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Universal Pensions

Jonathan Barry Forman*

I. INTRODUCTION

Most Americans are not saving enough for their retirement. According to U.S. Department of Labor Secretary Alexis M. Herman, the average worker should save at least \$6444 per year for retirement.¹ Yet, 20% of American workers have saved absolutely nothing toward retirement, and 13% of those who have started saving for retirement have less than \$9000 put aside.²

Financial planners usually say that an individual needs a retirement income equal to about 60% to 80% of pre-retirement earnings.³ Achieving that goal depends on building a proverbial three-legged stool consisting of Social Security, private pensions, and private savings. Unfortunately, all three of those "legs" are in trouble today.⁴

First, Social Security is in financial trouble. According to the actuaries, the Social Security trust fund will be depleted by 2032, and the annual tax income of the then-depleted trust fund will only cover about 75% of the cost of benefits payable.⁵ As a result, the federal government will need to either raise Social Security taxes or cut benefits, and nobody seems very interested in raising taxes.

Second, private pension coverage has stagnated. More than 50 million Americans—about half of the workforce—have no private pension coverage at all, whether through an employer-pro-

* Professor of Law, University of Oklahoma; B.A. 1973, Northwestern University; M.A. (Psychology) 1975, University of Iowa; J.D. 1978, University of Michigan; M.A. (Economics) 1983, George Washington University. Delegate to the 1998 National Summit on Retirement Savings. Research assistance was provided by Melissa French.

¹ Alexis M. Herman, *Uncle Sam Wants You . . . to Save Your Money for Retirement*, WASH. POST NAT'L WEEKLY ED., June 1, 1998, at S1 (Advertising Supp.).

² See *id.*

³ See CHRISTOPHER CONTE, AGENDA BACKGROUND MATERIALS FOR THE NATIONAL SUMMIT ON RETIREMENT SAVINGS: JUNE 4-5, 1998, at 6 (1998).

⁴ See U.S. DEPT. OF LABOR, FINAL REPORT ON THE NATIONAL SUMMIT ON RETIREMENT SAVINGS (1998). See also Christopher T. Kelley, Note, *Uncertainty in the Golden Years: The Growing Demands Upon the American Retirement Security System*, 2 ELDER L.J. 225 (1994).

⁵ See SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES, STATUS OF THE SOCIAL SECURITY AND MEDICARE PROGRAMS: A SUMMARY OF THE 1998 ANNUAL REPORTS 7-8 (1998).

vided plan or through individual retirement accounts (IRAs).⁶ Workers in small businesses are particularly hard-hit: only about 25% of the workers in these companies are covered by some kind of pension plan.⁷

Third, private savings have also fallen. Americans are saving just 3.8% of their disposable incomes, down from 9.2% in 1946.⁸

Yet, because American workers are living longer and retiring earlier, they will need more savings than ever. For example, a boy born in 1940 had a life expectancy of just 61.4 years, but a boy born in the year 2000 can expect to live 73.2 years.⁹ Moreover, a man reaching age 65 in 1940 could expect to live just 11.9 years, but a man reaching 65 in the year 2000 can expect to live another 15.8 years.¹⁰

Despite these increased life expectancies, Americans are retiring earlier and earlier. The average age at which workers begin receiving Social Security has fallen from 68.7 years old in 1940 to 63.6 in 1995.¹¹ Also, in 1996, only 16.9% of men and 8.6% of women aged 65 or older were still working.¹²

Of course, it is great that we are living longer, and it is wonderful that we can expect to have long and leisurely retirements, but these developments have led to the current financing problems for Social Security, and compound the shortfalls in private pensions and private savings. By 2020, there will be more than 53 million Americans age 65 and older,¹³ but many will not be able to afford to retire.

The time has come to admit that America's current retirement policies are failing. Only then can a new comprehensive retirement policy be developed. The nation needs a retirement system that actually will ensure that all Americans have adequate incomes throughout their retirement years. In short, the country needs a universal pension system that works.

At the outset, Part II of this article provides an overview of the current retirement system, and Part III discusses the need for a universal pension system. Part IV then considers three ap-

⁶ See Newt Gingrich, *50 Million American Workers Have No Retirement Coverage*, WASH. POST NAT'L WEEKLY ED., June 1, 1998, at S1 (Advertising Supp.).

⁷ See *id.*

⁸ See CONTE, *supra* note 3, at 10-11.

⁹ See STAFF OF THE HOUSE COMM. ON WAYS AND MEANS, 105TH CONG., 1998 GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 1031 tbl.A-2 (Comm. Print 1998) [hereinafter 1998 GREEN BOOK].

¹⁰ See *id.*

¹¹ See *id.* at 21 tbl.1-2

¹² See *id.* at 1032.

¹³ See FRANK B. HOBBS WITH BONNIE L. DANNON, 65+ IN THE UNITED STATES 5-7 (Current Population Reports Special Study No. P23-190, 1996) [hereinafter 65+ IN THE UNITED STATES].

proaches for providing a pension system that would ensure that all Americans have adequate incomes throughout their retirement years. Specifically, Part IV considers how a voluntary and universal individual retirement savings account system might work, how an expanded Social Security system might work, and how a mandatory universal private pension system might work. Finally, Part V considers which of these universal pensions approaches shows the most promise, and Part VI considers some issues that are common to all universal pension systems.

II. AN OVERVIEW OF THE CURRENT RETIREMENT SYSTEM

A. Social Security

The Social Security system includes three programs that provide monthly cash benefits to workers and their families. The Old-Age and Survivors Insurance (OASI) program provides monthly cash benefits to retired workers and their dependents and to survivors of insured workers, and the Disability Insurance (DI) program provides monthly cash benefits for disabled workers under age 65 and their dependents.¹⁴ A worker builds protection under these programs by working in employment that is covered by Social Security and paying the applicable payroll taxes. At present, about 96% of the work force are in covered employment.¹⁵ At retirement, disability, or death, monthly Social Security benefits are paid to insured workers and to their eligible dependents and survivors. In addition, Supplemental Security Income provides monthly cash benefits to low-income elderly Americans.¹⁶

The OASI program is, by far, the largest of these programs, and it is usually what people mean when they talk about Social Security. In 1997, for example, the OASI program paid more than \$316 billion in benefits to almost 38 million Americans, with the average benefit paid to a retired worker being about \$765 per month.¹⁷ Consequently, for the remainder of this article, the term "Social Security" will refer to OASI taxes, and the terms "Social Security benefits" will refer to OASI benefits.

¹⁴ See generally Social Security Act, Pub. L. No. 74-271, 49 Stat. 620 (1935) (codified as amended at 42 U.S.C. §§ 301-1397f); see also 1998 GREEN BOOK, *supra* note 9, at 1-99; SOC. SEC. ADMIN., SOC. SEC. HANDBOOK (13th ed. 1997); and SOC. SEC. ADMIN., SOC. SEC. BULL., ANN. STAT. SUPP. (1997).

¹⁵ See 1998 GREEN BOOK, *supra* note 9, at 10 tbl.1-4.

¹⁶ See *id.* at 261-326. In 1997, for example, the maximum federal benefit for an individual was \$484 per month, and the maximum federal benefit for couples was \$726 per month; however, some states provided small additional supplements. See *id.* at 277.

¹⁷ Current Operating Statistics: List of Tables, SOC. SEC. BULL., No. 2, 1988, at 43, 45, 47, 48.

1. Social Security Taxes

Social Security benefits are overwhelmingly financed through payroll taxes imposed on individuals working in covered employment or self-employment.¹⁸ For 1999, employees and employers each pay a tax of 5.35% on up to \$72,600 of wages earned in covered employment, for a combined OASI rate of 10.7%.¹⁹ Self-employed workers pay an equivalent OASI tax of 10.7% on up to \$72,600 of net earnings.²⁰

2. Social Security Benefits

Workers over age 62 generally are entitled to OASI benefits if they have worked in covered employment for at least 10 years. Benefits are based on a measure of the worker's earnings history in covered employment, known as the average indexed monthly earnings (AIME). Basically, the AIME measures the worker's career-average monthly earnings in covered employment.

The AIME is linked by a formula to the monthly retirement benefit payable to the worker at normal retirement age, a benefit known as the primary insurance amount (PIA). For a worker turning 62 in 1999, the PIA is equal to 90% of the first \$505 of the worker's AIME, plus 32% of the AIME over \$505 and through \$3043 (if any), plus 15% of the AIME over \$3043 (if any).²¹ It is worth noting that, on its face, the benefit formula is progressive, meaning that it is designed to favor workers with relatively low career-average earnings.

Dependents and survivors of the worker may also receive additional monthly benefits. These so-called auxiliary benefit amounts are also based on the worker's PIA. For example, a 65 year-old wife or husband of a retired worker is entitled to a monthly spousal benefit equal to 50% of the worker's PIA, and the widow or widower of the worker is entitled to a monthly surviving spouse benefit equal to 100% of the worker's PIA.

¹⁸ In addition, as much as 85% of a taxpayer's Social Security benefits is subject to income taxation. The actual amount to be included is determined by applying a complicated two-tier formula. See I.R.C. § 86 (1994 & Supp. II 1996). Basically, single taxpayers with incomes over \$25,000, and married couples with incomes over \$32,000, must include as much as half of their Social Security benefits in income, while single taxpayers with incomes over \$34,000, and married couples with incomes over \$44,000, must include as much as 85% of their Social Security benefits in income.

¹⁹ The OASI rate represents the lion's share of the total rate of 15.3% that is collected for OASI, disability insurance, and Medicare. See 1999 Cost-of-Living Increase and Other Determinations, 63 Fed. Reg. 58,446 (1998) [hereinafter 1999 Social Security COLA Determinations].

²⁰ See *id.*

²¹ See *id.*

B. Private Retirement Plans

1. ERISA-Covered Plans

Most private retirement plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA).²² These plans generally fall into two broad categories based on the nature of the benefits provided: defined benefit plans and defined contribution plans.

These private retirement plans typically qualify for favorable tax treatment. Basically, an employer's contributions to a tax-qualified pension plan on behalf of an employee is not taxable to the employee.²³ Nevertheless, the employer is allowed a current deduction for these contributions (within limits).²⁴ Moreover, the pension fund's earnings on these contributions are tax-exempt.²⁵ Workers pay tax only when they receive distributions of their pension benefits,²⁶ and, at that point, the usual rules for taxing annuities apply.²⁷

a. Defined benefit plans

Defined benefit plans typically provide each worker with a specific annual retirement benefit that is tied to the worker's final average compensation and number of years of service. For example, a plan might provide that a worker's annual retirement benefit (B) is equal to 2% times years of service (yos) times final average compensation (fac) ($B = 2\% \times \text{yos} \times \text{fac}$). Under this formula, a typical worker with 30 years of service would receive a retirement benefit equal to 60% of her preretirement earnings ($B = 60\% \times \text{fac} = 2\% \times 30 \text{ yos} \times \text{fac}$). Final average compensation is typically computed by averaging the worker's salary over the three years immediately prior to retirement.

b. Defined contribution plans

Under a typical defined contribution plan, the employer simply contributes a specified percentage of the worker's compensation to an individual investment account for the worker. For example, contributions might be set at 10% of annual compensa-

²² Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended in scattered sections of Titles 26 and 29 of the United States Code); see *generally* JOINT COMMITTEE ON TAXATION, 105TH CONG., OVERVIEW OF PRESENT-LAW TAX RULES RELATING TO QUALIFIED PENSION PLANS SCHEDULED FOR A HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE HOUSE COMMITTEE ON WAYS AND MEANS ON MAY 5, 1998 (Comm. Print JCX-30-98, 1998).

