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Paper No. 2007 - 16

The Aging of the Boomers and the Coming Crisis in America's Changing Retirement and Elder Care Systems

Henry H. Drummonds

11 Lewis & Clark L. Rev. 267 (2007)

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FORUM OVERVIEW

THE AGING OF THE BOOMERS AND THE COMING CRISIS IN AMERICA'S CHANGING RETIREMENT AND ELDER CARE SYSTEMS

by
Henry H. Drummonds[*]

An aging population, coupled with a trend toward shifting risk from employers to individual employees, has created a variety of issues within America's retirement system. In searching for a solution to the coming crisis, this Article steps back to analyze the retirement system as a whole. Instead of examining each type of retirement plan individually, the author argues for fundamental change within the entire retirement framework. Because the policy behind ERISA—creating tax benefits to reward long-term employment—has changed, America needs a new comprehensive retirement policy that accounts for the crisis facing the current pension system. The author contends that rather than fashioning individual solutions for each problem, the situation requires a broad solution governed by an overarching theme. Professor Drummonds calls for a "new ERISA," integrating all of the disparate parts of America's emerging retirement system. He argues the social security system should be maintained as a social, not retirement program, guaranteeing every worker some subsistence level income against the vicissitudes of life. He calls for the conversion and phasing out of defined benefit plans in the private and public sector toward the defined contribution/individual account model as fairer to the children and grandchildren of the Boomer generation. Professor Drummonds believes the individual account model is less subject to the funding and moral hazard problems seen pervasively in the defined benefit plans. To address the underfunding and non-participation in defined contribution plans, Professor Drummonds would mandate that employers offer such plans, with opt-out features and diversified default portfolios, and a mandatory employer match of

[*] Professor, Lewis & Clark Law School. Several Lewis & Clark students aided the author in the preparation of this article. Jonathan Donehower and Allison Birdsong provided invaluable research assistance both before and after the Forum. Silvana Arista and Amber Norling provided solid and much needed support with footnoting. And I would like to thank Lewis & Clark Law Review Editor in Chief John Grant and the other editors, particularly Matthew Ellis and Benjamin Garcia, for their above-and-beyond-the-call-of-duty patience with delays in revisions of this article.

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voluntary employee contributions up to 6%. He would eliminate less than market premium rates for termination insurance in remaining defined benefit plans and require a standardized and accurate accounting system for those plans.

I. INTRODUCTION 268
II. THE PROBLEM 269
A. *The Paradigm Shift and the Shifting of Risks from Employers to Employees* 269
B. *The Aging of the Boomers* 271
C. *Convergence Spells Trouble* 273
D. *Change is Inevitable and Appropriate* 274
III. A CLOSER LOOK AT THE MANY PARTS OF AMERICA'S RETIREMENT SYSTEM 276
A. *The Private Sector Defined Benefit System* 276
B. *The Defined Benefit Model in the Public Sector* 281
1. *Comparing Public and Private Sector Compensation* 282
2. *Good Things in the Public Sector Plans* 283
3. *Funding Problems in the Public Sector Plans* 285
4. *The Public Sector Trend to the Defined Contribution Plan Model* 287
5. *Differences Between Private and Public Sector Plans: Impairment of Contracts* 287
6. *The Oregon Public Sector Plan as a Case Study* 288
C. *Social Security and Medicare* 292
D. *The Private Sector Defined Contribution Model* 295
IV. WHERE CAN AMERICA'S RETIREMENT POLICY GO NEXT? 299
A. *Social Security* 299
B. *The Defined Contribution Plan / Individual Account Model Must be Extended and Improved as the Basic Mechanism for Supplementing the Subsistence Level Support Guaranteed in the Social Security and Medicare Systems* 300
C. *The Defined Benefit Plans Should No Longer Be Favored by Public Policy* 301
V. CONCLUSION 303

I. INTRODUCTION

The 2006 Lewis & Clark Law School Forum brought faculty and students together with seven distinguished scholars from other law schools to discuss and present papers about various aspects of America's changing retirement and elder care systems.[1] The contributions of the participants in the pages that

[1] The Lewis & Clark Law School Forum is organized each fall by the business faculty and brings prominent scholars from other schools together with Lewis & Clark faculty and students for presentation of papers and discussion of issues linked by a common theme. The author was given the honor of organizing the 2006 Forum and, with the support of the

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follow represent an impressive effort to rethink how our laws and practices will affect both the aging population and their children and grandchildren in the years ahead.

This Article paints a broad overview of the coming crisis. It further suggests that, rather than thinking of the various issues and concerns as separate and distinct issues, i.e. problems in defined benefit plans, defined contribution plans, social security, and elder care, and the public sector retirement plans, we must see these various aspects as part of an overall retirement system. Though the parts of this system developed separately—for example, the creation of the Social Security system during the Great Depression and the massive replacement of traditional pensions by individual account plans in the 1990s and the first years of the twenty-first century—these and other developments operate together to form a national retirement framework. As the baby boomers[2] begin their retirement over the next two decades, a broad bird's-eye view of this many faceted system reveals that it needs fundamental and not merely incremental change.

II. THE PROBLEM

A. *The Paradigm Shift and the Shifting of Risks from Employers to Employees*

America's retirement system is changing in fundamental ways. As Professor Ed Zelinsky wrote in the Yale Law Journal two years ago, we have shifted from a traditional or defined benefit pension system to a "Defined Contribution Paradigm."[3] Yet that is perhaps an oversimplification when one considers the continued prevalence of the defined benefit model in the public sector, approaching 90% of all public sector workers and affecting more than 10% of America's workforce.[4] Further, the Social Security debate of the past

business law faculty, chose America's changing retirement system as the focus for the 2006 event. Participants included Professors Dorothy Brown from Washington and Lee University, Sam Estreicher from New York University, Jeffrey Gordon from Columbia University, Richard Kaplan from the University of Illinois, Kathryn Moore from the University of Kentucky, Susan Stabile from St. John's University, and Katherine Stone from UCLA.

Several people at Lewis & Clark Law School deserve special mention for their support and assistance. Former Dean Jim Huffman provided unwavering support, including the authorization of expenses related to the event. Assistant Dean Lisa LeSage kept the planning on track. Shirley Johansen expertly handled the many logistical arrangements necessary for a Forum of this nature, and also made arrangements for various breakfasts, luncheons, and informal dinners involving the Forum participants and Lewis & Clark faculty and students. Professors Dan Rohlf, Larry Brown, and Jennifer Johnson, and Interim Dean Lydia Loren were generous with their time in attending and hosting various events.

[2] In this Article I define "baby boomers" as the generation born in the two decades following the Second World War.

[3] Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 453 (2004). A defined benefit pension specifies "an output for the participant" while a defined contribution plan "specifies an input for the participant." *Id.* at 455.

[4] Richard L. Kaplan, *Enron, Pension Policy, and Social Security Privatization*, 46 ARIZ. L. REV. 53, 61 (2004).

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few years also demonstrates the resilience of the defined benefit model. Even in the private pension system the dichotomy between defined benefit and defined contribution plans oversimplifies the reality: as Pamela Perun and Eugene Steuerle point out in a chapter of an impressive recent book published by the Oxford University Press, there are literally dozens of distinct plan types authorized in 3,000 pages of relevant statutes and regulations.[5] "Cash Balance Plans," for example, though nominally defined benefit plans, possess hybrid characteristics with many of the features of defined contribution plans.[6] About 21 million American workers still enjoy the traditional pensions embodied in defined benefit promises.[7]

Still, Professor Zelinsky is surely justified in describing a paradigm shift. In our employer-based private pension system, employers vote in the "defined benefit versus defined contribution" debate by increasingly structuring new plans and changing old plans toward the defined contribution model. Although the reported numbers vary depending on which focus one picks, less than 20% of private sector workers retain defined benefit, or traditional pension, coverage.[8] Twenty years ago more than 84% of private sector employees enjoyed traditional pension coverage.[9] Conversely, almost all new plans are now defined contribution, and about 50% of all employees now have individual account plans, including defined contribution plans such as 401(k) plans.[10] This shift extends beyond the pension question now to include individual medical accounts and educational savings accounts.[11]

The growth of defined contribution/individual account plans (including 401(k) plans which may or may not entail an employer "matching" contribution) shifts a variety of risks from employers to employees. These risks include the under-funding of retirement funds. It is difficult to predict such things as job stability, the economy, and future wages; moreover, like the ant

[5] Pamela Perun & C. Eugene Steuerle, *Reality Testing for Pension Reform*, *in* REINVENTING THE RETIREMENT PARADIGM 25 (Robert L. Clark & Olivia S. Mitchell eds., 2005).

[6] L. Bernard Green, *Questions and Answers on Cash Balance Pension Plans*, COMPENSATION & WORKING CONDITIONS ONLINE (Bureau of Labor Statistics, U.S. Dep't of Labor, Washington, D.C.), Sept. 22, 2003, http://www.bls.gov/opub/cwc/cm20030917ar01p1.htm.

[7] Mary Williams Walsh, *A Strategy for Prudence on Pensions*, N.Y. TIMES, Sept. 9, 2006, at C1.

[8] David Rajnes, *An Evolving Pension System: Trends in Defined Benefit and Defined Contribution Plans*, EBRI ISSUE BRIEF (Employee Benefit Research Inst., Washington, D.C.), Sept. 2002, at 5, *available at* http://www.ebri.org/pdf/briefspdf/0902ib.pdf; Kaplan, *supra* note 4. *See also* Walsh, *supra* note 7.

[9] Rajnes, *supra* note 8, at 5.

[10] Bryandt Rose Dickerson, *Employee Participation in Defined Benefit and Defined Contribution Plans, 1985–2000*, COMPENSATION & WORKING CONDITIONS ONLINE (Bureau of Labor Statistics, U.S. Dep't of Labor, Washington, D.C.), June 16, 2004, *available at* http://www.bls.gov/opub/cwc/cm20030325tb01.htm.

[11] Terry Savage, *Health Savings Accounts Let Unspent Money Grow,* CHI. SUN-TIMES, Feb. 12, 2007, at 53; John Crudele, *Look to 529s to Save for Kids' College*, N.Y. POST, Jan. 21, 2007, at 28.

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and the grasshopper fairy tale we remember from childhood, employees and employers alike procrastinate in setting money aside for the future. But the risks shifted to employees also include a bundle of other risks: investment risks (as the Enron debacle and the 2000–2002 free fall in the equity markets dramatically illustrated), longevity risks (outliving one's funds however adequately saved and successfully invested), leakage risks (using one's funds upon job severance or otherwise for non-retirement purposes),[12] and temporal risk (retiring at the wrong time in the investment and business cycle).[13]

In the traditional defined benefit pension regime, the employer and federal Pension Benefit Guarantee Corporation bore the risk of under-funding and the investment risks of market decline, malfeasance, and lack of diversification. Employees bore these risks only to the extent their employers might become insolvent and the promised pensions exceeded the maximums in the federal insurance program.[14] ERISA's funding, prudent investing, diversification rules, and prohibited transaction rules theoretically regulated these risks to protect employees and the federal government's Pension Benefit Guarantee Corporation. The monthly annuity form of payout featured in traditional defined benefit pensions eliminated longevity risk for individuals via pooling—that is, retirees who died earlier than predicted in mortality tables in effect subsidized those who died later than predicted. Leakage risks were abated by ERISA's restrictions on alienation or withdrawals before retirement age.[15] And the traditional defined benefit pension format eliminated temporal risk to the individual participants—again by the "pooling" feature inherent in promising a defined benefit to employees that retire at different times. In the defined contribution or individual account paradigm, all of these risks will now fall on employees and retirees as individuals.

B. The Aging of the Boomers

At the same time, as everyone knows, Americans,[16] and indeed the populations in Western Europe, Japan, and China, are aging.[17] With the baby

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[12] Gary W. Anderson & Keith Brainard, *Profitable Prudence: The Case for Public Employer Defined Benefit Plans*, (Pension Research Council, Working Paper No. 2004-6, 2004), *available at* www.rider.wharton.upenn.edu/~prc/PRC/WP/WP2004-6.pdf.

[13] *See generally* Kaplan, *supra* note 4.

[14] Kaplan, *supra* note 4, at 57.

[15] Edward E. Burrows, Am. Soc'y. of Pension Prof'ls & Actuaries, Comments on the Proposed Regulations Regarding Distributions from a Pension Plan Under a Phased Retirement Program (Feb. 2, 2005), *available at* http://www.aspa.org/archive/gac/2005/2005-02-02-nra.htm.

[16] *See, e.g.*, Patricia Bradley et al., U.S. Envtl. Prot. Agency, *Constructing a Research Agenda on Aging Americans and their Impact on Ecology and Environmental Quality*, *in* PROCEEDINGS OF THE AGING AMERICANS: IMPACTS ON ECOLOGY AND ENVIRONMENTAL QUALITY WORKSHOP 1, 1 (2004), *available at* http://www.epa.gov/aging/pdfs/2005_1012_finaldraftaging.pdf ("By mid-century, our population over sixty-five will have more than doubled.").

