits for Baby Boomers at greater risk.[483] Seeking to more widely distribute the benefits of private pensions, Congress began reducing the vesting requirements.[484] In addition, accounting rules were changed in a way that allowed lower levels of funding and plans were terminated with billions of dollars withdrawn as excess funding.[485]

During the first decade of the twenty-first century, many companies froze all or part of their defined benefit plans saving considerable amounts of money.[486] Much of the savings went to defined contribution plans in which employees sought to offset losses in the stock market and in their defined benefit plans.[487] The Pension Protection Act took effect in 2008 and required plans to attain full funding over a period of seven years.[488] Further, single-employer plans with less than 80% funding are subject to benefit restrictions, those with between 60% and 80% cannot increase benefits and can only pay partial lump-sum distributions,[489] and multi-employer plans must reach full funding over fifteen years.[490] The timing for this Act to become

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[479] *Longevity Risk: My Money or your life*, ECONOMIST, Aug. 23, 2014, at 69.

[480] *Id.* (referencing the International Monetary Fund).

[481] *Id.*

[482] SCHIEBER, *supra* note 9, at 154.

[483] *Id.* at 154-55. The Omnibus Budget Reconciliation Act of 1987 slowed pension funding during the early part of the Baby Boomers careers and left many plans over funded so that no current funding was required. *Id.* at 168. Further hindering the funding of private pensions was the Omnibus Budget Reconciliation Act of 1990, which imposed a tax on taking money out of an overfunded pension plan as well as the possibility that overfunding might be considered a breach of management's fiduciary duties to shareholders. *Id.* The author calls this erratic changing of the funding requirements in the 1980s and 1990s "regulatory schizophrenia" at the beginning years of the Baby Boomers work lives, which had a dramatic effect on the need to fund pensions in the first decade of the twenty-first century. *Id.* at 249.

[484] *Id.* at 168.

[485] *Id.* at 158-59. By the end of the 1980s, the funding of pensions had shifted from how much was needed to pay future retirees to how much had to be paid if the pension was shut down today. *Id.* at 163.

[486] *Id.* at 95.

[487] *Id.* at 195, 198.

[488] *Id.* at 198.

[489] *Id.* at 198-99.

[490] *Id.* at 199.

effective was unfortunate because the increased liabilities hit companies just as the Great Recession hit and market values plummeted forcing many companies into bankruptcy and the loss of many jobs.[491] The underfunding of plans was primarily the result of the boom in the 1980s and 1990s when funding requirements were curtailed, but government finds it a hard lesson to learn. In enacting the Highway Bill in 2014, it was proposed that "pension smoothing," by which the funding requirements would be delayed thereby increasing the tax revenues by reducing the deduction, could offset some of the cost of the bill.[492]

The effectiveness of employer provided pensions has been the subject of some debate. It appears the data to support its effectiveness is not available.[493] While a high percentage of people report being covered under a pension plan (either a defined benefit plan or a defined contribution plan, or both), the number of families receiving pension income is much smaller and the amount received seems inconsistent with reported assets in such plans.[494] This seeming incongruity could be the result of workers taking a lump sum and not converting it into an annuity or workers using the money to pay off debts or some other use, but it could also suggest that employer sponsored plans are a poor way to provide for retirement security.[495]

A major problem with most defined benefit plans is that the benefit accrues most rapidly at the end of a long career with a single employer. When employees leave after ten or fifteen years they have a greatly reduced pension that will only start when they reach retirement age. When they start work for an employer late in life, they have a limited time to accrue the pension so that the pension is often quite small.[496]

Managing pensions has become cumbersome for employers who are now forced to put the liabilities and investment losses from pension funds on their balance sheets.[497] Furthermore, the pension liabilities sometimes exceed the market

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[491] *Id.* at 199. The $1.1 trillion Omnibus Budget Reconciliation Bill, enacted in December 2014, contained a provision that would allow workers, retirees, and management an opportunity to voluntarily restructure retirement benefits to save a multi-employer pension plan from insolvency. Resistance to this legislation came from unions and the AARP who wanted to hold out for the plans to be bailed out, but a bailout seemed out of the question for law makers. Multi-employer plans are minimally covered by the PBGC, protecting retirees with 30 years of service for pensions less than $13,000. In 2014, the PBGC deficit for multi-employer plans grew to $42.4 billion from $8.3 billion in 2013 while the deficit single employer plans fell to $19.3 billion from $27.4 billion in 2013. PENSION BENEFIT GUARANTY CORPORATION, ANNUAL REPORT FISCAL YEAR 2014, at 10 (2014); *see also* Daniel Borenstein, *Before Retiring, Rep. George miller breaks ranks to help save trouble pension plan*, MERCURY NEWS (Dec. 28, 2014), http://www.contracostatimes.com/daniel-borenstein/ci_27201607/daniel-borenstein-before-retiring-rep-george-miller-breaks.

[492] Luca Gattoni-Celli, *Pension Smoothing Risks Losing Money, But Few Alternatives Seen*, 145 TAX NOTES 50 (2014).

[493] SCHIEBER, *supra* note 9, at 260-62.

[494] *Id.*

[495] *Id.* at 254-62 (including various charts demonstrating retirement assets held by various household types).

[496] MARIN, *supra* note 2, at 85.

[497] *Id.* at 86 (noting the impact of FASB ASC 715 and FAS 158b).

capitalization of the company. Before General Motors transferred their pension liabilities to Prudential, its global pension liabilities were approximately $134.7 billion ($25.4 billion unfunded), while its market capitalization was $30.7 billion.[498]

Increasing the payment rate to the PBGC also increases the burden on employers providing defined contribution plans.[499] Even with retiree health care plans, private employers as well as government employers have only gradually came to the point where accounting rules require disclosure of liabilities.[500] As health care costs escalated and accounting standards began to require disclosure, many private employers began to dramatically reduce or eliminate the benefit.[501]

1. GM's Pension Troubles

GM has been caught in a downward pension spiral since 1950 when the company signed the Treaty of Detroit with the UAW.[502] First, pensions had the effect of retiring workers early. By 1960, ten years after the treaty of Detroit, only three out of every ten senior citizens remained in the labor force compared to six out of ten in 1920.[503] According to the UAW union's Social Security department, "an increasing number of men in good health are choosing to retire rather than go on working."[504]

According to a UAW economist, "[p]ensions got better every year" and "there was little resistance."[505] However, the continued rise in pensions was primarily due to the fact it kept wage increases slow, was less inflationary than wage increases,[506] and GM did not have to account for the future obligations on its books.[507]

In 1966, Walter Reuther, the original head of the UAW, testified in favor of federal pension insurance. However, federal pension insurance was viewed as a form of welfare that would make workers lazy and unproductive and the idea that

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498 *Id.* (describing General Motors as a pension company that happens to make cars).

499 *Id.*

500 SCHIEBER, *supra* note 9, at 296-300. Funding retiree health care face the same problems as pensions which included: (1) the cost of benefits was not the current cost but the cost accruing for current workers; (2) the benefits had to be funded as they were earned so retirees would not be dependent on future success of the sponsoring firm; and (3) participants had to be vested in their rights after some reasonable time. *Id.* at 296. An added problem with retiree health care is that it was often the case that the retiree's spouse would also be covered by the plan. *Id.* at 299.

501 *Id.* at 301.

502 ROGER LOWENSTEIN, WHILE AMERICA AGED: HOW PENSION DEBTS RUINED GENERAL MOTORS, STOPPED THE NYC SUBWAYS, BANKRUPTED SAN DIEGO, AND LOOM AS THE NEXT FINANCIAL CRISIS 24 (2008).

503 *Id.* at 28.

504 *Id.*

505 *Id.* at 47.

506 Firms did not have to pay out the pensions until retirement, a stark contrast to pay hikes which were payable immediately and would, intuitively, only grow bigger and bigger in response to inflation.

507 *Id.* at 18, 19, 45 (the government froze wages throughout World War II, which ended only five years before the Treaty of Detroit and had an impact on negotiations with the UAW).

pensions should be fully or partially funded annually was seen as a way for employers to slow down the gradual and exponential increase of benefits.[508] Both views contributed to the unmitigated growth of pensions and their unfunded liabilities.[509] Social Security only added fuel to the fire because, rather than being viewed as a supplement to retirement, Social Security's "gross inadequacy" made higher pension insurance all the more necessary.[510]

GM's infamous "thirty-and-out" plan further hurt GM's ability to compete because of three problems: (1) GM would lose an experienced worker to early retirement, (2) GM would have to support that worker for a longer period of time, and (3) there was an increased likelihood that the worker's spouse and children would be eligible for benefits.[511] Five months after GM's "thirty-and-out" pension plan was increased in 1990, GM's stock dividend was cut from seventy-five cents to forty cents[512] and stockholders still had yet to receive a single dollar increase in their stock price for over the prior twenty-five years;[513] proof that shareholders were the ones suffering. Observers noted that GM was being managed for the benefit of GM's "institution" rather than its shareholders.[514]

GM could have acquired half of Toyota motors with the same amount of money it used to fund pensions in the mid-1990s.[515] As of 2006, GM workers were compensated between seventy-four dollars an hour compared to only forty-four dollars an hour for Toyota workers employed in American plants.[516] Consumers have been given a choice to either pay for cars encumbered by pensions from GM or to buy from foreign companies like Toyota.[517] A major reason for this is that pensions for Japanese automakers are paid by the state and they buy parts from outside suppliers and therefore do not pay pensions for the making of their parts *or* cars while GM is on the hook for both.[518]

GM did make an attempt to cut costs with the creation of an auto parts spin-off Delphi in 1998.[519] However, the UAW demanded that GM pay for Delphi's pension and healthcare obligations and if Delphi failed to do so, hire back Delphi's surplus workers and renew Delphi contracts on the same terms as GM for the next two

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508 *Id.* at 42-43.

509 *Id.*

510 *Id.* at 43.

511 *Id.* at 41-43 (the spouse and/or children could also be eligible for benefits for a longer period of time under the new plan).

512 *Id.* at 56.

513 *Id.* at 53.

514 *Id.*

515 *Id.* at 59-60.

516 ALEX TAYLOR, III, SIXTY TO ZERO: AN INSIDE LOOK AT THE COLLAPSE OF GENERAL MOTORS – AND THE DETROIT AUTO INDUSTRY 221 (2010).

517 *Id.*

518 LOWENSTEIN, *supra* note 502, at 60 (the pensions for German auto workers are paid by the state as well).

519 *Id.* at 61-62.

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rounds of negotiations (almost a decade).[520] Unsurprisingly, Delphi filed for bankruptcy in 2005 as the company had $8 billion in unfunded healthcare liabilities and $4 billion in unfunded pension liabilities.[521] The court filings stated, "Delphi needs a pension solution . . . it cannot afford to fund the pension . . . and no business can operate successfully if it cannot respond to market forces."[522] Other large corporations such as HP, Verizon, and IBM immediately began to permanently freeze their pensions around this time as well.[523] Starbucks even announced it was spending more on healthcare than coffee beans, proof that the Social Security problem is not exclusive to Social Security insurance or pensions.[524]

GM has been left with no choice but to keep its liabilities unfunded. Even if GM made its annual contribution and paid on its installment plan, each new deal makes the prior installment plan deficient.[525] Additionally, pension increases affect more than current workers; they apply to retired workers as well. A GM employee who retired with a forty-five dollar pension per month in 1950 was collecting $435 a month by 1980.[526] The result, a need for more and more employees to provide contributions to the already retired workers whose pensions continue to increase during each round of negotiations, a disincentive to fire unproductive workers, and an incentive to hire new workers even if their labor is not needed.

Furthermore, GM has developed a habit of creating more vehicles than consumers want because its fixed costs (included legacy costs) are too high to let factories sit idle when demand wanes.[527] According to CEO Wagoner, "[t]o the extent that we sell more products . . . we amortize those costs over more cars and trucks sold, and the impact (of retiree costs) isn't so great."[528] As a result, GM's brand and profits have taken a hit as resale value of GM cars drop due to market saturation.[529] By 2008, GM's two fundamental and closely related weaknesses—a huge legacy cost burden and an inability to adjust its structural costs—crippled the corporation's profitability, forcing a bailout.[530]

2. What to Do Now?

Concerning GM's 2012 deal with Prudential, Vice President of Finance and Treasurer Jim Davlin said, "[o]ur pension liability was so large . . . that each time funding went down the ratings agencies and others doing financial evaluations considered this a substantial debt-like obligation," and, "[a]s our funding status

520 *Id.*

521 *Id.* at 72.

522 *Id.*

523 *Id.* at 78.

524 *Id.* at 39.

525 *Id.* at 47-48.

526 *Id.* at 48.

527 *Id.* at 53-54.

528 TAYLOR, *supra* note 516, at 176.

529 LOWENSTEIN, *supra* note 502, at 53-54.

530 *Id.* at 78.

changed we'd go from no debt one year to dramatically high debt the next year."[531] He also highlighted how the pensioners were safer in Prudential's hands because "this is *their* core business."[532] Also, the Pension Protection Act of 2006 changed the pension issue from one of investment to one of finance because GM's finances are impacted more short-term with potential "shareholder repercussions."[533]

Moving Ahead for Progress in the 21st Century Act ("Map 21")[534] was enacted in 2012 and changed the minimum and maximum obligations for pension funding.[535] The minimum percentage decreased 5% every year from 90% in 2012 to 70% in 2015, while the maximum percentage increased 5% every year from 110% to 130%, giving companies more flexibility to underfund during tough times and overfund in times of growth.[536] The relief further came in the form of adjusting the calculations for overall liabilities known as segment rates, which are used to calculate funding obligations.[537]

On the other hand, Map 21 increased the annual premiums employers are required to pay the PBGC per plan from $30 in 2012, to $42 in 2013, and $49 in 2014, with inflation adjustments thereafter.[538] The additional variable rate premium for underfunded companies was also increased from nine dollars per $1,000 worth of underfunding as of 2013 to fourteen dollars in 2014.[539] The Bipartisan Budget Act of 2013[540] then raised premiums to fifty-seven dollars and sixty-four dollars in 2015 and 2016 respectively[541] while raising the variable rate premium to twenty-four dollars and twenty-nine dollars in 2015 and 2016 respectively.[542]

The relief undoubtedly helps, but overall liabilities do not change while the payments to the PBGC continue to rise increasing the short-term impact on employers and, potentially, shareholders. Also, if and when the current Map 21 extension phases out,[543] "the impact to operations (could) be substantial."[544]

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[531] Russ Banham, *The Great Pension De-Risking; Stung by funding shortfalls time and again, companies are using a variety of tactics to lighten their pension burdens for good.* CFO MAG., Apr. 2013, at 42, 43.

[532] *Id.* at 45 (emphasis added).

[533] *Id.* at 42.

[534] Moving Ahead for Progress in the 21st Century Act, H.R. 4348, 112th Cong. (2012).

[535] *Id.* at 845.

[536] *Id.* at 847.

[537] *Id.*

[538] *Id.* at 850.

[539] *Id.*

[540] Bipartisan Budget Act of 2013, H.R.J. Res. 59, 113th Cong. (2013).

[541] *Id.* at 26.

[542] *Id.* at 27.

[543] Surface Transportation and Veterans Health Care Choice Improvement Act, H.R. 3236, 114th Cong. (2015) (3rd Extension of Map 21; extension up to Oct. 29, 2013).

[544] Barry B. Burr, *Corporations Face Looming Pension Bills: End of Federal Relief and Increasing Longevity To Strain Balance Sheets*, PENSIONS & INV. (June 29, 2015),

In GM's 2014 annual report, the automaker described how their unamortized pre-tax actuarial gain went from a $1 billion dollar gain in 2013 to a $4.6 billion dollar loss in 2014[545] by saying "[t]he change is due primarily to the decrease in discount rates[546] and the change in mortality assumptions partially offset by actual asset returns in excess of assumed returns."[547] Liabilities for pension obligations are discounted at the market rate for corporate bonds and, for the past fifteen years, the average annual rate of return for corporate bonds has been 4.57%. GM's corporate bond rates have been below average at 3.59% in 2012, 4.46% in 2013, and 3.73% in 2014.[548]

Pension "contributions [should] rise very substantially, double if not triple" due to the possibility the stock market "turn[s] around, which it mostly will now that the fed [could] raise [interest] rates."[549] However, as of June 2015, GM's spokesman Tom Henderson said, "[w]e don't expect [to make] a significant mandatory contribution for the next five years."[550]

IV. LEG THREE: PRIVATE SAVINGS PLANS

A. The Rise of the 401(k) Plan

Leg three of the retirement stool is the private savings leg. Leg three has traditionally involved life insurance, bank accounts, individual stock purchases, and similar investments. However, as employer defined benefit plans have been discontinued, they have been replaced with Individual Retirement Accounts (IRAs), 401(k) plans, and other similarly tax motivated plans.

Defined benefit plans are perhaps the ultimate paternalistic oversight of an employee's well being. The participant often pays nothing into the plan, but upon retirement receives a lifetime benefit that is often inflation protected without casting any investment responsibility on the participant.[551] The main disadvantage for the participant is if the participant leaves the employment covered by the plan the accrual of benefits usually stops far short of the ultimate goal of providing an annuity based on a percentage of the participant's final years' earnings.[552] On the employer or sponsor's side the defined benefit plan creates tremendous burdens that

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http://www.pionline.com/article/20150629/PRINT/306299972/corporations-face-looming-pension-bills.

[545] GEN. MOTORS CO., 2014 ANNUAL REPORT 55, 56 (2015) [hereinafter GM 2014 REPORT].

[546] *Id.* at 103 (noting that the discount rate for United States pension benefit plans decreased from 4.46% to 3.73%).

[547] *Id.* at 55-56.

[548] *Id.* at 103.

[549] Burr, *supra* note 544.

[550] *Id.*

[551] MARIN, *supra* note 2, at 81-82.

[552] *Id.* at 82.

must be administered over an undetermined period dependent upon the longevity of the participants.[553]

Sponsors' concerns over defined benefit plans and participants' desire for some control over their investment future led to the introduction of defined contribution plans, typically individual retirement accounts and 401(k) employer sponsored retirement plans.[554] Defined contribution plans provide tax advantages to participants by allowing for a deduction of amounts contributed into the plan and then allowing the contributions to grow tax-deferred until such time as the participant withdraws the funds years later in retirement.[555] A variation of this scheme, which is economically equivalent if tax rates remain constant, is the ROTH 401(k), which denies the deduction for contributions but allows later withdrawals to be tax-free.[556] Under either variation, this method of saving is far superior to a bank savings account, which is taxed on an annual basis.[557] These plans encourage savings,[558] but unless contributions are made early in one's career, the plans are unlikely to provide sufficient funds at retirement and all investment risk is borne by the participant who is often an unsophisticated investor.[559]

The growth of 401(k) plans closely followed the fall of defined benefit plans such that the contributions to defined contribution plans exceeded the contributions

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[553] *Id.* at 82, 85. Government regulation under ERISA, financial reporting of pension plan performance, and payments to the PBGC all combine to make defined benefit plans unattractive to sponsors. *Id.* at 86-91.

[554] Tax legislation in 1978 and through the 1980s introduced the concept of the 401(k), which proved to be more popular than anyone at the Treasury Department anticipated. SCHIEBER, *supra* note 9, at 160-62.

[555] MARIN, *supra* note 2, at 83.

[556] *Id.*

[557] To perform a calculation on the lifetime impact of the 401(k), the medium earner is assumed to save 10% of lifetime income in which case the medium earner would accumulate $359,015 by age sixty-five based on assumed tax rates of 15%. SCHIEBER, *supra* note 9, at 286. At that tax rate, the tax would be $53,852, leaving an after tax amount of $305,163. *Id.* However, if instead of using the 401(k) plan, the medium earner had put his money into a regular savings account and been taxed currently he would accumulate and after-tax amount of $241,521 at age sixty-five. *Id.* The tax advantaged account would have resulted in $63,642 more than a regular savings account. *Id.* Thus, the medium earner would receive a tax benefit in this amount. *Id.* Each earner category would benefit from the tax benefitted savings, but the higher earner would receive higher benefits. *Id.* at 286 tbl.24.4 (identifying the net tax benefits for low, medium, high, and maximum earners as $17,185, $63,642, $152,014, and $433,604 respectively).

[558] Results of studies are conflicting on the question whether IRA or 401(k) savings contribute to the overall savings by contributors or are merely a change in the form of the savings. One study suggested that 45% to 60% of the contributions are new savings while another study suggested it was only 2%. *Id.* at 175 (citing William G. Gale & John Karl Scholz, *IRAs and Household Saving*, 84 AM. ECON. REV., Dec. 1994, at 1233–60).

[559] MARIN, *supra* note 2, at 83-84 (noting that "individuals habitually underperform professional money managers by as much as 10 percent, and the most 'gentle' surveys show that there is a at least a 2% disadvantage to individuals investing on their own").

to defined benefit plans in all but one year between 1984 and 2008.[560] As self-directed plans grew, concerns were raised about the effect of such changes on workers' retirement security since participants seemed to be older, higher-paid, male workers and not those most in need of retirement security.[561] During the 1980s, 401(k) plans shifted investment decisions to the beneficiary and retirement security become a "do-it-yourself" project supported by employer sponsorship with increasing investment options being provided.[562]

Initial enrollment restrictions such as the one-year waiting period were eliminated and enrollment was encouraged which helped companies to meet anti-discrimination rules.[563] Behavioral economists' suggestions about how to increase plan participation were included in The Pension Protection Act of 2006, which allowed for automatic enrollment and other automatic features such as increasing the contribution rate annually by 1% until the 10% level is reached or the employee says stop.[564] The Act also encouraged the use of default investments in various types of stock and bond funds. In 2007, the Department of Labor issued guidelines providing that automatic enrollees' contributions are to be invested in various stock funds.[565] The guidelines were in response to studies showing that professionally managed defined benefit plans outperformed self-managed defined contribution plans and that

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[560] SCHIEBER, *supra* note 9, at 205. Notwithstanding the increasing popularity of 401(k) plans in some circles, a number of states have experienced adverse results for workers from defined contribution plans and have opted to replace them with defined benefit plans after up to thirty-five years experience with defined contribution plans. Ron Snell, *Pension Reform: Not Easy, But Worth It*, NAT'L CONF. ST. LEGISLATORS, http://www.ncsl.org/research/labor-and-employmentpenson-reform-not-easy-but.aspx (last visited Apr. 24, 2016).

[561] SCHIEBER, *supra* note 9, at 203 n.7. Schieber describes a study using 1993 census data and concludes:

> [P]articipants tended to be older, have longer tenures, earn higher pay and work for larger companies than nonparticipants. Women were less likely to participate than men. Workers tended to contribute more to their plans as their pay levels climbed. The results suggested that those who needed help the most in acquiring retirement security were being left out.

Id.

[562] *Id.* at 201-03. The 22.6% drop in the stock market on Black Monday, October 19, 1987, reduced the value of assets in defined contribution plans and raised questions of fiduciary responsibility for market losses. *Id.* The result was regulations governing "self-directed" accounts that allowed participants to select the investments, which included equities, bonds or fixed income, or money market investments and relieved the fiduciary of any fiduciary obligation for investment losses. *Id.* Large mutual funds became the investments of choice and participants could move investments on a daily basis based on the end of day valuation. *Id.*

[563] *Id.* at 206.

[564] *Id.* at 208-09. Tony Robbins calls this a "save more tomorrow" plan and recommends this in his book, TONY ROBBINS, MONEY MASTER THE GAME: 7 SIMPLE STEPS TO FINANCIAL FREEDOM 67 (2014).