²³ I.R.C. § 402 (1994 & Supp. III 1997).

²⁴ I.R.C. § 404 (1994 & Supp. III 1997).

²⁵ I.R.C. § 501(a) (1994).

²⁶ I.R.C. § 402.

²⁷ I.R.C. § 72 (1994 & Supp. III 1997).

tion. Under such a plan, a worker who earned \$30,000 in a given year would have \$3000 contributed to an individual investment account for her. Her benefit at retirement would be based on all such contributions plus investment earnings thereon. There are a variety of different types of defined contribution plans, including money purchase pension plans, target benefit plans, profit-sharing plans, stock bonus plans, and employee stock ownership plans (ESOPs).

Profit-sharing and stock bonus plans may include a 401(k) feature which allows workers to choose between receiving cash currently or deferring taxation by placing the money in a retirement account.²⁸ Consequently, they are sometimes called cash or deferred arrangements (CODAs). The maximum annual amount of elective deferrals that can be made by an individual in 1999 is \$10,000.²⁹ Elective contributions are subject to payroll taxation, however.³⁰

c. Coverage

As of 1993, about 43% of private-sector workers were covered by at least one pension plan.³¹ Defined contribution plans comprised 88% of these plans, up from 67% in 1975.³² Moreover, 42% of the active participants in those private-sector plans had a defined contribution plan as their primary plan, up from just 13% in 1975.³³ Similarly, in 1993, 88% of private employers with only one retirement plan sponsored only a defined contribution plan, up from 68% in 1984.³⁴ Also of note, 401(k) plans are the fastest growing part of the defined contribution world. Their share of private retirement plans grew from 3% to 14% from 1984 to 1990.³⁵ At the same time, their share of employer-sponsored retirement plan participants grew from 19% to 46%.³⁶

2. IRAs and Roth IRAs

Favorable tax rules are also available for certain individual retirement accounts (IRAs).³⁷ Under the current IRA rules, al-

²⁸ I.R.C. § 401(k) (1994 & Supp. III 1997).

²⁹ See IRS News Release No. IR-98-63 (Oct. 23, 1998), *reprinted at* 25 BNA PENSION & BENEFITS REP. 2501 (1998).

³⁰ See, e.g., I.R.C. § 3121(a)(5) (1994 & Supp. III 1997).

³¹ See EMPLOYEE BENEFIT RESEARCH INSTITUTE, EBRI DATABOOK ON EMPLOYEE BENEFITS 81 (4th ed. 1997).

³² See *id.*

³³ See *id.*

³⁴ See U.S. GEN. ACCOUNTING OFFICE, MOST EMPLOYERS THAT OFFER PENSIONS USE DEFINED CONTRIBUTION PLANS 4 (Report No. GAO/GGD-97-1, 1996).

³⁵ See U.S. GEN. ACCOUNTING OFFICE, IMPLICATIONS OF DEMOGRAPHIC TRENDS FOR SOCIAL SECURITY AND PENSION REFORM 46 (Report No. GAO/HEHS-97-81, 1997).

³⁶ See *id.*

³⁷ See I.R.C. §§ 219, 408 (1994 & Supp. III 1997).

most any worker can set up an IRA account with a bank or other financial institution and contribute up to \$2000 (or, if less, 100% of compensation) each year to that account. Workers who are not covered by another retirement plan may deduct their IRA contributions. If the worker is covered by another retirement plan, however, the deduction may be reduced or eliminated if the worker's income exceeds \$31,000 (in 1999) for a single taxpayer or \$51,000 for married taxpayers.³⁸ Like private pensions, IRA earnings are tax-exempt, and distributions are taxable.

Also, since 1998, individuals have been allowed to set up so-called Roth IRAs.³⁹ Unlike regular IRAs, contributions to Roth IRAs are not deductible. Instead, withdrawals are tax-free. Like regular IRAs, however, the earnings of these Roth IRAs are tax-exempt.

III. THE NEED FOR A UNIVERSAL PENSION SYSTEM

A. The Need for Adequate Retirement Incomes

Because Americans are living longer and retiring earlier, they will need more retirement savings than ever to ensure that they will have adequate retirement incomes. At the outset, Appendix 1 shows how life expectancies have increased since the turn of the century.⁴⁰ Appendix 1 shows, for example, that a boy born in 1940 had a life expectancy of just 61.4 years, but a boy born in the year 2000 can expect to live 73.2 years. A man reaching age 65 in 1940 could expect to live just 11.9 years, but a man reaching 65 in the year 2000 can expect to live another 15.8 years.

Moreover, as the years go by, an increasing percentage of Americans will survive to old age. For example, Appendix 2 shows that just 53.9% of men born in 1875 survived from age 21 to age 65 in 1940.⁴¹ On the other hand, 82.7% of men born in 1985 are expected to survive from age 21 to age 65 in 2050.

Yet, even though life expectancies have increased throughout the century, there has been a trend toward earlier and earlier retirement. For example, Appendix 3 shows that the average age at which workers begin receiving their Social Security retirement benefits has fallen from 68.7 years old in 1940 to 63.6 years old in 1995.⁴²

Not surprisingly, a number of analysts have expressed concern about the financial prospects of the elderly retirees in the

38 See I.R.C. § 219(g) (1994 & Supp. III 1997).

39 I.R.C. § 408A (West Supp. 1999).

40 See 1998 GREEN BOOK, *supra* note 9, at 1031 tbl.A-2.

41 See C. EUGENE STEUERLE & JON M. BAKIJA, *RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY: RIGHT & WRONG APPROACHES TO REFORM* 41 (1994).

42 See 1998 GREEN BOOK, *supra* note 9, at 21 tbl.1-12.

21st century.⁴³ In that regard, it is worth noting that the United States already has around 35 million residents who are age 65 and over, and around four million who are age 85 and over.⁴⁴ Moreover, by the year 2020, the United States will have more than 53 million residents age 65 and over, and almost seven million age 85 and over.⁴⁵

The economic problems of these elderly citizens will be of paramount importance to the nation in the 21st century. In that regard, it is worth considering what it will cost to support the retired population. According to Lawrence Thompson, a senior fellow at the Urban Institute, the economic cost of supporting the elderly is best understood in terms of the fraction of society's goods and services that are consumed by the retired.⁴⁶ Specifically, "the cost of supporting the retired is simply the product of three different economic and demographic ratios:

(1) the *aggregate consumption ratio*, which is the fraction of total economic activity devoted to producing consumer goods and services;

(2) the *retiree dependency ratio*, which is the fraction of the population that is retired (which is going to be very similar to the aged dependency ratio); and

(3) the *living standards ratio*, which is the ratio of the average consumption of a retired person to the average consumption of all persons."⁴⁷

This formulation can be used to illustrate the rather direct and simple relationships between the ratios and the cost of supporting the elderly.⁴⁸ For example, a 10% increase in the fraction of the population that is retired will result in a 10% increase in the

43 See, e.g., Daniel B. Radner, *The Retirement Prospects of the Baby Boom Generation*, Soc. Sec. Bull., No. 1, 1998, at 3; CONGRESSIONAL BUDGET OFFICE, BABY BOOMERS IN RETIREMENT: AN EARLY PERSPECTIVE (1993); COMMITTEE FOR ECONOMIC DEVELOPMENT, WHO WILL PAY FOR YOUR RETIREMENT?: THE LOOMING CRISIS (1995); RETIREMENT IN THE 21ST CENTURY . . . READY OR NOT . . . (Dallas L. Salisbury & Nora Super Jones eds., 1994); THE FUTURE OF PENSIONS IN THE UNITED STATES (Ray Schmitt ed., 1993); HENRY J. AARON ET AL., CAN AMERICA AFFORD TO GROW OLD?: PAYING FOR SOCIAL SECURITY (1989); NATIONAL COMMISSION ON RETIREMENT POLICY, CAN AMERICA AFFORD TO RETIRE? THE RETIREMENT SECURITY CHALLENGE FACING YOU AND THE NATION (1998).

44 See 65+ IN THE UNITED STATES, *supra* note 13, at 2-3, tbl.2-1.

45 See *id.*

46 LAWRENCE THOMPSON, OLDER & WISER: THE ECONOMICS OF PUBLIC PENSIONS 40 (1998).

47 *Id.* In terms of mathematical formula, the *basic formula* is: Cost of Supporting the Retired = Consumption of the Retired ÷ Total National Production. The *expanded formula* is: Cost of Supporting the Retired = ((Total Consumption ÷ Total National Production)(Number of Retirees ÷ Total Population)(Average Consumption of Retirees ÷ Average Consumption of Total Population)). In summary, the *cost of supporting the retired* is simply the product of: the *aggregate consumption ratio*; the *retiree dependency ratio*; and the *living standards ratio*. *Id.*

48 See *id.* at 41.

cost of supporting the retired.⁴⁹ In that regard, only about 12.8% of the U.S. population consists of persons age 65 or over today, but by 2020, 15.7% of the population will be 65 or older.⁵⁰ That's almost a 23% increase ($122.66\% = 15.7\% / 12.8\%$).

Reducing the problem of how to support the elderly to mathematical formulae enabled Thompson to develop a model that can be used to estimate how much must be contributed to pensions in order to assure adequate incomes for the retired population.⁵¹ At the outset, Thompson's simple model assumes that all workers enter the labor force at age 22, work exactly 43 years, retire on their 65th birthday, and die exactly 17 years later on their 82nd birthday. His simple model also assumes that while working, each earns the average wage and that in retirement, each receives a benefit equal to one-half the average wage (indexed to average wage levels).

Using his simple model, Thompson was able to estimate the annual contributions that would be needed to fund the proposed pension benefits (one-half of wages). Specifically, he found that annual contributions of 19.8% of payroll would be needed to provide pension benefits equal to one-half of the average wage.⁵² Of particular note, in his simple model, contributions of 19.8% of wages would be required regardless of whether these pensions are provided through an individual savings account arrangement (like IRAs), a pay-as-you-go group pension plan (like Social Security), or an advance funded group pension plan (like traditional pensions).⁵³

Of course, the real world is much more complex. A variety of demographic and economic factors can have an impact on the required contribution rate. For example, in the real world not everyone lives to retirement age, let alone to age 82. Incorporating more realistic mortality patterns reduces the contribution rate to 17.4% for a simple pay-as-you-go group pension plan.⁵⁴ On the other hand, because assets accumulated in a worker's individual savings account become a part of the worker's estate at death, there would be no such savings for an individual savings account arrangement.

