Ten Steps to Reforming Baby Boomer Retirement

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Executive Summary

As 77 million members of the Baby Boom generation begin to retire, America is about to experience one of the most dramatic economic, sociological and demographic changes in its history. The institutions we have relied upon in the past are completely unprepared for what lies ahead.

Politicians, the national news media and the general public have become increasingly aware that our federal entitlement programs are about to be swamped. Social Security, Medicare and Medicaid have made trillions of dollars of explicit and implicit unfunded promises. In fact, by 2030 (about the midpoint of the baby boomers' retirement years), we will have to double every tax rate or cut every benefit in half.

But our problems do not end there. Federal, state and local governments have made $5 trillion in promises (many of which are unfunded) to civil service workers. Corporate America owes about $450 billion in pension promises and $350 billion in post-retirement health care promises that are also unfunded.

To make matters worse, the instruments we have created to help individuals save for their own retirement — principally through 401(k) accounts — are also not working well. In general, people are not saving enough, and they are not prudently investing the funds they do save.

Behind our inadequate institutions are inadequate public policies. For example:

- On balance, the tax law encourages current consumption, but discourages saving for consumption during retirement.
- Even more important, the tax law encourages overconsumption of health care before retirement, but discourages saving for what are likely to be greater health needs later in life.

The American answer to the European-style welfare state has traditionally been employer-provided benefits. Yet:

- Unwise public policies are encouraging large employers to abandon pension and post-retirement health care promises made to their employees.
- Other policies are preventing employers from helping employees make their own provision for income and health care during the retirement years.

The policies that are most inadequate for the baby boomers' retirement years are those affecting early retirees. In general:

- People who retire early will find that their opportunities to save are much more restricted than those available to people still in the workforce.
- They will find that health insurance is not only more costly when purchased by individuals, but the insurance (unlike insurance obtained at work) must be purchased with after-tax dollars.

- Once they begin drawing Social Security, they will discover that if they earn additional income, say by working part-time, they will face draconian effective tax rates — taking as much as two-thirds of what they earn.
- And even if they don't work for wages, they will discover that the tax rates on their pension income and IRA withdrawals are much higher than the rates paid by younger taxpayers at the same income level.

What steps can be taken to secure the retirement of baby boomers and future generations of retirees? The following are 10 recommendations.

Step 1: Improve Traditional Pension Plans. The current system encourages employers to unload unfunded pension obligations on the federal government's pension insurance agency — resulting in smaller retiree benefits and potentially large burdens for taxpayers. Clearly, corporations should be required to fully fund their own pension plans. We also need to encourage immediate vesting and full portability of those benefits.

Step 2: Improve 401(k) Plans. More than half of all workers invest in a 401(k) or similar savings vehicle. But not enough people are investing appropriately for their future. They either do not invest enough or they pursue investment strategies that will not provide an adequate retirement income. To correct this problem, employers should be given a safe harbor against lawsuits and receive other regulatory relief if they automatically enroll employees, escalate the employees' contributions over time, invest in diversified portfolios, follow an investment strategy that becomes more conservative as the employee ages, and convert the funds into an annuity at retirement — unless the employee specifically opts out.

Step 3: Expand Individual Retirement Accounts (IRAs). Current tax law penalizes those who do not have employer-sponsored savings plans. For example, participants in an employer-sponsored 401(k) plan can contribute up to $15,000 annually, while nonparticipants can contribute only $4,000 to a tax-advantaged IRA. This policy is particularly harmful to early retirees. We need a level playing field that treats all savers equally.

Step 4: Remove Social Security's Penalties on Work. For early retirees on Social Security, the earnings test is an arbitrary tax that imposes an effective tax rate as high as 50 percent on wages — in addition to regular income and payroll taxes. This policy hurts the elderly, reduces national output and serves no useful social purpose.

Step 5: Repeal the Social Security Benefits Tax. Although nominally a tax on benefits, this is really a tax on other income, and it imposes some of the highest marginal rates in the federal tax code. In fact, a middle-income couple living on IRA withdrawals can face a higher marginal tax rate than Warren Buffet and Bill Gates. If Social Security benefits must be taxed, they should be taxed as ordinary income.

Step 6: Use the Roth Method of Taxation. Unlike traditional savings vehicles, deposits into Roth IRAs are made with after-tax dollars and withdrawals are tax-free. Given the effects of the Social Security benefits tax, and the expectation that tax rates will be much higher in the future (in part to deal with the expenses of Social Security, Medicare and Medicaid), Roth taxation makes sense for many taxpayers. Yet Roth IRAs, like traditional IRAs, are discriminated against relative to employer-provided savings plans. Congress should level the playing field.