[565] SCHIEBER, *supra* note 9, at 201-10.

automatic enrollees were mostly contributing the minimum amounts (usually 3%) while leaving the money in the most conservative investments.[566]

The defined contribution plan also presented a problem with "leakage."[567] There was a tendency for participants, particularly younger participants with relatively small amounts in their plans, to cash out the plan when they changed jobs. This deprived them of early-career retirement savings compounding, which could work over a forty or fifty year period with maximum benefit. The "cashing-out" phenomena with defined contribution plans which reduces future retirement security may not be significantly different than when individuals change jobs in mid-career and the defined benefit plan accrual is terminated at one company and started fresh at a second company.[568]

Nevertheless, 401(k) wealth has been on the rise. A 2007 study compared the Social Security and 401(k) wealth of persons turning sixty-five in 2000 with the projected wealth that would be accumulated in 401(k) plans by persons turning sixty-five in 2010, 2020, 2030, and 2040.[569] In 2000, a time when defined-benefit-plan wealth was swiftly declining, the Social Security wealth of persons sixty-three to sixty-seven exceeded the combined wealth of their defined benefit plans and 401(k) plans.[570] Making the same comparison for persons turning sixty-five in 2010, 2020, 2030, and 2040 the study broke the age cohort into ten groups based on projected lifetime earnings and found that, by 2030, 401(k) wealth will exceed Social Security wealth in the six highest of the ten earnings groups, and, by 2040,

566 *Id.* Return differences of 1% to 2% would be significant over a forty-to fifty-year career. *Id.* Permissible investment options included a life-cycle fund reflecting an enrollee's age, target retirement date, or life expectancy; a balanced fund reflecting the characteristics of the plan participants as a whole; or an allocation between various funds reflecting the enrollee's age, target retirement date, or life expectancy. *Id.*

567 *Id.* at 210-11.

568 *Id.* at 211-12 (describing results from Andrew A. Samwick & Jonathan Skinner, *How Will 401(k) Pension Plans Affect Retirement Income?*, 94 AM. ECON. REV. 329 (2004)). The research found that distributions associated with job changes decreased in number and value from 2001 to 2007, while another researcher emphasized the need at least 25% of distributions early in one's career and 50% later in the career were necessary to approximate the values achieved in defined benefit plans, and that, for the most part, defined contribution plans would provide higher benefits. *Id.*

569 *Id.* at 212-13.

570 *Id.* at 213-14 (citing James M. Poterba et al., *Rise of 401(k) Plans, Lifetime Earnings, and Wealth at Retirement*, (Nat'l Bureau of Econ., Working Paper No. 13091, 2007), http://www.nber.org/papers/w13091. The comparison here does not include IRA or Keogh wealth in the calculation of 401(k) wealth in this calculation which, had it been included, would have found the highest lifetime earning decile's wealth to exceed the value of Social Security wealth. Poterba et al., *supra*, at 5. Social Security wealth was calculated as the present value of projected benefits and the results were categorized by the deciles based on lifetime earnings. The calculations were based on 2000 dollars using standard Social Security estimated wage growth of 3.9% and inflation of 2.8%. Lifetime earnings ranged from $70,993 in the first decile, to $1,336,716 in the fifth decile, to $1,722,307 in the sixth decile, to $3,565,347 in the tenth decile. *Id.* As with any study, the underlying assumptions of the study could be challenged, but the general thrust of the study that growing 401(k) wealth will outstrip Social Security wealth as the 401(k) plans mature. *Id.* at 6 tbl.1-2.

will exceed Social Security wealth in all but the two lowest earnings groups.[571] Thus, by 2030, 401(k) projected accumulations over a fifty-year period will exceed Social Security's accumulated wealth over a ninety-five-year period.[572]

Despite the projected success of the 401(k) phenomenon and the soaring stock market, the question remains whether and to what extent individuals are able to bear such responsibility. A recent op-ed piece by a renowned pension expert railed against privately managed plans referring to them as a ridiculous approach to retirement:

> Not yet convinced that failure is baked into the voluntary, self-directed, commercially run retirement plans system? Consider what would have to happen for it to work for you. First, figure out when you and your spouse will be laid off or be too sick to work. Second, figure out when you will die. Third, understand that you need to save 7% of every dollar you earn. (Didn't start doing that when you were 25 and you are 55 now? Just save 30% of every dollar.) Fourth, earn at least 3% above inflation on your investments every year. (Easy. Just find the best funds for the lowest price and have them optimally allocated.) Fifth, do not withdraw any funds when you lose your job, have a health problem, get divorced, buy a house or send a kid to college. Sixth, time your retirement account withdrawals so that so the last cent is spent the day you die.[573]

Although questioning the ability of individuals to manage private accounts, Ghilarducci recognizes the need for savings beyond Social Security, suggesting that someone earning $100,000 at retirement would need $2 million (twenty times annual income in financial wealth) beyond Social Security to maintain their living standard in retirement.[574] Ghilarducci may be overstating the case by suggesting saving $2 million for a person earning $100,000. Using a simplified mathematical model and assuming someone works for fifty years, retires at age seventy, and lives to age 100,

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[571] SCHIEBER, *supra* note 9, at 213-14.

[572] *Id.* at 212-13 n.30 (citing Poterba et al, *supra* note 570, at 28, 32 referring to Tables 4-1 & 4-4 respectively). Calculations for the comparison for 401(k) assets included assets in IRAs because it is likely that some retirees will have rolled over their assets in connection with a change of employment or at retirement. Poterba et al., *supra* note 570, at 4-5. The growth of 401(k) assets will be modest for the lowest earners although with automatic enrollment and other practices designed to increase enrollment may have a positive effect on these earners. SCHIEBER, *supra* note 9, at 213-14. One study found that workers covered by defined benefit plans would retire one to two years earlier than those with only defined contribution plans. *Id.* at 257.

[573] Teresa Ghilarducci, *Our Ridiculous Approach to Retirement*, N.Y. TIMES (July 21, 2012), http://www.nytimes.com/2012/07/22/opinion/sunday/our-ridiculous-approach-to-retirement.html. The article also suggests it is a myth that people can plan to work more years to boost their retirement. *Id.* Conditions such as layoffs, finding work after fifty, or spousal or personal illness, among other reasons, make it difficult to work as one ages. *See generally* TERESA GHILARDUCCI, WHEN I'M SIXTY-FOUR: THE PLOT AGAINST PENSIONS AND THE PLAN TO SAVE THEM (1964).

[574] Ghilarducci, *supra* note 573. There is some inconsistency in her statements since saving $7,000 a year for fifty years and earning an annual 3% only accrues $789,578, not the $2 million suggested as needed for the person making $100,000.

that person would need to save $17,400 every year and earn 3% per year to accumulate $1,962,665 by age seventy. At that point, the person could withdraw $100,000 per year until the fund was exhausted at age 100. If the same person invested in a broad based stock fund earning 7% per annum that person could accumulate the $2 million simply by contributing $4,900 per year. If the 7% return continued into the retirement years, the person could provide $100,000 for thirty years simply by accumulating $1.25 million by age seventy. Obviously, all sorts of combinations can be made, but the important point is that investing over long periods of time and utilizing the benefits of compounding can provide a relatively attractive retirement.

Ghilarducci does not think the population can be educated to voluntarily make the sacrifice to save for retirement and proposes a plan for guaranteed retirement accounts (GRAs) with a forced savings component as the way to proceed.[575] Her plan which addresses the need for additional retirement savings along with other plans, such as the one in Chile, which replaced its social security type plan, are discussed below.

B. Guaranteed Retirement Account

Ghilarducci's concern is real; and allowing individuals to micromanage their investments may need to be limited in any solution to the retirement dilemma. For Ghilarducci, expecting individuals to shoulder the responsibility to save in a private pension plan for forty years is to defy human behavior. She proposes a guaranteed retirement account model to supplement Social Security by a forced contribution of 5% of payroll, which may be split between employee and employer, into an investment account in which the government invests the monies in the financial markets but guarantees a minimum real return of 3%, reflecting the historic long-term growth of the economy with the possibility of an inflation adjusted lifetime annuity at retirement.[576] Covered payroll would be the same as current Social Security and everyone would receive a $600 tax credit against their contributions paid for through the reduction of tax expenditures for 401(k) plans.[577] At retirement, participants can elect how they will receive their account distributions.

The GRA supports retirement because it requires people to save, provides participants with flexibility on choosing a retirement date, provides lifetime benefits without the risk of not having the best investment advice, has predictable outcomes, is available to small businesses, is compatible with defined benefit plans, and is national in scope.[578] There is a lot of merit in Ghilarducci's approach and many of the features are reflected in the One-Fund Solution.

C. President Bush's Plan for Private Accounts

Numerous proposals have been made for private accounts as part of Social Security. New York Senator Daniel Patrick Moynihan added voluntary individual

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[575] *Id.* at 15.

[576] *See* Butler, *American Paternalism*, *supra* note 11, at 515-17 and citations therein (describing the guaranteed retirement account model); *see also* GHILARDUCCI, *supra* note 573, at 260-93.

[577] GHILARDUCCI, *supra* note 573, at 277.

[578] *Id.* at 263-74 (explaining each parameter in detail).

accounts to a proposal which Robert Ball, Commissioner of Social Security; thought was "antithetical to the social elements of the existing system." In Ball's view, individual accounts, if successful, would make workers want to make them larger, undermining commitment to the existing program.[579]

In the late 1990s President Clinton was ready to move forward with a reform proposal that included diverting 2% of the Social Security tax to private accounts.[580] The proposal was never formalized and unrelated events focused President Clinton's attention in other directions.[581]

Using private accounts to solve Social Security problems is seen by many as diverting revenues away from current payment obligations.[582] However, with or without private accounts the country will face the same choices only with private accounts they face them sooner.[583] One knowledgeable Democrat is reported to have summed up the current stalemate as follows:

> The unsaid but implicit conclusion in her statement was that we can't increase our contributions now and save them in a way that gives us meaningful financing relief later—added revenues put into the trust funds cannot be saved. All that is left is benefit cuts if we do anything now. She could not understand why any elected Democrats would ever want to put themselves in that no-win position. The implications of Kennelly's observation, as I see it, is that some policymakers will avoid taking up Social Security reform until the trusts funds are nearly depleted and we again face the prospect of coming up short on the monthly payroll.[584]

In 2005, President Bush proposed a system of voluntary accounts needed to be put into place on a phased in basis as part of a reformed Social Security system recognizing the long-term fiscal problem facing OASDI.[585] He stressed how the ratio of workers supporting each retiree had dropped from forty to one to 3.3 to one in 2005 and will drop to two to one by the time the youngest workers reached

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579 SCHIEBER, *supra* note 9, at 90.

580 *Id.* at 106.

581 *Id.* at 112.

582 *Id.* at 115.

583 *Id.* (referencing a statement from Andrew Biggs, an advocate of private accounts and member of President Bush's Commission to Strengthen Social Security).

584 *Id.* at 117 (reflecting on a conversation with Barbara Kennelly, a former Member of the House Ways and Means Committee and former president of the National Committee to Save Social Security and Medicare).

585 *Strengthening Social Security for the 21st Century*, WHITE HOUSE ARCHIVES, http://georgewbush-whitehouse.archives.gov/infocus/social-security/text/ (last visited Apr. 24, 2016). President Bush's plan was only outlined in general terms which were evaluated in LAURA HALTZEL, CONG. RESEARCH SERV., RL32879, SOCIAL SECURITY REFORM: PRESIDENT BUSH'S INDIVIDUAL ACCOUNT PROPOSAL (2005). A subsequent report evaluated the status of various proposals for reform including President Bush's proposal. DAWN NUSCHLER, CONG. RESEARCH SERV., RL33544, SOCIAL SECURITY REFORM: CURRENT ISSUES AND LEGISLATION (2006). That the idea of private accounts gained in popularity in the 1990s was surprising. SCHIEBER, *supra* note 9, at 107 n.16 (citing Douglas Elmendorf et al., *Fiscal Policy during the 1990s* 30 (Nat'l Bureau Econ. Research, Working Paper No. 8488, Sept. 2001)).

retirement.[586] Further, the problem would be aggravated by the Baby Boomer retirees scheduled to begin reaching sixty-two, the age for early retirement, in 2008 and continue thereafter until 2031 at which time the number of retirees would have doubled.[587] Also, because the wage index that determines initial benefits is growing faster than inflation, future retirees will be receiving higher benefits in real terms further jeopardizing Social Security. [588]

In making his proposal President Bush said a variety of proposals had previously been made to solve the fiscal short fall in Social Security including, "limiting benefits for wealthy retirees, indexing benefits to prices rather than wages, increasing the retirement age, discouraging early collection of retirement benefits and changing the way benefits are calculated."[589] These were all on the table for discussion as ways to make Social Security sound, but he emphatically stated that increasing payroll taxes was not a permanent solution.[590]

There were three other parameters that were cornerstones of the proposal. First, the system's progressivity must be maintained; second, there should be no change for persons fifty-five years and older; and third, any change should be gradual.[591] A fourth caveat that Social Security should be a better deal for younger workers through voluntary accounts continues to be controversial.[592]

Under President Bush's proposal for individual accounts (IAs), workers under age fifty-five would be given an option to divert 4% of the 12.4% Social Security contribution to a private investment account in which the worker could invest into a group of broadly diversified index funds similar to the funds offered government employees in their Thrift Savings Plan.[593] The maximum amount that could be diverted to IA would be $1,000 annually which would increase by $100 per year over a series of years.[594]

Worker's retirement benefit would be reduced to the extent that a worker diverted a portion of their Social Security tax to an IA. To determine the amount of the reduction, the administrator would create a hypothetical "shadow" account for the worker in which the worker's IA contribution would be credited on paper. That shadow account would accrue interest at a real (inflation adjusted) rate of return of 3%. At such time as the worker retired, the hypothetical amount in the shadow account would be used as the amount the worker could receive if he purchased a

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[586] SCHIEBER, *supra* note 9, at 53 (referring to the ratio of the number of beneficiaries receiving benefits to the number of workers paying into the system as the "dependency ratio" and the ratio of the average benefits paid to the average wage of workers contributing to the system as the "earnings replacement rate").

[587] *Strengthening Social Security for the 21st Century*, *supra* note 585, at 1-2.

[588] *Id.* at 2 (estimating for twenty-year olds in 2005 the benefit was estimated to be 40% higher in real terms when they retired).

[589] *Id.* at 3.

[590] *Id.*

[591] *Id.*

[592] *Id.* at 3-4.

[593] *Id.*

[594] *Id.* at 4.

lifetime annuity with an appropriate cost of living adjustment. That monthly amount would be used to reduce the worker's Social Security benefit.[595]

President Bush's proposal was subject to considerable debate as he travelled seeking to build support for the change. Unfortunately, the IAs would not help the long-term deficit, and President Bush did not address that issue, which made the plan incomplete. Further, the Democrats thought the present system was just fine and that the solvency problem was thirty-five years away. President Bush's plan never gained traction in the country or in Congress.

Advocates of reform see Social Security as an out-of-date depression-era plan in need of modernization. The economic, social, and demographic changes of the past seventy years force the need for change, which has been accomplished in other countries. The present pay-as-you-go system is unsustainable and a system that allows workers to acquire ownership in an account is preferable and would give workers a larger retirement income. Also, reform may have the effect of curbing entitlement spending. Finally, current workers are paying for over-generous payments to former retirees who will get a much better return than they will.[596]

Those advocating for a more restrained approach believe minor changes to the taxes or benefits would be sufficient and that advocates of private accounts want to undermine public support of the system and erode the social insurance nature of the system. They see considerable problems in transitioning to a system of private accounts and, even if it could be done, think it would put workers at excessive risk to the market. In any event, people already have the right to invest outside the Social Security system. [597]

D. Chile's Private Pension System

On November 4, 1980, Chile transitioned from a pay-as-you-go system[598] into an "Individual Capitalization" pension system, providing for individual member accounts.[599] The reform gave every individual the option of opting out fully from government run pension systems.[600] Under this new plan, employers were required

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[595] HALTZEL, *supra* note 585, at 4.

[596] NUSCHLER, *supra* note 585, at 3-4.

[597] It is also suggested that the demographic problem is overblown since people who live longer will likely work longer. *Id.* at 4-5.

[598] Pay-as-you-go ("PAYGO") is the practice of using funds currently collected for future obligation to pay amounts due under already accrued obligations rather than setting the funds aside for the future obligations. *Pensions in Chile*, WIKIPEDIA (Aug. 13, 2014), http://en.wikipedia.org/wiki/Pensions_in_Chile.

[599] *Id.*; *see also* SUPERINTDENCIA DE PENSIONES, THE CHILEAN PENSION SYSTEM, A DESCRIPTION OF THE CURRENT SYSTEM 53 (2008), http://www.spensiones.cl/portal/informes/581/articles-3523_chapter4.pdf [hereinafter THE CHILEAN PENSION SYSTEM] (stating each member has an individual account with an APF in which his/her social security contributions are deposited for investment in appropriate mutual funds). When the member retires or passes away, the amount in the account is returned to the member or his/her surviving beneficiaries in the form of a pension based directly on the amount in the account. *Id.*

[600] *Empowering Workers in Chile*, JOSEPINERA.ORG, http://www.josepinera.org/articles/articles_empoweringworkers.htm (last visited Apr. 26, 2016).

to pay a stated percentage of a worker's wages in the worker's pension fund.[601] Workers already in the system were not required to switch over to the new plan, new workers were automatically placed in the new plan, and older workers were given, as an incentive to convert, a statutory minimum contribution of 11% lower than their contributions under the old pension system.[602] As a result, over 95% of Chile's workers converted to privately managed personal retirement accounts (PRA).[603]

1. An Overview of Chile's Private Pension System

The pension system is managed by private institutions called Pension Fund Administrators (AFPs) each of which operate five mutual funds with different proportions of debt and equity securities purchased with funds accumulated by workers in their PRA accounts.[604] AFPs are highly regulated to protect the interests of the workers and to insure the workers are fully informed of their PRA accounts, which are the source of their pension.[605]

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[601] Employees are obligated to pay a total of 10% per pay period. THE CHILEAN PENSION SYSTEM, *supra* note 599, at 60; *see also* ALISON M. SHELTON, CONG. RESEARCH SERV., RL42449, CHILE'S PENSION SYSTEM: BACKGROUND IN BRIEF 2 (2012), www.crs.gov, R42449; *On the way to responsible citizens: Pension reform on the example of Chile*, JOSEPINERA.ORG, www.josepinera.com/josepinera/Jp_ABC_Revolucion_pension_ger.htm (last visited Nov. 21, 2014) (indicating that the 10% rate was determined on the assumption of a 4% average real return on a PRA during a whole working life for the typical worker would be sufficient money in his account to fund a retirement benefit equal to approximately 70% of his final salary).

[602] THE CHILEAN PENSION SYSTEM, *supra* note 599.

[603] The PRA is also referred to as an "individual capitalization account." *Id.* at 60. This same reform introduced two important changes to the health system: (a) the disability and survivor insurance system became an integral part of the so-called "AFP system" (the AFPs are highly regulated private companies which can be 100% foreign owned that manage the PRAs on workers' behalf); and, (b) it allowed workers to opt out from the monopolistic government health insurance system with all their mandatory contribution (another 7% of wages), as long as they were willing and able to buy with that money a minimum health insurance plan in what became the "ISAPRE system" (the ISAPREs are the private companies that offer diverse health insurance plans). *Empowering Workers in Chile*, *supra* note 600. This comprehensive reform has changed dramatically Chile's economy and society. Six million workers (95% of the labor force) have a PRA and 1.5 million (almost 25% of labor force and gradually increasing as higher wages allow their 7% of wages to buy the minimum health plan) have an ISAPRE plan. *Id.*

[604] *Empowering Workers in Chile*, *supra* note 600. The exclusive purpose of the AFP is to carry on activities related to the social security system. In the Chilean system, people can choose between five types of savings funds, denoted A to E, defined by their ratio of fixed-interest to variable-interest assets. Kristian Niemietz, *Chile's private pension system has weathered the crisis*, INST. ECON. AFF. (Jul. 27, 2010), http://www.iea.org.uk/blog/chile%E2%80%99s-private-pension-system-has-weathered-the-crisis. *Fondo A* is the most risky one, with up to 80% of its assets invested in equities. *Id. Fondo E* is the most conservative one, consisting of fixed interest bearing bonds only. *Id.* The other ones are intermediate solutions. *Id.*

[605] The AFPs are regulated by a government body, appointed by the President of the Republic, that guarantees the financing of benefits, which is represented within the system itself by the "Superintendency of Pension Fund Administrators" (SAFP). The SAFP is broken down into six separate divisions: Legal Department, Institutional Control Division, Finance Division, Benefits and Insurance Division, Research Division, and Internal Administration, and IT Division. In addition, the SAFP has two units – the Medical Commissions Unit,

Workers choose which AFP(s) to join as well as the individual funds within the AFP, although older members and pensioners are limited to funds with a high percentage of debt securities and younger members can have up to 80% in equities.[606] Employees are obligated and self-employed workers have the right to make regular deposits at 10% of taxable monthly wages and income subject to an upper limit.[607] An additional 3% voluntary payment can be made to cover disability and term life insurance.[608] These deposits are made into the employee's individual capitalization account and invested by the AFP. Workers not making timely payments are subject to collection procedures[609] and money put into the account remains tax-free.

In 2002, a voluntary contribution system was added to the current system to encourage voluntary contributions to the individual capitalization account. These extra savings could mean early retirement for an individual or a higher pension on retirement. Alternatively, the extra savings could be used to compensate the individual for periods when no contributions were made due to some misfortune, such as unemployment. Under the voluntary system, workers can contribute an additional 10% of his wage subject to limits.[610]

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ensuring compliance with disability legislation, and Unemployment Insurance Unit, ensuring that unemployment insurance functions correctly. THE CHILEAN PENSION SYSTEM, *supra* note 599, at 55-58.

[606] Investment decisions are made by the AFP but percentage limits are set for specific types of instruments and for the overall mix of the portfolio. *Empowering Workers in Chile*, *supra* note 600. The spirit of the reform is that those regulations should be reduced progressively as the AFP companies gain experience and capital markets work better. There is no obligation whatsoever to invest in government bonds or any other security. *Id.* Legally, the AFP companies and the mutual funds are separate entities. *Id.* Thus, should an AFP go under, the assets of the mutual funds-that is, the workers' investments-are not affected at all and only the AFP's shareholders lose their capital. *Id.*

[607] The contribution limit is approximately $2,427 USD (sixty UF in Chile's currency, the "Unidades de Fomento"). Barbra Kritzer, *Chile's Next Generation Pension Reform*, 68 SOC. SECURITY BULL. 69, 81 (2008), https://www.ssa.gov/policy/docs/ssb/v68n2/v68n2p69.pdf. Unidades de Fomento is a real, inflation-adjusted unit that is used for special purposes in Chile including pension contributions and guaranteed benefits under the pension system. SHELTON, *supra* note 601, at 2 n.5.

[608] Generally, it is advisable to pay the 3% and avoid the possibility of paying for their own disability costs. *See* Steve Idemoto, *Social Security Privatization in Chile: A Case for Caution*, ECON. OPPORTUNITY INST. (Sept. 29, 2000), http://www.eoionline.org/wp/wp-content/uploads/social-security/SSPrivatizationChileCaseCaution-Sep00.pdf.

[609] *See* THE CHILEAN PENSION SYSTEM, *supra* note 599.