[17] *See, e.g.*, Elisabeth Rosenthal, *In Northern Italy, the Agony of Aging Not So Gracefully*, N.Y. TIMES, Sept. 22, 2006, at A3. ("Genoa provides a vision of Europe's aging

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boomers just starting to reach retirement age, over the next twenty-five years the ratio of active to retired workers will decrease from 3.3:1 to 2.2:1.[18] Not only will boomers swell the ranks of the retired population, but the increasing number of Americans reaching retirement age will likely live longer than ever before. According to the Congressional Research Service, life expectancy for males in 1960 reached 66.8 years and increased from 66.8 years in 1960 to 74.8 years in 2003; life expectancy for women in 1960 reached 73.2 and increased from 73.2 years in 1960 to 80.1 years in 2003.[19] By 2025, according to projections of the U.S. Census Bureau, the population sixty-five or over will almost double—from 36.7 million Americans in 2005 to 63.5 million.[20] Many experts believe even these projections understate the probable increases in life spans during the 21st century.[21]

These demographic realities raise obvious sustainability issues for the pay-as-you-go defined benefit Social Security system, and for public sector defined benefit systems that suffer from underfunding or moral hazard issues arising from the political process in which the promised benefits are defined. The private sector problem compounds the "legacy" benefit cost problems in industries undergoing downsizing in the face of global competition with underfunded pensions (e.g. the airline and auto industries). Not surprisingly, in the human resources literature, articles like *The Aging of the U.S. Workforce* and *How to Manage Your Aging Workforce* now abound.[22] Even the Chairman of the Securities and Exchange Commission recently announced plans for a "sustained and increasing focus" on baby boomer issues.[23] Thus, as the front edge of the Baby Boomer Generation starts into retirement, and especially as more and more boomers reach retirement age over the next twenty years, the adequacy of retirement funds and investments will take on increasing importance.

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future, displaying the challenges of a society with more old than young."). *See also* Milton Ezrati, *Japan's Aging Economics*, FOREIGN AFFAIRS, May/June 1997, at 96 ("A future with only two workers for each retiree will force radical change."). Evan Osnos, *China Ages at Alarming Rate; Graying Population Clouds Economic Future, Threatens Major Strain on Public-Welfare System*, CHI. TRIB., Jan. 23, 2007, at C1.

[18] Allan J. Samansky, *Foreword*, *Symposium: Public Policy for Retirement Security in the 21st Century*, 65 OHIO ST. L.J. 1, 1 (2004); N. Gregory Mankiw, *A Personal Matter*, WALL ST. J., Dec. 16, 2004, at A16.

[19] LAURA B. SHRESTHA, CONG. RESEARCH SERV., LIFE EXPECTANCY IN THE UNITED STATES 3 (2006), *available at* http://ncseonline.org/NLE/CRSreports/06Sep/RL32792.pdf.

[20] PATRICK PURCELL, CONG. RESEARCH SERV., OLDER WORKERS: EMPLOYMENT AND RETIREMENT TRENDS 2 (2005), *available at* http://digital.library.unt.edu/govdocs/crs//data/2005/upl-meta-crs-7258/RL30629_2005Sep14.pdf?PHPSESSID=173a32e169a869a84f943895667a0cf5.

[21] Robert Pear, *Social Security Underestimates Future Life Spans, Critics Say*, N.Y. TIMES, Dec. 31, 2004, at A23.

[22] ANNE H. WILLIAMS, HR EXECUTIVE SPECIAL REPORTS: HOW TO MANAGE YOUR AGING WORKFORCE (2002), *available at* http://www.hrhero.com/sample/trialaging.pdf; Diane Piktialis & Hal Morgan, *The Aging of the U.S. Workforce and its Implications for Employers*, COMPENSATION & BENEFITS REV., Jan.–Feb. 2003, at 57.

[23] Kara Scannell, *Moving the Market: Cox Says SEC to Focus on "Baby-Boomer" Issues*, WALL ST. J., Aug. 2, 2006, at C3.

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C. Convergence Spells Trouble

The convergence of these two developments—the shifting of risk to individuals and the growth of the elderly population—raises a host of issues. What standard of living can be maintained for this expanding aging population, given the funds available in an expanding defined contribution universe? How will rising Medicare and Social Security costs be funded as the population ages? Will inter-generational transfers from those now under forty continue, as they have in the past, as crucial components of retirement and medical funding? Can public employee pensions be sustained as defined benefit systems when the taxpayers who must ultimately support these systems increasingly bear the risks of defined contribution/individual account plans? And what lies ahead for the remaining beneficiaries of the traditional defined benefit plans? Finally, but not least, what burdens will fall upon the children and grandchildren of the boomers?

All of these questions take on increased urgency in the light of one demographic that remains remarkably constant: only about 50% of private sector workers participate in private sector employer sponsored retirement plans at all.[24] Private sector undercoverage, as Professor Stone points out in her 2004 book, *From Widgets To Digits*, results from the non-coverage or low participation rates of part-time, independent contractor, temporary, and other members of the "contingent workforce," and from the trend toward diminishing long-term employment.[25] Further, almost one-third of all private sector employers (disproportionately smaller employers)[26] provide no retirement plan in the non-mandatory ERISA private pension regime.[27] Thus, for about one-half of the U.S. workforce, Social Security and private savings and assets will provide the only sources of post-retirement income.

Presently, the two lowest quintiles of the sixty-five and over population draw 90% of their income from Social Security (dropping below 50% only in

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[24] DEBRA WHITMAN & PATRICK PURCELL, CONG. RESEARCH SERV., TOPICS IN AGING: INCOME AND POVERTY AMONG OLDER AMERICANS IN 2004, at 12 (2005), *available at* http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1000&context=crs; Richard A. Ippolito, *Bankruptcy and Workers: Risks, Compensation and Pension Contracts*, 82 WASH. U. L. Q. 1251, 1295 (2004); Daniel Halperin, *Employer-Based Retirement Income—the Ideal, the Possible, and the Reality*, 11 ELDER L. J. 37, 42 (2003); Norman P. Stein & Patricia E. Dilley, *Leverage, Linkage, and Leakage: Problems with the Private Pension System and How They Should Inform the Social Security Reform Debate*, 58 WASH. & LEE L. REV. 1369, 1376 (2001).

[25] KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS 253 (2004).

[26] PATRICK PURCELL, CONG. RESEARCH SERV., PENSION SPONSORSHIP AND PARTICIPATION: SUMMARY OF RECENT TRENDS 5 (2006), *available at* http://www.opencrs.com/rpts/RL30122_20060831.pdf.

[27] Craig Copeland, *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data*, EBRI NOTES (Employee Benefit Research Inst., Washington, D.C.), Sept. 2005, at 2, 3, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_09-20051.pdf.

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the highest quintile).[28] Alan Greenspan, moreover, testified to a congressional committee in March 2005 that Social Security benefits would fall for "typical" workers from 42% today to 30% by 2050 of the worker's last wage.[29]

Personal savings outside retirement funds, moreover, have declined markedly during the past fifteen years and have trended down for fifty years.[30] Inside retirement funds, as of 2001, typical workers aged fifty-five to sixty-four had only $42,000 in 401(k) and IRA savings plans—enough for a $200 month annuity.[31] Potentially, rising asset accumulation, especially the appreciation of real estate assets, might generate income or be drawn from in older age, but as of 2003, EBRI reports show that the four lowest quintiles of the sixty-five and over population drew only 1.9%–10% of their income from assets and these percentages declined over the past twenty-five years.[32]

The Social Security "trust fund" and Medicare funds face severe shortages and, as Professor Kaplan points out, many aspects of health care for the aging population, including long-term care, are not presently covered in the governmental support systems nor adequately covered by private insurance.[33] While the social conditions described by Charles Dickens long ago may not soon be replicated, a marked resurgence in the number of older persons living in poverty or at near poverty levels seems probable over the next quarter century.

D. Change is Inevitable and Appropriate

But perhaps this paints too bleak a picture. Perhaps the shift to an individual account paradigm reflects an appropriate adjustment to the ending of a Ponzi-like dynamic in both the private and Social Security defined benefit systems.[34] Systems that depend on a larger group to pay benefits to those that come before cannot be sustained unless growth never slows, a point not lost in the popular discourse.[35] And surely the boomers notice the decreasing

[28] Employee Benefit Research Inst. (EBRI), *Sources of Income for Persons Aged 55 and Over*, *in* DATABOOK ON EMPLOYEE BENEFITS ch. 7 (2007), *available at* http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2007.pdf.

[29] Eduardo Porter, *Step By Step*, N.Y. TIMES, April 12, 2005, at G1.

[30] EBRI, *Personal Savings*, *in* DATABOOK ON EMPLOYEE BENEFITS ch. 9 (2007), *available at* http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2009.pdf.

[31] Porter, *supra* note 29.

[32] EBRI, *supra* note 28, tbl. 7.5.

[33] Kaplan, *supra* note 4, at 54.

[34] *See* Kathryn L. Moore, *Redistribution Under a Partially Privatized Social Security System*, 64 BROOK. L. REV. 969, 974 (1998) (acknowledging that Social Security in the past paid "nearly all participants far more in benefits than they paid in taxes" because of "intergenerational transfers").

[35] *See* Malcolm Gladwell, *The Risk Pool: What's Behind Ireland's Economic Miracle—and GM's Financial Crisis?*, NEW YORKER, Aug. 28, 2006, at 30 (discussing the "dependency ratio," the relationship between the number of both elderly and young dependants and the active workforce); Roger Lowenstein, *The End of Pensions?*, N.Y. TIMES, Oct. 30, 2005, § 6 (Magazine), at 56, *available at* http://www.nytimes.com/

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enthusiasm and trust that younger workers place in the traditional systems as they adjust to more mobile and transitory notions of employment. For example, younger employees, according to an empirical study involving university faculty, are more likely than older employees to choose a defined contribution over a defined benefit plan.[36] From the employee perspective, defined benefit vesting rules substantially alleviated the forfeiture problems that were a feature of pre-ERISA private pensions, but not the portability problems inherent in switching employers with the traditional back loaded defined benefit formula.[37] And the individual account plan model confers a more transparent ownership interest upon employees, including the often unrealistic but nonetheless appealing ability to devolve unexpended amounts to heirs.[38] From a normative perspective, a due regard for an equitable inter-generational sharing may dictate the evident changes now underway. Finally, to the extent that Americans now face increasing risk in their retirement systems, this may reflect, in part, macroeconomic trends such as globalization, with shifting flows of capital and wealth to the developing world, rather than to anything intrinsic to our national retirement policy.

Still, it seems evident that our retirement policy is broken. Nothing in the 1,000 page Pension Protection Act enacted in August of 2006 fundamentally addresses the problems sketched in this writing.[39] However, some provisions such as the tightening of ERISA funding rules in the Defined Benefit Plan (DBP) context and the provisions for "opt out" Defined Contribution Plan (DCP) participation and portfolio management represent substantial improvements in an incremental change model.

Let us now observe the prognosis for different parts of America's retirement system as the massive wave of boomers bears down on that system. Rather than a focus on the trees of America's multi-faceted retirement system, and the branches on those trees, let us lift our eyes to see the forest—the entire retirement structure for America as a whole system. To do that we must look at defined benefit plans in the private sector, in the public sector, and in the Social Security and Medicare systems, as well as the now ascendant defined contribution/individual account plan model. That will enable us, finally, to venture some tentative policy conclusions about where we are headed, informed by an awareness of where we have been.

2005/10/30/magazine/30pensions.html?ex=1288328400&en=cccc14f6a7a0b315&ei=5088&partner=rssnyt&emc=rss.

[36] Robert L. Clark & M. Melinda Pitts, *Faculty Choice of Pension Plan: Defined Benefit Versus Defined Contribution*, 38 INDUS. RELATIONS 18, 20 (1999).

[37] Jeffrey N. Gordon, *Individual Responsibility for the Investment of Retirement Savings: A Cautionary View*, 64 BROOK. L. REV. 1037, 1041 (1998).

[38] John H. Langbein, Professor of Law, Yale Univ., Statement at the Hearing of the Senate Committee on Governmental Affairs: The Enron Pension Investment Catastrophe: Why It Happened and How Congress Should Fix It (Jan. 24, 2002), *available at* http://hsgac.senate.gov/012402langbein.htm.

[39] *See* Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780. *See also infra* note 206.