Step 7: Make Health Insurance Portable. Workers with employer-based health insurance enjoy an enormous tax advantage because, unlike wages, employer-paid premiums avoid income and payroll taxes. By contrast, early retirees and workers who buy their own insurance get virtually no tax break. The tax law should be equally generous to everyone who obtains private insurance — regardless of how it is purchased. Further, as President Bush has proposed, we should encourage employers to purchase portable insurance for their employees — insurance that travels with them from job to job and that they can keep after they retire.

Step 8: Provide Tax Relief for Post-Retirement Health Insurance. Although many employers provide post-retirement health benefits, the current system has two drawbacks: 1) employer coverage must generally be all or nothing, and 2) employees who do not receive benefits get virtually no tax relief if they purchase their own coverage. One solution is to move to a system of individually-owned, personal and portable health insurance with appropriate tax relief. Short of that reform, employers should be able to allocate pretax dollars to retirees, up to the amount spent on active workers — provided that the funds are spent on health care — and retirees should receive tax relief if they purchase individual health insurance on their own.

Step 9: Create Health Savings Accounts for Seniors. Despite coverage from Medicare, seniors pay half their medical bills out of their own pockets. And they have few opportunities to use tax-free savings to prepare for these expenses. Under current law, Medicare-eligible seniors cannot open or make deposits to Health Savings Accounts (HSAs), and opportunities for young people to make deposits are too restrictive. Clearly we need a more liberal HSA policy. Short of that, seniors should be able to turn IRA and 401(k) funds into Roth HSAs.

Step 10: Encourage Preparation for Long-Term Care. Although the tax law grants unlimited tax relief for current spending on employer-provided health care plans, it is quite stingy toward people who try to provide for their own long-term care needs. In addition to tax relief, seniors need to be able to protect their assets (from Medicaid) by buying long-term care insurance. For example, a $100,000 long-term care policy would shelter $100,000 of assets that would not be counted in determining Medicaid eligibility. This policy — successfully implemented as a pilot program in four states — should be adopted in the other 46 states.

These 10 steps would allow the baby boomers — and the generations that follow them — to better prepare for their retirement years.

Introduction

This year, the first of the 77 million baby boomers — Americans born between 1946 and 1965 — will reach age 60. In two years they will become eligible for early retirement benefits from Social Security, and in five years they will become eligible for Medicare. As the boomers retire, they will stop contributing to America's elderly entitlement programs, their own corporate pension plans and their personal savings accounts; they will begin withdrawing money instead.

The problems of Social Security and Medicare have been examined in great detail by NCPA scholars.[1] In addition, Medicaid (for the poor) now spends more than Medicare, and as the ranks of the elderly swell, the cost of this program will also soar. Over the next 30 years, we will have to either cut boomers' benefits in half or double every payroll and income tax rate.

Unfortunately, the problems facing future retirees do not end there. Federal, state and local governments have promised their own employees pension and retiree medical benefits totaling more than $5 trillion and many of these promises are unfunded.[2] America's largest corporations have made unfunded pension promises totaling $450 billion[3] and an additional $340 billion of unfunded promises for post-retirement health care.[4] More than half of U.S. workers are now enrolled in 401(k) plans, widely viewed as the alternative to traditional employer-sponsored pensions. Yet the amounts they are contributing and the investment strategies they are following cannot begin to match the retirement incomes from traditional pension plans.

"We are unprepared for the retirement of the Baby Boom generation."

In addition to desperately needed reforms in Social Security, Medicare and Medicaid, many other changes are required to allow boomers to save more money, invest properly and plan adequately for their retirement years. We address 10 of those reforms below.

1. Improving Traditional Pension Plans

Since World War II, the dominant form of retirement plan provided by employers has been the defined benefit pension. Under these plans, employees acquire pension benefits based on their wages and years of service to the company. The plans make a promise — backed by the employer — for a specific amount of money to each employee. Pension benefits for employees who remain with an employer for their entire work lives are typically 60 percent to 70 percent of final salary. Although millions of employees still participate in such plans, virtually no new defined benefit plans are being established today.