[610] The voluntary contribution is limited to fifty UF per month (approximately $2,022 USD). *Id.* at 61; *see also Empowering Workers in Chile*, *supra* note 600. As a compliment to the individual capitalization account, an independent voluntary savings account was authorized in 1987, which can be used to create extra savings for retirement. Unlike the individual capitalization account, the voluntary savings account allows the individual to withdraw money from the account four times per year. THE CHILEAN PENSION SYSTEM, *supra* note 599, at 62-63. Withdrawals from the account are taxable income pursuant to a formula that determines the proportion of any withdrawal that constitutes gain or loss in the account. *Id.*

2. Obtaining Benefits

The individual capitalization system offers three different types of pensions. First, the normal pension offered at the time of an individual's retirement—–for men at or after age sixty-five and for women at or after age sixty.[611] Second, a person can retire early provided the member qualifies for a pension equal to or greater than 50% of his or her average taxable income for the last ten working years, but which is not less than 110% of the minimum pension guaranteed by the State.[612] Third, the members, through the plan's administrators, finance a disability and survivorship benefit, but if the member is not covered by such insurance then the benefit is financed through that member's individual capitalization account alone.[613]

The pension is paid at the option of the member, either as a programmed withdrawal, a life annuity, or temporary income with a deferred life annuity. The programmed withdrawal must meet certain requirements to insure that the member does not exhaust their account.[614] The member is able to withdraw the excess funds in his account to the extent the account balance is sufficient to meet 110% of the minimum pension guaranteed by the State and higher than 70% of the member's average monthly taxable wage over the last ten years. [615]

Chile also provides a minimum pension for those that contributed to the account for twenty years but have an amount in their fund below the minimum. In 2002, the value of the minimum pension was approximately $72,000 for members under seventy years of age and $79,000 for members over seventy years of age.[616] From 1992 to 2002, the minimum pension grew at an annual rate of 4.6% in real terms.[617]

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611 THE CHILEAN PENSION SYSTEM, *supra* note 599, at 65.

612 *Id.*

613 *Id.* at 65-66. To qualify for a disability pension, a person must be under the age of retirement and must have lost at least two-thirds of their ability to work. *Id.* If the worker loses only one-half to below two-thirds of their ability, the individual may still be able to receive a partial disability pension. *Id.*

614 Niemietz, *supra* note 604. The Programmed Withdrawal option allows a retiree to leave his funds in the PRA and make programmed withdrawals, subject to limits based on the life expectancy of the retiree and his dependents; with this option, if he dies, the remaining funds in his account form a part of his estate and can be given to his heirs basically tax-free. *Empowering Workers in Chile*, *supra* note 600. The Life Annuity option allows members to sign an irrevocable contract, losing ownership of their resources, allowing their pension benefits to be paid by a life insurance company (of their choice). *Id.* "This company promises to pay them a constant monthly income, in real terms, as long as they live, and to pay a survivorship pension to their beneficiaries. In this way, the member's resources are transferred to the Life Insurance Company which assumes both the financial risk and the risk of longevity on the part of the pensioner and his/her family group." THE CHILEAN PENSION SYSTEM, *supra* note 599, at 68-69. Lastly, the Temporary Income with Deferred Life Annuity option in essence allows a member to receive a loan on their benefits from the insurance company. *Id.* At the time of retirement, the individual retains ownership and therefore risk of loss on their annuity until such time as the loan is repaid. *Id.*

615 THE CHILEAN PENSION SYSTEM, *supra* note 599, at 68-69.

616 *Id.*

617 *Id.* at 69-71 (finding other criteria are in place to determine minimum pensions for the disabled and survivors).

3. The Transition Financing Pensions and Pension Options

The transition from a pay-as-you-go system to a system of private accounts is a difficult and expensive process, but was accomplished without raising taxes.[618] At the time Chile was in the hands of a dictator, essentially bankrupt, and had just started a modern pension system modeled on the United States system.[619]

Chile took three important steps to facilitate the transition. First, it guaranteed the benefits of those in the former system.[620] Second, workers who opted out of the former system were given a "recognition bond" in an amount equal in value to their interest under the former system.[621] The bond would be a zero coupon bond bearing real interest of 4% per annum payable on the date of the individuals retirement. The bond could be traded in secondary markets and would be deposited in the worker's PRA account. Third, all new entrants into the labor force were required to enter the PRA system.[622] An element of transparency in the system is the following:

> We also ended the illusion-artificially maintained by lawmakers around the world-that both the employer and the worker contribute to social security. As economists know well, all the contributions are ultimately paid from the worker's marginal productivity, and employers take into account all labor costs-whether termed salary or social security contribution-in making their hiring and pay decisions. So, by renaming the employer's contribution as additional gross wage, our reform made it clear, without reducing workers' take-home pay, that all contributions are paid ultimately by the worker and that he can control his own money. Of course, at the end of the day, wage levels will be determined by the interplay of market forces.[623]

At the time of transition in 1980, the Chilean pay-as-you-go system short fall was estimated to be equivalent to 80% of GDP.[624] Chile used five "sources" to finance the transition. First, Chile issued bonds at market rates of interest, some of which were purchased by the AFPs.[625] Second, since the savings rate needed to fund the

618 *Empowering Workers in Chile*, *supra* note 600. Addressing transition costs is difficult but a key insight is that: "[C]ontrary to the widely held belief, there is no 'economic' transition cost, because there is no cost to GNP due to this reform . . . . A completely different, and relevant, issue is how to confront the 'cash-flow' transition cost to the government of recognizing, and ultimately eliminating, the unfunded liability created by the pay-as-you-go system." *Id.*

619 MARIN, *supra* note 2, at 180.

620 *Empowering Workers in Chile*, *supra* note 600.

621 *Id.*

622 *Id.*

623 *Id.*

624 From 1981 to 1999, transition costs averaged about 3.25% of GDP. SHELTON, *supra* note 601, at 6.

625 Using debt, the transition cost was shared by future generations. In Chile, roughly 40% of the cost has been financed by issuing government bonds at market rates of interest. *See* Idemoto, *supra* note 608. Prior to changing the system, "the government deliberately created a budget surplus, and for many years afterwards the treasury minister was able to use . . . ." Jose

PRAs was lower than the payroll tax under the old system, a fraction of the difference was used as a temporary "transition tax."[626] Third, Chile sold government owned assets to raise funds.[627] Fourth, Chile reduced and held down government spending.[628] And, fifth, the value-added tax resulting from economic growth fueled by the PRA system increased tax revenues.[629] These actions led one commentator to point to two lessons: (1) pension plans and their critical role in providing retirement income and support are perhaps the single most important variable in the fiscal stability of the world economies, so understanding their status—country-by-country or entity-by-entity—is the key to assessing and/or running those economies; (2) pension plans are the most important source of long-term capital in almost all economies and, as such, are the true engines of growth and must be tended to accordingly.[630]

4. Criticism of the Chilean Model

The full impact of Chile's privatization remains unknown until the system matures. Critics point to its negative impact on public spending, exorbitant management fees, the income disparity between men and women and low-income individuals, and the susceptibility of the accounts to market down turns.[631] Some of these criticisms were addressed in a 2008 reform that limited commissions paid to the AFPs and enhanced the minimum pension (often referred to as a "poverty prevention tier") and benefits for women.[632]

Critics question whether Chile's model is applicable to other countries although a number of countries have already adopted it.[633] For example, the Social Security in

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Pinera, *Empowering Workers: The Privatization of Social Security in Chile*, *in* SOCIAL SECURITY AND ITS DISCONTENTS: PERSPECTIVES ON CHOICE (Michael D. Tanner ed., 2004).

626 *Id.*

627 *Id.*

628 *Id.*

629 *Id.*

630 MARIN, *supra* note 2, at 181. Regarding the sale of government assets, Marin points to the sale of Chile's largest pension fund company, Provida, and insurance company, Consorcio. *Id.* at 180.

631 *See* Idemoto, *supra* note 608, at 3 (reporting, in 1990, high management fees and unfairness to lower, middle, and women workers); Niemietz, *supra* note 604 (observing that the value of Chilean pension assets crashed "spectacularly" in 2008 but rebounded in 2009, that 30% of Chilean pension assets are invested abroad making them less dependent on Chile's economy, and that pensioners have more security than under the prior PAYGO system); *see also* THE CHILEAN PENSION SYSTEM, *supra* note 599, at 88 (explaining that, since administrators fix set commissions within a legally established structure and members have freedom to choose between AFPs, commissions should reflect competitive levels between AFPs).

632 SHELTON, *supra* note 601, at 8-9. The poverty prevention tier provides a means-tested minimum benefit (the "Basic Solidarity Pension") to everyone as well as a Pension Solidarity Complement for those who's PRA does not provide a pension equal to a threshold amount. *Id.* at 1-2. Furthermore, the enhanced provision for women who, among other things, provides a bonus at age sixty-five for every live birth or adopted child. *Id.* at 9.

633 "Since 1990, ten other countries in the region have adopted some form of what has

the United States was more efficient than Chile's system in 1981 when they converted to a private system.[634] Further, the high administrative costs incurred by Chile, a lack of a public mandate for change, the large cash flow requirements for transition, and the lack of a current budget surplus all make adoption of the Chile system in the United States unlikely.[635]

Chile's new system has performed well. Reports are, from 1981 through 2014, Fund C, a balanced fund, averaged real returns of 8.6% with annual real returns between minus 3% and plus 30%. While the rate of contribution is almost half the former payroll tax rate, the benefits have been many times higher. Further, capital has experienced significant productivity gains, poverty has been reduced, and government expenditures as a percentage of GDP declined from 34.3% in 1984 to 21.9% in 1990. Finally, pension funds and investment funds have accumulated funds equal to 70% of GDP.[636]

E. Australia's Model

The retirement income security system in place in Australia consists of three pillars.[637] The first pillar is a government provided, means-tested aged pension while the second and third pillars are mandatory and voluntary savings retirement funds together called the "superannuation fund."[638] The superannuation fund—employer sponsored mandatory retirement payments and private voluntary payments—was instituted by the government to alleviate some of the public burden and reduce

become known as the Chilean model: Argentina (1994), Bolivia (1997), Colombia (1993), Costa Rica (1995), Dominican Republic (2003), El Salvador (1998), Mexico (1997), Panama (2008), Peru (1993), and Uruguay (1996)." Kritzer, *supra* note 607, at 69; *see also* THE CHILEAN PENSION SYSTEM, *supra* note 599.

[634] Idemoto, *supra* note 608.

[635] SHELTON, *supra* note 601, at 9.

[636] For information regarding the success of the Chilean plan, see *Empowering Workers in Chile*, *supra* note 600. The success of the system will ultimately be evaluated of a full working life plus any period of retirement. *Id.*

[637] Australia's national health care (often a fourth pillar of retirement) provides world-class medical treatment for medical emergencies, but, for treatments that can be delayed such, as a non-emergency hip replacement, retired Australians purchase private insurance. *See Australia's Health System—An Overview*, AUSTRALIAN GOV'T DEPT. HEALTH, http://www.doctorconnect.gov.au/internet/otd/publishing.nsf/Content/australiasHealthSystem (last visited Apr. 24, 2016). Australia's medical system consists of two parts: a universal health care that is funded by the government and pays for about 70% of medical costs, and a private individualized insurance system that covers the other 30% of costs. *Id.* Similar to the health care system in the United States, their public system is referred to as "Medicare" and is only available to qualified citizens based on eligibility requirements that vary based on age, income, disability, and more. *Id.* Home ownership has also been described as a fourth pillar. *See* David Ingles & Miranda Stewart, *Superannuation Tax Concessions and the Age Pension: A Principled Approach to Savings Taxation* 1 (Tr. Territory of the Pacific Islands, Working Paper 7/2015, 2015).

[638] Cormick & McLaren, *supra* note 2, at 497.

government expenditures.[639] The Superannuation Guarantee Charge (SGC) requires employers to contribute 9.25% of the salary paid to employees[640] and employees can contribute an extra amount up to, in 2014, $30,000 ($35,000 if aged over forty-nine), as well as contribute to a voluntary savings account.[641]

Under the first pillar, all citizens are provided a basic means-tested benefit with a level of income deemed sufficient to provide a minimum standard of living.[642] Most retirees in Australia are entitled to a pension benefit from a government-sponsored and administered system.[643] Unlike the United States Social Security system, it is neither contributory nor meant to be a "safety net."[644] The amount of age pension an individual is eligible to receive "is determined by two factors: (1) the base amount, which is the same for every Australian, and (2) the means tests."[645] Coverage is not necessarily universal, but is based on eligibility criteria,[646] and is meant to be a

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639 *Id.* (finding currently over 25% of government expenditures is on health, age-related pensions, and aged-care and will grow to over 50% by 2049-2050). John Hewson, *The Politics of Tax Reform in Australia*, ASIA & PACIFIC POL'Y STUDIES 590, 595 (2014) (stating that, while Australia's overall tax burden is low, the simpler superannuation introduced in 2006 is both inequitable and inefficient, and finding that: "the [tax] system encourages wealth accumulation by borrowing and speculation, while . . . impos[ing] the highest rates of tax on wage and salary income and savings in deposits, while imposing substantially lower rates on the same amount of income from other investments and particularly if those investments are funded by debt.").

640 Nick Summers, *In Australia, Retirement Savings Done Right,* BLOOMBERG BUS. WK. MKTS. & PERS. FIN. (May 30, 2013), http://www.businessweek.com/articles/2013-05-30/in-australia-retirement-saving-done-right (explaining, when it began in 1992, the law required employers to divert 3% of most workers' salaries into retirement accounts). As of July 1, 2014, the rate was 9.5% and will remain flat for six years and increase to 10% on July 1, 2020, and to 12% on July 1, 2025. Ingles & Stewart, *supra* note 637, at 3; *see also Superannuation in Australia,* WIKIPEDIA, http://en.wikipedia.org/wiki/Superannuation_in_AUSTRALIA (last visited Apr. 24, 2016) (stating "[e]mployers are not required to make employer contributions for employees earning less than $450 per month not working more than 30 hours per week, or for employees aged under 18 or over 70. If however they are earning $450 per month before tax and working more than 30 hours per week full-time, part-time or casual, the employer is required to pay superannuation regardless of being under 18.").

641 Cormick & McLaren, *supra* note 2, at 497 n.15; Summers, *supra* note 640 ("One in five employees saves even more with voluntary contributions known as 'salary sacrifice.' Some companies match workers' contributions.").

642 Cormick & McLaren, *supra* note 2, at 497 and citation contained therein.

643 This system is known as "Age Pension." The age pension redistributes income both on the basis of wealth and between the stages of the life cycle and is paid by current tax, which is largely paid by younger workers. Dana M. Muir, *Building Value in the Australian Defined Contribution System: A Values Perspective*, 33 COMP. LAB. L. & POL'Y J. 93, 104-08 (2011).

644 *Id.* at 104.

645 *Id.* at 106-08 (finding the Age Pension uses both an income test and an asset test to determine the amount an individual may be eligible for).

646 The eligibility requirements are that the individual reaches the age of sixty-seven, if born after January 1, 1957, and either have a been a resident for a continuous period of ten years at the time of filing, or the individual must have been a resident for five continuous years prior to filing with other years of residency that would total ten years. *Id.* Ingles &

"social assistance program to prevent poverty among the elderly."[647] Furthermore, benefits are foregone if not received during the time period in which they are available.[648] Take for example, a sixty-seven year old beneficiary who is a resident and has worked for the past fifteen years but still working, he could not receive an age pension for the length of time in which he was still working and those benefits would not be later given to him upon his retirement; the benefits that accrued after age sixty-seven would have been.

For most individuals, private wealth is tied to owner-occupied housing and values in the superannuation fund.[649] Contributions, both mandatory and voluntary (pillars two and three), to the superannuation fund are taxed at a reduced rate of 15%.[650] At such time as the individual reaches retirement age, if the private account is above a certain amount, the individual will not be eligible for the social insurance retirement benefit.[651] However, all moneys taken from the retirement account are tax-free.[652] Over the past two decades, the retirement plan has increased in wealth, growing from just under 20% of GDP to roughly 90% of GDP, and with over 90% of employed Australians having savings in a superannuation account, the total assets in these accounts now exceed Australia's GDP.[653]

Australian marginal tax rates go up to 40% and the only deduction allowed is for charity.[654] No deduction is permitted for mortgage interest on a primary residence.

Stewart, *supra* note 637, at 5-17 (describing in detail the age pension and the income and asset tests and pointing out that the eligibility age will increase to sixty-seven in 2023 and to seventy in 2035).

647 Muir, *supra* note 643, at 105.

648 *Id.* at 104-08.

649 Cormick & McLaren, *supra* note 2, at 497.

650 *Id.* at 501 (noting the criticism that taxing contributions reduces the amount invested and the accumulation over the contributor's working life). Income generated in the superannuation fund is taxed to the member as it accumulates, and taxed according to their proportion of tax-free and taxable benefits, although the fund receives dividend imputation credits, based on investment in Australian equities that can reduce the effective tax rate for investment income to 8%. *Id.* at 506; *see also* MERCER, TAX & SUPERANNUATION: BENCHMARKING AUSTRALIA AGAINST THE WORLD'S BEST RETIREMENT SAVINGS SYSTEM 7 (2013), http://www.mercer.com/content/dam/mercer/attachments/asia-pacific/australia/News/130208_Global_Tax_Benchmarking_Final.pdf; Ron Bird & Jack Grey, *A Brief Critical Review of Australia's Retirement Savings System*, 12 J. INV. CONSULTING 53, 53 (2011).

651 Summers, *supra* note 640.

652 *Id.*

653 Daniel J. Mitchell, *Unexpected Praise for Australia's Pension Social Security System*, CATO LIBERTY, http://www.cato.org/blog/unexpected-praise-australias-private-social-security-system (last visited Apr. 21, 2016); *see also* Summers, *supra* note 640 (pointing out that assets in the superannuation fund grew to $1.52 trillion from 1992 to 2013 compared to $2.8 trillion in United States 401(k) plans with a population fourteen times larger than the Australian population).

654 If an individual has other investments income from such investments would be taxed at the regular rates. *See* Cormick & McLaren, *supra* note 2, at 501; *see* also MERCER, *supra* note 650.

Australia has a 10% goods and services tax (GST), but no local sales taxes.[655] In Australia, taxes make up 22.2% of GDP[656] and national debt is 20.48% of GDP.[657] The system, however, is far from perfect.[658] Migratory labor law, for example, is an area where the law is limited, making it difficult for migratory workers to save for retirement the way national workers can.[659]

F. Canadian Savings Account

Canada has instituted a savings program attractive for middle class investors called the Tax-Free Savings Account (TFSA). The TFSA is a flexible, registered, general-purpose savings vehicle that allows Canadians to earn tax-free investment income to more easily meet lifetime savings needs.[660] The nearest United States equivalent is Roth Individual Retirement Accounts (IRA). With a Roth IRA, earnings are taxed before contributions are made into the account. The money then grows tax-protected, and people pay no tax when the funds are withdrawn. However, Roth accounts have numerous restrictions and, in some cases, can be subject to penalties.[661]

While IRA accounts have been around for many years, only 38% of United States households own some type of IRA.[662] Canada introduced TFSAs in 2009, but 48% of Canadians have already signed up; and, as of 2013, TFSAs hold $109 billion

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[655] *See Exports & GST*, AUSTRALIAN TAX'N OFFICE, https://www.ato.gov.au/Business/International-tax-for-business/Australians-doing-business-overseas/Exports-and-GST/ (last visited Apr. 24, 2016).

[656] *Tax-to-GDP Ratio – Past and Prospective Developments*, AUSTRALIAN GOV'T TREASURY, http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/Economic-Roundup-Issue-2/Economic-Roundup/Tax-to-GDP-ratio (last visited Apr. 24, 2016).

[657] *Australian Government Debt to GDP*, TRADING ECON., http://www.tradingeconomics.com/australia/government-debt-to-gdp (last visited Sept. 14, 2014).

[658] *See, e.g.*, Hewson, *supra* note 639 ("Australians are left with a system that still visibly fails three original, key objectives of tax policy, let alone to have adequately adjusted to the dramatic shifts in global and domestic economic and social environment and related policy challenges . . . .")

[659] *See* Cormick & McLaren, *supra* note 2, at 503–12 (discussing issues such as: the ability of sovereign nations to tax workers on their own authority, thus leading to the double taxation of some migratory workers; and the inability of migratory workers in many cases to transfer their earned retirement in a separate nation to Australia without significant ramifications).

[660] *Tax Free Savings Account*, CAN. GOV'T. (Jan. 2, 2009), http://www.tfsa.gc.ca/.

[661] Roth IRAs are subject to a number of restrictions based on income limits (cannot have AGI over $191,000 in 2014) and penalties if money is withdrawn within five years or before reaching age fifty-nine and six months. *Id.*

[662] Amity Shlaes & Chris Edwards, *A Simple Tax Reform Can Help Families Promote Economic Growth*, WALL ST. J. (Aug. 24, 2014), http://online.wsj.com/articles/amity-shlaes-and-chris-edwards-a-simple-tax-reform-can-help-families-and-promote-economic-growth-1408919408.

in assets.[663] While the account is not completely without tax penalty, there are far fewer restrictions on these types of accounts than those placed on IRAs.[664]

1. Key Features

Some of the key features that set a TFSA apart from an IRA are, the lack of income limitations on contributions, lack of restrictions for using the account, and the tax benefits gained by having the account.[665] Unlike the income, contribution, and withdrawal restrictions in an IRA, a TFSA allows any qualified Canadian resident[666] to contribute up to $5,500 annually without tax penalty.[667] Any unused contribution is saved and carried forward for use in future years.[668] For example, if you contribute $3,500 this year, next year you could add the unused $2,000 and make a deposit of $7,500 that year. Any withdrawal made in the prior year can also be contributed without penalty.[669] In addition, TFSA account owners can choose from a wide range of investment options.[670] The investment income earned on the TFSA is tax free, as well as any withdrawals from the TFSA.[671]

Although contributions to a TFSA are not tax deductible, "neither income earned within a TFSA nor withdrawals from it affect eligibility for federal income-tested benefits and credits, such as Old Age Security, the Guaranteed Income Supplement, and the Canada Child Tax Benefit."[672] Unlike an IRA, a TFSA does not have to be withdrawn at retirement. In the event of the taxpayer's death, the assets within a

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[663] *Id.* ("At the end of 2013 Canadians held $109 billion in assets in TFSAs. In an economy the size of the United States' economy, that amount would be the equivalent of $1 trillion.").

[664] *Id.*

[665] *About the tax-free savings account (TFSA)*, CAN. REV. AGENCY, http://www.cra-arc.gc.ca/tx/rgstrd/tfsa-celi/bt-eng.html (last updated Dec. 15, 2015).

[666] Canadian residents must be eighteen years or older and have a valid social insurance number to be able to set money aside tax free. *Id.*

[667] *Id. see also Four Reasons to Open a TFSA*, GETSMARTERABOUTMONEY.CA, http://www.theglobeandmail.com/globe-investor/investor-education/investor-education-fund/tfsas/four-reasons-to-open-a-tfsa/article16886502/ (last visited Apr. 21, 2016) ("The money you put into a TFSA has already been taxed. So if your marginal tax rate is higher when you take the money out, you'll have paid less in taxes . . . . You can use the TFSA to shelter investments that would otherwise be taxed at the highest rate. That's because you don't pay tax on your TFSA's earnings.").

[668] *Tax Free Savings Account*, *supra* note 660.

[669] *Tax-Free Savings Account*, CAN. REV. AGENCY (Feb. 24, 2014), http://www.cra-arc.gc.ca/tfsa/; *see also Tax Free Savings Account*, *supra* note 660 ("Re-contributing in the same year may result in an over-contribution amount which would be subject to a penalty tax.").

[670] This includes mutual funds, bonds, and Guaranteed Investment Certificates. *Tax Free Savings Account*, *supra* note 660.