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III. A CLOSER LOOK AT THE MANY PARTS OF AMERICA'S RETIREMENT SYSTEM

A. *The Private Sector Defined Benefit System*

ERISA passed into law with reform trumpets blowing in 1974, after the failure of a Studebaker pension plan in the early l960s[40] and press reports about organized-crime-tainted corruption in the Teamster Central States Pension Fund.[41] A curious coalition that included organized labor, Wall Street, the banking industry, and Ralph Nader heralded the enactment of ERISA. After ten years of lobbying and legislative maneuvering, the traditional pensions of millions of American workers were at last secure! Yet we have it from a key Congressional draftsman of this amazingly complex legislation that in fact:

> ERISA was not connected to some grand, overarching vision of structural reform that would facilitate the adaptation of private benefit arrangements to the needs and expectations of an emerging post-industrial period. The consensus that formed around pension reform legislation, while it moved correctly to identify many of the problems associated with such a stage, and often used rhetoric that made it appear as if ERISA was intended to decisively address such problems, basically rejected any such ideas and concentrated instead on flushing out and correcting the major historic flaws in private plans in a way that it was hoped would minimize governmental intervention and strengthen the industries that sponsored these programs.[42]

Further, by federalizing pension policy via its preemption provisions, ERISA headed-off and largely foreclosed regulation in the states; the bill's congressional sponsor, Congressman Dent, thus described the preemption provisions as its "crowning achievement."[43] Alas, while ERISA created much work in a new specialty for lawyers, actuaries, accountants, and investment managers, and did many good things—most notably its anti-forfeiture rules on participation and vesting[44]—only thirty-three years after its enactment, its failures lie nakedly exposed. While its regulatory provisions focused on the traditional defined benefit pension plan, it spawned the individual

[40] James A. Wooten, "*The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683, 683 (2001).

[41] MARK A. ROTHSTEIN & LANCE LIEBMAN, EMPLOYMENT LAW, CASES AND MATERIALS 1292 (5th ed. 2003); Mary Williams Walsh, *Teamsters Find Pensions at Risk*, N.Y. TIMES, Nov. 15, 2004, at A1.

[42] Michael S. Gordon, *Introduction to the Second Edition: ERISA in the 21st Century, in* STEVEN J. SACHER ET AL., EMPLOYEE BENEFITS LAW lxiii, lxxxiv (2d ed. 2000).

[43] *See* Henry H. Drummonds, *The Sister Sovereign States: Preemption and the Second Twentieth Century Revolution in the Law of the American Workplace*, 62 FORDHAM L. REV. 469, 524 (1993) (quoting 120 CONG. REC. 29, 197 (1974)).

[44] Disclosure of Relative Values of Optional Forms of Benefit, 70 Fed. Reg. 18, page 4058-4062 (modifies sec. 411(a) to "prohibit a participant's benefit under a defined benefit plan from being satisfied through payment of a form of benefit that is actuarially less valuable than the benefit commencing at normal retirement age").

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account/defined contribution model that now dominates the private pension landscape (together with 401(k) plan regulations and statutory changes that followed a few years later), resulting in a shifting of risks onto employees as outlined above. As nearly everyone now knows, more than 80,000 defined benefit plans have already been terminated.[45] And as will be shortly explained further, ERISA's funding rules failed. ERISA's provisions for the governmental guarantee of promised pension benefits via the Pension Benefit Guarantee Corporation (PBGC) created moral hazard dynamics for many underfunded plans of distressed companies in or near bankruptcy. Also, the process for setting PBGC premiums has been political rather than economic.[46] ERISA's preemption provisions dislodged a wide variety of state-level experimentation and innovation, even in the welfare and health insurance plan areas where ERISA's substantive regulation is minimal.[47] As Professor Langbein points out, the Supreme Court interpreted ERISA's remedies provisions in an unnecessarily cribbed and literalistic manner, reducing the remedies previously available for breach of fiduciary duties in the preexisting state law of trusts.[48] Most fundamentally, ERISA has not delivered the retirement income security promised in its name.

Consider the airline, auto, and steel industries—bastions of the defined benefit traditional pension plan. United Airlines, Delta Airlines, Northwest, and US Airways have all sought the protection of the bankruptcy laws in large part in an effort to minimize pension deficit obligations.[49]

United Airlines' story is instructive. Seeking bankruptcy protection in 2002, United Airlines originally sought termination of its four massive defined benefit plans with its pilots, machinists, flight attendants, and ground personnel, reporting $6 billion in under-funding for these plans.[50] United won an agreement for plan termination in the bargaining mandated by the bankruptcy law with the pilots, in exchange for convertible notes and other concessions.[51] However, the bankruptcy court rejected the agreement as unfair to the pension interests of the other United Airlines unionized employees.[52] The PBGC was forced to intervene, seeking an earlier than planned termination of the pilots' pension plan to minimize PBGC's increasing losses; although the pilots would have absorbed $1.5 billion in pension cuts under the original agreement, the

45 Kim Clark, *Pension Tension*, U.S. NEWS & WORLD REP., Jan. 24, 2005, at 42.

46 JOHN H. LANGBEIN, SUSAN J. STABILE & BRUCE A. WOLK, PENSION AND BENEFIT LAW 225-226 (4th ed. 2006).

47 *See* Aetna Health Inc. v. Davila, 542 U.S. 200 (2004); Drummonds, *supra* note 43.

48 John H. Langbein, *What ERISA Means By "Equitable": The Supreme Court's Trail of Error in* Russell, Mertens, *and* Great-West, 103 COLUM. L. REV. 1317 (2003).

49 Steve Hargreaves, *Bankruptcies: The Threat to Your Pension*, CNNMONEY.COM, Sept. 16, 2005, http://money.cnn.com/2005/09/15/retirement/pensions/index.htm.

50 Mary Williams Walsh & Danny Hakim, *G.M. and a U.S. Agency See Pensions in Different Lights*, N.Y. TIMES, Oct. 3, 2005, at C3.

51 Micheline Maynard, *Airline Financing Proposal is Faulted by Union Leader*, N.Y. TIMES, Dec. 22, 2004, at C7.

52 Micheline Maynard & Mary Williams Walsh, *Judge Rejects United's Contract with Pilots*, N.Y. TIMES, Jan. 8, 2005, at C1.

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federal program would have been forced to absorb some $1.4 billion in underfunded pension promises.[53] United Airlines later settled with the unions and the PBGC on the basis that all four union pension plans were terminated in a settlement worth more than $9.8 billion.[54] The United Airlines employees and the PBGC shared losses in the underfunded plans that, upon takeover, proved to be $10.2 billion rather than the $6 billion originally projected.[55] Thus, a federal agency wound up with an ownership share of United, along with billions of "dumped" United pension obligations. With Delta and Northwest following United into the bankruptcy reorganization process, and with billions more of unfunded pension funds at stake for the PBGC, the Pension Protection Act signed into law by President Bush in August 2006 gave those airlines seventeen more years to "catch up" on the underfunding of their pension plans.[56] Even American Airlines and Continental Airlines, whose pension funds were not as severely underfunded as those of United, Delta, and Northwest, and who had not sought bankruptcy protection, were given ten years in the recent Act to catch up their pension funding.[57] Just a few weeks later Delta, with a pilots pension fund estimated to be underfunded by about $3 billion, won approval from the bankruptcy court for a negotiated termination of its pilots pension plan.[58]

A similar story—huge unfunded liabilities thirty-two years after ERISA's enactment and the moral hazard problem of potentially dumping liabilities onto an underfunded federal guarantee program ultimately backed by taxpayers (in 2004, PBGC reported a balance sheet deficit of $23 billion and the Congressional Budget office projects this will reach $86 billion by 2015)[59]—emerges in the auto industry. In perhaps the most dramatic example of the elasticity of accounting standards, the New York Times reported that the PBGC calculates that General Motors is $31 billion short from full funding of its pension plans; GM, however, contends the plans are "fully funded."[60] The disparity arises from the PBGC's currently favored methodology for calculating shortfalls upon plan terminations of underfunded plans in distressed companies—PCBG focuses on the amount that an insurance company would require to assume all pension plan liabilities in excess of plan assets.[61]

[53] Mary Williams Walsh, *Government Seeks Control of Pilot Fund*, N.Y. TIMES, Dec. 31, 2004, at C1.

[54] Babette Ceccotti, *Wake Turbulence: The Litigation over Termination of United's Pension Plans*, LAB. & EMP. L. (ABA, Chicago, Ill.), Summer 2005, at 1.

[55] Walsh & Hakim, *supra* note 50.

[56] Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780.

[57] Mary Williams Walsh, *A Pension Overhaul Gives, and Later Takes Away*, N.Y. TIMES, Aug. 5, 2006, at C1; Pension Protection Act of 2006 § 402 120 Stat. at 922.

[58] *Pension Agency Approves Delta Plan to Terminate Pilot Pensions,* INT'L HERALD TRIB., Dec. 21, 2006, *available at* http://www.iht.com/articles/2006/12/21/business/delta.php.

[59] Mary Williams Walsh, *Whoops! There Goes Another Pension Plan*, N.Y. TIMES, Sept. 18, 2005, § 3 (Magazine), at 1.

[60] Walsh & Hakim, *supra* note 50.

[61] *Id.*

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Although GM has not threatened bankruptcy as in the case of the airlines, ERISA allows plan termination so long as accrued and vested benefits are paid through the date of termination via an insurance type annuity contract.[62] Additionally, GM carries billion dollar obligations for retiree health costs. And then there is Delphi, the GM spin-off and auto parts supplier. Delphi runs a pension deficit it estimates at $5.1 billion (by PBGC calculation, $10.8 billion),[63] and carries obligations for retiree medical expenses estimated at $9.6 billion.[64] Delphi filed for bankruptcy protections in 2005.[65] The situation at the Ford Motor Company is little better.[66] These are staggering "legacy" costs for past production that must either be paid for out of the production of current workers, or by benefit cuts to retirees, or in the case of the pension obligations, absorbed, up to the maximums PBGC insures, by the federal agency. These costs also add thousands of dollars to the production costs of U.S. autos in a highly competitive global market that has already forced both GM and Ford to announce what amounts to a one-third cut in their U.S. workforce.[67]

The picture is the same in other industries including steel, chemicals, trucking, and wood products. In an infamous episode during the 1980s, the conglomerate LTV Corporation attempted to dump its pension obligations on the PBGC while replacing a terminated plan—after a deal with the Steelworkers' Union—with a "follow on" plan just as sweet.[68] National Steel and Bethlehem Steel sought relief from their underfunded pension obligations in bankruptcy.[69] In the chemical industry, DuPont eliminated its traditional defined benefit pension for new hires starting in 2007, and slashed benefit accrual for future service by two thirds for those current employees remaining in DuPont's traditional plan.[70] Consolidated Freightways jettisoned its defined benefit plan in bankruptcy, leaving the PBGC and employees holding a bag of broken promises.[71] Amazingly, by 2002, the Teamster Central States Pension Fund, managed for more than a quarter century by Wall Street firms like Morgan Stanley, Goldman Sachs, and J. P. Morgan because of a federal court consent decree after revelations of corruption a generation ago, held assets of $19 billion against pension promises to truckers and others valued at over $30

[62] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974).

[63] Michael Schroeder, *Big Stakes in Ailing Airlines Raise Questions for U.S. Pension Agency,* WALL ST. J., Nov. 3, 2005, at A1.

[64] Walsh, *supra* note 59.

[65] Mark Reutter, *Workplace Tremors; How Chapter 11 Is Demolishing Employee Expectations*, WASH. POST, Oct. 23, 2005, at B1.

[66] Micheline Maynard, *Already Reeling, Detroit Flails in Latest Effort to Reinvent Itself*, N.Y. TIMES, Sept. 16, 2006, at A1.

[67] *Id. See also* Kris Maher, *Demands for Labor Givebacks Grow More Aggressive; Union Leaders Increasingly Must Push for Concessions in Wake of GM-UAW Pact*, WALL ST. J., Oct. 27, 2005, at A1.

[68] Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 642 (1990).

[69] Lowenstein, *supra* note 35, at 56 (online at 1).

[70] Floyd Norris, *If Boomers Have It All, What's Left?*, N.Y. TIMES, Sept. 1, 2006, at C1.

[71] John Leland & Mary Williams Walsh, *Pension Failures Foil Six Figure Retirements, Too*, N.Y. TIMES, Oct. 5, 2004, at A1.

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billion, a ratio that compared poorly to that in the days of Jimmy Hoffa.[72] International Paper Company moved new employees to a 401(k) individual account plan in 2004.[73]

In addition to the temptation to underfund defined benefit plans created by flexibility in accounting rules and the pension insurance offered at non-market rates by the PBGC, other moral hazard problems have plagued private pensions. For example, executive officers have allegedly manipulated pension accounts to inflate balance sheets and income statements to enhance executive pay.[74] Manipulation of assumed rates of return in pension funds can bolster apparent corporate earnings (by decreasing pension contributions) and enhance executive pay tied to such earnings, including stock options; this in turn can generate pressure to enhance asset allocations to equities.[75] Of course, as the Enron debacle illustrates, these and similar manipulations of stock prices are not confined to the defined benefit plans. Altogether, 500,000 American workers experienced the failure of their pension plans between 2001 and 2004.[76] Employees suffer because some retirement promises lack federal guarantee backing (for example early retirement, retiree medical benefits, and pensions over the federal insurance ceiling of about $45,000/year) and the PBGC must make good on the remaining promises.[77] And as noted previously, the PBGC suffers from a deficit that is projected to grow. By 2005, the combined shortfall in private sector defined benefit funds reached a record $353.7 billion.[78]

The 2006 Pension Protection Act did tighten ERISA's porous funding requirements, but still allows all companies seven years to fully fund their pension promises[79] (considerably longer for favored or distressed industries like the airlines). But even non-industrial sectors have displayed an unwillingness to continue with defined benefit plans under the tightened but still flexible ERISA rules. Verizon, though fully funding its traditional defined benefit plan, ended future accruals of benefits in that plan for its non-union employees this year.[80] It transitioned those employees to the defined contribution model, following the lead of newly acquired MCI and their non-

[72] Walsh, *supra* note 41.