Problem: Unfunded Promises. For most of the post-war period, employers were not required to fund their pension plans. Like today's Social Security system, pension promises often were not backed by any saving or investment. This meant many pension plans were only as secure as the company that established them. If the employer went broke, employees could lose some or all of their benefits. For example, after Studebaker filed for bankruptcy in 1963, its autoworkers received only 15 percent of the pension benefits they had been promised.[5]

In response to the problem of bankrupt companies defaulting on their pension promises, Congress passed legislation that required all employers with defined benefit pension plans to begin to fund those plans.[6] The act also created the federal Pension Benefit Guarantee Corporation (PBGC), which provides insurance for private pension plans. This insurance does not work like insurance in a normal market, however. All companies with defined benefit pension plans are required to pay premiums to the PBGC. But the premiums paid by those who are at risk of default are much lower than their actual risk warrants. Fully-funded plans at virtually no risk of default are charged premiums that are too high. Thus, one way to think of this system is to see it as socializing the risks of pension default by overcharging healthy plans and undercharging sick plans.[7]

"Traditional pension plans are underfunded."

In 2004, PBGC insured more than $1.7 trillion in pension benefits. It paid $3 billion in benefits to more than 514,000 annuitants whose plans had been terminated and currently owes benefits to another 440,000 workers when they retire. While the PBGC has provided pension insurance for more than three decades, the agency's financial situation has deteriorated rapidly over the past several years. [See Figure I.] According to the Congressional Budget Office, the underfunding of all insured corporate pension plans (not just those currently administered by PBGC) amounts to more than $450 billion.[8]

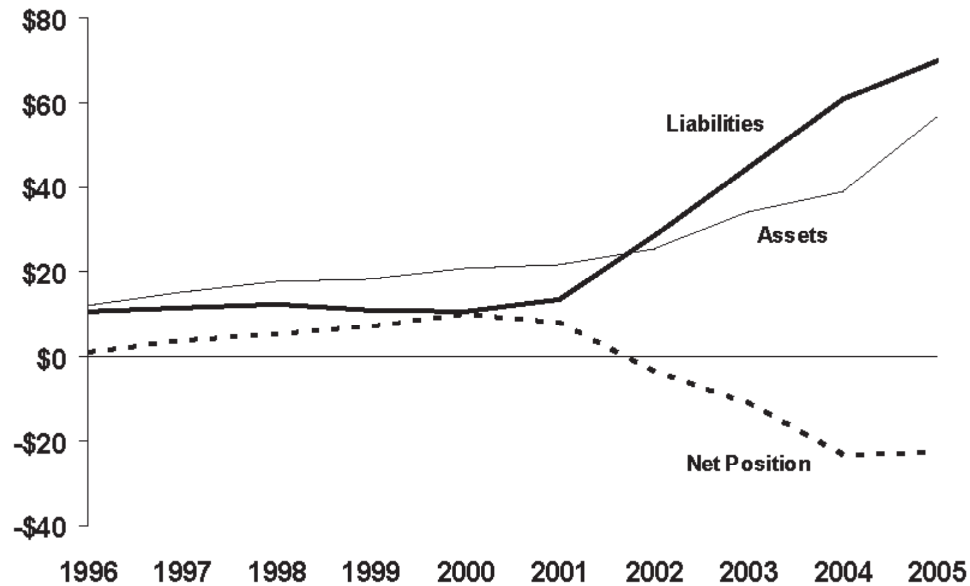
Under current funding rules, even sponsors of badly underfunded plans can continue to allow employees to accrue additional benefits, and can even make benefits more generous. Plan sponsors in financial trouble and nearing bankruptcy can promise larger pension benefits instead of pay increases, and employees may go along because of PBGC guarantees. Current rules also allow companies to substantially understate the financial position of their plans. For example:[9]

- Prior to declaring bankruptcy, Bethlehem Steel reported its plan was 84 percent funded, but when the plan was terminated it had assets adequate to cover only 45 percent of benefits promised; in fact, for the three years immediately preceding the termination of its plan, the company was able to avoid making contributions to its plan.
- U.S. Airways reported that the pension plan for its pilots was 94 percent funded, but the plan had assets adequate to cover only 33 percent of benefits when it was terminated; the company avoided making any contributions for the four years preceding the plan's termination.

"The federal government insures more pensions than it has the ability to pay."

FIGURE I

Financial Condition of the Pension Benefit Guaranty Corporation
(in billions of dollars)



Source: Pension Benefit Guaranty Corporation.

Even if all plans were fully funded, problems would remain. Defined benefit plans work well for people who stay with the same employer, but they do not work well for employees who switch jobs. Almost all of these plans calculate benefits under formulas that are "back-loaded." That means the 40th year is weighed a lot more heavily than, say, the 10th year.