[671] Full amount of withdrawals can be put back into the TFSA in future years. However, re-contributing in the same year may result in an over-contribution amount, which would be subject to a penalty tax. *Id.*

[672] *Id.*

TFSA can generally be transferred to the taxpayer's legal or common-law spouse.[673] An account can be opened at any bank branch, or online, and can hold different types of assets, including bank deposits, stocks, bonds, mutual funds, and more.

The largest danger faced by TFSA owners is over contribution to their accounts annually.[674] Canada's Revenue Agency imposes a tax penalty of 1% per month on the excess contributions.[675] Although the issue of penalties for excess contributions gained considerable attention in 2010, it eventually quieted down, but so far in 2012 the government collected $22.5 million in penalties.[676] In that year, nearly 80,000 people were sent notices of over contribution but less than 20,000 received a waiver on the penalties they incurred.[677]

The United States could adopt its own TFSA simply by expanding existing legislation. A TFSA is subject to simple and rather straightforward rules so that investors should be able to become adept at evaluating investment choices rather than the complex provisions of tax law. A United States TFSA would create an incentive for people to save for serious projects like the purchase of a home or saving for higher education or retirement. A TFSA would be equally available to both high-income persons as well as low-income persons. Even though there would be certain revenue losses, much revenue is already lost with Roth IRAs and 401(k)s and growth may be spurred with the additional savings created by a TFSA.

G. Social Security Works All Generations Plan

Those commentators who think private accounts are unacceptable, but realize the inadequacy of current arrangements in providing a secure retirement, propose expanding Social Security through the existing system and paying for it with increased taxes.[678] They reach their conclusions because they believe America is the richest nation in the world, income has been inequitably captured by the top 1% of earners, and numerous groups have suffered under the economic recession and from general adverse economic conditions beyond their control.[679] "The All Generations Plan" would expand the program to provide for millions of persons who give voluntary care to others in need and to those going through life changing events such

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673 *Id.*

674 Rod Carrick, *Misunderstanding This Simple TFSA Rule Could Cost You A Lot*, GLOBE & MAIL (Feb. 26, 2014), http://www.theglobeandmail.com/globe-investor/personal-finance/retirement-rrsps/dont-let-your-tfsa-land-you-in-tax-jail/article17123629/ (explaining that Canada's Revenue Agency (CRA) figures show that approximately 74,000 people were sent notices for over contribution in 2012). "Also, the CRA has waived its penalties an average of 21,000 times in the past three years [but only] for people who were able to argue they made an honest mistake and remove the amount of their excess contribution as soon as they were told about it." *Id.*

675 *Id.*

676 *Id.*

677 *Id.*

678 ALTMAN & KINGSON, *supra* note 8, at 88-104.

679 *Id.* The authors argue that legislation has shifted the redistribution curve upward toward the wealthiest 1% of the earners. *Id.* at 100-01.

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as the birth of a child or the oldest of the old.[680] The basic Social Security formulas and coverages are seen as offsetting these inequalities.[681] The All Generations Plan is seen as:

> [A] solution to . . . the income insufficiency of today's seniors; the retirement income crisis confronting today's middle-aged and young workers; insufficient recognition of and public support for the caregiving functions of the family; and increased inequality, now hollowing out the middle class.[682]

The first step in the All Generations Plan is to increase every benefit by 10% up to $1,500 per month.[683] The second step is to recognize that the cost-of-living index does not adequately address the costs incurred by seniors by creating a more accurate COLA for seniors.[684] This would prevent the erosion of benefits being received by seniors over time. Third, enhance the special minimum so that those working thirty years and retiring at full retirement age will receive a benefit equal to at least 1.25% of the federal poverty level.[685] Other parts of the plan would enhance supplemental security income, provide benefits during caregiving for family members and others, restore benefits for students through age twenty-two, and expand benefits for adult disabled children.[686]

The All Generations Plan contains proposals to pay for the enhancements.[687] Using GDP percentages, Social Security costs would be 4.94% of GDP as of 2015, will increase to 6.16% of GDP by 2035, and drop to 6.08% by 2085. This percentage is significantly lower than that incurred by other developed nations. The authors of the All Generations Plan consider this a minor and manageable increase since the United States is the wealthiest nation in history.[688] The All Generations Plan proposes gradually increasing the Social Security tax divided between employer and employee from 12.7% to 14.4% and expanding the tax base to include all salary reduction plans such as flexible spending accounts as income for this purpose.[689] In addition, it would eliminate the earnings ceiling on the tax and provide enhanced benefits affecting only 6% of the taxpayers.[690] The plan would gradually direct that

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680 *Id.* at 73-86.

681 *Id.* at 103.

682 *Id.* at 107.

683 *Id.* at 110.

684 *Id.* at 110-11.

685 *Id.* at 113-14.

686 *Id.* at 117-22.

687 *Id.* at 123-40.

688 *Id.* at 125. The authors compare the allocations of GDP for other uses to that of Social Security and conclude that the increase for Social Security is modest and affordable. *Id.* at 126. Further, the authors reason that if 0.93% of GDP can be allocated for 401(k) and related plans through tax expenditures that Social Security can be enhanced. *Id.* at 128.

689 *Id.* at 130-32.

690 *Id.*

40% of the trust fund assets be invested in equities to enhance fund's income.[691] Finally, reasoning that high-income persons benefit most from services provided by the government, the plan proposes a 10% tax on income above $1 million dollars.[692]

H. The Better Base Case

Edward D. Kleinbard would focus on public investment, particularly on "hard" infrastructure, science, education, and providing more comprehensive social insurance believing that we can accomplish the goals without "radically changing our tax system.[693] He advises greater spending in each area and, regarding education, thinks the focus should be on early childhood education in economically disadvantaged areas.[694] He would also rethink the cost of post-secondary education since:

> Student loan programs make college affordable in a technical sense for some students, but they then graduate with tens of thousands of dollars of debt, which hangs over their future, dampening their appetite for entrepreneurial risk-taking at precisely the point in their lives when such risks should be least costly to them.[695]

Kleinbard sees social insurance with mandatory participation, such as Social Security, employer provided health insurance, and unemployment insurance as a necessary characteristic of a modern growing state.[696] Kleinbard notes:

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691 *Id.* at 133-34.

692 *Id.* at 134-38. The plan would also eliminate the distinction between the OASI and DI trust funds and summaries of the proposals. *See id.* at 138-39, 216-77 (appendix B provides Additional Information About the Social Security Works All Generations Plan and Other Proposals Including Cost and Revenue Estimates).

693 KLEINBARD, *supra* note 21, at 267. Kleinbard thinks public investment in infrastructure is justified because governments have lower financing costs, there is an absence of financial profit, and it results in positive externalities in that everyone likely benefits and there is a creation of good paying construction jobs. *Id.* at 277-78.

694 *Id.* at 289-98. Kleinbard sees religiously based private education as "tribal havens" with low academic standards. *Id.* at 297.

695 *Id.* at 296. Making loans to students always seems like government is helping students, but, by failing to police the practices of schools in taking student loan money or providing money only for programs with a history of providing jobs to students, the government is faced with large numbers of students who cannot pay those debts. *Id.* The result is that the government creates ways to forgive those debts either through payment plans or by favoring work for non-profit organizations with forgiveness. *Id.* Lately governments are considering forgiving loans if the school violated state law in enticing students to matriculate there. Josh Mitchell, O*bama Administration opens Door for More Student-Debt Forgiveness*, WALL ST. J., June 8, 2015.

696 KLEINBARD, *supra* note 21, at 305. Kleinbard states:

> The universal experience around the world is that as a country grows richer the basket of insurance that its government offers its citizens—more accurately, the mutual insurance its citizens provide for each other through the intermediation of government—also grows in size. This is not the sure sign of decadence, but of common sense.

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> Countries employ social insurance as a key component of the social compact because most people believe that to be a member of a society is to have an interest in the welfare of other members of that society. This impulse can be expressed in ethical terms, but it also is based on straight forward economic logic: healthy and adequately nourished citizens are more productive, and will contribute more to the prosperity of society, than will sick and emaciated ones. Finally, in many cases, such as health insurance or insurance against absolute inadequacy," insurance most efficiently delivered as mandatory social insurance (that is, as a government program), because this effectively address problems of adverse selection.[697]

Social insurance is seen as a fair price to pay for the "safety net" and encourages risk taking by the youth because they know the down side is protected if their adventure does not work out. This safety net is paid for by the progressive income tax, which is seen as a "known alternative" justifying taking the risk where any moral hazard is a mere side effect that can be addressed with program design.[698] Kleinbard finds it ironic that individuals who have their health insurance subsidized through the tax code as well, receive numerous other tax benefits, and exemptions under the income and Social Security taxes still fight to repeal the subsidies and other benefits received by individuals forced to obtain health insurance under the Affordable Care Act.[699] Our current system spends more money per capital than other developed countries on healthcare and produces trillions of dollars in waste and poor overall outcomes, according to Kleinbard.[700] The answer for healthcare is a "national single-payer" system, the obvious and logical system, and Kleinbard stands amazed that President Obama did not pursue this option.[701]

Regarding Social Security, Kleinbard admits that it has a progressive benefit scheme funded by a regressive tax source. It is a form of social insurance that allows people to say, "I made contributions, and now I get benefits," although strictly speaking the early retirees did not pay very much for their benefits, which Kleinbard dismisses as an "accident of the start of the program" and a mere "generational

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Id. at 298.

[697] *Id.* at 303-04.

[698] *Id.* at 305-06.

[699] *Id.* at 307-08.

[700] *Id.* at 316, 321.

[701] *Id.* at 323. For Kleinbard, it is simple:

> At one stroke, the fundamental problem of adverse selection disappears, because all members of society participate. Premiums are easily collected through the existing tax administrative machinery. A patch work of largely monopolistic local sellers now faces a monopsonistic buyer. Operating administrative costs are reduced, as we see today in Medicare administration. There is more than enough value on the table here to compensate the medical community fairly and still reap hundreds of billions of dollars of savings every year.

Id.

mismatch."[702] He does not classify the refundable portion of the earned income tax credit as insurance but as an "investment in our fellow citizens" or as a "special set of tax rate" applicable to individuals with incomes at certain levels.[703] The refundable portion can be characterized as "primarily a rebate of payroll taxes borne by a low-wage worker" and he does not question how a low-wage worker can claim benefits of Social Security and later claim, "I paid for them."[704]

Kleinbard develops the history of how the income tax was adopted to move from a consumption tax (primarily tariffs) to an income tax based on ability to pay. The current tax scheme was an attempt to make wealthy Americans pay their "fair share."[705] Ability to pay builds on the "now-familiar language of the declining marginal utility of income,[706] which is the most common justification to this day for our zero rate foundational bracket of income and increasing marginal rates thereafter."[707] For Kleinbard, the solution to the fiscal problem comes from a mildly progressive tax structure primarily focused on funding a government "big enough" to create the social insurance programs that will change lives.[708] He finds the current focus on the progressivity of the income tax is misguided. Rather, the focus should be on what the spending side needs to achieve the goals of a good society and structuring the tax system as necessary to generate the needed revenues.[709]

The attempt to use a "progressive" tax structure to reduce inequality is shown by Kleinbard to be a mistake. He proposes that it is the size of the revenue raised, rather than its progressivity, that is important because the "progressive" overall fiscal system that distributes revenue in a progressive fashion should be the real focus.[710]

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702 *Id.* at 326.

703 *Id.*

704 *Id.* at 326-27.

705 *Id.* at 338, 339.

706 *Id.* at 343. The concept of declining utility of income is the basis for asserting the need for an "equal sacrifice" in paying taxes by all citizens so that the wealthy must pay a greater rate than less well-off people so they feel the same pain. As Kleinbard acknowledges, referring to a book by Walter Blum and Harry Kalvern, the criticism of the concept is that:

> [U]tility cannot be measured in cardinal terms, which is just a fancy way of saying that no one knows the quantum of utility I derive from my next dollar of income, according to some objective scale (like "pounds" or "yards"). As a result, interpersonal comparisons are impossible, which means that one cannot answer the question, how many dollars must we tax the rich fellow to make him feel the same pain that the poor one does when we tax her, say, $100?

Id. at 343 (citing WALTER BLUM & HARRY KALVERN, THE UNEASY CASE FOR PROGRESSIVE TAXATION (1953)). He would recast the concept as an aspirational one in which we could say that it represents how we would act if we all had good mothers. *Id.* Although determining the optimal degree of rate progressivity is difficult, the concept of the declining utility of income is the core theory of the utilitarian social welfare norms. *Id.* at 352-53.

707 *Id.* at 339. This combination meant that the income tax and progressive rate structure were "joined at the hip." *Id.*

708 *Id.* at 341.

709 *Id.* at 344.

710 *Id.* at 366.

In this regard, he demonstrates that the elderly are the overwhelming winners when government spending per household is compared to the taxes paid by those households.[711]

Kleinbard builds his argument on a foundation of a moral responsibility of every individual in society to give back to society in recognition of the fact that no one succeeds on his or her own but succeeds from the contribution of society and the "luck" of the draw. He asserts:

> [I]f you accept the fundamental premise of this book, that material outcomes are determined by an undifferentiated porridge of personal efforts and brute luck, by virtue of which we all have a bit less control over our material success than we like to pretend, then some tax rate progression functions as a broad social insurance program to address the brute luck component.[712]

Here he argues for big government funded by a "mildly" progressive tax system focused on investment and social insurance that will complement the private market and make for a much "happier" society as a byproduct.[713] To support his moral foundation, he builds on an early work by Adam Smith, *Theory of Moral Sentiments*.[714] He chooses this book because it creates a perspective with which to review Smith's better known book, *An Inquiry into the Nature and Causes of the Wealth of Nations*,[715] which is cited by conservative writers to support their views of limited government and see the road to happiness in reliance on "unalloyed real-world private market outcomes," referring to these writers derogatively as "market-triumphalists.[716]

Kleinbard proposes a "Better Base Case" to address the problems he has identified. He would expand infrastructure spending to create an infrastructure bank and raise the level of social investment and insurance. To provide the revenues for his expanded government, he would revert to the pre-2001 tax rate structure with four modest changes which include: (1) permanently repealing the individual alternative minimum tax; (2) retaining the child tax credit at the 2012 levels, including the refundable portion as a "make work pay" incentive; (3) keep the tax rate on dividends equal to the capital gain rate (20% pre-2001 rate); and (4) reinstate the 2009 estate tax level.[717] Revenue of up to $1.5 trillion over ten years lost by the tweaks would be made up by converting the personal itemized deductions and the

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[711] *Id.* at 363.

[712] *Id.* at 346.

[713] *Id.* at 169-70.

[714] ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (A. Millar, 6th ed. 1790) (this book was originally published in 1759, seventeen years before Smiths better-known book on the *Wealth of Nations*).

[715] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776).

[716] KLEINBARD, *supra* note 21, at 30 (this term is used throughout the book).

[717] *Id.* at 379. His illustrations could leave a 1% to 1.5% of GDP deficit, $235 billion to $355 billion in 2021. *Id.* at 377.

standard deduction from deductions to a 15% credit.[718] This, he believes, would be supported by "widespread bipartisan consensus."[719] He does not suggest curtailing tax expenditures for income support such as pensions and 401(k) plans. As mentioned earlier, making Social Security solvent over the next seventy years and increasing the progressivity of our tax system can be achieved easily by gradually phasing out the earning cap on the Social Security tax.[720]

Kleinbard describes his Better Base Case as modest and, from the standpoint of taxation, simple and straightforward.[721] He believes our national wealth is sufficient to service the debt and begin paying down the debt. However, his plan sees deficits for the next ten years. Kleinbard sees government as being good at infrastructure investments and social insurance such that these actions will not only produce positive returns but will also produce a well-designed social insurance program that will "increase our appetite for economic risk."[722] Notwithstanding Kleinbard's confidence in government, the primary impediments to the future are the trillion dollars of waste in the health care program and the trillion dollars of tax expenditures put in place by government.

V. ONE FUND SOLUTION

The foregoing has demonstrated the inability of governments (whether federal, state, or local), unions, and employers to effectively administer retirement plans in a political environment where restraint is required. Whether individuals can manage the accumulation of retirement wealth is an open question, although Social Security's lack of transparency has created a reliance and expectation with a retirement security that is likely to disappoint.

The One Fund Solution has been described in two previous articles.[723] The One Fund Solution proposes a government administered private account with characteristics similar to what is commonly thought of as a "whole-life" insurance policy in which post-tax contributions build up over a lifetime of mandatory contributions to be distributed and used tax-free upon retirement. Investment options within the plan are limited but gradually expand as balances in the fund grow and a secure retirement is established.[724] For security, there is a government guaranteed

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[718] *Id.* at 380-83. He proposes curtailing all the personal itemized deductions, including the charitable deduction, because he finds it impossible to choose among them. *Id.* at 382. Scaling them back would make the tax system more "progressive, more efficient, less distortive, and simpler." *Id.* at 383.

[719] *Id.* at 381.

[720] *Id.* at 384. Kleinbard views Social Security revenues like any other revenues as far as deficit reduction is concerned. *Id.* Removing the wage cap on Social Security would also likely create pressure to increase the benefit levels for those impacted by the removal.

[721] *Id.* at 401.

[722] *Id.* at 404.

[723] *See generally* Butler, *American Paternalism*, *supra* note 11; Butler, *It's My Money*, *supra* note 11.

[724] Because of the long period from beginning work until retirement, the individual should be allowed to invest early in the stock market to get the maximum benefits of compounding.

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fund with a guaranteed inflation protected return of 3%, which is available for all amounts in the fund.[725] By making the One Fund Solution the sole tax-advantaged retirement account funded with after tax dollars, every participant receives the same benefit.

Mandatory contributions to the One Fund would be set between 15% and 20% of taxable payroll, and voluntary contributions would be permitted so long as annual contributions do not exceed $50,000. Mandatory contributions are required only until the assets in the fund are valued at $1 million or more. Thereafter, voluntary contributions can continue until the fund value reaches $2 million, at which time no further contributions will be permitted. Tax-free withdrawals are limited to taxable gain of $2 million. All other retirement savings would be done on a personal level but would not be tax advantaged. Money in the One Fund account would belong to the contributor and would be inheritable at death.

The transition to the new system extends over a ten-year period and begins with a determination of the present value of the account held by each individual in the present system. Each person is then given the option of continuing in the present system or transferring to the new One Fund system with the value of the Social Security benefit being the initial deposit in the One Fund account. For a period of ten years, all deposits remain in the guaranteed account such that no funds would leave the system and move into stock, bond, or other available accounts. The gradual elimination of retirement tax expenditures during the ten-year period provides additional funds to cushion the transition. Likewise, additional revenues are transferred into the system by the increased taxation of the entire contribution, although tax rates may be adjusted to allocate the burden of the expansion of the tax base.

Capitalizing Social Security benefits would not be difficult since the value of each individual's contributions and expected benefit is calculated on an ongoing annual basis. Capitalizing the liability would not increase the amount of the liability, but would merely quantify it and allocate it in a fair and reasonable way, while income from the elimination of tax expenditures would increase over time thereby enabling the government to address the unfunded liability. The problem of using tax revenues to support Social Security payments is already upon us in the form of the need to pay interest on the trust fund. Furthermore, these payments are continuing to increase into the indefinite future.

While the One Fund Solution may seem inconsistent with the current retirement plans in place, it is intended to be a simple and straightforward approach to retirement planning. It replaces the complicated and inadequate Social Security system as well as the highly complex system of tax-benefited plans that benefit

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By adding a separate savings feature to the One Fund that would serve as an emergency fund which could be invested in the stock market so long as the individual was on a path to full retirement benefits.

[725] The United States economy has a history of 3% real growth over an extended period of time, which was the justification for the guaranteed return in the GRA and the reason it was chosen for the One Fund Solution guaranteed return. GHILARDUCCI, *supra* note 573, at 15. Unfortunately, not since 2004 has the economy experienced 3% growth, a full nine years of below par growth. Editorial, *Another Growth Dip*, WALL ST. J., Jan. 31, 2015, at A12. Interestingly, the State of Kentucky has an interesting plan that pays 4% on employee contributions. NJ STATUS REPORT, *supra* note 299, at 21.

various interests in different ways. Social Security was never intended to be the sole source of retirement funds; but, now that the full force of the mature system is upon us, we find that, except for certain categories of beneficiaries, it is not a good return on the 12% of a person's lifetime income used to fund the benefit.

The current system of federal tax expenditures has created a hodge podge of savings vehicles that favor high-income taxpayers, and a fairer and more transparent system could be put into place by combining the various systems of federal tax supported retirement programs. The time has come to acknowledge that the multitude of tax benefited federal, state, local, and private pension system made possible by the federal income tax code is, year after year, creating greater unfunded liabilities that future generations will be called upon to pay. The concept that such a system is contributory and an entitlement is an artificial creation that needs to be abandoned. Ultimately the risk will rest on the public, which has no control over the means to accept that risk. This artificial concept of an entitlement should be abandoned in favor of a system giving individuals control of their own destiny.

A. Integrating Social Security with the Total Retirement Scheme

President Roosevelt's comment that payroll tax contributions were put into the system to prevent future politicians from scrapping Social Security discloses the nature of the program;[726] a welfare program wrapped up in a retirement plan with limited insurance benefits added. Social Security advocates tout its benefits and necessity as noted in the following statement:

> To this day, public defenses of the program often start with a recitation of how many retirees have no other income and would fall into poverty without it. The pitch is made even more effective by the fact that much of the employer-sponsored pension income never shows up on surveys . . . so Social Security seems even more dominant in providing retirement income than it actually is. [727]

Social Security was implemented at a time when the Great Depression left millions of people who never expected to retire unemployed at an advanced age. Such poverty was devastating, but at that time there were few private pension plans and private savings were lost in the market crash. Social Security filled the gap, but times changed, and, during the 1940s, employers adopted defined benefit plans and in the 1970s defined contribution plans were created.[728] The retirement world is also different because in 1940 single earner couples were the norm but today those able to afford single earner couple status are high-income taxpayers.[729] These changes were not contemplated in the 1930s.

Social Security wealth and private pension wealth have traditionally been considered two separate realms and not integrated on matters of policy. If the numbers previously provided as to the investment return on Social Security contributions are correct, everyone except the single earner couple should be calling for change and a better return on their investment. But high-income taxpayers, or at

[726] Shaviro, *supra* note 170, at 140.

[727] SCHIEBER, *supra* note 9, at 280.

[728] *Id.*

[729] *Id.*

least those with incomes above the median who do not have their tax liability offset by credits, are beneficiaries of the rich tax expenditures available for 401(k) contributions and other types of retirement vehicles that make up tax expenditures totaling nearly $800 billion from 2014-2018 or $69.4 billion in 2014 alone.[730] Objecting to the poor return on Social Security could raise questions about massive subsidies for high-income taxpayers thereby giving them an incentive to accept the current system.

Schieber suggests the loss most earners experience in Social Security would be offset by the tax benefits received from 401(k) contributions over a lifetime.[731] He calculates that for a single male medium earner the net result over a lifetime would be a net loss of $17,109, reflecting a loss under Social Security of $80,751 but a gain of $63,642 from his 401(k).[732] A similar analysis for a single female showed a net gain of $14,609; for a single-earner couple a net gain of $264,071; and for a two-earner couple a net gain of $29,218.[733] The gain for the two-earner couple is merely twice the gain for a single-female and far less than the gain for a single-earner couple. For medium earners, the maximum gain goes to the single-earner household because of the spousal benefit under Social Security.[734] For maximum earners, only the single-earner couple has a net gain from the combined system.[735] The "winner" of this lottery is the single-earner couple and, to some extent, a two-earner couple where the lower earner is less than half the higher earner.[736]

This analysis suggests that in some broad context "government" programs for all income levels provide a rough equality to all participants. The advantage for single-earner couples may no longer be justified since the number of female retirees grew from 11.6% in 1944, when the benefit was adopted, to 35% in 1960.[737] In 2008, 44% of women drew benefits based solely on their own earnings, 28% had a benefit based partially on their own earnings and supplemented by their husband's earnings, and 28% based solely on their husband's earnings.[738]

[730] JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018, at 32 (2014) (identifying the five-year tax expenditure totals for items of income security). The figures in the text do not include the tax expenditure for the exclusion of untaxed Social Security and railroad retirement benefits which total $209.1 billion over five years or $37.4 billion in 2014. *Id.* at 33. For a breakdown of the $800 billion by type of plan see *infra* note 897.