[73] Walsh, *supra* note 7.

[74] *See*, *e.g.*, Murphy v. Am. Home Prod. Corp., 448 N.E.2d 86 (N.Y. 1983).

[75] Daniel Bergstresser et al., *Earnings Manipulation and Managerial Investment Decisions: Evidence from Sponsored Pension Plans* (Nat'l Bureau of Econ. Research, Working Paper No. 10543, 2004); *see also* Mary Williams Walsh, *A Pension Rule, Sometimes Murky, Is Under Pressure*, N.Y. TIMES, Nov. 8, 2005, at C1.

[76] Bergstresser et al., *supra* note 75.

[77] Walsh, *supra* note 59. *See also* Pension Benefit Guaranty Corp., What PBGC Guarantees, http://www.pbgc.gov/workers-retirees/benefits-information/content/page13181.html.

[78] Editorial, *Promise Now, Don't Pay Later*, OREGONIAN, Oct. 25, 2005, at B8.

[79] Pension Protection Act of 2006, Pub. L. No. 109-280, § 112, 120 Stat. at 850 (Amending 26 U.S.C. § 436(f)(1)(C)(iii)).

[80] Arshad Mohammed, *Verizon to End Traditional Pensions for Managers,* WASH. POST, Dec. 6, 2005, at D1.

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union Verizon Wireless unit.[81] These changes followed similar announcements at Hewlett-Packard and Motorola.[82] IBM closed its traditional pension plan to new employees a year earlier; its decision was apparently driven by the prospect of the tighter funding rules contemplated in the pension legislation then winding its way though the Congress.[83] Blount International announced a similar switch in August 2006.[84] As CNN Money pointed out, pension plan reform is a boon for 401(k)s.[85]

In summary, the defined benefit traditional pension system suffers from a marked decline in its coverage of American workers and a funding crisis in sectors heretofore thought to be its strength. The regulatory regime promised by ERISA has failed. As one of ERISA's leading congressional staff architects declared in 2001, "There is no federal agency enforcing participants' rights."[86] Younger private sector workers, at sea in global labor markets with declining prospects of "permanent" jobs or even permanent careers, find individual account plans and the portability, sense of personal control, and direct ownership offered in the DCP model increasingly appealing.[87] Far from lamenting the passing of the older order, younger employees embrace the changes now underway. As a popular writer recently summarized the implicit policy of the 2006 Pension Reform Act: "The message is loud and clear: Neither your government nor your employer will be responsible for your retirement. You will be."[88]

B. *The Defined Benefit Model in the Public Sector*

For the more than 10% of American workers employed by the federal, state, and local governments, the defined benefit or traditional pension model remains popular.[89] Pension promises by state and local governments, backed by taxpayers and the legal doctrines of contracts impairment, offer a major plus to

[81] *Id.*

[82] Ken Belson & Matt Richtel, *Verizon to Halt Pension Outlay for Managers*, N.Y. TIMES, Dec. 6, 2005, at A1.

[83] Mary Williams Walsh, *I.B.M. Prepares Substitution for Pensions of New Hires*, N.Y. TIMES, Dec. 9, 2004, at C1.

[84] Brent Hunsberger, *Blount Freezes Its Pension Plan*, OREGONIAN, Aug. 9, 2006, at D1.

[85] Jeanne Sahadi, *Pension Reform: Boon for 401(k)s*, CNNMONEY.COM, Aug. 17, 2006, http://money.cnn.com/2006/08/17/pf/retirement/pension_signing/index.htm?postversion=2006081715.

[86] Mary Williams Walsh, *Pensions: Big Holes in the Net*, N.Y. TIMES, Apr. 12, 2004, at G1.

[87] *See* Anderson & Brainard, *supra* note 12. *See also* Investment Co. Inst., 401(k) is Now the U.S.'s Leading Private Retirement Plan (Nov. 6, 2006), http://www.ici.org/statements/nr/06_news_401k_anniv.html; Peter J. Ferrara, Ams. for Tax Reform, Advantages of Defined Contribution Plans, *available at* www.akrepublicans.org/kelly/24/pdfs/kell_hb191_advantages_of_defined_contribution_plans.pdf.

[88] Julie Tripp, *Retirement Plans Face a Major Upheaval Under New Law*, OREGONIAN, Aug. 27, 2006, at D1.

[89] Anderson & Brainard, *supra* note 12.

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public employees. But again fundamental issues arise about the long-term viability of these systems. Although this discussion focuses on state and local pension funds, the Federal Thrift Savings Fund covers 3.7 million federal employees[90] and carried $93 billion in assets as of 2000.[91] As Professor Kaplan notes, approximately 88% of these federal sector employees enjoy coverage by a defined benefit plan.[92]

1. Comparing Public and Private Sector Compensation

At the most fundamental level, the long-term viability of the public sector plans depends on public and taxpayer support. As average private sector compensation for the three lowest quintiles stagnates or even declines[93] under pressure from the globalization of labor markets and resulting shifts in internal labor markets, maintaining traditional pensions for public employees faces diminishing public, taxpayer, and voter support.[94] Recall that almost 50% of private sector employees receive no private pension benefits (counting part-time workers).[95] Among full-time employees, retirement/savings plan participation stands at 98% for state/local governmental employees[96]—10% of the entire U.S. workforce[97]—whereas 60% of private sector employees participate in such plans.[98] Similarly, health insurance participation rates are approximately 86% for public employees and 66% for private sector employees.[99] Whereas private sector employees overwhelmingly and increasingly bear the risks outlined above in defined contribution plans, public employees overwhelmingly find protection from these same risks in defined benefit plans. Further, the public employer plans are often much richer. On the retirement side, state and local governments paid on average $2.23 per hour in 2004, whereas private sector plan costs were $0.85 per hour.[100] Similarly

[90] Fed. Retirement Thrift Inv. Bd., Press Release, Thrift Savings Plan Executive Director Resigns to Accept New Position (Jan. 24, 2007), *available at* http://biz.yahoo.com/bw/070124/20070124006128.html?.v=1.

[91] Stein & Dilley, *supra* note 24, at 1371; Kaplan, *supra* note 4, at 60.

[92] Kaplan, *supra* note 4, at 61.

[93] Press Release, Bureau of Labor Statistics, U.S. Dep't of Labor, Real Earnings (Dec. 2006), *available at* http://www.bls.gov/news.release/realer.nr0.htm; *see also* Hal R. Varian, *Many Theories on Income Inequality, but One Answer Lies in Just a Few Places*, N.Y. TIMES, Sept. 21, 2006, at C3.

[94] Michael Cooper, *Retirees Get Albany Attention, and New York City Gets the Bill*, N.Y. TIMES, Aug. 22, 2006, at A1.

[95] *See supra* notes 25–28 and accompanying text.

[96] EBRI, *Benefit Cost Comparisons Between State and Local Governments and Private-Sector Employees*, *in* FUNDAMENTALS OF EMPLOYEE BENEFIT PROGRAMS pt. 5, ch. 40 (2005), *available at* http://www.ebri.org/pdf/publications/books/fundamentals/Fnd05.Prt05.Chp40.pdf [hereinafter EBRI 2005].

[97] Robert L. Clark & Olivia S. Mitchell, *The Changing Retirement Paradigm*, *in* REINVENTING THE RETIREMENT PARADIGM 3, 9 (Robert L. Clark & Olivia S. Mitchell eds., 2005).

[98] EBRI 2005, *supra* note 96, at 13, fig. 40.1.

[99] *Id.* at 12, fig. 40.1.

[100] *Id.*

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Cite as 11 LEWIS & CLARK L. REV. 267 (2007). Available at http://law.lclark.edu/org/lclr/

medical insurance costs ran 124% higher for state and local governments, at $3.49 per hour worked, versus $1.56 per hour worked in the private sector.[101]

Some might argue that richer benefit packages along with more job security, via the civil service exception to the American "at-will employment" rule, are part of the historic tradeoff for public employees to compensate for relatively lower wages. Not any more. Total compensation costs for state and local employees reached $34.72 per hour worked in 2004 compared to $23.76 in the private sector.[102] Looking at wages/salary costs alone, the differential was $23.83 for public employees and $16.96 for private sector employers.[103] These differentials reflect the differential composition of the work forces in the public and private sectors: 54.2 % of state/local government employees are K–12 and university educators with relatively high levels of educational attainment: 46.7 % of private sector employees work in service industry jobs.[104] Even amongst the service sector public workforce, many public sector service workers in the Bureau of Labor Statistics reporting systems are police and firefighters whose jobs expose them to higher levels of risk. Additionally, whereas in 2003 only 8.2% of the private sector workforce remained unionized, the rate for state/local government stood at 37.2%—another factor associated with higher levels of total compensation.[105] Thus, valid comparisons are difficult.

But it is not necessary to make a normative judgment about whether public sector compensation is too high or too low to realize that these disparities imply long-term erosion of support for the now much richer and more secure retirement packages enjoyed by public sector workers. And certainly with the defined contribution/individual account model increasingly entrenched in the private sector, support for the defined benefit structural model in the public sector can also be expected to decline. A bury-one's-head-in-the-sand posture will not change these realities. Indeed, it may not be in the long-term interests of public employees to insist on maintenance of a structural retirement model at variance with that of most American workers. Additionally, to the extent scarce tax dollars for vitally needed public services are diverted to make good on the defined benefit promises to older and retired public employees, the wages and benefits of younger public workers must inevitably suffer.

2. Good Things in the Public Sector Plans

Other developments also suggest that the evident eclipse of the DBP model in the private sector foreshadows a similar shift in the public sector. Before reviewing these, however, let us first acknowledge the good things accomplished in many of these professionally-managed and/or -advised state and local defined benefit funds. They have delivered solid retirement security

[101] *Id.* at 14.
[102] *Id.* at 17, fig. 40.3.
[103] *Id.* at 12, fig. 40.1.
[104] *Id.* at 14.
[105] *Id.* at 15, fig. 40.2.

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to 10% of the U.S. workforce, not an insignificant achievement.[106] These funds have been professionally managed to achieve, on the whole, good rates of return on the $2 trillion assets involved. For example, a study by the Nebraska PERS showed that over the sixteen year period ending in 1999, the DBP component averaged an 11% return, while the DCP component of the Nebraska plan averaged only 6%.[107] Thus public sector defined contribution plans suffer from some of the same investment choice problems as do private individual account plans. As public sector boomers retire, the release of these funds into the consumption economy will provide a significant economic boost in coming decades.[108]

Additionally some public sector plans—perhaps most notably the $180 billion CALPERS—have leveraged their huge financial power in governance campaigns and other efforts to bring about changes in American corporate behavior.[109] CALPERS covers 1.2 million California public employees and retirees and generates $20 billion per year in revenues.[110] ERISA and private sector trust law, in contrast, restrict "social investing" in the private sector.[111] Such public sector efforts to spur corporate reform generate controversy, [112] but have been defended as an appropriate use of employee ownership interests to combat management and financial sector abuses.[113] As the Chair of the Texas Pension Review Board put it,

> President Bush talks about transitioning to an ownership society . . . Well, we already have an ownership society, and the people who are owners don't know they're the owners. The owners are the people in America who hope to retire, and who are retired, and who depend upon a stream of income that their deferred compensation generates. And they don't have many advocates.[114]

Grover Norquist, President of Americans For Tax Reform, succinctly summarized the heart of the critique of such use of public pension funds: "Just

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[106] Clark & Mitchell, *supra* note 97.

[107] Gary W. Anderson & Keith Brainard, *Profitable Prudence, in* REINVENTING THE RETIREMENT PARADIGM 206, 209 (Robert L. Clark & Olivia S. Mitchell eds., 2005)

[108] Clark & Mitchell, *supra* note 97, at 9.

[109] Press Release, Cal. Pub. Employees' Ret. Sys. (CalPERS), CalPERS Backs United Nations Principles for Responsible Investment (Apr. 27, 2006), *available at* http://www.calpers.ca.gov/index.jsp?bc=/about/press/pr-2006/april/united-nations-principles.xml.

[110] Stein & Dilley, *supra* note 24, at 1370.