Also, real world pension systems have administrative expenses that necessitate increasing the contribution rate—for example, back up to 17.8% for a simple pay-as-you-go system, but all

⁴⁹ See *id.*

⁵⁰ See 65+ IN THE UNITED STATES, *supra* note 13, at 5-4. Similarly, by 2020, fully 2.1% of the U.S. population will consist of persons age 85 and over, up from 1.6% in the year 2000. *Id.*

⁵¹ THOMPSON, *supra* note 46, at 97-113.

⁵² *Id.* at 99.

⁵³ See *id.* at 107. See Appendix 4.

⁵⁴ See *id.* at 105.

the way up to 28.03% for an individual savings arrangement.⁵⁵ Moreover, while pay-as-you-go plans typically provide benefits in the form of an annuity, individual savers must pay an extra premium to acquire private annuities that will drive up the contribution rate for an individual savings plan. On the other hand, an increase in the rate of return (interest rates) can reduce the contribution rate for individual retirement savings plans, but such a change would have no effect on pay-as-you-go plans. Finally, changes in the birth rate, life expectancy, the inflation rate, or the rate of growth of wages also could have significant impacts on the contribution rates required under the various funding approaches.

Thompson's research shows that the "optimal" contribution rate will vary depending upon the pension funding mechanism chosen, and upon a host of demographic and economic factors that only can be estimated. Reasonable minds might well differ as to what the optimal contribution rate should be, but Thompson's research makes it crystal clear that the meager contribution rate required by the present Social Security system, a combined individual-employer rate of just 10.7% of the first \$72,600 of compensation, cannot possibly fund adequate incomes for the retired population.

B. The Failure of the Current System

1. The Failure of Social Security

The success of the Social Security system is that, since its creation in 1935, poverty rates for the elderly have fallen from an estimated 50% in 1935, to around 11% today.⁵⁶ At the same time, however, the failure of Social Security is that it has not solved the problem of poverty among the elderly. Social Security alone cannot provide adequate income for retirees, yet it is virtually the only source of income for the poorest 40% of American retirees.⁵⁷

In particular, women over the age of 65 continue to face a much higher risk than men of poverty in old age.⁵⁸ In that regard, it is worth noting that women tend to live longer than men, and that men tend to marry younger women.⁵⁹ The typical couple will spend about 15 years together in retirement, and the wife will live

⁵⁵ See *id.* at 107.

⁵⁶ See U.S. GEN. ACCOUNTING OFFICE, SOCIAL SECURITY: DIFFERENT APPROACHES FOR ADDRESSING PROGRAM SOLVENCY 2 (Report No. GAO/HEHS-98-33, 1998) [hereinafter SOCIAL SECURITY SOLVENCY].

⁵⁷ See CONTE, *supra* note 3, at 4.

⁵⁸ See NATIONAL ECONOMIC COUNCIL INTERAGENCY WORKING GROUP ON SOCIAL SECURITY, WOMEN AND RETIREMENT SECURITY 5 (1998).

⁵⁹ For example, the average life expectancy for women age 65 is about 19 years, versus about 15 years for 65-year-old men. See 1998 GREEN BOOK, *supra* note 9, at 1031 tbl.A-3.

another six years as a widow.⁶⁰ Indeed, women are five times more likely to become widowed,⁶¹ and many of these women will find themselves living below the poverty level.⁶² Similarly, elderly divorced women are particularly at risk. They tend to have an exceptionally high incidence of poverty (around 30%), an unusually high incidence of serious health problems, and low Social Security benefits.⁶³

2. The Failure of the Private Pension System

The private pension system has failed to pick up the slack left by our inadequate Social Security system. Less than 60% of workers in the private sector are covered by pension plans, and only about 40% are covered by defined benefit plans.⁶⁴ Workers in small businesses are particularly hard-hit, with only about 25% of the workers in these companies covered by any type of pension plan.⁶⁵ In general, pension coverage tends to decrease as age, job tenure, firm size, and annual earnings decrease, and some industries and sectors are more likely to cover their workers than others.⁶⁶ Too many employees have no tax-favored savings vehicle to supplement Social Security beyond do-it yourself \$2000-a-year IRAs.⁶⁷

Also, despite their longer life expectancies and consequently greater need for retirement income, women have not found much support in the private retirement system.⁶⁸ Indeed, there is a particularly large gender gap concerning private pension income.⁶⁹

⁶⁰ See Howard M. Iams & Stephen J. Sandell, *Cost-Neutral Policies to Increase Social Security Benefits for Widows: A Simulation for 1992*, SOC. SEC. BULL., No. 1, 1998, at 34, 37.

⁶¹ See Camilla E. Watson, *The Pension Game: Age- and Gender-based Inequities in the Retirement System*, 25 GA. L. REV. 1, 31 (1990).

⁶² See David E. Ott, *Survivor Income Benefits Provided by Employers*, MONTHLY LAB. REV., June 1991, at 13; David A. Weaver, *The Economic Well-Being of Social Security Beneficiaries, with an Emphasis on Divorced Beneficiaries*, SOC. SEC. BULL., No. 4, 1997, at 3.

⁶³ See Weaver, *supra* note 62; Donald T. Ferron, *Social Security Benefits for Women Aged 62 or Older*, SOC. SEC. BULL., No. 4, 1997, at 32.

⁶⁴ See William J. Wiatrowski, *On the Disparity Between Private and Public Pensions*, MONTHLY LAB. REV., Apr. 1994, at 3, 4.

⁶⁵ See Gingrich, *supra* note 6.

⁶⁶ See EMPLOYEE BENEFIT RESEARCH INSTITUTE, *supra* note 31, at 82; Donald O. Parsons, *Recent Trends in Pension Coverage Rates*, in PENSION AND WELFARE BENEFITS ADMIN., U.S. DEP'T LAB., PENSION COVERAGE ISSUES FOR THE '90s, at 39 (1994); Mary Ellen Benedict & Kathryn Shaw, *The Impact of Pension Benefits on the Distribution of Earned Income*, 48 INDUS. & LAB. REL. REV. 740, 746 (1995) (The empirical evidence shows that "high-wage workers are more likely to have pensions than are lower-wage workers; the probability of pension coverage is greater for workers in large firms, for men, for unionized workers, for high-tenure workers, and for highly educated workers.").

⁶⁷ See Richard J. Kovach, *A Critique of SIMPLE—Yet Another Tax-Favored Retirement Plan*, 32 NEW ENG. L. REV. 401, 408 (1998).

⁶⁸ See Watson, *supra* note 61.

⁶⁹ There are many reasons for this gender gap in retirement income. In particular, women tend to earn less than men. Also, women tend to work for smaller companies that

While 46.5% of men over age 65 in 1995 received pension and/or annuity income, averaging \$11,460 per year, only 26.4% of women over age 65 received a pension or annuity, and these averaged just \$6684 per year.⁷⁰ Moreover, women age 50 or over are more likely to receive a pension benefit through their husbands (as spouses or survivors) than through their own savings or employment.⁷¹

C. Some Recent Efforts to Expand the Retirement System

Concerns about the adequacy of retirement incomes have led to a number of expansions in recent years. These expansions include the introduction of IRAs, Roth IRAs, SIMPLE retirement plans, simplified employee pensions, expanded 401(k) plan eligibility, and simplifications to ERISA.

1. IRAs and Roth IRAs

As retirement savings vehicles go, IRAs, themselves, are a relatively new phenomenon, and almost 80% of taxpayers are eligible to make tax-deductible contributions to them.⁷² Moreover, Congress recently increased the amount that could be contributed to so-called spousal IRAs.⁷³ In addition, since 1998, individuals have been allowed to set up so-called Roth IRAs.⁷⁴

2. SIMPLE Retirement Plans

In an effort to encourage more small employers to adopt retirement plans, the Small Business Job Protection Act of 1996 authorized employers with less than 100 employees to establish SIMPLE plans (savings incentive match plan for employees).⁷⁵ SIMPLE plans can be set up either as IRAs or 401(k) plans, and avoid many of the complex rules usually applicable to tax-qualified plans.

are less likely to have a retirement plan. Women also tend to spend more time away from the workplace to raise a family or care for an aging relative. It has been found that there is a strong association between marital and fertility decisions and pension coverage. On the other hand, because younger women today spend more time in the work force and at more equal salaries, the financial security of women is likely to improve somewhat over time. See, e.g., William E. Even & David A. Macpherson, *Gender Difference in Pensions*, 29 J. HUM. RESOURCES 555 (1994); Robin L. Lumsdaine et al., *Pension Plan Provisions and Retirement: Men and Women, Medicare, and Models*, in STUDIES IN THE ECONOMICS OF AGING, 183 (David A. Wise ed., 1994); Sophie M. Korczyk, *Are Women's Jobs Getting Better, or Are Women Getting Better Jobs?* in PENSION AND WELFARE BENEFITS ADMIN., *supra* note 66, at 61.

⁷⁰ See EMPLOYEE BENEFIT RESEARCH INSTITUTE, *supra* note 31, at 63.

⁷¹ See *id.*

⁷² Paul Yakoboski, *IRA Eligibility and Usage*, EBRI NOTES, Apr. 1995, at 5, 6 tbl.1.

⁷³ See Kathy Stokes Murray & Paul Yakoboski, *Congress Considers IRA Expansion*, EBRI NOTES, Apr. 1995, at 1, 2; I.R.C. § 219(c) (1994 & Supp. III 1997).

⁷⁴ See I.R.C. § 408A (West Supp. 1999).

⁷⁵ I.R.C. § 408(p) (West Supp. 1999) (added by Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1421(a), 110 Stat. 1755, 1792 (1996)).

A SIMPLE plan allows employees to make elective contributions of up to \$6000 per year, as long as the employer satisfies one of two contribution formulas. Under the matching contribution formula, the employer generally is required to match employee elective contributions on a dollar-for-dollar basis up to 3% of the employee's compensation. Alternatively, the employer can instead make a 2% of compensation nonelective contribution on behalf of each eligible employee. The usual tax rules apply (i.e., the employer deducts and the employee excludes), and all contributions to an employee's SIMPLE account must vest immediately.

3. Simplified Employee Pensions

Simplified employee pensions (SEPs) were added to the Code to provide small businesses with an easy-to-use retirement plan.⁷⁶ SEPs have minimal paperwork because they rely on IRAs. To qualify, the employer must make a contribution on behalf of each employee who is at least 21 years old, has performed service for the employer during at least three of the immediately preceding five years, and received at least \$400 in compensation from the employer for the year. Employer contributions are limited to the lesser of 15% of compensation or \$30,000, and cannot discriminate in favor of highly compensated employees.

4. Expanding Eligibility for 401(k) Plans

Two recent changes have also helped to expand the universe of employees participating in 401(k) plans. First, the Small Business Job Protection Act of 1996 authorized tax-exempt organizations to adopt 401(k) plans.⁷⁷ Second, a recent ruling authorizes plan sponsors to automatically include employees in their 401(k) plans unless the employees affirmatively choose not to participate in the plan.⁷⁸

5. Simplifying ERISA

Over the years, there have also been numerous amendments to ERISA. Often these amendments have been for the avowed purpose of simplifying the pension laws,⁷⁹ but relatively little simplification has occurred.