[731] SCHIEBER, *supra* note 9, at 287-88.

[732] *Id.* at 287.

[733] *See id.* at 288.

[734] *Id.*

[735] *Id.* at 287-89 tbl.24.5. Table 24.5 provides the analysis for the four household styles and for low, medium, high, and maximum earners. *Id.* For maximum earners, the net loss for the single male is $61,858, for the single female $15,060, and for the two-earner couple $30,119. *Id.* The net gain for the one-earner couple is $325,226. *Id.*

[736] *Id.* at 288.

[737] *Id.*

[738] The spousal benefit could change and be made more equitable but there may be other anomalies such as differential mortality rates across the demographic profile. *Id.* at 290.

Studies show that any redistribution of income from higher earners to lower earners is undermined by "spousal benefits for married couples where one spouse earns significantly less than the other."[739] When tax-favored retirement plan participation is considered, the redistribution of income is even further undermined. The conclusion is that future policy discussions need to be conducted in the context of the complete retirement support system and not merely Social Security in isolation.[740]

B. The True Cost of Retirement

A significant problem with the current retirement system, that integrates the three legged stool analogy with government control and tax advantages, is that people fail to appreciate the true cost of the benefits they expect to receive. The three legs are not independent, but instead are all related and ultimately stand or fall directly or indirectly on the employee's compensation package. Employers can allocate so much to compensation and that amount is divided between Social Security, supplemental retirement, healthcare, and other benefits with the remaining amount being take-home pay. When one cost increases, other benefits suffer or take-home pay is reduced affecting personal savings. These costs are "hidden" to the employee who only sees that his pay is flat and his health care deductibles are increasing.[741]

Productivity increases, which should benefit the employee, are being absorbed by increases in the cost of payroll taxes, retirement plan funding, and health benefits. A study of the 1980 through 2009 period showed that the 1980s increases in total compensation were absorbed by payroll tax increases (30%) and by health benefit costs (50%) while retirement plan costs were reduced (by 45%) as a result of reduced ERISA funding requirements.[742] Increases in the 1990s were absorbed by payroll tax increases (6%) and health benefit costs (22%), while retirement plan costs were reduced slightly (by 8%).[743] Increases from 2000 to 2009 were absorbed by payroll tax increases (3.5%),

[739] *Id.* at 292 (citing Alan L. Gustman & Thomas L. Steinmeier, *How Effective Is Redistribution under the Social Security Benefit Formula?* (Nat'l Bureau of Econ. Research, Working Paper No. 7597, 2000)). The working paper concludes:

> When families are arrayed according to the total lifetime earnings, and spouse and survivor benefits are taken into account, the extent of redistribution from families with high lifetime earnings to families with low lifetime earning is roughly halved. Much of the remaining redistribution is from families where both spouses spend much of their potential work lives in the labor market, to families where a spouse, often with high earning potential, chooses to spend a significant number of years outside of the labor force. . . .

Id. Schieber also relies on Jeffrey R. Brown et al., *Is Social Security Part of the Social Safety Net?* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 15070, 2009) (reaching similar conclusions as Gustman and Steinman).

[740] SCHIEBER, *supra* note 9, at 292-93.

[741] "[T]he American middle class has absorbed a step increase in the cost of health care and other necessities as income have stagnated over the past half-decade, a squeeze that has forced families to cut back spending on everything from clothing to restaurants." Ryan Knutson & Theo Francis, *Basic Costs Squeeze Families: Surging Price Taxes for health Care, Other Essentials Leave Less for spending Elsewhere*, WALL ST. J., Dec. 2, 2014, at A1.

[742] SCHIEBER, *supra* note 9, at 248 tbl.21.3.

[743] *Id.*

health benefit costs (28%), and retirement plan costs (28%) that grew dramatically as ERISA funding standards were reinstituted to make up of the lack of funding in the 1980s and 1990s.[744] Funding future benefits will exact a toll on productivity for some time in the future, although a few years of economic growth with exceptional returns on pension funds may alleviate some of the pressure.[745]

Another way to look at the problem is through Schieber's estimates on how these hidden costs in compensation have escalated over the past fifty-six years and have become an increasing weight on an employee's take-home pay.[746] Schieber analyzes the situation of persons retiring at age sixty-five in 1955, 1975, 1995, and 2011 and estimates the percentage of lifetime income a person would have allocated to Social Security returning approximately 40% to 45% of final pay, to the contribution required to produce an annuity for an additional 40% of final pay, and to the cost of healthcare.[747] His estimates are in the following chart.

Table 6

Year reaching age 65	1955	1975	1995	2011
Lifetime payroll tax as percentage of lifetime earnings	2.1%	5.9%	9.9%	13.1%
Supplemental retirement benefit 40% of final pay	4.6%	5.9%	6.7%	7.5%
Total retirement cost per year	6.7%	11.8%	16.6%	20.6%
Annual health benefits cost[748]	1.0%	3.5%	8.0%	10.6%

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744 *Id.* (detailing percentages for three categories of non-cash compensation that absorbed workers' compensation increases over three decades for ten wage groups. The percentages in the text are approximations of the percentages in the middle compensation deciles).

745 As women entered the workforce in the 1980s, the number of two-earner families increased significantly yet families did not feel as though they were getting ahead since "most of the rewards for all that extra work were diverted to benefit costs, especially among the bottom half of earners." *Id.* at 250. During the 1990s, much of the increase was being paid out in additional wages, but during the 2000s benefit costs were again absorbing compensation increases although not as much was going to the lower income workers and the distribution was therefore more equitable. *Id.* at 250-51.

746 *Id.* at 241 tbl.21.1, 365. Schieber predicts that a worker retiring in 2020 will see an increase of 20% over that of the person retiring in 2011. *Id.* at 334. When the Social Security system in 1939 was being amended in a way to carry the program into the future, the issue of whether to fund it, or a move toward pay-as-you-go was discussed by the Advisory Council on Social Security. *Id.* When member, Edwin Witte, seeking to put the program on an insurance model with funding as desired by President Roosevelt, suggested that to put the system on pay-as-you-go would make future taxpayer have greater payroll tax obligations, another member, J. Douglas Brown, responded by telling Witte that by then "we will all be dead." *Id.* at 366 n.5 (citing MARTHA DERTHICK, POLICYMAKING FOR SOCIAL SECURITY 235 (1979)).

747 *Id.* at 240.

748 *Id.* at 242. The health care costs are those paid by the employer divided by the total payroll without reduction for persons not covered by the health care benefits. Further, the health care costs do not include amounts paid by the worker for the insurance or out-of-pocket expenses. It has been estimated that a sixty-five-year-old couple retiring in 2013 will, on average, spend $220,000 out-of-pocket for medical expenses not including the cost of long-term care. ALTMAN & KINGSON, *supra* note 8, at 53. In 2015, Fidelity Investments suggests the couple will spend $245,000 over two decades including Medicare premiums and non-covered

Year reaching age 65	1955	1975	1995	2011
Retirement plus health costs	7.7%	15.3%	24.6%	31.2%

Cumulative Lifetime Employee plus Employer Payroll Taxes as a percentage of Cumulative Lifetime Earnings, Supplemental Retirement Savings Rate, Employer Average Contributions for Health Benefits, and Totals as a percentage of pay for Workers Retiring at Various Dates.[749] *(All amounts stated as a percentage of salary or wages)*

These estimates reflect assumptions regarding age of retirement, life expectancy, and quality of healthcare in each of the referenced years and do not represent the actual experience of any retiree.[750] Nevertheless, the specific observations are striking. In 1955, the cost of providing a retirement benefit equal to 80% of final pay was roughly 6.7% of lifetime income (2.1% for Social Security and 4.6% for a supplemental annuity).[751] By 2011, the combined cost grew to 20.6%. Adding in health care, the lifetime payroll commitment to retirement and healthcare would have been 7.7% in 1955 and 31.2% in 2011.[752]

With the way these benefits are structured, their true cost is hidden from the employee, allowing most taxpayers to assume they are getting a "good" deal for their "contributions" or perhaps that some government subsidy will allow them to collect more than they paid for. Some may think, "My 6.2% payroll tax for Social Security and 1.45% for Medicare will make my retirement comfortable," when they should actually be thinking, "I am already contributing 31.2% of my compensation, but, is it enough? Maybe a higher number is more realistic."[753] One possibility is to make employees aware of these hidden costs so they would choose less expensive plans,

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portions of Medicare but not including dental and long-term care expenses, leading one commentator to suggest that a health savings account is preferable to a 401(k), after funding to receive the employer match, or individual retirement account because contributions are excluded from Social Security and Medicare taxes and withdrawals for medical expenses are free of income tax. Anne Tergesen, *HSAs Offer Benefits Beyond 401(k)s*, WALL ST. J., Jan. 30, 2016, at B7.

749 *Id.* at 241 tbl.21.1.

750 For example, the comparison reflects certain assumptions for the supplemental retirement; namely, that a return of 7% per annum and a retirement date that has gradually become earlier and earlier determined the costs of an annuity to supplement retirement income. For this Article's purposes, the numbers are sufficiently accurate.

751 SCHIEBER, *supra* note 9, at 240 tbl.21.1.

752 That we retire earlier, live longer, and have superior health care in 2011 can explain some of the difference but allocating income to these purposes has a dramatic impact on the employees' ability to provide for life's other needs or desires. *Id.* Schieber puts it somewhat differently, pointing out that, for retirement alone, the average worker would surrender roughly 3.5 to 4 more years for their lifetime earnings to finance their retirement benefits than the generation retiring in the mid-1950s. *Id.* Going a step further, he points out that, when health care is added into the equation, the difference between 1955's contribution and 2011's contribution is more than nine years worth of pay out of a forty-year career. *Id.*

753 Schieber suggests that "[i]f we simply sit on our hands until 2030, those workers would have to divert roughly 16% of their pay to make up Social Security's financing shortfall. Under recent health cost growth rates, the tab for health benefits could be as much as 17% of workers' pay. Given the need to save for their own retirement, these costs could consume more than 40% of workers' earnings. What are we leaving the next generation." *Id.* at 252.

thereby allowing for greater take home pay or increased retirement savings. For example, limiting the costly exclusion[754] for employer provided healthcare would make employees aware of the cost of healthcare and broadens the income tax and Social Security tax base.[755]

C. Market Failure

The enthusiasm for private accounts dissipated when the stock market experienced dramatic declines during the bursting of the "tech-bubble" in 2000, and again when the "housing-bubble" collapsed and took the stock market with it in 2008. People saw their 401(k) balances fall in half and their retirement security evaporate.[756] Taxpayers close to retirement age decided to stay on the job and forego retirement.[757] However, since that time, the market has largely recovered, although the recovery is attributed to actions of the Federal Reserve Bank's quantitative easing and near zero interest rates.[758] But reacting to individual market downturns does not form a basis or require staying away from the market and perhaps a better understanding of markets would change that attitude.

The notion that an average earner in 2011 dedicated up to 31% of their lifetime earnings to healthcare and retirement together with the low rate of return on Social Security should raise serious questions about the system in place. Such knowledge should cause people to develop a serious savings habit at a young age. Unfortunately, unless someone has a business degree, they are unlikely to understand the basics of financial management. Many people are unable to understand their own paycheck. The basics of financial management should be included in every high school curriculum to create a culture of savers rather than a

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[754] KLEINBARD, *supra* note 21, at 246-47 (noting the loss of tax revenues in 2014 as $143 billion from the income tax and another $100 billion from the Social Security tax).

[755] STEUERLE, *supra* note 4, at 145; *see also* KLEINBARD, *supra* note 21, at 246-47 (pointing out how the exclusion for employer provided health care has distorted the market for health care). Kleinbard states:

> The core story line of healthcare policy in the United States over the last fifty years is a meditation on how the tax exclusion for employer-provided healthcare has impeded sensible policy. Employees have every reason to prefer oversized healthcare plans over cash income and employers have every reason to accommodate them. The result has been the relative over consumption of healthcare insurance (that is, a relative insensitivity to its costs), the proliferation of employer-provided plans, and with the latter the collapse of the individual health insurance markets, because most people most of the time are covered through their employers. (The technical formulation here would be that the subsidy distorts "allocative" decisions—decisions about how and when we spend our money.).

Id.

[756] *The Impact of the Financial Crisis on Worker's Retirement Security*: *Hearing Before the H. Comm. on Educ. and Labor*, 110th Cong. (2008) (statement of Hon. George Miller, Chairman).

[757] *Id.*

[758] Quantitative easing in the United States is now over but is just getting started in Europe and Japan so that United States investors are anticipating a benefit from investments in those countries.

culture of spenders. By creating a single account that individuals can see and understand, the One Fund Solution seeks to provide that impetus needed to learn the basics of investing, which, when coupled with government oversight of the investment choices and disclosure, make responsible savers.

A simple illustration may help understand how basic financial management concepts provide protection against stock market failure. A young person starting their first job at age twenty will likely have fifty years before needing retirement funds. Allowing compounding of interest to work over this period say at a rate of 3% per annum would increase a $1,000 to $4,384 by age seventy. Of course the investor may reach age seventy during a year in which the stock market crashed as it did in 1929, 2000, and 2008. The risk of market failure should be minimal since in every twenty-year period since 1802 the stock market after-inflation return has been between 1% and 12.6%. Considering that our young investor will have lived through more than two such twenty-year periods, it is likely that he is still in a position to retire.[759] If he invests every year he should be in a position to withdraw the increased funds every year for the remainder of his life. A further protection our investor would have against market failure is that as he begins to see retirement on the horizon, he would begin either converting a portion of his portfolio into bonds that would form a buffer against any unexpected down turn in the market.

Respected Professor of finance at the Wharton School of the University of Pennsylvania, Jeremy Siegel, suggests that although the future might see lower realized returns than in the past, there is "overwhelming reason to believe stocks will remain the best investment for all those seeking steady, long-term gains."[760] Commenting in Professor Siegel's latest book, Peter Bernstein states:

> "[O]verwhelming reason" is an understatement. The risk premium earned by equities over the long run must remain intact if the system is going to survive. In the capitalist system, bonds cannot and should not outperform equities over the long run. Bonds are contracts enforceable in courts of law. Equities promise their owner nothing—stocks are risky investments, involving a high degree of faith in the future. Thus, equities are not inherently "better" than bonds, but we demand a higher return from equities to compensate for their greater risk. If the long-run expected return on bonds were to be higher than the long-run expected return on stocks, assets would be priced so that risk would earn no reward. That is an unsustainable condition. Stocks must remain "the best investment for all those seeking steady, long-term gains" or our system will come to an end, and with a bang, not a whimper.[761]

A common fear is that, as America ages, it will be unable to afford the massive retirement of the Baby Boom generation and, accordingly, the retirement age should

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[759] JEREMY J. SIEGEL, STOCKS FOR THE LONG RUN: THE DEFINITIVE GUIDE TO FINANCIAL MARKET RETURNS AND LONG-TERM INVESTMENT STRATEGIES 95 fig.6-1 (5th ed. 2014). Over thirty years, stocks averaged from a low of 2.6% and a high of 10.6%. The lowest return on stocks approximated the return on Social Security. Bond returns over thirty years averaged from negative 1.9% to a positive 7.7%.

[760] Peter Bernstein, *Foreword* to SIEGEL, *supra* note 759, at xviii.

[761] *Id.*

be lifted. Further, how will the aging population sell all their securities if the number of young people able to buy those securities is declining? Will the next generation be as well off as the present generation? Jeremy Siegel noted that from 1950 to 2010 life expectancy rose from sixty-nine years to seventy-eight years while the age at which men retire from the workforce fell from age sixty-seven to sixty-two and the period of retirement grew from 1.6 years to 15.8 years. [762] This trend is not likely to continue demographically, and the question of increases in retirement age will become paramount as fewer people will be called upon to support a growing retiree population.

Siegel suggests that, if the developed world depended on its own productive capacity to produce the goods and services needed by the retiree generation, the retirement age needs to increase to age seventy-seven by mid-twenty-first century.[763] However, when growth in the emerging markets is considered, he projects that the retirement age need only increase to age sixty-eight, but that depends on the continued growth of emerging markets at a rate of 4.5% over the next fifty years, the rate obtained since 1990.[764] The United States retirement age could continue to fall to age fifty-eight if the growth rate meets the 9% that China experienced over the past twenty years.[765] This reflects the scenario that emerging markets provide goods needed by the aging developed world that are paid for with the funds from the purchase of shares by the savers in the emerging markets.[766] Siegel projects that by 2060 the developed world's percentage of the economy will drop from its current 50% to 25% and to 14% by the end of the century.[767]

This simple view of the future should make every twenty-year-old consider the wisdom of devoting 12% of their lifetime income to a system whose return was based on United States government bonds. Citizens need to be educated on the accumulation of wealth and the One Fund Solution would provide them with an incentive to do so. Those unwilling or unable to understand such information would be protected by the paternalism of the federal government that would guarantee a real rate of return of 3% protected from taxes, inflation, and actions of the federal government.

The impact of inflation is a difficult concept to understand when considering long-term investing. Government policy is that a certain amount of inflation is

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[762] SIEGEL, *supra* note 759, at 60.

[763] *Id.* at 62, 63 fig.4.2 (Scenario A).

[764] *Id.* at 63 fig.4.2 (Scenario B), 64-66.

[765] *Id.* at 63 fig.4.2 (Scenario C), 67.

[766] *Id.* at 63 fig.4.2. Siegel addresses the question whether people in the emerging markets are likely to purchase assets of Western firms and notes that the firms are becoming global and not dependent on the country of origin. *Id.* at 68. Responding to recent unrest in the Chinese market, Siegel's research continues to confirm that emerging markets will provide the needed savings to absorb retirees' asset sales. Jeremy J. Siegel, *China Worries Are Overblown*, KIPLINGERS PERS. FIN. 48 (Dec., 2015), http://www.kiplinger.com/article/investing/T019-C019-S002-china-worries-are-overblown.html.

[767] SIEGEL, *supra* note 759, at 65 fig.4-3.

necessary for a growing economy.[768] Today, interest rates are so low that the return on government bonds or certificates of deposit is virtually zero.[769] Although inflation is also low, any return on such bonds is taxed, leaving an after tax return that is somewhat less than the inflation so that the investor would be losing money by investing.[770] Remarkably, rates in Europe have been pushed into the negative territory, a concept few investors can comprehend.[771] The One-Fund Solution's guaranteed 3% real rate of return protects those taxpayers who are unable to grasp

[768] Deflation is a threat to the economy even to the point that negative interest rates may be needed just to avoid falling into the grips of deflation. A recent article in *The Economist* points out that:

> On March 25th Jens Weidmann, president of the Bundesbank, suggested that the ECB might need to be more forceful in order to keep the euro-area economy out of the grips of deflation. Look again, however, and the path forward appears similar across the rich world. The outlook is clearest in Europe, where the ECB may toy with negative rates as a means to fend off deflation. But even in America and Britain 'normal' rates are a distant prospect.

Inflation and Interest Rates: Up, up, and away: Higher inflation may be needed to leave extra-low interest rates behind, ECONOMIST, Mar. 29, 2014, at 75. Moving on to 2015, the European Central Bank (ECB) has announced its bond-buying program, but skeptics wonder if the ECB will be able to find enough bonds to purchase to carry out its objective, which is to achieve 2% inflation target. Christopher Whitall, *ECB's Test Is to Find Enough Bonds,* WALL ST. J., Feb. 26, 2015, at C1. Takashi Nakamichi & Megumi Fujikawa, *Japan Adopts Negative Rates*, WALL ST. J., Jan. 29, 2016, at A1 (reporting the Bank of Japan (BOJ) is instituting negative interest rates in a "desperate" attempt to avoid sliding back into stagnation that has plagued Japan for two decades). In this effort, the BOJ is following the lead of the ECB and various national central banks in instituting negative rates. Quantitative easing seems to have lost its effectiveness leading one editorial writer to conclude: "The failure of unconventional monetary policy in Japan and Europe is proof that central banks can't conjure growth in economies that need major reforms to let resources find more effective uses." Editorial, *Japan Goes Negative*, WALL ST. J., Jan. 30, 2016, at A10. It has also been pointed out that the main effect of quantitative easing has been a run-up in prices of investment assets and that the ending of quantitative easing in late 2014 presented a good time for Congress to raise taxes on capital and puncture the asset price bubble. *See* Lee A. Sheppard, *News Analysis: International changes the United States shouldn't Have Made*, 145 TAX NOTES 739 (2014). However, this is unlikely because of the dependence on the political class of money from corporate sources.

[769] Central banks worldwide have been frustrated in their attempts to reach the targeted 2%. The fall of oil prices and other commodities in 2015 may be temporarily suppressing core inflation at a stable 1.3% (which excludes food and energy prices) as well as the price index for personal-consumption on which the Federal Reserve bases its 2% target is currently at 0.4%. *Global inflation: Low for longer*, ECONOMIST, Jan. 2, 2016, at 53.

[770] Emese Bartha & Ben Edwards, *Germany Sells Five-Year Debt at Negative Yield for First Time on Record,* WALL ST. J., Feb. 25, 2015, at C2.

[771] German bond yields fell to a negative 0.08% in anticipation of the European Central Bank's sovereign-bond-buying program, which investors believe will push bond prices higher. In any event, negative yields mean the investor is paying the German government for holding its debt. *Id.*

inflation's impact on their investments. Investing in a diversified portfolio of stocks is also a long-term inflation hedge.[772]

There will be limited investment choices for funds and those choices will be monitored by the federal government to determine they are following sound business practices including accurate disclosure. Recently, index funds tend to outperform actively managed funds on a regular basis and may be a possible avenue for the One Fund investments.[773] Low-cost index funds have put a considerable squeeze on fund managers, seeking to outperform the market as market analysis becomes ever more efficient making the market more efficient and harder to beat.[774] Once a participant's assets reach predetermined levels, the One Fund Solution would permit greater fund choice. Such flexibility is important since:

> [H]ow your money is invested is far more important than the amount you save (actually somewhere between 6 and 100 times more important). And, in addition, it only gets more important in the later periods once the retirement pool is accumulated. Thus, pensions must rely heavily on their investment schemes to succeed in providing retirement income security.[775]

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[772] SIEGEL, *supra* note 759, at 221 ("In contrast to the returns on fixed income assets, the historical evidence is overwhelming that the returns on stocks over long time periods have kept pace with inflation. Since stocks are claims on the earnings of real assets—assets whose value is intrinsically related to the price of the goods and services they produce—one should expect that their long-term returns will not be harmed by inflation.").

[773] *Cheap is cheerful*, ECONOMIST, May 3, 2014, at 10 (discussing *Fund management: Will invest for food*, ECONOMIST, May 3, 2014, at 19). Individual hedge funds have not done well, so investor management firms now seek to allocate investors' money among hedge funds but the management fee is "1 and 10" (1% on the assets managed plus 10% on the profits) on top of the hedge fund management fee of "2 and 20." *Funds of funds: Not yet dead*, ECONOMIST, June 7, 2014, at 80.

[774] Jason Zweig, *The Decline and Fall of Fund Managers*, WALL ST. J., Aug. 23-24, 2014, at B9. Competition continues to force mutual fund fees toward zero. Jason Zweig & Sarah Krouse, *Mutual-Fund and ETF's Tumble Toward Zero*, WALL ST. J., Jan. 27, 2016, at A1.