[111] *See, e.g.*, Donovan v. Bierwirth, 680 F.2d 263 (2d Cir. 1982); Blankenship v. Boyle, 329 F. Supp. 1089 (D.D.C. 1971).

[112] *See, e.g.*, Mary Williams Walsh, *California Pension Activist Expects To Be Ousted*, N.Y. TIMES, Dec. 1, 2004, at C1.

[113] *See, e.g.*, Mary Williams Walsh, *Calpers Ouster Puts Focus On How Funds Wield Power*, N.Y. TIMES, Dec. 2, 2004, at C1.

[114] *Id.*; *see also* Phil Angelides, *The Right's Attack On Public Pensions*, L.A. TIMES, Feb. 7, 2005, at B11 (Phil Angelides, Treasurer for the State of California, opposing Gov. Schwarzenegger's proposals to replace California's defined benefit traditional pension plan with an individual account plan) [hereinafter *Right's Attack*].

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115 people control $1 trillion in these funds."[115] New York State's pension fund also allies itself with the proponents; for example, filing suit against the pharmaceutical firm Merck for allegedly misleading shareholders (not to mention doctors, patients, and the Food and Drug Administration) about the cardiovascular risks of the arthritis drug Vioxx.[116] Still, many of the stories of problems in the public sector plans bear an eerie resemblance to the problems in the private sector's defined benefit plans—specifically, problems of under-funding and moral hazards arose.

3. Funding Problems in the Public Sector Plans

In theory, like the private sector defined benefit plans, and unlike the pay-as-you-go defined benefit Social Security and Medicare systems, most public sector defined benefit plans are, in theory, "funded." That is, contributions are theoretically set aside today to be invested, with projected accumulating earnings being just enough to pay the projected future liabilities for today's workers. Although public sector funds officially reported 95% funding in 2003,[117] as with private sector defined benefit plans, financial and moral hazard problems appear. The City of San Diego faces a $1.4 billion shortfall in its pension fund, a deficit now soaking up scarce cash needed for city services.[118] Former SEC Chair Arthur Levitt Jr., after leading an independent investigation of the fund said:

> The city's pension system was not brought to crisis merely as a result of abnormally low investment returns. Nor was the system brought to a crisis as a result of a 'perfect storm' of unpredictable catastrophes. San Diego officials fell prey to the same type of corruption of financial management and reporting that afflicted municipalities such as Orange County and such private sector companies as Enron, HealthSouth, and any number of public corporations.[119]

The $7.5 billion pension fund for San Diego County, was ironically exalted as the "Public Pension Plan of the Year" as recently as April, 2006.[120] Yet, its $1.3 billion dollar stake in largely unregulated hedge funds looked less promising when massive losses came to light in the Amaranth Advisors hedge fund in September, 2006.[121]

Such problems are not confined to the Golden State. As Professor Willborn reported:

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[115] *Right's Attack*, *supra* note 114, at B11.

[116] Barry Meier, *Pension Fund of New York Files Suit Against Merck*, N.Y. TIMES, C1 (Dec. 1, 2004)

[117] Anderson & Brainard, *supra* note 107, at 216.

[118] Mary Williams Walsh, *Public Pension Plans Face Shortages in the Billions, Without Oversight*, N.Y. TIMES, Aug. 8, 2006, at A3 [hereinafter *Pension Shortages*].

[119] Mary Williams Walsh, *San Diego Broke Laws in Pension Crisis, Panel Says*, N.Y. TIMES, Aug. 9, 2006, at C3.

[120] Mary Williams Walsh, *Pension Fund Tallies Losses And Rethinks Its Strategy*, N.Y. TIMES, Sept. 9, 2006, at C4.

[121] *Id.*

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> New Jersey Governor Christine Todd Whitman twice engineered changes to the funding of public pension systems that helped her fulfill campaign promises to cut state income tax rates . . . changes in actuarial assumptions and methods resulted in lower required pension contributions and saved the state approximately $1.5 billion . . . Then, in 1997, the state made funding changes to the pension system that resulted in 'surplus assets' of about $2.4 billion. The savings were available to help solve budgetary problems the state would face over the next five years.[122]

The New York Times reports that the New Jersey deficit now stands at $18 billion; the state put $1 million into the fund even though its own actuary recommended $652 million.[123] Wisconsin paid $215 million to settle a lawsuit claiming it had acted illegally ten years earlier by reallocating $84.7 million from a pension fund.[124] MSNBC reported that many Michigan school districts, cities, and towns faced financial problems when pension payouts grew by 50% over a four year period of low investment returns.[125] West Virginia was reported to be holding only 22% of its liabilities in its pension fund.[126] In New York, the City of Lockport, suffering from declining population, faces severe "legacy" costs of paying the pensions promised to its firefighters, police, and other public employees.[127] These pensions now consume over 14% of the city's budget.[128] New York City's pension costs quadrupled in five years, and are now consuming 10% of the City's budget. Without "smoothing" in its pension reporting, New York City carries a staggering $49 billion shortfall in its pension funds, according to the system's own chief actuary.[129] Buffalo's pension costs increased sixfold in a recent five year period, necessitating a takeover by a financial control board.[130] These difficulties stemmed both from losses during the stock market fall of 2000 to 2002, and from the local government's and state legislature's tendency to agree to or mandate increased pension and health care benefits under lobbying from public employee unions.[131] Promise-now-and-pay-later carries understandable appeal to politicians.

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[122] Steven L. Willborn, *Public Pensions and the Uniform Management of Public Employee Retirement Systems Act*, 51 RUTGERS L. REV. 141, 172 (1998).

[123] Walsh, *supra* note 118, at A3. *See also* Mary Williams Walsh, *New Jersey Diverts Billions, Endangering Pension Fund*, N.Y. TIMES**,** Apr. 4, 2007, at A1.

[124] Willborn, *supra* note 122, 142 n.2; Wis. Retired Teachers Ass'n v. Employee Trust Funds Bd., 558 N.W.2d 83, 99 (Wisc. 1997).

[125] Kevin Tiblles, *Michigan School District Feels the Pension Pinch*, MSNBC, Nov. 11, 2005, *available at* http://www.msnbc.msn.com/id/10143598/.

[126] Lowenstein, *supra* note 35, online at 8.

[127] Danny Hakim, *Cost of Pensions Adds to Factory Troubles of Factory Town*, N.Y. TIMES, Sept. 4, 2006, at A1.

[128] *Id.*

[129] Mary Williams Walsh, *Panel Plans to Make Cities Reveal More on Pensions*, N.Y. TIMES, Dec. 1, 2006, at C8.

[130] Hakim, *supra* note 127.

[131] *Id.*; *see also* Cooper, *supra* note 94.

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The picture in the aggregate tells a similar story. The New York Times recently reported that state and local governments face a $375 billion shortfall in pension funding.[132] The Times also reported that some experts place the shortfall higher; Barclays Global Investments calculates that if America's state plans were required to use the same actuarial methods required of private corporations, the deficits would exceed $460 billion.[133] For example, Illinois and Colorado both stretch pension payments for accrued liabilities to 40–50 years—well over the long-established private sector standard of 30 years.[134] (Yet, as we have seen, many private sector plans suffer from under-funding too.) In recognition of the vagary of public sector accounting standards, the Governmental Accounting Standard Board recently announced probable changes in its rules for public sector plans which will enhance disclosure but still allow considerable flexibility.[135] And of course disclosure rules do nothing directly to require full funding of the plans. As acknowledged by Robert Kurtter, senior vice president for state ratings at Moody's Investors Service,

> What this highlights, for us, is a big problem. . . .In any financial report, there are a wide range of assumptions and acceptable practices. But in the area of public pension, it seems, the range of acceptable methods is extremely wide. Given that extremely wide spectrum, which runs from extremely generous to extremely conservative, it becomes very difficult to value these systems on a consistent basis across the country.[136]

4. The Public Sector Trend to the Defined Contribution Plan Model

These and other concerns have triggered a variety of reforms in the states. Here again, states have moved toward the defined contribution model. These states include Oregon, Michigan, Florida, South Carolina, Colorado, Arizona, Ohio, and Montana.[137] Unlike the exodus from defined benefit plans in the private sector, or the freezing of future accrual of benefits in those plans, the states, facing similar deficit dynamics, must confront impairment of contract constraints (to say nothing of the political power of public employee unions). Because of limited space, I shall tell only one of these state stories in detail—the story of the pension crisis that gripped Oregon's PERS from 2000 to 2003.

5. Differences Between Private and Public Sector Plans: Impairment of Contracts

In most states, state and local governmental pension promises to public employees are considered "contracts," thus triggering federal and state constitutional impairment of contract protections. Oddly, these promises are sometimes interpreted to restrict changes in pension benefits for future service of existing employees. In contrast, although ERISA in theory protects private

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132 Walsh, *supra* note 118.
133 Lowenstein, *supra* note 35, online at 8.
134 Walsh, *supra* note 118.
135 Walsh, *supra* note 129.
136 Mary Williams Walsh & Michael Cooper, *Pension Fund Short or Full? Depends on the Evaluator,* N.Y. TIMES, Aug. 27, 2006, § 1, at 27.
137 Lowenstein, *supra* note 35, online at 9.

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pension promises for past service (albeit, with funding, bankruptcy, and limited PBGC insurance problems discussed above), the private sector law does not purport to prevent prospective changes for tomorrow's work. Thus private companies are able to "terminate" traditional pension plans (taking any surplus funds in the plans as was common in the l980's and 1990s), and pay accrued and vested benefits via an insurance annuity or, in the case of bankruptcy, via dumping their pension obligations on the PBGC, or on the employees (for benefits not covered under the federal insurance program). In other words, in the private sector, yesterday's and today's pension promises bind companies and the government (with the caveats discussed above), but do not restrict changing the pension promise for future work. This has triggered the private sector's flight into individual account plans for new hires, and for the future service of existing employees to be covered in "frozen" or terminated defined benefit pension plans. But as the pension promise is sometimes interpreted in the public sector plans, the promise binds the public employer even as to future service to all existing employees.[138] This is so even if the promised pensions are severely underfunded. Such holdings, not always compelled by precedent,[139] in effect, may bind future generations to pay for deferred compensation long after the service that earned the pension, and long after underfunding problems come to light, even though other items of total compensation, like salary and medical benefits, can be changed downward prospectively for future service.

However illogical this may be, the bottom line is that public officials have much less flexibility to change pension arrangements than is exercised in the private sector. While public employees might naively cheer these restrictions on changes in the pension promises to existing employees for future service, the money to pay the unchangeable pensions must come from somewhere. It must come from scarce resources for K–12 and higher education, from medical and other benefit programs for the elderly and disabled, from the salaries and other non-pension compensation of public employees themselves, and from newly hired public employees whose pension promises can be reduced.

6. The Oregon Public Sector Plan as a Case Study

Oregon's population is relatively small (at about 3.8 million) but grew rapidly in the 1990s (by 20.4%, 11th in the nation).[140] The rate of growth has continued to accelerate into the twenty-first century (Oregon is one of only five states to grow rapidly in the 1990s, and to continue accelerating with population gains past the year 2000; the others were Idaho, Utah, Colorado, and North Carolina).[141] Most of the increase has come from migration.[142] Thus, unlike private companies like GM and Ford, caught in downsizing resulting from the globalization of labor markets, and unlike the Great Plains states

[138] *See, e.g.*, Or. State Police Officers Ass'n v. State, 323 Or. 356 (1996).

[139] *E.g.*, Hughes v. State, 314 Or. 1 (1992).

[140] Barry Edmonston, *Oregon's Major Population Trends*, OR. OUTLOOK (Population Research Ctr., Portland, Or.), April 2003, at 3.

[141] *Id*.

[142] *Id*. at 2–3.

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where "thousands of small towns are caught in a vicious cycle of depopulation,"[143] Oregon does not have a diminishing ratio of active workers to retirees. Still, Oregon's population is aging with the Boomer Generation, as is the case nationally. (Oregon's median age stood at 36.6 years in 2000 compared to 35.3 years across the nation.)[144] And the sixty-five and over population has increased faster than other groups in the population.

Let us examine the impairment of contracts and future service problems in the context of a real controversy in Oregon.[145] Oregon's public employee pensions grew rich during the 1980s and 1990s, eventually resulting in average pensions for 2000 and 2001 retirees with thirty years of service of 105% and 106%, respectively, of their final salaries.[146] Note that Oregon public retirees could often receive more income in retirement than they had received when working! Of course these are averages; many public employees retiring in 2000 and 2001 received benefits less than their salaries, but, many also received benefits above the 105% average.