⁷⁶ I.R.C. §§ 402(h), 408(k) (1994 & Supp. III 1997).

⁷⁷ I.R.C. § 401(k)(4)(B)(i) (1994 & Supp. III 1997) (added by Pub. L. No. 104-188, § 1704(k), 110 Stat. 1755, 1882 (1996)).

⁷⁸ Rev. Rul. 98-30, 1998-25 I.R.B. 8.

⁷⁹ See, e.g., Kovach, *supra* note 67.

IV. SOME UNIVERSAL PENSION OPTIONS

This Part considers three approaches that might be used to help ensure that all Americans have adequate incomes throughout their retirement years. Specifically, this Part considers how a voluntary and universal individual retirement account system, an expanded Social Security system, and a mandatory universal private pension system might work.

A. A Voluntary Universal IRA System

1. Recent Proposals to Expand IRAs

Over the years, there have been a number of proposals to expand IRAs, and it can be argued that expanding the IRA system would help encourage Americans to save for retirement.⁸⁰

a. Unlimited retirement savings accounts

A number of analysts have suggested unlimited consumption tax treatment for retirement savings in tax-qualified plans and individual retirement savings accounts (IRSAs).⁸¹ This approach would give equivalent tax treatment for all types of retirement savings.⁸² Under this approach all individuals would be allowed to save as much of their earnings as they wanted in tax-qualified plans and/or in IRSAs. Not all workers would save, but every worker would have the opportunity to save an unlimited portion of her earned income tax-free.

b. An individual-based limit on retirement savings

A somewhat more restrictive approach would be to limit the total amount that could be deferred by each individual.⁸³ For example, one might consider limiting each individual's total tax-qualified savings (in whatever form) to the lesser of 15% of compensation or \$30,000.⁸⁴ Under this approach, every worker would be allowed to save up to 15% of her income tax-free.

c. Mandatory salary reduction agreements

Short of making employers provide pensions to their employees, it might make sense simply to require that employers give

⁸⁰ This section follows: Jonathan Barry Forman, *The Tax Treatment of Public and Private Pensions Around the World*, 14 AM. J. TAX POL'Y 299, 342-44 (1997).

⁸¹ See, e.g., RICHARD A. IPPOLITO, PENSIONS, ECONOMICS AND PUBLIC POLICY 226 (1986).

⁸² See WORLD BANK, AVERTING THE OLD AGE CRISIS: POLICIES TO PROTECT THE OLD AND PROMOTE GROWTH 20 (1994) [hereinafter AVERTING THE OLD AGE CRISIS].

⁸³ See RICHARD A. IPPOLITO, AN ECONOMIC APPRAISAL OF PENSION TAX POLICY IN THE UNITED STATES (1990); CONGRESSIONAL BUDGET OFFICE, TAX POLICY FOR PENSIONS AND OTHER RETIREMENT SAVINGS (1987); Kovach, *supra* note 67.

⁸⁴ Cf. I.R.C. § 415 (1994 & Supp. III 1997).

their employees the opportunity to participate in tax-qualified savings arrangements through salary reduction agreements.⁸⁵ In a recent study, 79% of the individuals surveyed said that the best way for them to save for retirement is to have money automatically deducted from their paychecks.⁸⁶ Thus, simply requiring employers to withhold and forward employee savings to individual retirement accounts, or to 401(k) accounts, could generate a significant amount of new retirement savings.⁸⁷

2. How a Voluntary Universal IRA System Could Work

It would be relatively easy to design a universal IRA system.⁸⁸ The IRA mechanism is already well-established. All that would be needed would be to repeal or relax the rules that now restrict contributions. Moreover, it could make sense to require employers to provide salary reduction arrangements, and to exempt these IRA contributions from both income and Social Security taxes.

For example, one approach would be to let every individual contribute and deduct up to 15% of their compensation to IRAs up to, say, \$10,000,⁸⁹ or \$30,000.⁹⁰ Perhaps the allowable amount should be reduced for workers who are covered by another retirement plan. Alternatively, a tax could be imposed on pension distributions that are in excess of some reasonably large amount.⁹¹ On the other hand, workers who were late to start saving for retirement might be allowed to make additional contributions to "catch up."⁹²

B. An Expanded Social Security System

Expanding Social Security would be an alternative way to provide adequate incomes to the retired population.⁹³ The expansion could be achieved by expanding the benefits provided under the current system, or by adding another separate program to the

⁸⁵ See CONGRESSIONAL BUDGET OFFICE, *supra* note 83; David Lindeman & Larry Ozanne, *Effects of Tax Policy on Retirement Saving and Income*, PROC. OF THE 80TH ANN. CONF. OF THE NAT'L TAX ASSOC. 98 (1987).

⁸⁶ PUBLIC AGENDA, PROMISES TO KEEP: HOW LEADERS AND THE PUBLIC RESPOND TO SAVING AND RETIREMENT (1994); see also *Salary Reduction Plans Gain Popularity*, Mercer Survey of Employers Shows, 25 BNA PENSIONS & BENEFITS REP. 1948 (1998).

⁸⁷ At the very least, it would make sense if a single universal salary reduction plan were available to all employers who wanted to adopt them. See NATIONAL COMMISSION ON RETIREMENT POLICY, THE 21ST CENTURY RETIREMENT SECURITY PLAN 21 (1998); Colleen T. Congel, *Pension Simplification: Proposal Mandates Section 401(k) Plans; Bars New Plans under Sections 403(b), 457*, 25 BNA PENSIONS & BENEFITS REP. 2443 (1998).

⁸⁸ See especially Kovach, *supra* note 67, at 420-34.

⁸⁹ See *id.* at 426.

⁹⁰ Cf. I.R.C. § 415 (1994 & Supp. III 1997).

⁹¹ Cf. I.R.C. § 4980A (1994) (repealed by Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1073(a), 111 Stat. 788, 948 (1997)); Kovach, *supra* note 67, at 427.

⁹² See Kovach, *supra* note 67, at 426.

⁹³ See ALICIA MUNNELL, THE ECONOMICS OF PRIVATE PENSIONS 28 (1982).

current system. As more fully discussed below, one of the most common suggestions is to supplement the current Social Security system with a system of individual retirement savings accounts (IRSAs).⁹⁴

1. Recent Proposals to Reform the Social Security System

The Social Security system is also in financial trouble. The Trustees of the Social Security Funds estimate that benefits will exceed income starting around 2013, and the program will be unable to pay full benefits after about 2032.⁹⁵ In fact, the Trustees estimate that the deficit over the traditional 75-year projection period is about 2% of payroll. In short, the federal government will either need to raise Social Security taxes, or to cut Social Security benefits. Not surprisingly, Social Security reform has become a hot topic in the past few years.⁹⁶

a. The 1994-1996 Social Security Advisory Council

In January of 1997, the 1994-1996 Social Security Advisory Council issued a long-awaited report on how to reform the Social Security system.⁹⁷ The Council members were unable to achieve a consensus, but a majority of the Council agreed that at least a portion of Social Security payroll tax contributions should be redirected into individual retirement savings accounts (IRSAs), which would be invested in the stock market. Under the so-called Individual Accounts (IA) approach, these individual accounts would be held by the government, invested in secure equity funds, and annuitized on retirement.⁹⁸ Alternatively, under the so-called Personal Security Accounts (PSA) approach, these individual accounts would be held by financial institutions, and their investment would be directed by individual workers.⁹⁹

Under the Personal Security Accounts (PSA) plan, the current Social Security system would be replaced with a two-tiered system. The first tier would provide a flat retirement benefit for all workers, while the second tier would provide workers with privately owned individual retirement savings accounts, referred to as Personal Security Accounts (PSAs).

Under the first tier, workers under age 25 in 1998, who work at least 35 years in covered employment, would receive a flat dol-

⁹⁴ See note 124, *infra* and accompanying text.

⁹⁵ SOCIAL SECURITY AND MEDICARE BOARDS OF TRUSTEES, *supra* note 5.

⁹⁶ See, e.g., SOCIAL SECURITY SOLVENCY, *supra* note 56.

⁹⁷ ADVISORY COUNCIL ON SOCIAL SECURITY, REPORT OF THE 1994-1996 ADVISORY COUNCIL ON SOCIAL SECURITY (1997) (2 vols.)

⁹⁸ See *id.*, Vol. 1, at 28-29.

⁹⁹ See *id.*, Vol. 1, at 30-33. See also *Report of the Technical Panel on Trends and Issues in Retirement Savings*, in *id.*, Vol. 2, at 87-90 (discussing individual Social Security retirement accounts).

lar benefit equivalent to \$410 monthly in 1996 dollars. These benefits would be financed by employer Social Security contributions. Workers age 25 to 54 would receive a composite tier 1 benefit, which would include their accrued benefit under the current Social Security system, and a prorated share of the new tier 1 flat benefit.

Under the second tier, the plan would create Personal Security Accounts (PSAs) dedicated to retirement savings. These PSAs would be financed by reallocating five percentage points of the employee's share of Social Security taxes. Every worker under age 55 would participate in the 5% payroll reallocation, and receive PSA benefits based on their accumulations plus interest. Individuals could begin withdrawing funds from their PSAs at age 62, and any funds remaining in their accounts at death could be passed on to their estates.

b. The Committee for Economic Development

The Committee for Economic Development recently issued a report on Social Security reform in which it advocated leaving the basic Social Security system pretty much intact, but creating a second tier of privately owned, personal retirement accounts (PRAs).¹⁰⁰ Both employers and employees would be required to contribute 1.5% of payroll to these PRAs, while the self-employed would be required to contribute the entire 3%.

c. The National Commission on Retirement Policy

The National Commission on Retirement Policy recently offered a proposal that would allocate two percentage points of the current 10.7% of payroll tax into Social Security Individual Savings Accounts.¹⁰¹ In addition, individuals would be allowed to contribute another \$2000 per year (net of any IRA contribution) to those accounts. These individual accounts would be administered and invested in a way that is analogous to the Thrift Savings Plan provided to federal employees; that is, employees could choose to invest their accounts among broad-based funds such as a stock index fund, a bond index fund, and a government securities fund.¹⁰²

d. Supplementary Individual Savings Accounts

Similarly, former Social Security Commissioner Robert M. Ball recently suggested adding a voluntary savings plan adminis-

100 COMMITTEE FOR ECONOMIC DEVELOPMENT, *FIXING SOCIAL SECURITY: A STATEMENT BY THE RESEARCH AND POLICY COMMITTEE OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT* 49-54 (1997).