To see what this means in practice, consider a man who works for four different companies — each for 10 years. All four have identical pension plans and the worker fully vests in each one. Upon retirement, he will get four separate pension checks, but his combined income will be less than half of what it would have been if he had stuck with just one company for the full 40 years.[10]

Under this system, people sacrifice substantial pension benefits if they switch employers frequently throughout their career, even though they remain fully employed for their entire work lives. Accordingly, these plans have become less attractive to employers who need to provide a benefit that is suited to the dynamic labor market and to employees participating in that market.

Solution: Six Key Reforms.[11] The defined benefit pension system needs six reforms to aid baby boomers as they near retirement.

1. Full Funding. Congress is already taking steps to reduce the underfunding of plans by increasing premiums paid by plan sponsors, cutting the time required for companies to fully fund underfunded plans, and tightening rules for what constitutes a funded plan. Decision-makers should avoid the temptation to soften the rules or exempt favored industries. Taxpayers should not have to bail out companies that have over-promised and underfunded their pension plans.

2. No Back-Loading. Historically, back-loading was adopted by employers both to reward long-serving employees for loyalty and to discourage job hopping. But this feature is inconsistent with the needs of a mobile labor market. To keep pace with today's dynamic workforce, federal policy should encourage employers to move as soon as possible to a system under which workers are not penalized because they change jobs. In general, employers and employees should be able to reach any agreement satisfactory to all parties through voluntary exchange. But taxpayer subsidies (through tax-free buildup) should not be available for plans with features that are inconsistent with good public policy.

3. Immediate Vesting. Another tool employers have used to retain employees or reward longer service is vesting. Vesting means that employees must work for an employer a certain number of years before they obtain full rights to the promised retirement benefits. An employee who leaves before fully vesting in a defined benefit plan will receive a smaller pension as a result.[12] Why have vesting at all? The issue is similar to back-loading. A short vesting period makes sense to allow the employer to recover some administrative costs for employees who pop in and out of employment. However, like back-loading, vesting penalizes people who change jobs frequently. Federal policy should eliminate vesting periods or make them as short as possible.

"Defined benefit pension plans should be fully funded."

4. Full Portability. Defined benefit pensions are generally not "portable," which means that they cannot be rolled over into an Individual Retirement Account (IRA) or the employee's next plan to grow for the future. Benefits are typically "frozen" in the former employer's plan until the scheduled retirement date. This feature is not optimal in a labor market in which employees frequently change jobs. For example, workers who are currently ages 35 to 43 have held an average of 9.6 different jobs.[13]

5. No Government Pension Insurance. Today, a company that wants to voluntarily terminate a defined benefit plan purchases private insurance. The firm pays a highly rated insurance company to assume its pension obligations. We should consider requiring all employers to contract with financial firms to provide the benefits. Companies usually have no special expertise in managing pensions, any more than they have expertise in managing health care. Competing insurance companies would conduct an actuarial analysis of each plan and its investments, and price their insurance accordingly. Insurance would be fairly cheap for fully funded plans with solid investments, but would be very expensive for severely underfunded plans. However, expensive insurance merely reflects high intrinsic risk — risk now being shifted onto other employers and taxpayers. During the transition, PBGC must keep collecting premiums from employers to meet their existing claims, but no new obligations should be taken on by this agency.

6. Full Disclosure. The two groups with the biggest financial stake in the health of a company's defined benefit pension plan are shareholders and employees. Unfunded pension plans lead to lower shareholder equity and put employee retirement security at risk. Requiring companies to fully disclose the status of their pension plans serves both groups, in addition to company executives and government watchdogs.

2. Improving 401(k) Plans

For the past 27 years, defined contribution pension plans — such as 401(k)s, and the nonprofit version, 403(b)s — have taken the nation by storm. These plans are well suited for workers who change jobs frequently or experience gaps in employment. Unlike defined benefit plans, defined contribution plans promise no specific benefit at retirement. The employee has ownership rights over the assets in a specific account and is entitled to the full accumulation. Typically, some or all of the employee's deposits are matched by the employer after a vesting period.

"Workers with defined contribution pension plans save too little and invest too conservatively."

Today more than 40 million workers participate in 401(k)-type plans, with total assets of about $1.4 trillion.[14] While these plans are popular with employers and employees, they have their own set of problems.

Problem: Retirement Savings Mistakes. With respect to every employer-sponsored retirement plan, there are four decisions that need to be made:

- Whether to join the pension plan;
- How much to contribute;
- How to invest the assets of the plan; and
- How to receive the benefits during retirement.