[775] MARIN, *supra* note 2, at 63 ("What differentiates pension fund management is the long-term nature of the retirement cycle and thus the impact . . . that the investment return has on the amount of money available to satisfy retirement income security." *Id.* at 64. Although investment constraints often give rise to hedge fund manipulation, these options would likely not be available for One Fund accounts. *Id.* at 75. Marin notes:

> For alpha to exist, there must be mispricings or anomalies to exploit, inefficiencies or arbitrages to be exact. The secret to hedge funds being able to avail themselves of these anomalies lies in the highly constrained nature of most institutional investing. That same ERISA that protects pension funds from bad thing happening to them also serves to dramatically constrain them. Hedge funds do not, for the most part, live in these constraints . . . There are fewer risk controls, no restriction on using derivatives and other sophisticated structures, no foreign content or the use of foreign exchange contracts, generally no limits on leverage except what is stated in their own prospectuses, no limitation shorting or the borrowing and lending of securities to accommodate that activity, and historically much less regulatory constraint.

Id.

D. Annuities

Upon reaching retirement age, the One Fund participant will need to determine whether to keep and manage their own retirement fund or accept a lifetime annuity structured to meet the participant's anticipated needs. Richard Marin offers an example of such a decision coming from General Motors' transfer of pension liabilities to Prudential Insurance Company.[776] The participant, a sixty-three-year-old man with a twenty-year life expectancy is given the option of taking a lump sum of $818,000 or an annuity of $4,854 per month for life.[777] In its simplest terms, the man could put the lump sum in a mattress and remove $3,408 each month ($818,000/240) for 240 months or put $4,854 in the mattress for 240 months and accumulate $1,164,960 at age 83. On the other hand, if he invests the lump sum at 5% return per annum he could withdraw $4,854 per month for 240 months and have $214,575 left in his account at age 83. At 6%, he would have a final account balance of $451,529. Finally, if he received a 3% return, he would run out of money after 218 months; and, with a return of 2.5%, he would run out of money in 207 months.[778] If he takes the annuity and dies before reaching eighty-three, he leaves nothing to his survivors; but, if he lives to age 100, his payments continue.

Although retirees in defined contribution plans choosing to annuitize their savings are more sanguine about retirement than those who do not, the overwhelming majority of private retirement assets are not being annuitized.[779] To

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Marin further states:

> Alpha is actually the risk-adjusted measure of excess return. That relates to beta in that it implies the value of the selection of a specific security versus the market return. That is what we define as excess return. Naturally since no return is generally had without risk, the issue of interest is the amount of excess return only after you have adjusted for the added risk you are taking. If the investing world was truly "perfect" . . . there would be no alpha because the amount of excess return available from any security would be offset by the risk being taken to achieve it.

Id. at 65.

776 *Id.* at 158.

777 *Id.*

778 *Id.* (calculating the actual annuity a person would receive is a complicated matter based on mortality tables and bond rates not discussed here).

779 SCHIEBER, *supra* note 9, at 355. Between 1990 and 2004, 60% of retirees with a defined benefit plans took their benefit in the form of an annuity while only 5% of those retirees with a defined contribution plan did so. *Id.* at 263. Economists are confounded by people's avoidance of annuities when on a simple expected return analysis they would be better off with an annuity. Several reasons are offered, including the observation that often people in ill health do not expect to live long and the opposite for those in good health, the desire to have some money remaining to give their heirs, and the perceived excessive fees associated with annuities. *Id.* at 266-67. Some variations of the survey suggested that, if the annuity were presented in the context of consumption rather than as an investment, the annuity option was selected. *Id.* One study supported the conclusion that, at every income level, having an annuity made retirees report greater satisfaction in retirement than those who did not have them. *Id.* at 355, 355 n.14. (citing Constantijn W. A. Panis, *Annuities and Retirement Satisfaction* (Rand Labor & Population Program, Working Paper 03-17, 2003), http://www.rand.org/pubs/drafts/2008/DRU3021.pdf.

be sure, there are numerous uncertainties including the longevity risk and the risk that the annuity provider becomes insolvent. The impact of interest rates on the amount necessary to provide an annuity can be significant, especially over the past six years in which the Federal Reserve has kept interest rates low. For example, the amount needed to fund an annual annuity of $1,000 at age sixty-five when interest rates are 8.5% is $8,900 but is $10,670 when interest rates are 6% and $12,580 when interest rates are 4%.[780]

Providing annuity default protection might overcome this reluctance to annuitize retirement savings.[781] Purchasing annuities by installment over the ten years prior to retirement rather than purchasing the annuity at age sixty-five in a lump sum may help also. Installment purchases smooth out two prime variables in the determination of annuity values—total savings accumulated at the time the annuity is purchased and the interest rate on the date of purchase. Purchasing annuities through a group market could reduce fees.[782] Inconsistent government regulations discourage employers from changing automatic default settings because they have fiduciary obligations to employees. An independent clearinghouse accepting lump sums from retirees over the installment period and spreading the risk among insurance companies might help.[783]

Concern about the financial literacy and sophistication among self-managing retirees will be increased with the One Fund solution, since, presumably, many will decide to self-manage their funds. A 2008 study testing the ability of participants fifty-five years and older to make investment decisions showed the majority of retirees did not know what a bond was and only about one-third understood risk diversification.[784] Men generally have had more knowledge about investing than women, and men were more likely to take risks and diversify their investments.[785] Age related dementia showed that retirees' ability to manage their own affairs diminished over time, but the real challenge is to plan for and cover both anticipated and unanticipated expenses over an undeterminable period of time.[786]

[780] *Id.* at 183. In 1991, corporate pensions were using 8.49% to calculate funding requirements, but by 2009 it was 5.97% causing a 20% increase in funding requirements if everything else remained the same. *Id.* But it did not, and by 2009 Baby Boomers were ready to retire, the stock market was no longer exuberant, and the pension bill was coming due. *Id.* Further the Pension Benefits Guaranty Corp. (PBGC) was experiencing greater claims from underfunded plans from bankrupt employers. *Id.* Much of the PBGC problem arises from charging the same rate for all plans regardless of risk. *Id.* This is a continual problem with government insurance.

[781] *Id.* at 356.

[782] *Id.* at 357-60 (describing the simulation to compare the installment method of purchasing the annuity with the spot market purchase for retirees reaching age sixty-five for each year from 1915 to 2010).

[783] *Id.*

[784] *Id.*

[785] Georgette Jasen, *Male Investors vs. Female Investors: Studies show men and women could learn from the other's approach*, WALL ST. J., May 3, 2015.

[786] SCHIEBER, *supra* note 9, at 263-66.

One study posited a worker, who saved 6% of their income from age twenty-five to sixty-five, retired and purchased a lifetime annuity with their savings paying a 15% purchase and longevity fee at the time.[787] Depending on which calendar year the worker turned age sixty-five and retired, the replacement percent of pre-retirement income covered by the annuity varied from 15% to 43% with an average replacement rate of 28.4%.[788] The replacement rate has generally been above the average since 1965.[789] The assumption here is that the worker saved religiously, worked forty years with no periods of unemployment, took no distributions, and had constant plan coverage.[790]

It is possible to purchase annuities with contractual automatic increases in amounts up to 7% with 3% being the most popular. Contractual cost of living increases are also available, although such increases depend on a formula, which is not easily understood.[791] Such features are protection against the possibility of inflation. Some people think the "best inflation adjusted annuity on the planet is Social Security."[792] A final warning on annuities:

> Annuities can help when planning for future inflation but it's important to understand that you need to have realistic expectations levels and not fall for the current over-hyped annuity income sales message that's flooding the airwaves. It's always a mathematical trade off when adding any type of income increase to an annuity.[793]

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787 *Id.*

788 *Id.* at 266.

789 *Id.* at 265-67.

790 *Id.* at 270-71. The return is comparable to that under Social Security, but the initial annuity payment would be lower if the worker wanted inflation protection, spousal protection with a joint and survivor format, or wanted an amount for his or her heirs. *Id.* at 271.

791 Be warned to "just make sure to run the real contractual numbers so you can properly drink the annuity COLA, and not swallow annuity Kool-aid." Stan Haithcock, *Should you drink the annuity COLA?*, MARKETWATCH (Sept. 30, 2014), http://www.marketwatch.com/story/should-you-drink-the-annuity-cola-2014-09-30.

792 *Id.*

793 *Id.*

E. Put No Confidence In princes . . . or Their Economists[794]

For 2015, the federal government expects to have an expenditure of $3.750 trillion through direct spending and another trillion dollars through tax expenditures leaving a deficit of $469 billion for the year.[795] From 2015 to 2019, it expects a deficit of $2.777 trillion and from 2015 to 2024; the deficit is expected to be $7.196 trillion.[796] Direct expenditures and tax expenditures will impact and virtually control the individual's housing, medical care, education, and retirement. Not only is spending controlled but the financial system is controlled, through the Federal Reserve System, which over the past eight years has kept short term interest rates near zero and, through a process known as "quantitative easing," flooded the market with funds maintaining the liquidity of the financial system.[797]

Elected officials at the national level have been able to avoid responsibility for the sluggish economy by relying on the Federal Reserve System to address the financial crisis.[798] The action of the Federal Reserve System has, in large measure, given record profits to the owners of equities in the stock markets but a meager return on the savings of millions of retirees who were depending on their modest nest egg to supplement their Social Security payments. As inflation is kept low, the COLA on those Social Security Payments has been minimal, although that benefit cuts both ways depending on the items affected by the increases in price.

The financial crisis of 2007-2008 is credited with undermining support for private accounts as a part of Social Security, since it convinced many people that they could not rely on the equity markets to produce an adequate return. It is inaccurate to think that the crisis simply resulted from overleveraging that took place prior to the financial crisis. The action of the government in encouraging expanded homeownership and the failure of oversight played a part as did failures of rating

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[794] In *Trillion Dollar Economists*, Robert E. Litan extols the virtues of economists and suggests they got a bad rap for not accurately predicting the 2008 crash. One reviewer suggests that Mr. Litan paid little attention to guilds although the economics profession exhibits the classic characteristics of a guild which: "[I]nsists on adherence to a particular methodology and set of beliefs—in this case, the standard understanding of macroeconomics, with its emphasis on Keynesian categories and government-fueled aggregated. The guild operates with an unofficial but real license from the banks and the federal governments." Amity Shlaes, *The Wonks Can't Save Us*, WALL ST. J., Oct. 28, 2014, at A17. Further, macroeconomists eschew the Austrian School, which focuses on the individuals, and Public Choice Theory, which "predicts that governments will take advantage of market crises to expand in nonmarket sectors." *Id.* Ironically there were no Public Choice Theorists in the White House or powerful institutions to warn that there might be a housing bubble if government expanded its presence in the housing sector. *Id.* Economists who can demonstrate the inefficiency of guilds fail to focus their attention on their own guild of economists. *Id.*

[795] CONG. BUDGET OFFICE, CBO AN UPDATE TO THE BUDGET AND ECONOMIC OUTLOOK: 2015 TO 2025, at 2 (2015).

[796] CONG. BUDGET OFFICE, CBO AN UPDATE TO THE BUDGET AND ECONOMIC OUTLOOK: 2014 TO 2024, at 2 (2014).

[797] *Id.*

[798] Willis L. Krumholz, *Blame The Next Economic Crisis On The Fed*, FEDERALIST (Dec. 15, 2015), http://thefederalist.com/2015/12/15/blame-the-next-economic-crisis-on-the-fed/.

agencies in rating mortgage backed securities.[799] But Jeremy Siegel concluded: "[I]t was the management of many of these financial firms who should be held most accountable. They were unable to grasp the threats that would befall their firms once the housing boom ended, and they abdicated responsibility for assessing risks to technicians running faulty statistical programs."[800]

But this conclusion should not negate the part played by the federal government and the Federal Reserve System. Indeed, other observers reject the assertion that financial firms were the primary cause and place that mantle on federal housing policies.[801] Prior to the crisis, it was believed that the Federal Reserve could bring about a "soft" landing from the excessively low interest rates and a return to normal. Siegel's analysis is mixed:

> The financial crisis also punctured the myth that grew during Greenspan's tenure as Fed chairman that the Federal Reserve could fine tune the economy and eliminate the business cycle. Nevertheless, despite having failed to see the crisis brewing, the Federal Reserve acted quickly to assure liquidity and prevented the recession from becoming far more severe than it turned out to be.[802]

Whatever responsibility the federal government may have for the Great Recession, the One Fund Solution should have the effect of pressing the government toward financial stability by insisting on a fair rate of return on the government's borrowing from its citizens. It will also create an incentive to keep inflation under control and, in the long run, reduce federal borrowing. In the developed world, 2% is

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799 *See id.*

800 SIEGEL, *supra* note 759, at 36.

801 *Id.*; *see also* Peter J. Wallison, HIDDEN IN PLAIN SIGHT: WHAT REALLY CAUSED THE WORLD'S WORST FINANCIAL CRISIS AND WHY IT COULD HAPPEN AGAIN (2015). Wallison points out that:

> [T]here is compelling evidence that the financial crisis was caused by the government's own housing policies. These policies . . . were based on an idea—still popular on the left—that underwriting standards in housing finance are excessively conservative, discriminatory, and unnecessary . . . Indeed, if we look back over the last hundred years, it is difficult to see instability in the financial system that was not caused by government's own policies.

Id. at 4.

802 SIEGEL, *supra* note 759, at 36. Siegel also states:

> The Federal Reserve was able to avoid deflation by stabilizing the money supply. In the Great Depression, the money supply . . . fell by 29%. . . . In contrast, the money supply actually rose during the 2008 financial crisis as the Federal Reserve increased the total reserves by over $1 trillion. This action provided sufficient reserves so that banks were not forced to call in loans as they were forced to in the 1930s. Although one can certainly question whether the later injections of reserves (called *quantitative easing*) aided the economy, there was little doubt that the initial provisions of liquidity were critical to stabilizing the financial markets and preventing the downturn from becoming substantially worse.

Id. at 41.

the magic number for inflation.[803] Anything less seems to be a problem for the developed economies. Inflation provides an incentive to invest money and to purchase goods today because prices will be higher tomorrow. It also supports rising wages in which employers can reward productive employees and borrowers can expect to lessen their debt load over time. Falling prices are seen as creating the opposite effect, slowing down an economy.[804] But government induced inflation works against those on fixed incomes who see the purchasing power of their pensions and savings consumed by higher prices. The One Fund Solution offsets this government-induced effect.

F. Markets Not as Free as People Think

Accepting investment responsibility should reflect an appreciation of market principles, but over the last couple of decades investment return has been determined (or rather guaranteed) more by Federal Reserve policy than overall market conditions. This has been the case since the United States' intervention in the Mexican Peso Crisis, the Long Term Capital Management Liquidation by the Federal Reserve in 1998, the bursting of the Dot-Com Bubble in 2000, and the Great Recession in 2007-2008, which saw the market plummet precipitously.[805] In each case, the Federal Reserve intervened by supporting loans, dramatically reducing interest rates, or instituting bond purchases (called "quantitative easing") thereby providing liquidity in the economy but also stimulating increases in stock prices.[806]

Stock market commentary over the past few years has been dominated by speculation on when Federal Reserve policy would reduce bond purchases or return interest rates to more normal rates.[807] The slightest murmur from the Chair of the Federal Reserve regarding future action causes dramatic instantaneous upward or downward swings in market prices, making market participants enormous returns.[808]

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[803] Binyamin Appelbaum, *2% Inflation Rate Target Is Questioned as Fed Policy Panel Prepares to Meet*, N.Y. TIMES (Apr. 28, 2015), http://www.nytimes.com/2015/04/29/business/economy/2-inflation-rate-target-is-questioned-as-fed-policy-panel-prepares-to-meet.html?_r=0.

[804] *Deflation: The high cost of falling prices*, ECONOMIST, Feb. 21, 2015, at 69 (suggesting that most shoppers can ignore the slow ascent of prices).

[805] The crisis followed the Asian Financial Crisis of 1997 and the Russian Financial Crisis of 1998. An earlier crisis caused by the devaluation of the Mexican Peso in 1994 and 1995 required intervention by the United States through loans recommended by the Federal Reserve. JOSEPH A. WHITT, JR., THE MEXICAN PESO CRISIS, ECONOMIC REVIEW OF THE ATLANTA FEDERAL RESERVE BANK 16-17 (1996). The loans totaling $12.5 billion were issued through the Exchange Stabilization Fund controlled by the Secretary of the Treasury. *Id.* This fund is normally used for short-term foreign exchange intervention, not for medium-term loans such as those to Mexico, but was used by President Clinton since Congress was reluctant to act because of the moral hazard of bailing out creditors of foreign governments. *Id.*

[806] *Id.*

[807] *See, e.g.*, Jon Hilsenrath, *Fed Likely to Remove 'Patient' Barrier for Rate Increase as Soon as June*, WALL ST. J., Mar. 10, 2015, at A1.

[808] *Id.* (noting that interest rates have been near zero since 2008 and that raising them requires the Federal Reserve Chair to be confident that inflation would move toward the 2% target). Volatility is expected in the market as investors speculate on the action of the Federal

At the same time, stock values soar from zero interest rates, retired persons, seeking modest returns from secure bonds and Treasury notes, have been devastated; the little interest they receive is subject to income tax and their initial investment has been subject to lost value due to inflation.[809] Even Charles Schwab was forced to comment, "[b]ut is it fair that seniors subsidized cheaper credit for others?"[810] Until the Federal Reserve's inflation target of 2% is met, the Federal Reserve will likely keep the rates near zero.[811] While seniors benefit from low inflation, they receive little or nothing from their "safe" investments as their Social Security payments remain stagnant and costs unique to seniors such as drugs and medical care increase.[812] Government, not the market, has been determining winners and losers.

A similar problem occurs because people have a strong incentive to save a large percent of their income for retirement while the economy depends on high levels of consumer spending to generate growth in the economy. The government therefore often finds it necessary to provide incentives for consumers to increase spending by lowering the Social Security or other taxes.[813] Those efforts can be impeded if people use the extra income to pay off credit card or other debt; although, if they save for retirement then those savings will result in investments in the economy.[814] Here, the One Fund Solution allows individuals an avenue to invest in the economy directly.

When the Bush tax cuts were extended in 2011 and 2012, the government sought to stimulate consumer spending with a 2% reduction in the payroll tax.[815] The lost Social Security revenue was nevertheless reflected by an accounting increase in the amount owed to the trust fund.[816] While the use of dedicated tax revenues was

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Reserve. *Id.* The Federal Reserve raised interest rates by 0.25% in December 2015, but the market response caused the Federal Reserve to question whether to continue the anticipated increases in 2016. *See supra* note 373 and accompanying text.

809 *See* Hilsenrath, *supra* note 807.

810 Charles Schwab, *Raise Interest Rates, Make grandma Smile*, WALL ST. J., Nov. 19, 2014; *see also* Robert F. Stauffer, Letter to the Editor, *The High Costs of the Fed's War on Seniors and Savers: Is it fair that seniors subsidize cheaper credit for others? Not only is it unfair but it has been an ineffective policy in stimulating the economy*, WALL ST. J., Dec. 4, 2014, at A16; Paul Schoenbaum, Letter to the Editor, *The High Costs of the Fed's War on Seniors and Savers: Is it fair that seniors subsidize cheaper credit for others? Not only is it unfair but it has been an ineffective policy in stimulating the economy*, WALL ST. J., Dec. 4, 2014, at A16.

811 Eric Morath, *Inflation Well short of Fed's 2% Target*, WALL ST. J., Feb. 3, 2015, at A2. The annual rate of inflation in November 2015 was 0.5%, well short of the target 2% but if energy and food are excluded from the calculation the rate was close to 2%. Greg Ip, *Fear of Low inflation Getting Out of Hand*, WALL ST. J., Dec. 16, 2015, at A6.

812 *Id.*

813 *Id.*

814 *Another Growth Dip*, WALL ST. J., Jan. 31, 2015, at A12; *see also Consumers Lead Economy As Factories Falter*, INV. BUS. DAILY, Mar. 2, 2015, at A1.

815 EXEC. OFFICE OF THE PRESIDENT, COUNCIL OF ECON. ADVISERS, THE ECONOMIC IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT: FIVE YEARS LATER, FINAL REPORT TO CONGRESS, 29 (2014)

816 *See generally* David Pattinson, 75 SOC. SECURITY BULL. 1 (2015).

originally intended to remove Social Security from the scope of political oversight, failing to collect the tax can give people the impression that Social Security is little more than a welfare program. This impression was enhanced in 1976 when the earned income tax credit was introduced and the government began refunding many low-income people amounts exceeding their Social Security contributions.[817] The earned income tax credit and, later, the refundable child tax credit have insured that low-income taxpayers bear none of the burden of the Social Security tax or the federal income tax for that matter.[818] These policies are merely a "payroll tax rebate program operated through the income tax. Its operation obscures its effect."[819] Having a high percentage of citizens contributing little or nothing to the federal government raises a serious question of tax policy. It is estimated 45.3% of households pay no federal income tax.[820] Although, one 2016 presidential candidate suggested that, in a democracy, everyone should make some contribution to the common good while most others candidates propose tax plans that would significantly increase percentage of households not paying any federal income tax.[821]

In February 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA), a $787 billion stimulus package aimed at reinvigorating the nation's economy (the "Federal Stimulus Package") for purposes of, inter alia, job creation[822] and to "help states avoid slashing funding for education and other programs."[823] Upon signing the Bill, which was thought to be the greatest stimulus program in United States history,[824] President Obama promised the money would "help those who were hardest hit by our economic crisis."[825] Years later,

[817] SCHIEBER, *supra* note 9, at 331.

[818] *Id.*

[819] *Id.* Other tax programs operate to offset the payroll tax such as the 6.2% Making Work Pay tax credit in 2009 and 2010. *Id.* President Obama in 2011 proposed further payroll tax deductions as a method of stimulating the economy in amounts far exceeding President Bush's 2004 proposal to fund private accounts. *Id.* President Bush was loudly condemned for creating a funding "hole" in the Social Security trust fund but Obama's proposal was merely an extension of the 2010 agreement. *Id.* at 331.

[820] *Id.*

[821] Doug Bandow, *Everyone Needs To Pay Taxes To Limit Gov't*, INV. BUS. DAILY, Dec. 17, 2015 (describing a proposal by former presidential candidate, Governor Bobby Jindal, to impose a 2% rate with few or no deductions so that everyone would have "skin in the game" and an incentive to resist wasteful programs).

[822] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 1553(a)(1), 123 Stat. 115, 116 (2009) (establishing the purpose for the stimulus funding).

[823] Meghan Ashford-Grooms, *President Obama says Gov. Perry used stimulus fund to help balance budget, then started 'blaming' federal lawmakers who voted for legislation*, POLITIFACT TEX. (Apr. 24, 2011), http://www.politifact.com/texas/statements/2011/apr/24/barack-obama/president-obama-says-gov-perry-used-stimulus-fund-/.

[824] Yuval Rosenberg, *Obama's Stimulus Plan: What Worked, What Didn't*, FIS. TIMES (Feb. 21, 2012), http://www.thefiscaltimes.com/Articles/2012/02/21/Obamas-Stimulus-Plan-What-Worked-What-Didn't.