101 NATIONAL COMMISSION ON RETIREMENT POLICY, *THE 21ST CENTURY RETIREMENT SECURITY PLAN* 3-4 (1998).

102 See *id.* at 12-14.

tered by the Social Security Administration.¹⁰³ Specifically, he would allow wage earners to have an additional 2% deducted from their earnings and forwarded by their employers to the Social Security Administration through the regular withholding process. Each year participants could choose to have that 2% invested by the Social Security Administration in the stock market, in Treasury bonds, or split 50-50 between stocks and Treasury bonds. The funds would be held in so-called "supplementary individual savings accounts" that would follow the usual IRA rules governing the maximum amount to be deducted, the tax treatment of contributions and earnings, the withdrawal rules, and so on. Commissioner Ball argues that with these accounts "workers in small companies and the lower-paid generally would have a real opportunity to build conveniently on top of their assured Social Security benefits and to participate in ownership of equities should they care to do so."¹⁰⁴

e. President Clinton's proposal for universal savings accounts

Along similar lines, President Clinton recently called for using 62% of the projected federal budget surpluses for the next 15 years, an estimated \$2.7 trillion, to save the Social Security system until at least 2055.¹⁰⁵ As part of his plan, President Clinton would use 11% of those surpluses to create "Universal Savings Accounts" (USA accounts) for individuals to supplement their basic Social Security benefits. Under this proposal, the federal government would match a portion of the individual contributions made to these new retirement accounts.¹⁰⁶

f. Chilean-style privatization

A number of analysts suggest that we should privatize Social Security, specifically by completely replacing the current Social Security system with a system of individual retirement savings

103 Prepared testimony of Robert M. Ball before the Subcommittee on Social Security of the House Committee on Ways and Means (June 3, 1998) (available on LEXIS, NEWS database, CURNWS file); see also Jane Bryant Quinn, *What Price Reform?*, NEWSWEEK, June 22, 1998, at 57; Elizabeth A. White, *Former SSA Head Calls for Add-On Accounts, Partial Trust Fund Investment in Equities*, 25 BNA PENSIONS & BENEFITS REP. 1328 (1998).

104 Prepared Testimony of Robert M. Ball, *supra* note 103.

105 See, e.g., Mark Felsenthal, *Clinton Offers Plan to Spend Surplus*, 26 BNA PENSIONS AND BENEFITS REP. 197 (1999); Gene Steuerle, *A Government Match for Private Pension Savings?*, 82 TAX NOTES 891 (1999).

106 See, e.g., Ryan J. Donmoyer, *Clinton's USA Plan: Progressive Personal Retirement Accounts*, 83 TAX NOTES 329 (1999); cf. Elizabeth A. White, *"Progressive" Formula for Private Accounts Included in Proposal Santorum to Offer*, 26 BNA PENSION & BENEFITS REP. 575 (1999).

accounts (IRSAs).¹⁰⁷ Proponents of privatization typically point to the country of Chile, which began to privatize its Social Security system in 1981.¹⁰⁸ Under Chile's Social Security system, workers are required to contribute at least 10% of their salary to IRSAs held by private pension funds of their choosing. There are about 20 different companies that manage these new IRSAs, subject to extensive regulation by the government. The Chilean example has been followed by a number of other countries,¹⁰⁹ and it is being promoted by the World Bank.¹¹⁰ Replacing at least a portion of Social Security with individual retirement savings accounts has also found a good deal of support in Congress.¹¹¹

g. Funded Social Security

Another approach would be to shift from the current pay-as-you-go Social Security system toward a funded system.¹¹² Funding Social Security would require two essential elements: fund accumulation and portfolio diversification. Fund accumulation would require substantially higher payroll tax rates (or lower benefits), and portfolio diversification would be achieved by having the Social Security Administration invest in the stock market.

The funded Social Security system would not have individual accounts. Indeed, funded Social Security is offered as a "politically *strategic alternative* to individual accounts."¹¹³ Social Security would continue to operate as a defined benefit plan, with the beneficiary's benefits linked by a legislated formula to the retiree's wage history. The principal difference is that Social Security benefits would be paid out of a mix of payroll taxes and portfolio in-

107 See, e.g., Karl Borden, *Dismantling the Pyramid: The Why and How of Privatizing Social Security*, 1 CATO PROJECT OF SOC. SEC. PRIVATIZATION (1995); SOCIAL SECURITY: PROSPECTS FOR REAL REFORM (Peter Ferrara ed., 1985); PETER J. FERRARA & MICHAEL TANNER, A NEW DEAL FOR SOCIAL SECURITY (1998).

108 See, e.g., Joseph L. Scarpaci & Ernesto Miranda-Radic, *Chile*, in INTERNATIONAL HANDBOOK ON OLD-AGE INSURANCE 25 (Martin B. Tracy & Fred C. Pampel eds., 1991); Barbara E. Kritzer, *Privatizing Social Security: The Chilean Experience*, SOC. SEC. BULL., Fall 1996, at 45; Robert J. Myers, *Chile's Social Security Reform After 10 Years*, BENEFITS Q., 3d Quarter 1992, at 44.

109 See, e.g., Michael Alan Paskin, *Privatization of Old-Age Pensions in Latin America: Lessons for Social Security Reform in the United States*, 62 FORD L. REV. 2199 (1994); *Chilean Social Security Reform as a Prototype for Other Nations*, EBRI NOTES, Aug. 1997, at 1.

110 See AVERTING THE OLD AGE CRISIS, *supra* note 82.

111 See, e.g., BIPARTISAN COMMISSION ON ENTITLEMENT AND TAX REFORM, FINAL REPORT TO THE PRESIDENT 26, 40, 177, 221-22 (1995) (favoring a personal investment plan option for all workers in lieu of 1.5 percentage points of the payroll tax); *Kerry, Simpson Offer Plan to Reform Social Security, Make Other Changes*, 22 BNA PENSIONS & BENEFITS REP. 1243 (1995); Borden, *supra* note 107, at 10-14.

112 See Laurence S. Seidman, *Funding Social Security*, 81 TAX NOTES 241 (1998); see also Lok Sang Ho, *A Universal Fully Funded Pension Scheme*, CONTEMP. ECON. POL'Y, July 1997, at 13.

113 Seidman, *supra* note 112, at 241.

vestment income, rather than just out of payroll taxes and Treasury debt instruments.

h. Raising Social Security taxes and benefits

Historically, the simplest way to "fix" the Social Security system has been to raise payroll taxes and provide additional Social Security benefits. In the current Social Security reform debate, however, few have argued for payroll tax increases beyond those that might be necessary to meet the benefit levels already promised under the current system.¹¹⁴

2. How an Expanded Social Security System Could Work

An expanded Social Security system could take the form of either enhanced benefits under the current system, or a system of individual retirement savings accounts (IRSAs). There does not appear to be much support for expanding the current Social Security system, but it seems quite plausible that a system of IRSAs could be added on top of a reformed current system. These individual accounts could be held by the government and invested in secure equity funds. Alternatively, these individual accounts could be held by financial institutions, with their investments directed by individual workers.

C. A Mandatory Pension System

A final way to help improve the retirement security of individuals would be to mandate private pensions.

1. Recent Proposals to Expand the Pension System

a. Proposals to reform the voluntary pension system

Over the years, there have been a number of proposals to expand participation in employer-sponsored pensions. In particular, many analysts have suggested shortening the vesting period, eliminating or restricting Social Security integration,¹¹⁵ promoting pension plan portability, and increasing participation (e.g., by covering part-time workers).¹¹⁶

¹¹⁴ Still, in passing, it should be noted that a more generous Social Security system could help meet the retirement income needs of most workers and their auxiliaries. See, e.g., Jonathan Barry Forman, *Promoting Fairness in the Social Security Retirement Program: Partial Integration and a Credit for Dual-earner Couples*, 45 TAX LAW. 915, 948-57 (1992), and sources cited therein.

¹¹⁵ See especially, Patricia E. Dilley, *The Evolution of Entitlement: Retirement Income and the Problem of Integrating Private Pensions and Social Security*, 30 LOY. L.A. L. REV. 1063 (1997).

¹¹⁶ See, e.g., Vicki Gottlich et al., *Ten Pension Guidelines to Prevent Poverty Among Older Women*, 29 CLEARINGHOUSE REV. 616 (1995); Watson, *supra* note 61, at 65-67.

Another alternative would be to allow designated financial institutions to administer defined contribution megaplanes for numerous small employers.¹¹⁷ Employers would contribute to these megaplanes; each employee would have her own account, and the financial institution would take on all of the reporting, disclosure, and fiduciary responsibilities.

b. Mandatory private pensions

Another approach would be to mandate private pensions.¹¹⁸ Depending upon the size of the program, this approach could compel most workers to set aside a large enough share of their earnings over their careers to fund adequate retirement benefits.

For example, in 1981, the President's Commission on Pension Policy recommended adoption of a Mandatory Universal Pension System (MUPS).¹¹⁹ Basically, the proposal would have required all employers to contribute at least 3% of wages to private pensions for their workers. The proposal drew little interest at the time. Recently, however, there has been renewed interest in mandated pensions.¹²⁰

Relatively few countries presently mandate private pension coverage of workers.¹²¹ Private pension coverage is mandatory in Australia and Switzerland, and industry-wide collective bargaining agreements make such coverage quasi-mandatory in Denmark and the Netherlands.¹²² Chile requires its workers to contribute at least 10% of their wages to the privately managed individual retirement savings accounts that have replaced that country's social security system.¹²³ Most private pension systems, however, are voluntary.

¹¹⁷ See, e.g., Lindeman & Ozanne, *supra* note 85, at 102.

¹¹⁸ See, e.g., AVERTING THE OLD AGE CRISIS, *supra* note 82, at 74; Estelle James & Dimitri Vittas, *Mandatory Saving Schemes: Are They the Answer to the Old Age Security Problems?*, in SECURING EMPLOYER-BASED PENSION: AN INTERNATIONAL PERSPECTIVE 151 (Zvi Bodie et al. eds., 1996). In fact, it seems clear that nothing close to universal private pension coverage will occur under a voluntary private pension system. See Daniel I. Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It 'Still' Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1, 35 (1993).

¹¹⁹ PRESIDENT'S COMMISSION ON PENSION POLICY, COMING OF AGE: TOWARD A NATIONAL RETIREMENT POLICY (1981); Lee A. Sheppard, *Toward a Rational Pension Policy*, 37 TAX NOTES 235, 237-38 (1987); Jim Wright, *Pension Reform Will Require Radical Change*, DALLAS MORNING NEWS, Dec. 15, 1987, at A19; Thomas C. Woodruff, *Employer Mandates to Increase Private Pension Portability and Participation*, in SOCIAL WELFARE POLICY AT THE CROSSROADS: RETHINKING THE ROLES OF SOCIAL INSURANCE, TAX EXPENDITURES, MANDATES, AND MEANS-TESTING 69 (Robert B. Friedland et al. eds., 1994).

¹²⁰ See *supra* note 118.

¹²¹ See AVERTING THE OLD AGE CRISIS, *supra* note 82, at 165.

¹²² See *id.* at 166-67.

¹²³ See *supra* note 108 and accompanying text.

2. How a Mandatory Pension System Could Work

The simplest design for a mandatory pension system would be to piggyback a system of individual retirement savings accounts (IRSAs) onto the existing Social Security withholding system. For example, both employers and employees could be required to contribute 1.5% of payroll to these IRSAs (and the self-employed could be required to contribute the entire 3%).¹²⁴ These accounts could be held by the government and invested in secure equity funds, and annuitized on retirement. Alternatively, these individual accounts could be held by financial institutions, and their investment could be directed by individual workers.