Under the traditional defined benefit system these decisions were made by employers, not individual employees. Specifically, employers automatically enrolled full-time workers in their pension plans. They also decided how much to allocate to this plan (as opposed to paying wages and other forms of compensation) in order to reach the desired retirement objective. In making investment decisions, they chose diversified portfolios and managed the investments according to "prudent-man" standards that apply to all fiduciaries. During retirement, employees received a fixed monthly payment.

Under the current defined contribution system, however, these decisions have been relegated to employees. And we are unfortunately discovering that most employees are ill-prepared to make them.

Failing to Save. About a quarter of workers who are offered 401(k) plans at work do not participate.[15] And, the participation rate of higher-income workers in tax-deferred plans — plans in which contributions receive special tax advantages — is much greater than lower-income workers.[16] As Figure II shows:

- Only 22 percent of workers with incomes of less than $20,000 participate in tax-deferred plans.
- By contrast, the participation rate is 56 percent for workers earning between $20,000 and $40,000, and 70 percent for workers between $40,000 and $80,000.
- Almost 80 percent of workers with incomes of more than $80,000 are enrolled in a 401(k) plan.

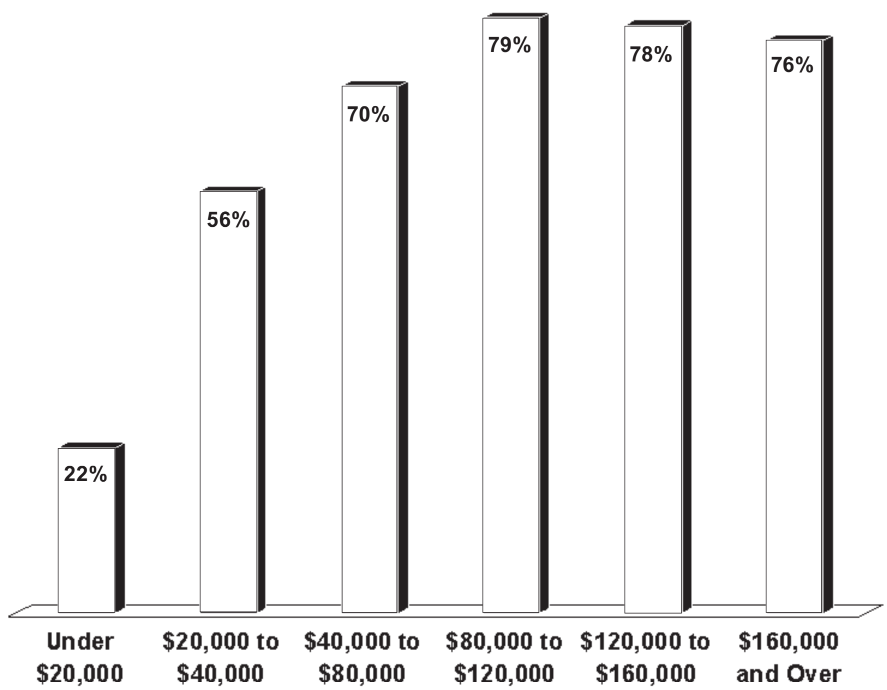
Failing to Save Enough. Those who do participate often do not contribute enough (even with their employer's match) to provide the same level of retirement income as the old defined benefit plans. The result is that many households fail to accumulate adequate retirement savings. In 2001, for example, the median balance in such accounts among all households headed by 55- to 59-year-olds was only about $10,000.[17]

"Many lower-income workers do not participate in retirement savings plans."

FIGURE II

Workers' Participation in Tax-Deferred Retirement Plans

(as a percentage of workers in each income category)



Source: Congressional Budget Office, "Utilization of Tax Incentives for Retirement Saving," August 2003.

"Workers often fail to diversify their savings, increasing their risk and lowering their returns."

Making Poor Investment Decisions. In general, workers make two kinds of mistakes in their investment decisions. They tend to invest in what they know or in what they perceive is safe. What they know is their employers' stock. What they perceive is safe is a money market fund or a government bond fund. Unfortunately, the first decision leads to too little diversification and subjects the employee to too much risk. The second decision involves too little risk and produces returns that are too low to secure an adequate retirement income.