[825] Ron Hart, *Where did the stimulus money go?*, ORANGE CNTY. REG. (Aug. 21, 2013), http://www.ocregister.com/articles/stimulus-501352-money-obama.html.

however, critics disagree over the success of the stimulus plan.[826] Of the billions of dollars allocated, "[a]bout $500 billion went to tax cuts, unemployment benefits, and "state fiscal relief" (shoring up insolvent state budgets)"[827] with $105.7 billion given to the states for Medicaid and Medicare.[828] States used their allocation for several purposes.[829] Texas used it to reduce their budget deficit and put the majority of its funds towards Medicaid and education; while California, which accounted for about $31 billion of this initiative, spread the money over several programs, including education, health, labor and workforce development, social services, transportation, housing programs, resources and environmental protection, criminal justice, and other programs.[830] Much of the money went to maintain jobs rather than create new ones.[831]

Reliance on the government is preferable to reliance on the market. However, Congress adds new programs without paying for them, except to the extent that the new program eliminates waste in existing programs, giving the impression that the new program will not be expensive. With the adoption of the Affordable Care Act, the elimination of waste would be available to help pay for the expanded coverage.[832] Later, when Congress imposed an across the board sequester of funds for federal programs, there was no talk about eliminating waste, but only talk of the dire consequences of cutting vital federal programs. No one seemed able to find any waste to eliminate:

> Economists are quick to speak of "market failure," and rightly so, but a greater threat comes from "government failure." Because it is a monopoly, government brings inefficiency and stagnation to most things it runs; government agencies pursue the inflation of their budgets rather

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[826] *Id.* (discussing the disparity between President Obama's promise and the allocation of stimulus money per capita); Tom Howell Jr., *Obama's stimulus package, 5 years later: Dems defend, Republicans ridicule*, WASH. TIMES (Feb. 17, 2014), http://www.washingtontimes.com/news/2014/feb/17/obama-stimulus-package-dem-defends-gop-mocks/?page=all (providing political insight into the rate of unemployment five years after the stimulus).

[827] Philip K. Howard, *Howard's Daily: Finding Infrastructure in the Stimulus Plan*, HUFFINGTON POST (Feb. 20, 2014), http://www.huffingtonpost.com/philip-k-howard/howards-daily-finding-inf_b_4808898.html.

[828] *American Recovery and Reinvestment Act (ARRA)*, U.S. DEP'T EDUC., http://www.ed.gov/open/plan/recovery-gov (last visited Apr. 25, 2016).

[829] *See Stimulus Spending by States*, WALL ST. J. (Aug. 6, 2009), http://online.wsj.com/public/resources/documents/info-STIMULUS0903.html (illustrating each state's allocation of the stimulus money it received); Jennifer LaFleur et al., *How Much Stimulus Funding is Going to Your County*, PROPUBLICA (Oct. 1, 2012), https://projects.propublica.org/recovery/; *State oversight of Federal Stimulus Funds*, NAT'L CONFERENCE ST. LEGISLATURES, http://www.ncsl.org/research/fiscal-policy/state-economic-stimulus-package-oversight-plans.aspx (last updated Aug. 4, 2009) (providing individual websites for each state to track their use of stimulus money).

[830] *Update from Washington, D.C.*, CAL. ST. ASS'N COUNTIES (July 8, 2011), http://www.counties.org/csac-bulletin-article/update-washington-dc-07082011.

[831] *See* Hart, *supra* note 825.

[832] MATT RIDLEY, THE RATIONAL OPTIMIST 182 (2011).

> than the service of their customers; pressure groups form an unholy alliance with agencies to extract more money from taxpayers for their members. Yet despite all this, most clever people still call for government to run more things and assume that if it did so, it would somehow be more perfect, more selfless, next time.[833]

The tremendous waste occurring in the United States health care system is a clear example of how inadequate oversight is costing taxpayers billions of dollars each year. It is reported:

> Health care is a tempting target for thieves. Medicaid doles out $415 billion a year, Medicare (a federal scheme for the elderly) nearly $600 billion. Total health spending in America is a massive $2.7 trillion, or 17% of GDP. No one knows for sure how much of that is embezzled, but in 2012 Donald Berwick, a former head of the Centres for Medicare and Medicaid Services (CMS), and Andrew Hackbarth of the Rand Corporation, estimated that fraud (and the extra rules and inspections required to fight it) added as much as $98 billion, or roughly 10%, to annual Medicare and Medicaid spending–and up to $22 billion across the entire health system.[834]

G. The Great Recession and Lost Wealth

Government works against itself when it lowers interest rates. Low interest rates hurt retirees and makes states use a lower discount rate in valuing their unfunded pension obligations. The low rates also push people into the stock market to get any decent return on their savings.

The 2007 Great Recession is just now becoming part of the economic history of the twenty-first century as employment in the United States is reaching pre-recession levels and GDP in Europe, generally, is reaching the pre-recession levels.[835] But reaching pre-recession levels seven years after the beginning of the recession is overlooking the lost GDP and productivity projected prior to the recession. Evaluating economic potential based on pre-recession conditions, as of last year, the United States was 4.7% below potential and Britain was 11% below. Other European Union countries fared even worse with Greece, the worst of the countries in the developed world, with 30% below. By 2015, the weighted average loss among rich countries as a whole was projected to reach 8.4%–as if the entire German economy had evaporated.[836]

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833 *Id.*

834 *Health-care fraud: The $272 billion swindle*, ECONOMIST, May 31, 2014, at 26; *see also Health Care Fraud in America, That's where the money is, How to hand over $272 billion a year to criminals*, ECONOMIST, May 31, 2014, at 13.

835 *The US Economy to 2024*, U.S. BUREAU LAB. STAT. (Dec. 2015), http://www.bls.gov/opub/mlr/2015/article/pdf/the-us-economy-to-2024.pdf.

836 *Wasted potential: Counting the long-term costs of the financial crisis*, ECONOMIST, June 14, 2014, at 71 (citing Laurence M. Ball, *Long-term Damage from the Great Recession in OECD Countries* (Nat'l Bureau Econ. Research, Working Paper 20185, 2014); Robert. E. Hall, *Quantifying the Lasting Harm to the U.S. economy from the Financial Crisis* (Nat'l Bureau Econ. Research, Working Paper 20183, 2014)).

The primary causes of the loss of GDP were identified as loss of employment hours worked, labor-force participation, a capital investment shortfall, and disappointing productivity growth.[837] China's demographic clock is ticking against its economic growth. The fifteen to fifty-nine working age population fell by 3.45 million last year to 937.27 million.[838] This declining demographic may trim 3.25 percentage points from its yearly growth rate between 2012 and 2030.[839]

In addition, Central banks, while reducing interest rates to zero, are fighting to get inflation up to 2%, but are failing in that effort and economies are struggling:

> Europe is in dire economic straits. Growth in the euro zone is stuck below 1%, unemployment is above 11% and inflation is hovering around 0.4% far from the European Central Bank's 2% goal and dangerously near outright deflation. This week the Paris-based OECD rich-country club warned that the euro zone was mired in stagnation, and added that it was dragging down the world economy. Even the pope has joined in, calling the European Union "elderly and haggard."[840]

Deflation is destructive to the economy as explained:

> [T]he belief that money made tomorrow will be worth less than money today stymies investment; the belief that goods bought tomorrow will be cheaper than goods bought today chokes consumption. Central bankers can no longer set real (that is, inflation-adjusted) interest rates low enough to restore demand. Wages, incomes and tax revenues all stall, undermining the ability of households, businesses and governments to pay their debts-debts which, in real terms, will grow more burdensome under deflation.[841]

The burden of Eurozone debt can cause turbulence in the market:

> Soldiering has been described as long periods of boredom punctuated by moments of sheer terror. Financial markets seem to be developing the same pattern. The boredom stems from a massive central-bank intervention in markets.
>
> As long as investors remain convinced that central banks are in control of events, and can adjust monetary policy to avoid recession and inflation, volatility will be low for most of the time. In these quiet periods, the dominant trend will be momentum-investors buying the assets that have most recently risen in price. By September, for example, investors were heavily exposed to peripheral European bonds (the debt of Greece and

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837 *Id.*

838 *Id.*

839 *Id.*

840 *Fiddling while Europe burns*, ECONOMIST, Nov. 29, 2014, at 13.

841 *The dangers of deflation: The pendulum swings to the pit*, ECONOMIST, Oct. 25, 2014, at 25 (containing a by-line that reads, "Politicians and central bankers are not providing the world with the inflation it needs; some economies face damaging deflation instead"). With an inflation rate of 0.3% Europe, which produces almost a fifth of world output, may be forced into recession next year. *Id.* at 15.

> Spain, for example) and to cyclical stocks (those that perform best when the economy is dong well).
>
> But when the trend changes, prices may move very sharply, as the terrified herd stampedes out of what can be illiquid markets. In the last four weeks, defensive stocks have outperformed cyclicals by one of the greatest margins in history, according to BlackRock, a fund management group.[842]

After six years of near zero interest rates, central banks are considering how to return to normal interest rates since there continues to be low rates of inflation.[843] The fear is that returning too quickly will undermine the recovery while deflation looms as a great concern. Many observers are calling for efforts to bring inflation up to the target of 2% or even somewhat higher than that.[844]

H. Social Security: A Different Kind of Defined Benefit Plan

Social Security is different than state or private pension plans because of the federal government's taxing power, ability to borrow money, fiscal policy control, and ability to create demand deposits through the Federal Reserve's quantitative easing. These powers in the hands of a solvent and stable government may provide the confidence desired by the public, but, in the hands of irresponsible politicians, can lead to a disaster affecting the entire nation with no one there to bail them out.

The federal government has reached the point where the Social Security tax receipts by themselves are insufficient to pay the benefits and general budget funds are used to repay accruing interest on the Social Security trust fund. That condition will worsen as claims against the trust fund grow. Since the federal budget is not in balance, the Social Security deficit will be closed with borrowed funds. The federal government, like Illinois, New Jersey, and California, is borrowing to pay current Social Security benefits.

Over its first four decades, Social Security provided much larger windfall benefits for high earners than for lower earners. This occurred early in the program when participants had little time to contribute. The costs for the windfalls were left for later generations to pay when, for many workers, the windfalls would disappear and Social Security would become a bad deal.[845] That bad deal will likely become even worse as the system is reformed to save it.[846]

Traditional methods of reducing government debt through inflation may not work with debt accumulated for Social Security since benefits are structured to

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[842] Buttonwood, *Liquid diet: Recent market turbulence may be only a foretaste*, ECONOMIST, Oct. 25, 2014, at 74.

[843] *See generally* Neil Irwin, *Why Very Low Interest Rates May Stick Around*, N.Y. TIMES (Dec. 14, 2015), http://www.nytimes.com/2015/12/15/upshot/why-very-low-interest-rates-may-stick-around.html.

[844] *Monetary policy and asset prices, A narrow path*, ECONOMIST, June 21, 2014, at 67 (noting central banks around the world are struggling to promote growth without fomenting worrisome risk-taking.)

[845] SCHIEBER, *supra* note 9, at 279.

[846] *Id.*

account for inflation unlike many other pensions. The case is different in Europe where:

> Inflation indexation of pensions is a politically charged issue and is particularly so in European countries, where this has become the norm. This probably lines up with many other entitlement issues, which are likely to be thrown into serious challenge as the full extent of the pension crisis problems unfold.[847]

Of course we may simply believe we will never have to pay off the national debt or that inflation will eliminate it altogether. But at some point, the reality of the flawed system will manifest itself and some people will bear the pain of that system.

Social Security creates a complex set of incentives and disincentives for continuing to work. If you retire early at age sixty-two, you receive a reduced benefit that is further reduced if you continue to work and earn more than a minimum amount of money, creating a disincentive to work.[848] At "full" retirement there is an incentive to continue working and delaying starting the benefit until age seventy when the benefit will be enhanced by 8% for each year worked after full retirement age until age seventy.[849] A disincentive to continue working after age seventy is that a person continues to contribute to Social Security without any significant increase in benefit. [850]

When discussing the sustainability of Social Security, most focus on the increasing ratio of retired persons to working persons paying for the retirement and on the increased longevity of the retired population.[851] Until recently, the retirement age has been moving earlier and earlier and the impact of the Social Security program on this decision has not been highlighted. Many people find that retirement is not what it is cracked up to be and prefer working. In fact, some perceive that the long-term trend is that people will be working well into their seventies.[852]

In the Social Security system, each individual has no choice in the amount to contribute, the manner in which it is invested, or the form of payment in which the

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[847] MARIN, *supra* note 2, at 18.

[848] *Retirement Planner: Benefits By Year Of Birth*, SOC. SEC. ADMIN., https://www.ssa.gov/planners/retire/agereduction.html (last visited Apr. 26, 2016).

[849] *Id.*

[850] One commentator observes:

> What has not been widely appreciated is that the provisions of the social security programs themselves often provide strong incentives to leave the labor force. By penalizing work, social security systems magnify the increased financial burden caused by aging populations and thus contribute to their own insolvency.

Jonathan Gruber & David A. Wise, *Social Security Programs and Retirement Around the World: the Relationship to Youth Employment* 3 (Nat'l Bureau Econ. Research, Working Paper 14647, 2010), http://www.nber.org/papers/w14647.pdf.

[851] CHRIS FARRELL, UNRETIREMENT HOW BABY BOOMERS ARE CHANGING THE WAY WE THINK ABOUT WORK, COMMUNITY, AND THE GOOD LIFE 21 (2014).

[852] *Id.* ("My own guess is that the average age at retirement over the next quarter century or so will rise to seventy.").

benefit is to be received.[853] Because changes advocated to the Social Security system all involve a form of forced savings with some limitation on investment choices, the assertion can be made that the differences are merely "haggling about the price."[854] However, "no choice" is qualitatively different than having some choice in the future of one's retirement assets, and, having choice and control, creates a sense of ownership and investment in a system in which one can see and understand the implications of saving for the future.

With the One Fund Solution, a participant recognizes that at some point the required contributions may come to an end. The level projected herein is when the value of the account reaches $1 million. As time passes, many people will inherit a portion of the One Fund accounts of their parents and thus begin life with a legacy of inter-generational inherited wealth to build their own future. One can make additional contributions in an effort to get to a given level and qualify for alternative investments earlier in life. Of course, making additional contributions would work against many economic policies, which depend on consumer spending. Further, and more importantly, the One Fund Solution encourages the participant to investigate and learn about the system rather than merely being a passive participant.

Today, in exchange for a base amount in retirement and certain disability and survivor benefits every person is required to give approximately 12.4% of their lifetime earnings into the Social Security system.[855] This 12.4% commitment begins with one's first job and ends only when one stops working, but the restrictions end only at death. The capturing of over 12% of our lifetime earnings is like an indentured servant of colonial times who gave three years labor for passage to the new world.[856] But an indentured servant could look forward to a day in the near future when he would be free to make his own decisions and perhaps improve his lot.

With Social Security, unless the individual is in the lowest earning groups, the "deal" is not a good deal, nor a fair deal, but a deal that is sure to get worse; and a time will come when the legacy costs will demand payment and benefits will have to shrink. Thus far, Congress's sole objective has been to avoid pain for anyone and pass the problem on to the next generation. The choices suggested herein are not politically attractive. Even when solutions are suggested in other broad reform proposals, they receive stinging rebukes. No one will be happy to pay for benefits, but at some point, hard choices will need to be made and the choice will come down

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853 Shaviro, *supra* note 170, at 91-92.

854 *Id.* at 113.

855 *Id.* at 106.

856 In 1738, Henry Meyer, in consideration of the payment of his passage from Rotterdam to Bucks County Pennsylvania by Abraham Heslant, agreed to work for Heslant as a servant for a period of three years and Abraham Heslant agreed to provide Meyer with food, clothing, and lodging during the three year period and thereafter Meyer was to be made free and given two suits of clothes, one of which to be new. The contract of indenture is available at the Wikipedia site for the definition of indentured servant. *Contract of Indenture,* WIKIPEDIA, http://upload.wikimedia.org/wikipedia/commons/8/86/Indenturecertificate.jpg (last visited Sept. 10, 2014).

to housing, health care, retirement, or education. States and cities are already making such choices.[857]

The enormous growth of government into the control of housing, health care, and education has taken much of the freedom once experienced by individuals. The result has been a total dependence of government decisions in every major area of life. With dependence comes a loss of freedom, control, and human dignity, precisely the opposite of what the founders of the program intended.

Social Security has become a mixture of retirement planning and welfare. The picture lacks transparency and is distorted. If welfare is necessary, it should be provided outside the retirement system or be a separate supplemental system distinct from the One Fund Solution.[858] Such a separation will allow people to intelligently save for retirement and be responsible for their own future.

I. Alleviating the Problem and Facilitating a Transition

State and local governments, along with their elected officials, are great at promising benefits but abhorrent at setting the money aside to fund those promises. Although funding pensions and retiree health care will come at the expense of bridges, roads, schools, and other vital community needs. Further, cutting benefits requires political fortitude that few politicians are willing to muster. Private employer pensions have also proved problematic, as government-funding requirements have been subject to manipulation depending on the revenue needs at the time. Finding defined benefit plans impossible to manage employers have shifted the burden of investment decision and risk onto insurance companies and are in the process of eliminating defined benefit plans.

Transitioning to a new system requires radical change and a source of revenue to fund the change as demonstrated by the Chilean system. Chile achieved the transition by transferring government assets into private hands.[859] There are ways this could be accomplished in the United States and it could involve a gradual change. Removing the United States and its people out of the spiral of continuing debt should begin with a ten-year transition period as described in this and the following sections. The society and the world have grown up in a debt dependence that bankrupts nations and ruins individual lives and families. Insuring against catastrophes for individual disability and premature death is relatively inexpensive if planned for in advance through life and disability insurance.

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[857] Mark Peters & Kris Maher, *Schools in Detroit, Chicago Seek State Help*, WALL ST. J., Jan. 21, 2016, at A3.

[858] This recommendation goes against the argument that a program for the poor is a poor program because the use of dedicated tax revenues and making the system universal has had the desired effect of preventing reductions in Social Security, but has also prevented any change that would make the system more efficient or financially sustainable. *See supra* notes 195, 224 and accompanying text. Lack of transparency and system complexity has also allowed for the gaming of Social Security. Two strategies to maximize Social Security benefits, "file and suspend" and "restricted application," are being eliminated by the Bipartisan Budget Act of 2015. Glenn Ruffenach, *A Strategy to Maximize Social Security Benefits*, WALL ST. J., Feb. 1, 2016, at R2.

[859] Pensions in Chile, *supra* note 598.

1. Expand the Workforce

Professor Samuelson's comment that "[a] growing nation is the greatest Ponzi game ever contrived"[860] could provide an answer to the dilemma faced by nations with large aging populations and younger populations desiring smaller families. In terms of Social Security, this dilemma prompts the perpetual discussions of the ratio of workers paying the taxes and the beneficiaries receiving the payments from the system. In such discussions, the questions focus on birth rates, women in the work force, and immigration.

The United States is ahead of the many developed countries in that women started migrating into the workforce back in the 1960s and the United States birth rate has consistently been maintained at the replacement rate of 2.1 births per woman age eighteen to forty-eight.[861] With United States immigration and expanding female participation in the workforce, the imbalance between household types is changed and Social Security funding is enhanced. The United States has already reaped economic benefits from some of these changes:

> The increases in women's labor force participation rates since the late 1960s have more than offset the reduced labor force participation rates of older men. As a result, since 1970, the percentage of time in the workforce has increased for the prime-age adult population. This has been a major contributing factor in our economic growth and higher standards of living over the latter part of the century. The trends raise the question whether higher female workforce participation rates will change long-term retirement patterns. The answer is, probably not.[862]

Congress and the administration has been debating reform of the immigration system, but show little hope of reaching a solution before the 2016 elections.[863] The flow of low-skilled workers seems to be continuing while higher skilled workers find immigration opportunities limited.[864]

2. Return to the Fiscal Constitution

A 2014 book by Bill White outlining the fiscal condition of the United States from the Revolutionary War to the present notes five periods in which the country has incurred high levels of debt it moved quickly to balance the budget, even

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[860] Shaviro, *supra* note 170, at 95 (citing Paul A. Samuelson, *An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money*, 66 J. POL. ECON. 467 (1958)).

[861] GLADYS MARTINEZ ET AL., FERTILITY OF MEN AND WOMEN AGED 15–44 YEARS IN THE UNITED STATES: NATIONAL SURVEY OF FAMILY GROWTH 2006–2010, at 1 (2012), http://www.cdc.gov/nchs/data/nhsr/nhsr051.pdf.

[862] SCHIEBER, *supra* note 9, at 179.

[863] *See* Joshua Briesblatt, *What to Expect from Congress on Immigration in 2016*, IMMIGR. IMPACT (Jan 5, 2016), http://immigrationimpact.com/2016/01/05/congress-immigration-2016/.

[864] A recent article suggests that the Obama administration is looking to immigration reform as a vital element in improving the financial health of Social Security by adding millions of newly legalized workers to the workforce. Editorial, *President Obama's New Budget*, N.Y. TIMES (Feb. 2, 2015), http://www.nytimes.com/2015/02/03/opinion/president-obamas-new-budget.html.

maintain surpluses, for up to a decade to bring the debt into controllable levels calling the tradition the "Fiscal Constitution."[865] That tradition collapsed in the twenty-first century when the author could assert:

> Never before had the federal government waged major wars without raising taxes. Never before had it so heavily relied on foreign creditors. Never before had the president and Congress financed a permanent new domestic program entirely with debt. Never before had progressives accepted, much less insisted on, the substitution of federal debt for payroll contributions supporting the Social Security trust fund. Never before had many conservatives organized the fight against a constitutional amendment requiring a balanced budget. Never before had so many leaders of each major political party claimed that balancing the budget—even with national income at an all-time high—would impair sustainable economic growth. After 2000 the federal government borrowed increasing amounts to pay for routine operating expenses in addition to debt incurred to pay for wars and recession-related stimulus.[866]

The Fiscal Constitution is comprised of four basic principles that stood for 200 years until its collapse under President Bush. The first principle is clear budget accounting (i.e. transparency of the budget revenues and expenditures). The second principle is pay-as-you-go budget planning. The third principle is dedicating taxes to a fund for a specific purpose tightening the link between spending and taxing. The fourth principle is congressional approval of the amount and purpose of any new debt.[867]

The following statement by President Lincoln's last treasury secretary, former Indiana banker Hugh McCulloch, provided a clear example of the principle of paying down debt:

> As all true men desire to leave to their heirs unencumbered estates, so should it be the ambition of the people of the United States to relieve their descendants of this national mortgage . . . . since wars are not at an end, and posterity will have enough to do to take care of the debts of their own creation."[868]

Secretary McCulloch's statement recognizes a flaw not only in Social Security, but a flaw in our own thinking as a country and society that we live to consume all that we produce and failing to leave an inheritance is somehow a virtue.[869] Another story line is set out in a recent book, in which the author described telling his clients the "last check they write should be to their undertaker . . . and that it should

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[865] TOM WHITE, AMERICA'S FISCAL CONSTITUTION: ITS TRIUMPH AND COLLAPSE 408 (2014).

[866] *Id.* at ix.

[867] *Id.* at 43-44, 68.

[868] *Id.* at 110 (citing HUGH M. MCCULLOCH, MEN AND MEASURES OF HALF A CENTURY 206 (1888)).