Oregon has a complex pension system, the product of both decades of lobbying by public employees and the propensity of legislators to play Santa with pension gifts that are paid for by future generations, despite formally "funded" promises. Oregon's base defined benefit for public employees rested on a typical formula that yielded an annuity of 50% of final average salary at retirement after thirty years of service.[147] Such a "replacement ratio" is common in both public and private sector pension plans, and is based on the hope that Social Security will supplement that retirement income, and the (questionable) assumption that income needs decline after retirement (see the discussion below of medical costs). [148] But besides this traditional defined benefit, Oregon's plan provided other defined benefits at the employee's option. One of the defined benefit options (which the employee could elect at the time of retirement) carried characteristics like an individual account plan. The employee "paid" 6% of salary into the account (public employers most often "picked up" or paid this 6% percent contribution on behalf of the employee), and the state, in practice, guaranteed an annual 8% return on that

[143] Phillip Longman, *Multiply and Be Fruitful,* WIRED, Aug. 31, 2004, *available at* http://www.newamerica.net/publications/articles/2004/multiply_and_be_fruitful.

[144] Quin Cai, *Oregon's Population Change: 1990–2000*, OR. OUTLOOK (Population Research Ctr., Portland, Or.), Dec. 2003, at 3, *available at* https://stage.www.pdx.edu/media/p/r/prc_Oregon_Outlook_Dec_2003.pdf.

[145] The facts below are taken from the Oregon Supreme Court's opinion in *Strunk v. Public Employees Ret. Bd*., 338 Or. 145 (2005), and from the Special Master's Findings in that case, and from the amicus brief submitted in the case on behalf of the Associated Oregon Industries, Oregon Business Association, Oregon Business Council, and the Portland Business Alliance, for which the author was "Of Counsel." The author also served as an advisor to Oregon Governor Ted Kulongoski during the 2003 Oregon Legislative Assembly during which Gov. Kulongoski led the efforts to reform Oregon's PERS.

[146] Amicus Curiae Brief for Respondent at 22, *Strunk*, 338 Or. 145 (on file with the author) (citing the Special Master's Report at 14).

[147] *Id*. at 16 (citing the Special Master's Report at 12).

[148] *Id*. at 16 (citing the Special Master's Report at 15).

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Cite as 11 LEWIS & CLARK L. REV. 267 (2007). Available at http://law.lclark.edu/org/lclr/

money.[149] Upon retirement the employee was entitled to not only the accumulated balance under this option but to an equal amount of "matching" funds by the public employer.[150] The sum was converted to an annuity based on outdated mortality tables that assumed a shorter life in retirement than was (most often) the case, resulting in a larger monthly annuity than the 6% annual contributions, and accumulated earnings, with the "matching" funds equal to that accumulation, could actually have purchased in the annuity markets.

But there was one final factor that redounded to the benefit of the pre-1996 hires in Oregon's public pension system (the system was changed as to employees hired after that year). The 8% guarantee was treated as a minimum by the Oregon PERS Board, made up overwhelmingly of public employees and other beneficiaries of the system.[151] While the 8% guarantee was the projected average return certified by the pension fund's actuary, during the 1990s stock market boom, the fund earned returns approaching or exceeding 20% for several years.[152] Very little of those extraordinary earnings were reserved against the inevitable turn in the equity markets. Instead the PERS Board allocated most of those extraordinary returns to the individual accounts subject to the 8% guarantee and employer obligation to match the resulting compounding accumulation.[153] Thus, beneficiaries got the upside returns without the downside risks. By making the average return a minimum, Oregon was headed for trouble.

When the markets turned in 2000–2002, the fund's double-digit losses, together with the 8% guarantee, meant that the fund built up a deficit in excess of 18% (the 8% guaranteed but not earned, and the losses).[154] Very soon, a near $20 billion deficit developed between the assets of the fund and the present value of its future liabilities.[155] (As a point of reference, Oregon's entire biennial general fund budget during this period was about $12 billion.) Whereas in the private sector such a situation might have resulted in bankruptcy reorganization, plan termination, or at least the freezing of future benefit accrual, the impairment of contracts doctrine restricted the options for Oregon's lawmakers and governor. Under Oregon law, public employers were obligated to increase public pension contributions to address this deficit. The required contributions threatened to double and then double again, as the individual account balances of pre-1996 hires ballooned due to the dynamics of the 1990s era 20% range allocations, the 8% guarantee, the public employer matching requirement, and the compound interest effect. Scarce tax dollars drained from the schools and other needed public services, and forced a freeze of many active public employees' salaries and other compensation, even though those hired after 1996 did not enjoy the rich pension benefits that pre-

[149] *Id*. at 30, 32 (discussing OR. REV. STAT. §§ 238.205, 238.255 (2001)).
[150] *Id*. at 17.
[151] *Id*. at 32, 37.
[152] *Id.* at 10 (citing the Special Master's Report at 26).
[153] *Id.* at 32.
[154] *Id*. at 14.
[155] *Id*. at 11 (citing the Special Master's Report at 22, 31).

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1996 hires looked forward to. The "Cadillac" pensions could only be paid for by increased contributions, or cuts in services and other compensation.

In these circumstances the Oregon legislature and governor adopted reforms.[156] The outdated mortality tables that led to inflated monthly annuity payments were updated.[157] The 6% contributions for future service were diverted into a new individual account system, which was not subject to the 8% guarantee, nor the "match" of accumulations by the employer.[158] The 8% annual guarantee on the monies accumulated in individual accounts prior to the reforms was changed to a guarantee of an average return of 8%.[159] Newly hired public employees were placed in a combined defined benefit/defined contribution system designed to yield about 67% of final salary after retirement.[160] (The defined benefit component was 45%.)[161] These changes, fought with understandable ferocity by public employee unions dominated by public employees hired before 1996 and thus with a strong vested interest in defeating the reforms, trimmed about half of the deficit. However, the reforms soon faced impairment of contracts challenges in the courts.

In a close 4-3 decision, the Oregon Supreme Court upheld the updating of the mortality tables, and the diversion of the 6% contribution for future service into new individual accounts for the employees (again, not subject to the 8% guarantee, nor the employer match on accumulations).[162] Three Justices, however, would have struck down these parts of the reform even though they had prospective application only. Thus did Oregon narrowly dodge the absolutist view that any change that causes a downward adjustment of an existing public employee's projected pension, even as to future service, runs afoul of constitutional impairment of contracts limitations.[163] As to money in the original accounts, money accumulated from past service and subject to the employer match on accumulations, the court held that the 8% guarantee must remain an annual guarantee and not merely an average return through time.[164] Still, the court said nothing required that returns in the accounts exceed 8%.[165] In short, the court upheld those parts of the reforms which affected only accrual of benefits from future service, but struck down those that dealt with already accrued benefits.[166] The upshot was that by 2004 average retiring employees with thirty years of service received pensions of 79% of final salaries—down from the 106% averages during 2000 and 2001.[167] And public employer

[156] *Id*. at 23 (discussing the 2003 Oregon legislature reforms to PERS).
[157] *Id.*
[158] *Id*. at 30.
[159] *Id*. at 34.
[160] Steve Law, *Pensions in PERS Decline*, STATESMAN J., Dec. 12, 2005, at 1A.
[161] *Id*.
[162] Strunk v. Pub. Employees Ret. Bd., 338 Or. 145 (2005).
[163] *Id*.
[164] *Id*. at 202.
[165] *Id.* at 192.
[166] *Id*.
[167] *Id.* at 161.

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contributions into the system were reduced sharply downward, though still higher than historical standards.[168]

Oregon's story in many ways replicates the pension stories of other states and the private sector pension defined benefit system. Even systems nominally designed to be fully funded often do not wind up that way. It proves difficult to project the future. Actuarial calculation is no science and rests upon a variety of malleable assumptions that often do not bear out. The risks reviewed at the beginning of this essay carry real downside possibilities. Moral hazard stems most often from systemic flaws, not individual skullduggery. Life witnesses many unintended consequences, no less than in defined benefit pension systems. Let us now turn to another defined benefit aspect of America's retirement system, the Social Security system, and its sister program, Medicare.

C. Social Security and Medicare

President Bush's 2005 proposals for partial Social Security privatization on a defined contribution model touched off a furious national political debate. But scholars waged an active discussion of proposals to move Social Security from a defined benefit to a defined contribution model much earlier. In 1998, Professor Moore noted that partial privatization proposals "abound[ed]" and that they were "beginning to receive serious consideration."[169] As several writers pointed out, and contrary to the assumptions of proponents of moving Social Security toward a defined contribution model, experience in the private sector plans taught that individually controlled account plans do poorer than defined benefit plans generally.[170] Moreover, investment risks and transition costs, as Professor Moore further pointed out, also undermined the case for partial privatization.[171] The privatization proposals also ignored the redistributive aspects of Social Security via its progressively weighted benefit formula and the benefits paid to disabled persons, children of deceased beneficiaries, and to surviving spouses,[172] and might erode middle- and upper-income level political support for these redistributive aspects of the present system.[173]

Social Security, beyond these general redistributive effects, disproportionately benefits racial and ethnic groups with fewer assets and income than the general population. As of 1998, for example, elderly African-Americans and Hispanics derived 44% of their income from Social Security

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[168] Steve Law, *Lower PERS Rates Mean Most Public Agencies Will See Savings*, STATESMAN J., Nov. 18, 2006, at 1A.

[169] Moore, *supra* note 34, at 971.

[170] Colleen E. Medill, *Challenging the Four 'Truths' of Personal Social Security Accounts: Evidence from the World of 401(k) Plans,* 81 N.C. L. REV. 901, 901 (2003); Kaplan, *supra* note 4, at 81–83; Tom Lauricella, *Money Trouble—A Lesson For Social Security: Many Mismanage Their 401(k)s,* WALL ST. J., Dec. 1, 2004 at A1.

[171] Kathryn L. Moore, *Privatization of Social Security: Misguided Reform*, 71 TEMP. L. REV. 131, 153 (1998).

[172] *Id.* at 138, 163–64.

[173] *Id.* at 167.

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while whites derived 37% of their income from Social Security.[174] "In 1999, three out of every five elderly persons lifted out of poverty by Social Security were women."[175] Moreover, the defined contribution model embodied in the privatization proposals would negatively affect women, minorities, and low income workers due to their greater collective vulnerability to investment risks, and would disadvantage blacks and lower income workers due to longevity risks and disadvantages in the annuity markets due to shorter life expectancies and "antidiscrimination" norms.[176] Not every aspect of Social Security, however, benefits black Americans. As Professor Dorothy Brown points out, Social Security benefit formulas contain a bias against two-earner families where the spouse earns an income approaching 50% of total family income, and in favor of traditional families where one spouse works only inside the family home; as an empirical matter, black women are far more likely than white women to contribute roughly half of household income.[177] Moreover, the progressive benefit formula that generally privileges lower income groups including black Americans "is blunted by a countervailing mortality effect."[178] The regressive flat rate tax system for Social Security also undercuts its re-distributive benefit formula, but, as Professor Brown points out, any calculus of overall effects must take into account a variety of factors such as the disability and spousal benefits, including some extrinsic to the Social Security system such as the Earned Income Tax Credit.[179] In balance, as Professor Brown concludes, the impact of the Social Security system appears to be moderately progressive.[180]

In sum, as the national Social Security debate demonstrated, the system serves significant "safety net" purposes and is far from an individual retirement plan. Thus Professor Halperin describes Social Security as ensuring a "subsistence" standard of living.[181] As its name implies, the system creates social protection against the poverty and lack of medical care that await the many citizens who in any society fail or are unable to accumulate adequate resources for their post working lives.

Still, change awaits in the pay-as-you-go Social Security system because benefits cannot be sustained at present levels without substantial increases in contributions from the Post-Boomer Generations. Current federal budget deficits will inevitably be greatly exacerbated when, less than a decade from

[174] Kilolo Kijakazi, Ctr. on Budget & Policy Priorities, The Importance of Social Security to People of Color and Women (July 18, 2001), *available at* www.cbpp.org/7-18-01socsec2.htm.

[175] *Id.*

[176] Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect On Women, Minorities, and Lower Income Workers*, 65 MO. L. REV. 341, 366, 372 (2000).

[177] Dorothy A. Brown, *Social Security and Marriage in Black and White*, 65 OHIO ST. L.J. 111, 111–12 (2004).

[178] Dorothy A. Brown, Karen C. Burke & Grayson M.P. McCouch, *Social Security Reform: Risks, Returns, and Race*, 9 CORNELL J. L. & PUB. POL'Y 633, 637 (2000).

[179] *Id*. at 641–44, 651.

[180] *Id.* at 657.

[181] Halperin, *supra* note 24, at 38.

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now, Social Security contributions begin falling short of the amounts needed to pay benefits each year.[182] Though "on the books" the Social Security trust fund faces exhaustion in 2029, less than twenty-five years from today and well within the probable lives of many boomers and the working lives of almost all pre-boomers,[183] in fact, an even more dire reality faces us. The "surpluses," in Social Security contributions versus benefits paid out each year, have long been utilized for other governmental purposes. There is in fact no Social Security "lockbox" of money or assets to pay future benefits; the trust fund contains only IOU's from the already deficit-spending federal government and from, ultimately, taxpayers in both the Boomer and especially the Post-Boomer Generations.