A different approach would be for the government to mandate that employers provide a suitable defined benefit plan for their employees. In that regard, the government might authorize employers to use a central clearinghouse where employers could send pension contributions on behalf of their employees. Over the course of her career, each worker would earn entitlement to a defined benefit, which, at retirement, would supplement Social Security.

V. CHOOSING BETWEEN THE ALTERNATIVES

A. Mandatory Versus Voluntary Pensions

Without a doubt, the most important choice to be made with respect to universal pensions is whether they should be voluntary or mandatory.¹²⁵ This choice brings into conflict two principles that we hold dear: the principle of individual autonomy and the principle of retirement income adequacy.

On the one hand, we believe that the government has no business telling individual workers what to do with the money that they earn. In our *laissez-faire* system, workers can save or spend their earned income in any way they please. This is the principle of individual autonomy. At bottom, the principle of individual autonomy suggests that it is really none of the government's business if workers spend their money on a refrigerator, or a vacation, or invest their money in a bank or the stock market.

¹²⁴ Cf. COMMITTEE FOR ECONOMIC DEVELOPMENT, *supra* note 100.

¹²⁵ See, e.g., EMPLOYEE BENEFIT RESEARCH INSTITUTE, GOVERNMENT MANDATING OF EMPLOYEE BENEFITS: EBRI-ERF POLICY FORUM (1987); EMILY S. ANDREWS, PENSION POLICY AND SMALL EMPLOYER: AT WHAT PRICE COVERAGE?: AN EBRI-ERF POLICY STUDY 154-63 (1989); Marvin H. Kusters, *Mandated Benefits—On the Agenda*, REGULATION, No. 3, 1988, at 21; Lawrence H. Summers, *What Can Economics Contribute to Social Policy? Some Simple Economics of Mandated Benefits*, 79 AM. ECON. REV. 177 (Papers & Proceedings, 1989); Dwight R. Lee, *Why Workers Should Want Mandated Benefits to Lower Their Wages*, 34 ECON. INQUIRY 401 (1996).

On the other hand, we believe that, left to their own devices, many individuals will not save enough for their own retirement.¹²⁶ Consequently, we have empowered our government to enact paternalistic Social Security and pension policies to ensure that workers will, in fact, save for their own retirements.¹²⁷ This is the principle of retirement income adequacy. For example, Social Security collects payroll taxes from virtually all workers and uses those receipts to pay benefits to virtually all retirees and their dependents. Private pension policy also has many paternalistic features.¹²⁸ For example, the limitations on early withdrawals and loans help ensure that retirement savings will be available to meet retirement needs, and the qualified joint and survivor annuity rules help ensure that both participants and their spouses will have adequate incomes throughout their retirement years.¹²⁹

The present system balances these two competing principles by having a nearly universal Social Security system, and a voluntary private pension system that covers about half of all workers. Unfortunately, the present system does not ensure that the elderly will have adequate incomes throughout their retirement years. In particular, a voluntary private pension system is unlikely to ensure that low-income and moderate-income workers will save enough for retirement.¹³⁰

On the other hand, if retirement income adequacy were the only principle guiding government action, it would be relatively easy to ensure that every American would have an adequate retirement income. This goal could be achieved either by expanding the current Social Security system, or by mandating some type of universal private pension system. In the end, the fact that the government has not mandated an adequate universal pension system may turn out to be just a perverse tribute to our belief in the importance of the principle of individual autonomy.

¹²⁶ See THOMPSON, *supra* note 46, at 25-36.

¹²⁷ Thompson notes that there are four common reasons for mandatory pensions: (1) individual myopia; (2) protection of the prudent; (3) income redistribution; and (4) insurance market failure. *Id.* at 28-32. See also Deborah M. Weiss, *Paternalistic Pension Policy: Psychological Evidence and Economic Theory*, 59 U. CHI. L. REV. 1275 (1991); Alice G. Abreu, *Taxes, Power, and Personal Autonomy*, 33 SAN DIEGO L. REV. 1 (1996); Peter J. Wiedenbeck, *Paternalism and Income Tax Reform*, 33 U. KAN. L. REV. 675 (1985); Edward J. Gac & Wayne M. Gazur, *Tapping "Rainy Day" Funds for the Reluctant Entrepreneur: Downsizing, Paternalism, and the Internal Revenue Code*, 86 KY. L.J. 127 (1997-1998); Gregory S. Alexander, *Pensions and Passivity*, 56 LAW & CONTEMP. PROBS. 111 (1993).

¹²⁸ See, e.g., Joseph Bankman, *Tax Policy and Retirement Income: Are Pension Plan Anti-Discrimination Provisions Desirable?*, 55 U. CHI. L. REV. 790 (1988).

¹²⁹ See Jonathan Barry Forman, *Protecting Spousal Rights in Private Pensions*, J. OF COMPENSATION AND BENEFITS, Mar.-Apr. 1999, at 5, 8.

¹³⁰ In fact, it seems clear that nothing close to universal private pension coverage will occur under a voluntary system. See Halperin, *supra* note 118.

B. Defined Benefit Versus Defined Contribution Plans

Another important public policy choice with respect to any universal pension system is to decide between a defined benefit plan and a defined contribution plan.¹³¹ Table 1 shows some examples of the various combinations. For example, individual retirement accounts (IRAs) are defined contribution-like plans that are almost universally available on a voluntary basis. Traditional pension plans are typically defined benefit plans that are almost universally available to employers. Social Security is an almost universal, mandatory defined benefit system. Finally, many proposals to fix Social Security would mandate individual retirement savings accounts (IRSAs), which would be structured like defined contribution plans.

TABLE 1. A MATRIX OF PENSION CHOICES

	VOLUNTARY	MANDATORY
DEFINED CONTRIBUTION	IRAS, 401(K)S	MANDATORY INDIVIDUAL RETIREMENT SAVINGS ACCOUNTS (IRSAS)
DEFINED BENEFIT	TRADITIONAL PENSION PLANS	SOCIAL SECURITY

1. Influence on Worker Behavior

Pension benefits accrue differently under defined benefit and defined contribution plans. In particular, under a defined benefit plan, benefit accruals increase significantly the closer a worker gets to retirement. On the other hand, under a defined contribution plan, benefits accrue at a constant rate (e.g., 10% of annual compensation). Consequently, defined benefit and defined contribution plans result in different incentives that can affect employee decisions about work and retirement.¹³²

¹³¹ Recall that a typical defined benefit plan might provide that a worker's annual retirement benefit is equal to 2% times years of service times final average compensation ($B = 2\% \times \text{yos} \times \text{fac}$). Under this formula, a typical worker with 30 years of service would receive a retirement benefit equal to 60% of her preretirement earnings ($B = 60\% \times \text{fac} = 2\% \times 30 \text{ yos} \times \text{fac}$).

On the other hand, under a typical defined contribution plan, the employer simply contributes a specified percentage of the worker's compensation to an individual investment account for the worker. For example, contributions might be set at 10% of annual compensation. Under such a plan, a worker who earned \$30,000 in a given year would have \$3000 contributed to an individual investment account for her. Her benefit at retirement would be based on all such contributions plus investment earnings thereon.

¹³² See, e.g., RICHARD A. IPPOLITO, PENSION PLANS AND EMPLOYEE PERFORMANCE 10-17 (1997); IPPOLITO, *supra* note 81, at 133-50; JOSEPH F. QUINN AT AL., PASSING THE TORCH: THE INFLUENCE OF ECONOMIC INCENTIVES ON WORK AND RETIREMENT (1990); THOMPSON,

In particular, defined benefit plans typically create "windows" of retirement opportunity that push older workers out of the work force between early retirement age and normal retirement age.¹³³ After all, once a worker is eligible to receive full retirement benefits, delaying retirement can actually be quite costly. Those who delay retirement lose current benefits, and the increase in benefits that can result from an additional year of work rarely compensates for the benefits lost.¹³⁴

2. Investment and Risk

One of the biggest problems with defined contribution plans is that individuals, rather than professional money managers, control investments. Individuals tend to invest too conservatively, especially toward the end of their working careers. Moreover, many individual investors are unsophisticated, and some may even end up being bilked by con artists.

On the other hand, defined benefit plans are able to pool investments and achieve superior returns and efficient fee structures through professional managers. Unlike individual investors, pension fund managers invest for the long haul, and do not panic when the market becomes volatile.

Still another problem for defined contribution plans is uncertainty. Financial planning is difficult because the value of the ultimate benefit is unknown. For example, because of stock market volatility, workers who retire when the market is up will have higher pensions than those who retire when it is down. Moreover, under a defined contribution plan, the responsibility for purchasing an annuity is borne by the individual worker. Unfortunately, there is just not much of a market for private annuities, and the costs are often prohibitive.¹³⁵

A final problem with defined contribution plans is the relatively longer life span of women. Because women tend to live longer than men, they are more likely to outlive their retirement

supra note 46, at 71-83; ALAN L. GUSTMAN & THOMAS L. STEINMEIER, PENSION INCENTIVES AND JOB MOBILITY (1995); Michael D. Hurd, *Research on the Elderly: Economic Status, Retirement, and Consumption and Saving*, 28 J. ECON. LIT. 565 (1990); Alan L. Gustman et al., *The Role of Pensions in the Labor Market: A Survey of the Literature*, 47 INDUS. AND LAB. REL. REV. 417 (1994); Michael V. Leonesio, *The Economics of Retirement: A Nontechnical Guide*, SOC. SEC. BULL., Winter 1996, at 29; THOMPSON, *supra* note 46, at 78 (noting that labor force decisions are influenced by such factors as: the age of the individual, the availability of retirement benefits, the individual's health, the level of the retirement benefits to which the individual is entitled, other sources of income, and any earnings limitations imposed as a condition for receiving benefits).

¹³³ See Jonathan Barry Forman, *Reforming Social Security to Encourage the Elderly to Work*, 9 STAN. L. & POL'Y REV. 289, at 292-93 (1998).

¹³⁴ And those who work until they drop often leave nothing behind for their estates.

¹³⁵ See THOMPSON, *supra* note 46, at 162-64.

savings.¹³⁶ This life span difference is less of a problem for beneficiaries of defined benefit plans because distributions usually take the form of lifetime annuities.

3. Inflation

Another problem with both defined benefit and defined contribution plans is that inflation after retirement can erode the value of accrued pension benefits.¹³⁷ Currently, Social Security benefits are adjusted for inflation each year.¹³⁸ On the other hand, relatively few private-sector defined benefit plans provide for cost-of-living adjustments for inflation, and postretirement inflation is always a problem for defined contribution plans.¹³⁹

4. Leakage and Distributions

Another major problem with defined contribution plans is that they are "leaky." While defined benefit plans typically provide lifetime annuities for retirees and their spouses, defined contribution plans typically allow participants to withdraw all or a portion of their individual accounts, and many plans allow them to borrow against their accounts. In 1995, for example, about 47% of the savings and thrift plans of medium and large businesses permitted withdrawals, and 44% permitted loans.¹⁴⁰ Unfortunately, a significant portion of these distributions and loans may end up being dissipated, sometimes even before retirement.¹⁴¹ A recent study suggests that 60% of the lump sum distributions made to job changers from large plans are not rolled over into Individual Retirement Accounts (IRAs) or other retirement savings plans.¹⁴²

C. Public or Private

Another policy choice is whether or not the enhanced retirement system should be public or private. For example, a system of

¹³⁶ Cf. Janet C. Boyd, *When Is a Girl Not a Girl and a Boy Not a Boy*, 80 TAX NOTES 729 (1998) (discussing a similar problem when defined benefit plans are allowed to make lump sum distributions in lieu of annuity payments).