[869] MCCULLOCH, *supra* note 868, at 206.

bounce.[870] To be fair, the author suggests living off "life-time" annuities and making judicious gifts to loved ones during life rather than at death so that you can conclude, "by striving to die broke you guarantee you live well."[871]

An honorable practice recognized early in our nation's history was the understanding that the nation needed to conserve its credit capacity to be available in the event of an emergency. Thus early borrowings tended to be longer term even at a higher interest rate because "[l]ong maturities on the federal debt gave the United States more flexibility in dealing with the unknown."[872] Debt was a resource to be used sparingly and then paid off quickly. Debt was necessary to (1) preserve the union, (2) secure and extend the nation's borders, (3) fight a war, or (4) fund deficits during a recession.[873] Another lesson is that the federal government does not need to spend borrowed money in order for the economy to grow.[874]

3. Breaking the Logjam of Tax Expenditures

Another author finding confidence in America's ability to handle its fiscal problems was C. Eugene Steuerle.[875] Steuerle finds support for his confidence in the actions of Alexander Hamilton who handled the Revolutionary War debt through the institution of the "hidden" tariff tax and of Theodore Roosevelt who enacted the "not so hidden" income tax and the creation of the Federal Reserve Bank at the beginning of the Progressive Era.[876] These actions took political courage, flexibility, and a determination to solve the problems facing the nation. The problem today, in Steuerle's view, is that all government revenues are committed not just for today, but also for the twenty-first century and beyond, as a result of inconsistent spending and tax policies.[877] The result is that the current discussion is about sustainability rather than how can government be opened so that future generations have the ability to make their own policy choices.[878] Steuerle's three-point plan is summarized as:

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[870] STEPHEN POLLAN & MARK LEVINE, DIE BROKE: A RADICAL FOUR PART FINANCIAL PLAN (1998).

[871] *Id.*

[872] WHITE, *supra* note 865, at 51.

[873] *Id.* at 67.

[874] *Id.* at 86, 393. The idea of America's Fiscal Constitution was taken up again in Carl Lane's book, A Nation Wholly Free, which describes in detail how, through the efforts and determination of President Andrew Jackson, America was able to experience two years, 1835-1837, as a debt free country. Applying the lessons of Jackson to the current situation, Lane warns of the urgency, stating anything might trigger a loss of confidence in the United States creditworthiness which could cause "wide spread misery, civil disorder, and the possible collapse of our institutions." CARL LANE, A NATION WHOLLY FREE (2015); *see also* Daniel Shuchman, *When America Paid Its Debts*, WALL ST. J., Jan. 22, 2015, at A1.

[875] Steuerle recognizes that the nation's long-standing aversion to debt, which seems to have ended with Vice President Dick Cheney's comment to Treasury Secretary O'Neill that "[d]eficits don't matter." STEUERLE, *supra* note 4, at 35.

[876] *Id.* at 22-29.

[877] *Id.* at 29.

[878] *Id.*

1. Remove the automatic and eternal built-in growth in programs that current policies will generate . . . .
2. Pay our bills in normal economic times and stop pretending that deficit-financed tax cuts do anything more than shift burdens onto our children; and
3. Start using some of the resources that we free up from steps (1) and (2), above, to invest wisely in our children, in programs devoted more to opportunity and mobility than ever-more consumptions . . . .[879]

Seeing the federal government tax and spending policies as alternating between "giveaways" and "takebacks," Steuerle sees the country entering the "takeback" phase after excessive spending and tax cuts dominated the Presidency's of Bush and Obama, although both Republicans and Democrats will seek to keep their prior successes.[880] Steuerle sees the rate of growth of spending exceeding the growth of revenue forever—or until the economy collapses—and points out that projections under current law are that United States federal debt as a percentage of GDP will approach 250% by mid-century.[881] Such growth of debt will result in four economic consequences as follows: (1) rising and unsustainable levels of debt; (2) a shrinking ability to fight recession or meet other emergencies; (3) a budget for a declining nation that invests ever less in its future, particularly in children and youth; and (4) broken government, as reflected in antiquated tax and social welfare systems.[882]

In discussing these consequences, Steuerle points out that no one knows when lenders will come to the point of refusing to fund the national debt, but it is sure to come at some point. But it is the broken system in which he points to outdated tax expenditures for housing and retirement that fail to achieve their purposes. Over $400 billion in tax relief is dedicated toward savings for retirement, higher education, and retirement, but personal savings remains low often hardly exceeding the amount of the subsidy.[883] Numerous other tax subsidies likewise fail to achieve their purposes.[884] He criticizes state and military pensions as not reflecting realistic budget constraints and notes many inconsistencies in the Social Security program including requirements to pay for benefits you will not receive such as the spousal benefit being paid for by single taxpayers, the benefit for divorced spouses requiring ten years of marriage, and certain benefits for children of healthy but retired parents.[885]

Along with the four economic consequences, Steuerle posits three deadly political consequences:

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[879] *Id.* at 31.

[880] *Id.* at 66-70.

[881] *Id.* at 82-83.

[882] *Id.* at 82.

[883] *Id.* at 98.

[884] *Id.* at 97-99.

[885] *Id.* at 99-101.

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1. The decline of "fiscal democracy," as previous decisions by dead and retired policymakers deprive today's and future generations of the power to make their own decisions;
2. A classic "prisoners' dilemma," in which liberals and conservatives alike assess correctly that they will "lose" politically by acquiescing to spending cuts or tax increases, respectively to reduce budget deficits or create budget flexibility; and
3. Obstacles to "fixing" government because, to address new priorities or create new programs, elected officials must renege on old promises, telling people they are no longer entitled to the higher benefits or low taxes that they have come to expect.[886]

The third consequence is the greatest obstacle because, with all future revenues committed, politicians will be called upon to renege on old promises to get resources for new priorities. Restoring fiscal freedom requires more than merely reducing deficits under current policies to sustainable levels. Rather it requires broadly rescinding promises for ever-growing benefits or low taxes and moving government in new directions.[887] For example, real reform of health care will force a realization that, "we cannot have it all, that we can no longer live with the illusion that we are entitled to all the health care we can get, no matter the price."[888] Overturning the status quo may take years or even decades, but Steuerle sees a bright future when fiscal freedom is restored and the young can again set their own priorities.[889]

In summary, Steuerle is concerned about the loss of fiscal freedom brought about by current spending and tax priorities that has effectively committed the nation's wealth through the end of the twentieth-first century. His solution is to limit or eliminate the automatic provisions that cause these items to grow faster than the economy. This is a return to a situation in which priorities are again set annually by the current generation of leaders. In particular, he sees the need to curtail the automatic growth in health and retirement spending (as protected by the Democrats) and the myriad of tax expenditures built into the system (as protected by the Republicans) in order to focus on making the twenty-first century the century of the child as the country focuses on promoting education of the young and investment that creates social mobility.[890]

4. Excessive Tax Expenditures and Retirement Tax Complexity

Improving the long-term outlook of the Social Security System inevitably focuses on curtailing benefits or increasing the earnings cap on the Social Security tax in a way that impacts higher earners.[891] Such action would increase the inequality

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[886] *Id.* at 104.

[887] *Id.* at 113-14.

[888] *Id.* at 127.

[889] *Id.* at 132.

[890] *Id.* at 150.

[891] Schieber does not think the solution is as suggested by recent commissions to increase benefits for the low earners, decrease benefits for higher earners, increase taxes on higher earners, and then limit retirement tax expenditures which primarily help higher income individuals. SCHIEBER, *supra* note 9, at 369.

of the system but would be viewed as maintaining or improving the progressivity of the system. Although it would make a "bad deal" for higher earners even worse, it may be palatable to them since they are the primary beneficiaries of the many tax expenditures already embedded in the Federal Income Tax Code.[892]

The engine of retirement planning is the federal tax code. People wish to avoid paying tax on current income and want to have it accumulate tax-free over their working life. These plans originated during World War II when benefits provided to employees were not subject to the wage controls so unions could circumvent the limits on labor costs by demanding higher benefits.[893]

Tax reform is constantly discussed in the pages of tax magazines but never happens. The allure of the revenue that could be generated by curtailing many tax expenditures is a prime target for reformers interested in lowering tax rates. However, tax reform seems to be only acceptable when it is "revenue neutral." In other words, everyone will pay the same tax after tax reform as they paid before tax reform.[894] It will just be lower rates and fewer deductions.

Many of the so-called tax expenditures support pensions for middle and upper income individuals, many of which are in a position to fund their own retirement through other means.[895] Furthermore, while the Social Security trust fund is credited for contributions from low-income individuals, the earned income tax credit and tax credit for children under seventeen are refundable in part to relieve low-income individuals of the burden of Social Security taxes.[896] There is enormous revenue tied up in these tax expenditures. Currently, the tax expenditure associated with employer provided plans, IRAs, and Keoghs totals $800 billion over five years from 2014 to

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[892] *Id.* at 337. Amendments to the Social Security Act in 1977 sought to tax approximately 90% of covered wages but that percentage has since fallen to closer to 83% due to higher earnings growing faster than lower earnings. *Id.* at 336.

[893] *See id.* at 13-15.

[894] Significantly, tax reform requires bipartisanship to be successful. A recent report suggested that Republicans, who generally advocated major tax reductions, would like to repeal the deduction for state and local taxes because the benefit of the deduction favors states that have high state income taxes and are generally Democratic voting states (for example Connecticut, New York, New Jersey, California, Massachusetts, Maryland, Illinois, Rhode Island, and Virginia are the top ten states impacted with estimated per household increases from $4,286 to $2,333, respectively). Richard Rubin, *GOP Candidates Seek End to a Federal Tax Break That Benefits Blue States Most,* WALL ST. J., Jan. 30, 2016, at A5.

[895] *See id.*

[896] *See* Thomas Hungerford & Rebecca Theis, *The Earned Income Tax Credit and the Child Tax Credit History, Purpose, Goals, and Effectiveness*, ECON. POL'Y INST. (Sept. 25, 2015), http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness/.

2018.[897] The earned income tax credit is $352.8 billion in tax expenditures over five years and the credit for children under seventeen is another $285.5 billion.[898]

A proposal by recent commissions to limit the tax deduction for defined contribution plans to 20% or $20,000 was criticized as not providing an adequate retirement for persons earning between $100,000 and $200,000.[899] Ghilarducci's proposal for the Guaranteed Retirement Account (GRA) suggested curtailing the tax expenditures for 401(k) plans to fund the GRA.[900] Another commentator suggests redirecting spending away from the automatic increases in retirement and healthcare spending on the elderly toward an investment in education for the young, increased infrastructure spending, and research.[901] There will be many voices looking at the federal accumulation of power and wealth.

The One Fund Solution would cut through the mass of tax expenditures and treat everyone equally. It is funded with after-tax dollars, which means that it has a progressive element built into the structure of the plan since low-income persons would contribute virtually untaxed dollars and high-income persons would be contributing funds taxed at the highest marginal rate. This feature alone creates an incentive for younger workers to make additional contributions early in their career when they are in low-tax brackets and able to create a retirement plan that is never taxed. Capping contributions to accounts at $2 million in assets and tax-free withdrawals up to $2 million over a lifetime would provide a $100,000 annual payment over thirty years of retirement even with the guaranteed real return of 3%. As one commentator concludes:

> I recognize that all of these items [e.g. tax expenditures for employer provided health care, housing and other personal itemized deductions] are frequently described as political "sacred cows," but they simply are luxuries that we can no longer afford. Either we corral theses sacred cows, or they will stampede us.[902]

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[897] JOINT COMM. ON TAXATION, *supra* note 730, at 32 (identifying the five-year tax expenditure totals as follows (in billions of dollars): Keogh plans: $52.1; Defined Benefit plans: $248.3; Defined Contribution plans: $399.0; Traditional IRAs: $69.5; and Roth IRAs: $30.2, all of which are listed under the heading "Income Security").

[898] *Id.* at 30, 32 (the earned income tax credit is listed under "Income Security" while the credit for children under seventeen is listed under "Education, Training, Employment, and Social Services").

[899] SCHIEBER, *supra* note 9, at 369 (referring to the Bowles-Simpson Commission and the Domenici-Rivlin Task Force).

[900] *Id.*

[901] STEUERLE, *supra* note 4, at 158 (as part of the author's plan, the budget process needs to be reformed and "permanent" tax cuts need to be repealed).

[902] KLEINBARD, *supra* note 21, at 259. Kleinbard believes that:

> All these social expenditures delivered through the tax system should be accounted for consistently as spending programs, whether they reduce tax liabilities or result in the receipt of a check. There again we see how tax expenditures occlude our understanding of size and function of government.

Id. at 347.

Curtailing existing tax expenditures, providing income security, and dedicating the revenue generated thereby to funding the legacy costs of Social Security would be an important step toward addressing the nation's long-term debt problem. Other tax expenditures directed toward middle and higher income individuals that could be curtailed for the same purpose are the deduction for mortgage interest on owner-occupied residences ($405.2 billion over five years) and the deduction for property taxes on real property ($182.1 billion over five years).[903] These two-tax expenditures have their advocates and their critics but whether they actually assist many middle income tax payers is questionable. The inability to assess the effectiveness of tax preferences was evident in a 1955 report, Federal Tax Policy for Economic Growth and Stability:

> [If the government] decided to subsidize a certain activity, we should be hesitant about administering the subsidy by way of a tax preference. Subsidies in this form vary directly in amount with the tax brackets for the recipients; they are invariably hidden in the technicalities of the tax law; they do not show up in the budget; their cost frequently is difficult to calculate; and their accomplishments are even more difficult to assess.[904]

A 1977 estimate was that tax expenditures for pension plans affected high end taxpayers more with the bottom 50% of taxpayers receiving only 5% of the benefits of the tax expenditures.[905] While inequities in the present system of tax expenditures could be addressed,[906] the difficulty of doing so has led some commentators to suggest adopting a value-added tax (VAT) to fund entitlement reform and reduce reliance on income taxes.[907] Raising revenue is raising revenue and a VAT may well

[903] STEUERLE, *supra* note 4, at 25. Kleinbard sees "curbing tax expenditures as the most powerful single fiscal instrument by which we can right our fiscal ship." KLEINBARD, *supra* note 21, at 259. In particular, Kleinbard would substitute a 15% tax credit for all personal itemized deductions including mortgage interest deduction, real estate tax deduction, and charitable deduction, among others. *Id.* at 258-60.

[904] SCHIEBER, *supra* note 9, at 141 (citing *The Effects of Special Provisions in the Income Tax on Taxpayer Morale, in Joint Econ. Comm. Fed. Tax Pol'y for Econ. Growth & Stability*, 84th Cong., 250-51 (1955) (statement of Walter J. Blum)). The concept of tax expenditures would later be taken up and formally instituted into the federal system by Stanley Surrey. *Id.* at 151.

[905] *Id.* at 151.

[906] Other inequities involve the misuse of individual retirement accounts to shelter millions of dollars in wealth associated with the funding of IRAs with assets where incredible wealth can be directed for tax deferred growth.

[907] Martin A. Sullivan, *Setting the Ground Rules for Tax Reform*, 144 TAX NOTES 1352, 1354 (2014) (citing MICHAEL GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLE, FAIR, AND COMPETITIVE PLAN FOR THE UNITED STATES (2010) (proposing a 13% VAT that would cut the corporate tax to 15% and include certain provisions to offset income taxes and the heavy burden on the poor)). Sullivan further notes that resistance to the VAT is from conservatives who believe it will be a "money machine" to fund new and expanded governmental entitlements and liberals who believe it is unfair in disproportionally burdening the poor. *Id.* at 152.

stunt economic growth.[908] But, the real reason to avoid a VAT is that its adoption allows politicians to avoid the tough question of reforming the income tax code and eliminating special interest provisions.[909] Indeed, one commentator, concerned that politicians would be unable to resist continual rate increases once a VAT is instituted, suggested expansion of tax-preferred accounts such as 401(k)s and IRAs as a way to move toward a VAT without actually adopting one.[910] The One Fund Solution proposed herein would offer such a move.[911]

5. Technological Breakthrough

The last few decades have seen enormous wealth developed through technical advances. It is possible that some such advance would produce sufficient wealth to make reform possible if that wealth were directed toward solving the entitlement problems. We see one possible advance in the oil and gas industry with the revolution in fracking. The fracking techniques have created a great deal of wealth for individuals as well as for states that have encouraged such practices.[912] But states like California have resisted development of its energy resources and other practices on environmental grounds.[913] The federal government has been slow to embrace the new technology most noticeably in the refusal to approve the Keystone XL pipeline.[914]

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908 *Japan's consumption tax, The Big Squeeze: A tax goes up while recovery remains fragile,* ECONOMIST, Mar. 29, 2014, at 42. Japan's consumption tax goes from 5% to 8% April 1, 2014 and to 10% in October 2015 as a way to shore up Japan's stretched public finances. *Id.* Abe's effort is to inflate the yen and has pushed for wage increases but not all have received the increased wage. *Id.* Exporters seem to profit most. *Id.* Prime Minister Abe delayed the scheduled October 2017 increase to 10% until April 2017 and he is still planning to implement the increase at that time. Mari Yamaguchi, *Japanese Prime Minister Shinzo Abe says he has no plans to nix a consumption tax hike planned for next year, denying speculation that it will be postponed amid suggestions that Japan's economy won't be able to handle it*, U.S. NEWS & WORLD REP. (Mar. 29, 2016, 10:02 AM), http://www.usnews.com/news/business/articles/2016-03-29/japans-abe-says-no-plans-to-postpone-consumption-tax-hike.

909 KLEINBARD, *supra* note 21, at 375 (noting that there are not resources for a VAT or other consumption tax, at least for the next decade or more, and finding that a return to the income tax as it was prior to the Bush tax cuts in 2001 would be adequate for the foreseeable future). Kleinbard continues:

> I have shied away from new taxes deliberately, however. Old taxes have two great virtues. One is that they are well understood; the other is that they are baked into prices and behaviors. Moving to large-scale new taxes can later relative prices or change behaviors in ways that are profoundly unsettling.

Id. at 385.

910 Diana Furchtgott-Roth, *Resist the Seductive VAT*, 150 TAX NOTES 355 (2016).

911 *Id.*

912 Editorial, *Less Government Means More Water*, INV. BUS. DAILY, Apr. 29, 2014, at A2.

913 *Id.*

914 Mark J. Perry, *Holding Back America AS Energy Megapower*, INV. BUS. DAILY, July 28, 2014, at 2.

One prediction of a bright future is:

> The current deficit in retirement savings took a long time to develop, and the resulting problems will require an equally long time to solve. But the important point is that these are soluble problems. The United States is still a very rich country. Growth rates have slowed in recent years, but technology and growing prosperity in emerging markets promise renewed robust growth going forward. If we act quickly, intelligent financial planning can enable us to meet the current challenge.[915]

The fall in the price of oil is a "once-in-a-generation opportunity."[916] Some observers see it as an opportunity to reform the energy policy and promote clean energy with the first step being the elimination of all forms of fossil fuel subsidies and tax breaks, the elimination of prohibitions on the export of oil and gas, and the imposition of a tax on carbon use.[917] There is an opportunity to change policies but the priorities should include retirement, education, and healthcare, which is making ever-increasing demands on the economy. Federal government ownership of 52% of the lands in the west offers an opportunity for oil and gas exploration that could provide funds directed towards solving the long-term fiscal imbalance, but most of these lands are off limits to exploration.[918] The boom in natural gas is already having an impact in supplying cheap natural gas worldwide and could also have profound geopolitical ramifications.[919]

CONCLUSION

Under Social Security, individuals receive a form of social insurance they barely understand or are able to evaluate for 12% of their lifetime income. Indeed projections are that the benefit to be received in the future may not be as attractive as it appears since the funding sources seem inadequate to provide the benefit.

The One Fund Solution seeks to replace the Social Security system with an individual account for each individual having a guaranteed real rate of return of 3% along with the possibility of investing in broad based mutual funds after the account reaches a certain level. Amounts in the fund will be withdrawn for retirement and

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[915] Frank, *supra* note 3, at x.

[916] *Seize the day*, ECONOMIST, Jan. 17, 2015, at 9 (containing a by-line that reads: "The fall in the price of oil and gas provides a once-in-a-generation to fix bad energy policies.").

[917] *Id.* ("A cheaper, greener and more reliable energy future could be within reach."). United States bans on the export of oil and the 1920 Jones Act requiring domestically shipped oil to be shipped on United States owned ships are impeding the sale of oil abroad at a time when storage capacity is being filled threatening to force well closings and oil producer bankruptcies rather than lifting bans that could open world markets to United States producers. Holman W. Jenkins, Jr., *How the Oil Export Ban Chokes the Fracking Boom*, WALL ST. J., Mar. 7, 2015, at A11. Congress lifted the 1975 ban on the export of United States oil on December 18, 2015. *America lifts its ban on oil exports*, ECONOMIST, Dec. 18, 2015.

[918] Thomas J. Pyle, *Federal Lands Are A Potential Energy Bonanza,* INV. BUS. DAILY, Feb. 11, 2015, at A15 (citing studies indicating that the tax collectors would reap a $2.7 trillion reward for opening only a small portion of the federal lands to exploration).

[919] Mark Perry, *Natural Gas boom Is Win-Win-Win Policy*, INV. BUS. DAILY, Feb. 18, 2015, at A15.

other specified uses on a tax-free basis. The One Fund is sufficiently large to justify the idea that it will, after an appropriate phase in period, be the sole tax benefited plan for retirement savings. Other tax motivated plans will be phased out. Balances in the One Fund at the death of the owner can be passed on to the owner's beneficiaries thereby creating a pattern of intergenerational wealth.

The One Fund, since it is funded by participants with after-tax dollars, will create the same tax benefit for all persons. It is not a progressive plan but there is no reason that government cannot structure welfare plans that will dovetail with the One Fund. Indeed the One Fund should be expanded so that health care plans, education savings plans, and other savings needs can be structured through the One Fund over time. Individuals need to understand the true cost of retirement and health care to appreciate the need to accumulate significant savings over a lifetime. The One Fund provides that vehicle; and, should the education system provide adequate financial literacy to its graduates, then the One Fund would be understood throughout society. The One Fund Solution promotes freedom and human dignity as people take control of their lives and, to some extent, realize that their tax contributions will actually have a positive effect on the truly poor.

In the long run, the One Fund Solution would replace the need to guarantee private pensions, which are likely to be terminated as people rely on the One Fund as their primary source of retirement income.[920] The One Fund Solution is superior to other proposed solutions; it reduces complexity in the tax code, while promoting responsible independent citizens, and a more open, responsible political system.

America's fiscal problems are in the news on a daily basis, but rather than address the problem directly, Congress and President Obama choose to continue kicking the can down the street. This was seen in the temporary fix for the DI trust fund that was made in the 2015 budget deal. Congress and President Obama diverted additional funds from the Social Security tax for three years to avoid fixing the Social Security disability program before the 2016 presidential election.[921] Perhaps a future Congress and the next President will address the problem. But the general federal budget has already begun repaying its OASI trust fund obligations and the repayment will continue to increase until the trust fund is exhausted sometime around 2030. Since the federal budget is in deficit, and deficits are projected for the indefinite future, repaying the "so-called" trust fund obligation will entail additional borrowing and increasing the national debt. In 2030, the trust fund is exhausted and the "legal" decision will be on Congress to raise taxes, decrease benefits, or simply recognize that funding Social Security is a general obligation of the federal budget. Nevertheless, the $2.8 trillion trust fund will likely have been converted to an equal amount of public debt.[922]

A better solution is the One Fund Solution; and, the sooner it is adopted and the nation addresses the fact that government cannot successfully carry the burden of everyone's housing, education, healthcare, and retirement and facilitates a return of those burdens to the individuals who are able to plan for themselves, the sooner we will find financial security.

[920] MARIN, *supra* note 2, at 149-50 (describing the restrictions placed on corporate actions by the need to have such actions approved by the PBGC).

[921] *See supra* note 65 and accompanying text.

[922] Graham, *supra* note 57.

Everyone will feel this problem. The crisis is summarized as follows:

> As it turns out, you can outrun a food shortage problem . . . and even a population growth problem . . . but who can outrun the demographic monster created by an aging work force, slowing population growth, slowing economic growth, and the profligate spending that ignores retirement savings in favor of pretending that a pay-as-you-go approach will suffice? It turns out the very few can.[923]

[923] MARIN, *supra* note 2, at 61.