Sadly, when one considers the increased medical care needed by elderly Americans, the safety net funding problems grow even more severe. In any realistic appraisal of boomer retirement income security and the burdens of that security on non-boomers, the costs and funding of medical care must enter the calculus. Medicare, available to workers reaching age sixty-five, covers most elderly citizens.[184] Part A covers most costs of hospitalization, as well as home health visits by skilled caregivers and nursing home facilities where skilled medical care is provided,[185] and is funded by a 2.9% payroll tax on all earnings.[186] Part B covers doctors' bills, ambulance charges, and some home health expenses, funded 75% from general tax revenues and 25% by annually adjusted premiums of the enrollees ($54/month in 2002).[187] The system faces insolvency by 2018, and within seventy-five years, hospital insurance costs will be three times the level of tax revenues, creating a substantial deficit.[188] So, once again a defined benefit funding problem looms. Further, as Professor Kaplan demonstrated, Medicare covers only some of the medically related care costs of the elderly, and does not cover many long-term care needs at all (for example, assisted living and non-skilled nursing home care).[189]

In summary, as the boomers start into retirements and their years of escalating medical costs, pressures to expand Medicare coverage will likely build to meet the needs identified by Professor Kaplan and others, while funding for even the present level of benefits seems problematic.[190] And all this

[182] *See* Brown, *supra* note 177, at 634 n.6.

[183] Moore, *supra* note 169, at 146–47.

[184] Richard L. Kaplan, *Cracking the Conundrum: Toward a Rational Financing of Long-Term Care*, 2004 U. ILL. L. REV. 47, 57–58 (2004).

[185] *Id*.

[186] Nat'l Bipartisan Comm'n on the Future of Medicare, Building a Better Medicare for Today and Tomorrow (Mar. 16, 1999), http://medicare.commission.gov/medicare/bbmtt31599.html. *See also* IRS, Tax Law Changes for Businesses: Tax Year 2006, http://www.irs.gov/formspubs/article/0,,id=109879,00.html#ss_med_2006.

[187] *Id*.

[188] BDS. OF TRS. OF FED. HOSP. INS. & FED. SUPPLEMENTARY MED. INS. TRUST FUNDS, 2006 ANNUAL REPORT (2006), *available at* http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2006.pdf.

[189] Kaplan, *supra* note 184, at 59.

[190] *Id*. at 82.

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comes at a time when private sector employers are dropping or cutting back on private plan coverage for retirees,[191] when 40 million working Americans receive no health insurance and coverage has stagnated, and when those with employer-sponsored plans face increasing restrictions on benefits and rising co-payments, deductibles, and premiums.[192]

Thus we see building in the Social Security and Medicare systems the same funding and sustainability issues observed in the private and public sector employer defined benefit systems. And moral hazard problems again appear. This time those hazards take the form of political rhetoric that either attempts to utilize the impending crisis to reduce the safety net features of Social Security and Medicare, or ignores the reality of the looming crisis. But unlike the situation in those sister defined benefit systems, there is no option to "dump" obligations (as in the private sector), or to demand the diversion of scarce taxpayer money as in the impairment of contract protected public systems.[193] The question thus arises: will the private defined contribution plans save the day?

D. The Private Sector Defined Contribution Model

Why did the individual account plan model replace the defined benefit model now eclipsed in the private sector? No broad national policy debate—certainly none like that which followed President Bush's proposal to partially privatize Social Security—preceded the shift. Instead it proceeded gradually, almost insidiously, as factor after factor began to point employers and employees to the individual account model. Professor Zelinsky attributes at least the origins of the shift to unintended consequences of ERISA itself.[194] ERISA, enacted during the heyday of the traditional defined benefit pension in 1974, carried within it the seeds of the popularity of the individual account model by introducing on a broad basis the IRA, and within a few years, changes in regulations and the statute launched the now ubiquitous 401(k) plan. Further, ERISA's substantial compliance burdens made the much-less-regulated defined contribution plans more attractive. So, too, did ERISA's fiduciary duties and diversification requirements; for example, ERISA's 10% limit on defined benefits plans' stake in sponsoring employer stock and the absence of such a limit for defined contribution plans and other individual account plans. Efforts by the PBGC to seek Congressional increases in the employer premiums for federal default insurance frequently met cries that more expensive premiums would drive more employers from the defined benefit model.

[191] *See supra* Section III.A.

[192] *See* Jonathan Peterson, *Employers Chip Away at Retiree Health Benefits*, L.A. TIMES, Sept. 26, 2006, at A1; Milt Freudenheim, *Health Care Costs Rise Twice As Much As Inflation*, N.Y. TIMES, Sept. 26, 2006, at C1.

[193] Fleming v. Nestor, 363 U. S. 603 (1960).

[194] Zelinsky, *supra* note 3, at 472.

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Similarly unintended perhaps, ERISA's reversion rules for "overfunded" plans, especially after the Tax Reform Act of 1986, ironically began to encourage employers to reduce contributions into defined benefit plans in order to avoid federal taxes on excess funds removed from these plans.[195] Alternatively, employers with already substantially overfunded defined benefit plans (according to the permissive actuarial standards of the day) could terminate those plans in order to capture the excess for corporate purposes. Though in the early 1980s the ownership of "excess" funds generated litigation and was hotly debated,[196] with employees and unions arguing any excess monies derived from deferred compensation payments were made to them as beneficiaries of the plans, the 1986 Act developed by then Senate Finance Committee Chair Senator Bob Packwood explicitly recognized the right of plan sponsors to capture such excess monies so long as all accrued benefits were paid via annuities upon plan termination.[197] Often replacement plans took the defined contribution form. And through time the percentage of salaries paid by employers into these defined contribution plans declined, moving them ever closer to the model of defined contribution plans.[198] As with the Oregon public sector plan's failure to reserve adequate funds against a turn in the equity markets, it bears speculation whether less aggressive capture of excess funds via decreased contributions during the late 1980s and 1990s might have mitigated the deficits that piled up in defined benefit plans when the bear finally returned to the equity markets in the spring of 2000.

Furthermore, the transfer of risks from employers to employees, as outlined at the outset of this Article, especially after the stock market fall of 2000 to 2002, made adoption of a defined contribution plan model increasingly attractive to employers. And especially in the high technology sector, defined contribution plans allowed employer contributions to be made on a relatively unregulated basis in company stock, giving employees a stake in the companies and direct financial incentives to promote corporate success. Finally, the implicit bargain underlying defined benefit plan—a backloaded benefit structure designed to build employee loyalty and long-term employment—eroded under pressures from globalization and the shift in labor markets, as Professor Stone's recent book illuminates.[199]

First, defined benefit plans lacked portability. Employees lost everything if their benefits were not vested, and even if vested, the back-loaded benefit formula in most defined benefit plans penalized employees who switched jobs. Second, the alternative rapidly gaining in popularity, defined contribution plans, gave the employees a more transparent ownership interest and even

[195] *See generally* Richard A. Ippolito, *Replicating Default Risk in a Defined-Benefit Plan*, FIN. ANALYSTS J., Nov.–Dec. 2002, at 31.

[196] *See, e.g.*, Jeremy I. Bulow & Myron S. Scholes*, Who Owns the Assets in A Defined Benefit Pension Plan* (Nat'l Bureau of Econ. Research, Working Paper No. 924, 1982).

[197] *See generally* Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

[198] *See* Margaret M. Blair, *The Great Pension Grab: Comments on Richard Ippolito, Bankruptcy and Workers: Risks, Compensation and Pension Contracts*, 82 WASH. U. L.Q. 1305, 1307 (2004).

[199] STONE, *supra* note 25, at 257.

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included, in contrast to the life annuity in defined benefit plans, an asset which could theoretically be bestowed on will beneficiaries and legal heirs.[200] Third, prior to the fall in the equity markets, defined contribution/individual account plans allowed employees to participate in the stock market's "go-go" boom years of the 1990s; several years of compounding double-digit returns made individual account plans appear to be sources of rapidly increasing wealth.[201]

The rise of the defined contribution plan/individual account model, however, carries downside aspects as well. The Enron stock collapse drove home to the public, as reflected in numerous newspaper stories, the dangers of overinvestment in one company's stock. The collapse also illustrated the potential abuses in stock bonus plans with "lock-down" features, which made it difficult or impossible to unload company stock even when that stock fell freely in the markets.[202] Academics, too, spilled ink discussing the lessons of this disaster.[203] Professor Langbein called for extension of the 10% rule applicable to defined benefits plans to 401(k) and other individual account plans.[204] Professor Stabile advocated this earlier, warning years before the Enron scandal broke into public view, that more employer stock is not always better.[205] Professor Kaplan opined that "the better solution would be to ban all 401(k) stock investment in employer stock."[206] Yet despite this chorus of warnings about the inappropriate lack of diversification and firm-specific risk inherent in large retirement holdings in an employee's own employer's stock (piled onto employees' job loss, human capital, and loss of health insurance risks in the event of firm failure or retrenchment), the 2006 Pension Protection Act failed to address the company stock diversification issue.[207]

More generally, many employees, perhaps most, inadequately manage their self-directed accounts. For some time now efforts to educate employees

[200] Langbein, *supra* note 48.

[201] *Id.*

[202] Tom Detzel, *Panel Hears* [Enron subsidiary] *PGE Workers' Woes*, OREGONIAN, Feb. 6, 2006, at A1 ("Our members said they could see their [Enron] accounts on the computer but could not transfer any assets or make any changes."); Ellen E. Schultz, *Enron Workers Face Losses On Pensions, Not Just 401(k)s*, WALL ST. J., Dec. 19, 2001, at C1; William A. Berg, *Is it Time to Call in all the King's Men? Yes: Lawmakers Should Step in With Legislation to Help Guide Employees Past the Common Pitfalls of 401(k) Plans*, OREGONIAN, Feb. 10, 2002, at C1; Editorial, *Adventures in Stock Investing: Enron Offered a National Model of Not Just Corporate Mismanagement, but Corporate 401(k) Malpractice*, OREGONIAN, Dec. 20, 2001, at C10.

[203] *See, e.g.*, Norman Stein, *Three and Possibly Four Lessons About ERISA That We Should, But Probably Will Not, Learn from Enron*, 76 ST. JOHN'S L. REV. 855 (2002); David Millon, *Worker Ownership Through 401(k) Plans: Enron's Cautionary Tale*, 76 ST. JOHN'S L. REV. 835 (2002).

[204] Langbein, *supra* note 48.

[205] Susan J. Stabile, *Pension Plan Investments in Employer Securities: More Is Not Always Better*, 15 YALE J. ON REG. 61, 64 (1998).

[206] Kaplan, *supra* note 4, at 78.

[207] Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780.

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about risk/reward tradeoff in investment decisions have been building.[208] The 2006 Pension Protection Act encouraged greater efforts to educate employees by allowing company-sponsored professional investment advice under ERISA-covered plans.[209] This responds to a widely acknowledged criticism of self-directed individual account plans that, in the words of Professor Stabile, many employees in these plans "are financially illiterate."[210] Professor Stabile's observation arises from empirical studies showing that employees fail to conform to the rational decision-making model assumed in the current legal framework and among free market theorists.[211] For example, nearly one-half of all 401(k) participants in one study could not name a single investment option in their plans, while another study found "that 40% of participants did not know how their investments were allocated."[212] Participants display, on one hand, loss aversion (over-investing in fixed income investment options and thus failing to optimize risk-return relationships), and on the other hand, a tendency "to follow the market" (investing today in yesterday's rising stocks).[213] Professor Zelinsky's leading article also acknowledges a "consensus" that employees in defined contribution plans are "poor investors."[214]This "bounded rationality" calls into question whether employees, even with the best investment advice, have the aptitude, inclination, and time to actively manage their individual account plan options. Recall, also, the difficulties defined benefit plan advisors and fiduciaries experienced—on the whole far more financially sophisticated than the average employee—when making decisions that would fully fund those defined benefit plans. When the experts falter, what solace does passing the buck to employees provide?

The 2006 Pension Reform Act responds to these points by encouraging employers and plan sponsors to provide for presumptive participation in the employer's 401(k) or individual account plan, subject to an "opt out" option for the employee.[215] This responds to the reality that in the "opt in" plans that predominated before the Act, 30% of employees fail to take the affirmative step to participate at all in their employer's plan.[216] This default participation rule, however, is not mandatory. Similarly, employers can provide for a

[208] *See, e.g.*, Fran Hawthorne, *First Came 401(k)'s. Now Some Advice*, N.Y.TIMES, Mar. 12, 2002, at G2.

[209] The Money Alert, Pension Protection Act Overview, http://www.themoneyalert.com/PensionProtectionAct.html.

[210] Susan J. Stabile, *The Behavior of Defined Contribution Plan Participants*, 77 N.Y.U. L. Rev. 71, 88 (2002); *see also* Dana M. Muir, *ERISA and Investment Issues*, 65 OHIO ST. L.J. 199, 235–38 (2004); *see generally* Brown et al., *supra* note 178.