¹³⁷ See PRESIDENT'S COMMISSION ON PENSION POLICY, *supra* note 119, at 32.

¹³⁸ See 42 U.S.C. § 415(i) (1994).

¹³⁹ See, e.g., Mark J. Warshawsky, *The Market for Individual Annuities and the Reform of Social Security*, BENEFITS Q., 3d quarter 1997, at 66 (discussing how the private sector might provide inflation-adjusted annuities).

¹⁴⁰ See BUREAU OF LABOR STATISTICS, DEPT. OF LABOR, EMPLOYEE BENEFITS IN MEDIUM AND LARGE PRIVATE ESTABLISHMENTS 1995, at 132, 138 (1998).

¹⁴¹ Dissipation of retirement savings is also a problem for IRAs, as preretirement distributions may be used for education, health, and first-time homebuyer expenses. See I.R.C. § 72(t)(2) (West 1988 & Supp. 1998).

¹⁴² See PAUL J. YAKOBOSKI, LARGE PLAN LUMP SUMS: ROLLOVERS AND CASHOUTS (EBRI Issue Brief No. 188, 1997); see also G. LAWRENCE ATKINS, SPEND IT OR SAVE IT? PENSION LUMP-SUM DISTRIBUTIONS AND TAX REFORM (1986); John R. Woods, *Pension Vesting and Preretirement Lump Sums Among Full-Time Private Sector Employees*, SOC. SEC. BULL., Fall 1993, at 3.

individual retirement savings accounts (IRSAs) could be managed by the Social Security Administration. Alternatively, IRSAs could be held and managed by private-sector employers or financial institutions, subject to regulation by the government. By itself, this particular aspect of IRSAs may not make much difference.

It may make a great deal of difference, however, if the investment decisions are made in the private sector (either by individuals or investment firms), or by the Social Security Administration. The danger always exists that public pension funds might undertake imprudent investments for political reasons.¹⁴³

VI. OTHER ISSUES

A. Participation and Vesting

At the outset, it is worth noting that participation in private pension plans is far from universal, and even those employers who maintain pension plans can currently exclude part-time workers, and workers who have not yet reached the age of 21 or have not been with the employer for at least one year.¹⁴⁴ Similarly, it currently takes 10 years to become vested (fully insured) under Social Security,¹⁴⁵ and it often takes five years to vest under the typical private pension plan.¹⁴⁶

If retirement income security is the principal goal, then it would make sense for any universal pension system to have universal participation and immediate vesting for all employees, including part-time workers. One way to avoid burdening private employers would be to allow them to piggyback their contributions onto their existing Social Security withholding obligations.

B. Mandatory Annuitization

Another issue for any universal pension plan is the form of distribution. By spreading payments over a period of years, annuitization helps ensure that retirees have adequate retirement incomes throughout their lives. Similarly, annuitization over the joint lives of a participant and spouse can help ensure that both have adequate retirement incomes. On the other hand, there is a

¹⁴³ See e.g., Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993); ROBERTA ROMANO, *POLITICS AND PUBLIC PENSION FUNDS* (1994); David L. Gregory, *The Problematic Status of Employee Compensation and Retiree Pension System: Resisting the State, Reforming the Corporation*, 5 PUB. INTEREST L.J. 37 (1995); Ridgeley A. Scott, *A Skunk at A Garden Party: Remedies for Participants in State and Local Pension Plans*, 75 DEN. U.L. REV. 507 (1998); Holman W. Jenkins, *Business World: The Rise of Public Pension Funds*, WALL ST. J., Apr. 16, 1996, at A15.

¹⁴⁴ See I.R.C. § 410(a) (1994).

¹⁴⁵ See 42 U.S.C. § 414(a) (1994).

¹⁴⁶ See I.R.C. § 411(a)(2)(A) (1994).

good deal of evidence that lump-sum distributions are quickly dissipated.¹⁴⁷

Social Security pays out benefits in the form of a joint and survivor annuity covering the retired worker and spouse. Many pension plans also pay out benefits in the form of an annuity. In particular, most defined benefit plans pay benefits in the form of a single life annuity covering the retiree, or in the form of joint and survivor annuity covering the retiree and spouse. Some defined benefit plans, however, allow the retiree to receive a lump-sum payment instead of an annuity. In fact, about 15% of the defined benefit plans of medium and large businesses allow the retiree to select a lump-sum distribution.¹⁴⁸

On the other hand, few defined contribution plans or IRAs provide for annuities. In 1995, for example, only about 17% of the savings and thrift plans of medium and large businesses allowed the participant to select annuity distributions, and only 30% even allowed them to select installment distributions.¹⁴⁹

If retirement income security is the principal goal, then it could make sense for any universal pension system to mandate that benefits take the form of a mandatory annuity.¹⁵⁰ Moreover, it is less expensive to provide adequate income for the retired population through annuities than through alternative investment strategies. For example, ignoring administrative costs, a 65-year old man could buy a lifetime annuity indexed to the inflation rate for 11 times the desired annual benefit (see Appendix 5).¹⁵¹ Thus, it would cost him \$220,000 to purchase an annuity that paid him an indexed \$20,000 a year for life.

On the other hand, alternative investment strategies would require the accumulation of more funds to protect him against the risks of outliving his life expectancy (here assumed to be 16.3 years), and the risk of unanticipated inflation. The simplest way to avoid outliving one's resources is to live off the interest and never spend the principal. Under reasonable assumptions, however, this investment strategy would necessitate accumulating 40 times the desired annual benefit if the funds are to be invested in government bonds, or 23.5 times the desired annual benefit if he is willing to invest half the funds in the stock market.¹⁵² Consequently, to get \$20,000 a year under a live-off-the-interest strategy would require an accumulation of \$800,000 (or \$470,000).

¹⁴⁷ See citations, *supra* note 142.

¹⁴⁸ See DEPT. OF LABOR, BUREAU OF LABOR STATISTICS, *supra* note 140, at 114.

¹⁴⁹ See *id.* at 145.

¹⁵⁰ See, e.g., SOCIAL SECURITY SOLVENCY, *supra* note 56, at 64-66.

¹⁵¹ See THOMPSON, *supra* note 46, at 162, 168. A joint and 75% survivor annuity would cost about 15% to 25% more. *Id.*

¹⁵² See *id.* at 161, 168.

Still another alternative would be to adopt a rule of thumb. If he were willing to draw down 5% of his portfolio accumulation each year, he would run only one chance in 30 of running out of money in less than 30 years.¹⁵³ Still, under this rule-of-thumb-investment strategy, he would need to accumulate 20 times the desired annual benefit (\$400,000).

Of course, an individual cannot actually buy the type of hypothetical annuity described above. In the absence of a universal mandatory annuity arrangement, each individual would have to pay a premium of as much as 25% over the cost of the "pure" annuity.¹⁵⁴ The sellers of such annuities must charge more because they can rationally conclude that the buyers of such annuities have reason to believe that they will outlive the average life expectancy. On the other hand, under a universal mandatory annuity system, like Social Security, all risks are pooled, and the life expectancy of each generational cohort of retirees should be fairly close to the predicted number.

In short, a universal mandatory annuity strategy is the least expensive way to provide adequate income to the retired population. The other approaches require significantly more "ambitious" goals for retirement saving¹⁵⁵ and presumably result in significant bequests to subsequent generations of workers.

C. Spousal Rights

Another issue is what, if any, rights a nonparticipant spouse should have in the retirement plan of the covered worker.¹⁵⁶ Under current law, the answer can vary dramatically depending on the type of retirement plan in which the worker participates. Widely different rules apply to Social Security, to pension plans, to profit-sharing and stock bonus plans, and to IRAs.

Social Security, for example, pays benefits to married couples in a way that mimics a joint and two-thirds survivor annuity, and divorced spouses can also receive annuity-like benefits. Moreover, Social Security benefits are indexed for inflation.

On the other hand, most private pension plans are required only to offer a joint and survivor annuity option to married couples,¹⁵⁷ and most profit-sharing and stock bonus plans can avoid even that requirement if the balance of the account is paya-

¹⁵³ See *id.*

¹⁵⁴ See *id.* at 105-06.

¹⁵⁵ See *id.* at 161.

¹⁵⁶ See generally Forman, *supra* note 129; and Jonathan Barry Forman, *Whose Pension Is It Anyway? Protecting Spousal Rights in a Privatized Social Security System*, 76 N.C. L. REV. 1653 (1998).

¹⁵⁷ See I.R.C. §§ 401(a)(11), 417 (1994); 29 U.S.C. § 1055(a) (1994).

ble to the spouse at the participant's death.¹⁵⁸ Moreover, IRAs are not required to provide any spousal guarantees at all. Divorcing spouses of private retirement plan participants, however, can secure an interest in the participant spouse's pension by obtaining qualified domestic relations orders (QDROs) (or similar orders with respect to IRAs).¹⁵⁹

All in all, if the government is concerned about ensuring adequate retirement incomes for the beneficiaries of a universal pension system, then it might want to mandate that at least a portion of the couple's retirement plan accruals be paid out in the form of a joint and survivor annuity, perhaps even one that is indexed for inflation.¹⁶⁰ Beyond the amount of retirement savings necessary to purchase this basic annuity, however, more relaxed distribution rules might apply.

For example, at retirement, couples might be required to purchase an indexed joint and survivor annuity that, together with Social Security, would provide the equivalent of an indexed annuity that is targeted to, say, at least 125% of the poverty level.¹⁶¹ Consequently, assuming a 125-percent-of-the-poverty-level target, a married couple retiring this year would need the equivalent of an indexed annuity that paid \$13,825 this year ($\$13,825 = 125\% \times \$11,060$), and appropriately adjusted amounts in future years. For many couples, Social Security would provide a good chunk of this minimum 125-percent-of-the-poverty-level benefit, leaving only the balance to be made up from the couple's other retirement plans.

Similar protections could be designed to protect spouses of workers who die before retirement, and divorcing spouses. The key would be to design benefits that generally ensured that surviving spouses and ex-spouses are assured an adequate income throughout their retirement years.

D. Loans And Early Distributions

Two other issues for a universal pension system involve the permissibility of loans, and preretirement distributions.¹⁶² On the one hand, allowing loans and preretirement distributions may en-

¹⁵⁸ Specifically, profit-sharing and stock bonus plans are not subject to the automatic survivor benefit rules if the plan provides that the spouse of a participant is the beneficiary of the participant's entire account under the plan, the participant's benefit is not paid in the form of an annuity, and the participant's account does not include amounts transferred from another plan that was subject to the automatic survivor benefit rules. 29 U.S.C. § 1055(b) (1994); I.R.C. § 401(a)(11)(B) (1994).