[211] Stabile, *supra* note 210, at 88.

[212] *Id.*

[213] *Id.* at 89–90.

[214] Zelinsky, *supra* note 3, at 459.

[215] Pension Protection Act of 2006, Pub. L. No. 109-280, § 902(a), 120 Stat. 780, 1033–35; *see also* Miller Nash LLP, Pension Protection Act of 2006: Summary of Automatic Enrollment Provisions Under 401(k), 403(b), and Governmental 457(b) Plans (Aug. 25, 2006), http://www.millernash.com/showarticle.aspx?Show=439.

[216] Carla Fried, *How to Make Employees Take Their 401(k) Medicine*, N.Y. TIMES, Aug. 13, 2005, § 3, at 7.

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professionally-managed risk-reward investment mix on a default basis, again with an "opt out" provision.[217]

IV. WHERE CAN AMERICA'S RETIREMENT POLICY GO NEXT?

A. Social Security

The Social Security and Medicare systems are social programs that provide a minimum floor of income and medical care for all retired workers, disabled workers, and the dependents of those workers. Social Security is not a "retirement" program at all, in the sense that it saves monies from today's work for tomorrow's retirement. Rather, it expresses a judgment that no one should be left completely without income whatever the many vicissitudes of life. Further, it recognizes that beyond concern for basic humane treatment of the elderly, disabled, and dependents of deceased workers, society has a social and stability interest in providing a floor of income support at the subsistence level.

There is broad ideological support for this basic principle of providing income to allow everyone to live, at least, at a subsistence level. Though President Bush proposed structural changes in 2005 that would have introduced the individual account savings model to the system, his and almost all similar proposals assume that a floor protection would exist to guarantee a minimum subsistence income *whatever the accumulation in the proposed individual accounts*. While the significance of this concession was little-noticed in the charged political debate in 2005 about the President's proposals, it confirms that "liberal" and "conservative" proponents alike agree on the fundamental premise that beyond reliance on an individual worker's resources and accounts, society must provide a social guarantee in the post-industrial twenty-first century, a guarantee paid for by taxes, and not "retirement savings." Thus, the starting point of any new vision of America's retirement system requires the preservation of the Social Security and Medicare systems as defined benefit social, and not savings, plans. The real question is: at what level, given projected deficits, can this minimum social guarantee be preserved?

Furthermore, as Professor Kaplan's article demonstrates, there are holes in the existing coverage in the Medicare and long-term care systems.[218] These gaps will become increasingly evident as the boomers swell the ranks of the elderly population—living longer, but facing, in rising numbers, diseases like Alzheimer's. I defer to Professors Kaplan's article on feasible improvements, and his comment that pressures will build—as children and grandchildren deal with the practical consequences of existing coverage deficits—for some redefinition of defined benefits in these programs.

But how will the projected social security deficits be closed? A further extension of the retirement age, already sixty-seven for almost all of the boomers, seems inevitable in the Social Security system, given the rising life

[217] Pension Protection Act of 2006 § 621, 120 Stat. at 978–79.

[218] Kaplan, *supra* note 4, at 54. *See also* Richard L. Kaplan, *Retirement Planning's Greatest Gap: Funding Long-term Care*, 11 LEWIS & CLARK L. REV. 407 (2007).

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expectancy for persons reaching age sixty-five. As a practical manner, more and more workers will work past age sixty-five in any event, because that will be the only option for them to preserve their standard of living. A retirement age of seventy would leave many boomers with a post-retirement life expectancy approaching that of their own grandparents, and could be phased in gradually as the extensions to age sixty-seven were, when adopted in the l980s. Otherwise, benefit cuts that will further intensify the problems of the low income/low asset population become the only alternative to unacceptable payroll tax increases for the post-boomer generations.[219] As Professor Brown points out, however, raising the retirement age may have adverse affects for those lower-income Americans, including African-Americans, whose life expectancy is shorter.[220] Perhaps some system of medical certification of lower life expectancy based on objective and individually-determined factors could address this problem. It would surely be a mixed blessing to many persons to be certified for Social Security retirement at say, sixty-seven (the current standard for those born during or after 1960[221]), rather than age seventy (the proposed new retirement age) because a medical board believed these persons will die before seventy. Additionally, the number of disability claims will rise significantly with an extension of the retirement age, and perhaps adjustments could be made in the Social Security disability system to provide more equity to those whose medical conditions do not permit work after age sixty-seven.

B. The Defined Contribution Plan / Individual Account Model Must be Extended and Improved as the Basic Mechanism for Supplementing the Subsistence Level Support Guaranteed in the Social Security and Medicare Systems

Rather than lamenting the triumph of the defined contribution plans in the private sector, boomers should embrace and enhance that model. In essence, the boomers must recognize that, in exchange for continued social support by their children and grandchildren for the minimum social guarantees of Social Security and Medicare, public policy must promote the accumulation of transparent ownership interests in private individual account plans.

Some of the needed improvements to the defined contribution plan require little debate. Individual account plans should be limited to 10% ceilings on investments in employer securities, perhaps with a phase-in to avoid undue disruption of the equity markets. Default participation (with an "opt out" provision) and ideal portfolio management provisions should be mandatory, not optional, in order to address the problem of employee inaction.[222] With technological advances, workers should have some choice of professionally

[219] Peter A. Diamond & Peter R. Orszag, *Reforming Social Security: A Balanced Plan*, BROOKINGS INST. POLICY BRIEF (Brookings Institution, Washington, D.C.), Dec. 2003, at 1, *available at* http://www.brookings.edu/comm/policybriefs/pb126.pdf (presenting an alternative mix of benefit reductions and tax increases).

[220] Brown et al., *supra* note 178, at 656.

[221] U.S. Soc. Sec. Admin., Social Security Online: Find Your Retirement Age, http://www.ssa.gov/retirechartred.htm.

[222] Zelinsky, *supra* note 3, at 527.

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managed investment plans, thus using participant choice to introduce more market competition among the professionals. To address the risk aversion problem, the financial industry could follow something similar to Professor Gordon's 1997 proposal and develop a new capital market instrument (a "pension equity collar") to allow individual account holders to receive a guaranteed return close to long-term equity averages, in exchange for giving up some of the upside potential of the investment.[223] The government can address reverse risk aversion and general diversification issues in various ways once the rational investor ideology is discarded and the bounded rationality model accepted for employee account plans, as suggested by Professor Stabile.[224] For example, asset allocations could be constrained in a reasonable range as determined from time to time by financial experts, and some multiple sector, multiple stock requirements could be adopted for equities and other instruments.[225] Leakage problems can be addressed by tightening the rules against withdrawal, contrary to the trend of recent legislation.[226] To address the longevity and temporal risk problems, employers should adopt a life annuity payout requirement for defined contribution and individual account plans (perhaps with certain exceptions), or at least a default "opt out" feature along those lines. Again, because of the lower life expectancies of certain groups, some special treatment via medical certification of a lower life expectancy might be necessary. These life expectancy adjustments could be funded by slightly lowering the annuities for people not qualified for the lower life expectancy adjustment. Too many Americans have no retirement program at all.

But the above steps fail to address the poverty that awaits aging boomers who have no retirement program. To encourage more workers to participate in a retirement program, the government should require every employer, perhaps with exceptions for the smallest employers, to make a defined contribution or individual account plan available to its employees. Furthermore, with "opt out" mandatory participation in such plans, employees will be better prodded to (paraphrasing an old popular song) "start thinking about tomorrow." Our retirement policy should encourage employees not to "opt out" by providing for a mandatory "match" of employee contributions up to, say, 6%. These mandatory defined contribution plans and matching requirements could be phased in gradually, starting, say, at 3% and adding 0.5% each year.

C. The Defined Benefit Plans Should No Longer Be Favored by Public Policy

First, it seems clear that the defined benefit/traditional pension model is spent. That model floundered on the twin problems of underfunding and the

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[223] Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1522 (1997).

[224] Stabile, *supra* note 210, at 88–91.

[225] *Id.*

[226] *See, e.g.*, Richard L. Kaplan, *Retirement Funding and the Curious Evolution of Individual Retirement Accounts,* 7 ELDER L. J. 283, 309–10 (1999).

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systemic moral hazard arising from the promise-now-and-pay-later dynamic. Despite good intentions, all the king's actuaries and all the queen's accountants cannot restore confidence in the model's "fully funded" promise. This proves true in both the private sector and public sector, state and local governmental plans. Although some proposals, such as those in Professor Estreicher's and former AFL-CIO General Counsel Laurence Gold's article,[227] might delay the decline somewhat, they cannot save the defined benefit model because the model relied too heavily on the de facto assumption that an ever-increasing pool of younger workers would be able to create new wealth to pay for yesterday's work.

It is true that defined benefit plans may persist for a time, for a diminishing number of employees. And some improvements can be made in the defined benefit model. Several commentators, including Professor Stone, suggest immediate vesting of accrued defined benefits to create more portability in those plans, in recognition of the transient and boundaryless workplace.[228] Professor Halperin also favors immediate vesting, but points out that immediate vesting alone fails to address the back-loaded benefit formula problem: final salary determines how much the period of service yields in most defined benefit pension formulas.[229] Professor Halperin suggests the law require that terminated employees receive a defined benefit based on a projected salary at retirement.[230] Some of the interest rate swing problems (lower interest rates inflate funding deficits by reducing the projected earnings on assets; rising interest rates generate the opposite effect on the assets-to-liabilities relationship) can be hedged by bond investments which appreciate in value when interest rates fall.[231] Professor Halperin also suggests restrictions on the "integration" (i.e. set-off) of defined benefits with Social Security benefits where a defined benefits replacement ratio (the ratio of retirement income to pre-retirement income) falls under 80%,[232] and a re-tightening of "porous" discrimination standards which allow highly-compensated employees to receive much more than lower-paid employees even as a percentage of income.[233] Still, it is doubtful that incremental changes on this scale can save, in a significant way, the defined benefit plans.

Let us now address the funding standards more directly. Funding standards should be made uniform in both the public and private sectors, and made effective by insistence that today's work must be paid for today, and not over a mortgage period stretching for decades. No promises should be made for past service credit—the generosity of a bygone era simply cannot be sustained. A

[227] Estreicher & Gold, *The Shift From Defined Benefit Plans to Defined Contribution Plans*, 11 Lewis & Clark L. Rev. 331 (2007).

[228] STONE, *supra* note 25, at 25.

[229] Halperin, *supra* note 24, at 54–58.

[230] *Id*.

[231] *E.g*., Mary Williams Walsh, *A Strategy for Prudence on Pensions*, N.Y. TIMES, Sept. 9, 2006, at B1 (describing International Paper's new pension strategy).

[232] Halperin, *supra* note 24, at 51.

[233] *Id.* at 68.

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realistic and conservative standard accounting system for both the public and private plans must be mandated. Many defined benefit plans in both the public and private sector should be terminated and replaced with annuities representing the market value of all accrued benefits prior to termination. For future service, these plans should be replaced with defined contribution plans that more transparently represent the retirement funds available for each employee, and minimize the promise now and pay later moral hazard problems seen again and again in the defined benefit plans.[234] Further, considering the inter-generational factor, the back-loaded features of defined benefit plans—absorbing more of a firm's total compensation for older employees compared to younger employees—is simply no longer acceptable, or fair, to younger generations facing less-permanent employment than enjoyed by their parents and grandparents. While cash balance plans eliminate or reduce this inter-generational inequity by defining the promised benefit in terms of a defined contribution and accumulation in theoretical individual accounts, they remain defined benefit plans in which employers and plan participants may or may not find sufficient monies available to fund the promises made.[235] They remain subject to the same funding and moral hazard problems that traditional pension plans exhibit.[236] The federal PBGC "insurance at less than market rates" program should be phased out over time. Americans can no longer afford to subsidize these plans, and if insurance remains desirable, it should be purchased at market rates.

V. CONCLUSION

In summary, America needs a new ERISA—a new comprehensive pension policy that attempts to integrate the divergent parts of our retirement systems built-up over time in seemingly unrelated developments. We need to see the retirement income security problem as a whole system, not a collection of smaller issues with no overarching theme and policy. The basic assumptions of ERISA no longer hold true. Retirement policy is no longer about extending tax incentives to induce employers and employees to establish and seek systems rewarding long-term employment. As the boomers age, and new generations feel the weight of yesterday's promises without the benefits of yesterday's employment relationship, new thinking and new policies must emerge. I hope, with this review, in at least a small way, to advance the vital discussion now underway.

[234] *See* Mary Williams Walsh, *Texans Want to Strike Rule on Projecting Retiree Care*, N.Y. TIMES, Mar. 12, 2007, at C1 (discussion of how Texas is addressing the call for more transparency in funding its pensions).

[235] Halperin, *supra* note 24, at 57, 62.

[236] *Id.* at 57.

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