¹⁵⁹ See I.R.C. §§ 401(a)(13)(B), 408(d)(6) (1994).

¹⁶⁰ See Forman, *supra* note 129, at 9.

¹⁶¹ In 1999, the poverty level for a married couple was \$11,060. See Annual Update of the HHS Poverty Guidelines, 64 Fed. Reg. 13,428 (1999).

¹⁶² See citations, *supra* note 142.

courage greater elective contributions to retirement plans. On the other hand, retirement savings may be dissipated and retirement income security threatened if loans and preretirement distributions are permitted. All in all, it is difficult to tell just what the right policy is, but it seems likely that at least some restrictions on loans and preretirement withdrawals are needed.

E. The Tax Treatment of Mandatory Pensions

Theoretically, tax incentives are not needed if there is a mandatory pension system. It could make sense, however, to offer some tax breaks. The simplest approach would be to tax all retirement plans under a consumption tax approach that exempts contributions and pension fund income from tax, but taxes benefits.¹⁶³

F. Redistribution

Almost all pension systems redistribute economic resources. That is, they take money from certain workers and give it to others. Social Security, for example, is wildly redistributive. There are clearly winners and losers.¹⁶⁴ In particular, Social Security favors current retirees over future retirees, low-earners over high-earners, larger families over smaller families, married couples over unmarried individuals, one-earner couples over two-earner couples, and elderly retirees over elderly workers.¹⁶⁵ In short, not everyone gets his or her "money's worth" out of Social Security.

The private pension system also has redistributive aspects.¹⁶⁶ Current participants in private pension plans, for example, tend to pay less taxes than those who lack the opportunity to participate. Defined benefit plans also tend to "redistribute" money from those who die to those who survive, although we typically call this

¹⁶³ Cf. Forman, *supra* note 80, at 341-50.

¹⁶⁴ Indeed, the link between the Social Security retirement taxes paid by workers and the Social Security retirement benefits that they can expect to receive is actually quite loose and can vary dramatically based on such factors as family status, income, and age. See, e.g., Michael J. Boskin et al., *Social Security: A Financial Appraisal Across and Within Generations*, 40 NAT'L TAX J. 19 (1987). That is, relative to a program in which each worker earned an actuarially fair rate of return on payroll taxes paid, the current Social Security retirement program results in significant transfers that favor some workers over others.

¹⁶⁵ See, e.g., Forman, *supra* note 114, at 937-48.

¹⁶⁶ See, e.g., Benedict & Shaw, *supra* note 66. Their results suggest that private pension plans increased annual income inequality (relative to the inequality observed in the distribution of wage income) by about 2% among all employed individuals, but by 21% among unionized workers. This inequality appears to be largely the result of the increasing rate of return to tenure through pension "backloading" and the increasing incidence of pensions with age. *Id.* See also Edward Lazear & Sherwin Rosen, *Pension Inequality*, in ISSUES IN PENSION ECONOMICS 341 (Zvi Bodie et al. eds., 1987) (finding that pensions increased income inequality, particularly between blacks and whites and between black men and black women).

insurance. Moreover, ERISA-covered plans mandate "redistribution" to spouses, via the qualified joint and survivor annuity rules for pension plans, and the death benefit for spouses required of most profit-sharing and stock bonus plans.

Redistribution is not *per se* bad, but the government does bear the burden of justifying its redistributive mandates. Redistribution on the basis of need seems the most justifiable; that is, it can make sense to redistribute economic resources from rich to poor. But neither a payroll tax system, nor a private pension system, seems to be an appropriate vehicle for such redistribution. For example, why should high-wage earners be compelled through the payroll tax system to subsidize the Medicare benefits of low-wage earners and their spouses, while, at the same time, "coupon-clipping trust fund brats" can avoid the payroll tax altogether. When redistribution is called for, it would seem to be more appropriate to use the income tax system or a wealth tax system to achieve that redistribution, rather than the payroll tax system¹⁶⁷ or the compensation-based private pension system. Indeed, it may well be that concern about the redistributive nature of Social Security is one of the principal reasons why there is so much resistance to simply raising Social Security taxes, and why there is so much support for creating some kind of a system of individual retirement savings accounts.

VII. CONCLUSION

America's current retirement policies are failing, and the time has come to adopt a universal pension system that will ensure adequate incomes for the retired population. It seems unlikely that an expansion of the voluntary pension system can achieve the goal of retirement income adequacy. Instead, the time is ripe to adopt a mandatory universal pension system. The consensus seems to favor developing a system of individual retirement savings accounts (IRSAs) that piggybacks on the current Social Security payroll withholding system. But, no doubt, the devil will be in the details.

¹⁶⁷ Cf. Jonathan Barry Forman, *Reconsidering the Tax Treatment of the Elderly: It's Time for the Elderly to Pay Their Fair Share*, 56 U. PITT. L. REV. 589 (1995).

APPENDIX 1. LIFE EXPECTANCY FOR MEN AND WOMEN, 1900-2070

Year	Life expectancy at birth		Life expectancy at age 65	
	Male	Female	Male	Female
Actual:				
1900	46.4	49.0	11.4	11.7
1910	50.1	53.6	11.4	12.1
1920	54.5	56.3	11.8	12.3
1930	58.0	61.3	11.8	12.9
1940	61.4	65.7	11.9	13.4
1950	65.6	71.1	12.8	15.1
1960	66.7	73.2	12.9	15.9
1970	67.1	74.9	13.1	17.1
1980	69.9	77.5	14.0	18.4
1990	71.8	78.9	15.0	19.0
Projected:				
2000	73.2	79.7	15.8	19.3
2010	74.7	80.5	16.2	19.6
2020	75.5	81.1	16.6	20.0
2030	76.2	81.8	17.0	20.4
2040	76.8	82.4	17.5	20.9
2050	77.5	82.9	17.8	21.3
2060	78.1	83.5	18.2	21.7
2070	78.6	84.0	18.6	22.1

Note.—The life expectancy for any year is the average number of years of life remaining for a person if that person were to experience the death rates by age for that year.

Source: STAFF OF THE HOUSE COMM. ON WAYS AND MEANS, 105TH CONG., 1998 GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 1031 tbl.A-2 (Comm. Print 1998).

APPENDIX 2. HISTORICAL AND PROJECTED IMPROVEMENTS IN LIFE EXPECTANCY

Year Cohort Turns 65	Percentage of population surviving from age 21 to age 65	
	Male	Female
1940	53.9	60.6
1950	56.2	65.5
1960	60.1	71.3
1970	63.7	76.9
1980	67.8	80.9
1990	72.3	83.6
2000	76.0	85.5
2010	78.4	87.1
2020	79.3	88.1
2030	80.4	88.8
2040	81.8	89.5
2050	82.7	90.0

Source: C. EUGENE STEUERLE & JON M. BAKIJA, RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY: RIGHT & WRONG APPROACHES TO REFORM 41 tbl.3.1 (1994).

APPENDIX 3. PERCENTAGE OF WORKERS ELECTING SOCIAL
SECURITY RETIREMENT BENEFITS AT VARIOUS AGES,
SELECTED YEARS 1940-95¹

Year	Age 62	Ages 63-64	Age 65	Ages 66+	Average Age
1940	²	²	8.3	91.7	68.7
1950	²	²	23.1	76.9	68.5
1960	10.0	7.9	35.3	46.7	66.2
1970	27.8	23.2	36.9	12.1	64.2
1980	40.5	22.2	30.7	6.6	63.7
1990	56.6	20.2	16.6	6.7	63.6
1995	58.3	19.5	16.3	6.0	63.6

¹ Excludes conversions at age 65 from disability to retirement rolls.

² Retirement before age 65 was not available.

Source: STAFF OF THE HOUSE COMM. ON WAYS AND MEANS, 105TH CONG., 1998 GREEN BOOK: BACKGROUND MATERIAL AND DATA ON PROGRAMS WITHIN THE JURISDICTION OF THE COMMITTEE ON WAYS AND MEANS 21 tbl.1-12 (Comm. Print 1998).

**APPENDIX 4. ADJUSTING CONTRIBUTION RATES FOR REALISTIC
MORTALITY ASSUMPTIONS, PROGRAM ADMINISTRATIVE EXPENSES,
AND ADVERSE SELECTION COSTS**

Base Scenario

PAYG	19.77%
IS	19.77%
Advance GP	19.77%

Above Plus Administrative Costs

(2% of contribution for PAYG; 8% of contributions + 0.9% of assets for IS;
0.5% of assets for advance funded group plan)

PAYG	20.17%
IS	28.03%
Advance GP	22.94%

Above Plus Annuity Fee

(15% of assets for IS only; 0% for PAYG, advance funded group plan)

PAYG	20.17%
IS	32.98%
Advance GP	22.94%

Above Plus Early Mortality

(Uses U.S. life table for males born in 1960)

PAYG	17.80%
IS	32.98%
Advance GP	*

Assumptions: Birth rate is constant; wage growth = 0; real interest = 0

* Depends on how plan treats preretirement death

Note: The base scenario assumes that all workers enter the labor force at age 22, work exactly 43 years, retire on their 65th birthday, and die exactly 17 years later on their 82nd birthday. While working, each earns the average wage. In retirement, each receives a benefit equal to one-half the average wage (indexed to average wage levels). The calculations assume that all payments are made once a year on the final day of the year. PAYG denotes the contribution rate required under a pay-as-you-go, defined benefit pension plan; IS denotes this for advance funded, individual savings plans; and Advance GP denotes this for advance funded (defined benefit), group plans.

The second set of calculations incorporates all of the assumptions outlined above except that the contribution calculations are adjusted to show the gross contribution needed to pay a benefit of 50% of average wages and also cover the administrative costs associated with each plan. The cost assumptions are shown in the table.

The third set is a recalculation of the second set using a real life table (U.S. males born in 1960). The sample life table used previously assumed all retirees lived through retirement and died at age 82. In using the real life table, some workers will die prior to retirement. This lowers the pay-as-you-go contribution rate 2.4% from the preceding example.

Source: LAWRENCE THOMPSON, OLDER & WISER: THE ECONOMICS OF PUBLIC PENSIONS 107 tbl.1 (1998).

APPENDIX 5. ASSETS REQUIRED UNDER DIFFERENT RETIREMENT
INCOME STRATEGIES

(RATIO OF ASSETS AT RETIREMENT TO INITIAL INCOME)

ASSUMES INCOMES ADJUSTED FOR INFLATION AFTER RETIREMENT

Strategy	Ratio
Live Off the Interest	
Government Bonds	40.0
Bond/Equity Mix	23.5
Rule of Thumb	
4% Drawdown	25.0
5% Drawdown	20.0
Pure Annuity	
65-Year-Old Male	11.0
65-Year-Old Female	12.8
<u>Assumptions</u>	
Inflation (%)	6.1
Average Real Bond Returns (%)	2.5
Average Real Equity Returns (%)	6.0
Life Expectancy at 65	16.3
Males	20.6
Females	

Source: LAWRENCE THOMPSON, OLDER & WISER: THE ECONOMICS OF PUBLIC PENSIONS 168
tbl.A (1998).