In 2001, thousands of Enron employees lost most of their retirement savings when the company stock price fell dramatically. Enron's case is not unique. A Hewitt Associates survey of Fortune 500 companies offering 401(k) plans found 84 percent offer their own stock as an investment choice. Thirty-four percent invest their company's matching funds exclusively in company stock.[18] As the Enron example demonstrates, putting all of one's eggs in one financial basket is risky. And if the basket is the worker's company, these risks are magnified, since bankruptcy endangers workers' retirement accounts and their jobs.

Many workers are invested in overly-conservative assets, such as lower-earning money market funds or bond funds, which are safe but provide a low rate of return. Often this occurs because a company chooses that type of fund as its default investment option — when an employee makes no investment choice. According to a recent study by the Vanguard Group of more than a thousand retirement plans, 80 percent use a money market fund or other short-term investment fund as the default option; only 16 percent use a fund that yields higher returns.[19]

Lower-income employees are particularly prone to remain in lower-earning funds because many do not select an investment option and are defaulted into a money market fund. In fact, in a typical 401(k) plan, almost two-thirds of the money invested by the lowest-income quintile is in a money market fund or other fixed-type investment. By contrast, about 85 percent of the money invested by the highest-income quintile is in higher-earning, equity-type investments.[20]

As workers approach the retirement years, many make another mistake: They fail to adjust their portfolios to reflect the need for less variability in returns as retirement nears. Since stocks are more risky than bonds or money market funds over the short term, workers should shift their portfolio toward less variable investments as they near retirement. This can be accomplished automatically with "lifecycle" funds. A lifecycle account invests in a premixed portfolio of stocks and bonds, and automatically adjusts the level of risk as the worker ages, primarily by changing the allocations of stocks and bonds. An example of a lifecycle account is the Vanguard Total Retirement 2045 Fund. The fund is targeted toward a person retiring in 2045; initially the fund invests almost completely in stocks, but gradually shifts to almost all bonds by 2045.

Making Poor Withdrawal Decisions. Because of healthier living and advances in medical technology, Americans are living longer. Life expectancy for males increased from 61.4 years to 74.8 years over the past seven decades, and is expected to rise to nearly 80 years over the next 70 years. Life expectancy for women increased from 65.7 years to 80 years over the past seven decades and is expected to rise to age 83 over the next 70 years.[21] In the future, workers may spend up to a third of their lives in retirement. Thus, the prospect that retirees may outlive their retirement savings grows over time. Without proper planning, new retirees may be inclined to draw down their assets too quickly or take a lump-sum withdrawal from their retirement accounts. Retirees should be encouraged to consider payout options, like annuities, that will provide them with lifetime paychecks. Unfortunately, a recent study by Hewitt Associates found that the number of 401(k) plans that offer annuities actually declined from 31 percent to 17 percent between 1999 and 2003 and only 2 percent of participants in those plans chose annuities.[22]

Solution: The NCPA/Brookings Institution Reform Plan.[23] Public policies should encourage employers to sponsor plans that allow workers to build the largest possible nest egg, with a minimum of risk and reduced volatility as retirement age approaches. Accordingly, the NCPA and the Brookings Institution, a left-of-center think tank, developed a proposal to encourage employers to adopt plans with features proven to be effective in helping workers better prepare for retirement:

1. Automatically Enroll Employees in 401(k) Plans Unless They Opt Out. Until recently, most defined contribution plans required workers to opt into the plan. However, there has been a trend in recent years to automatically enroll employees unless they opt out. When workers are automatically enrolled in a 401(k), participation rates are significantly higher. Studies show the introduction of automatic enrollment increases the rate of participation from about 75 percent of eligible employees to between 85 percent and 95 percent.[24] Even without the legislative carrots proposed below, almost one in five employers has already adopted this reform.[25]

"Workers should be automatically enrolled in 401(k) plans."

2. Provide Automatic Contribution Increases Unless the Employee Opts Out. Building an adequate nest egg is easier when employers automatically step up workers' contributions each year — by saving part of their future pay raises, for example — rather than committing them to save at a higher rate from the start. As employee pay increases, the percent invested in the 401(k) plan would increase as well.

3. Invest in Diversified, Balanced Portfolios Unless the Employee Opts Out. Participants' funds should be automatically invested in a diversified portfolio that includes a mix of stocks and bonds. If workers begin contributing larger amounts to their 401(k) plan, their interests will still not be properly served if they are investing in low-yielding or overly-risky assets.

4. Follow a "Lifecycle" Investment Strategy Unless the Employee Opts Out. As noted above, a lifecycle account automatically shifts a worker's funds from higher-earning, but more volatile, investments to more stable, lower-earning funds as the worker ages. Thus, a lifecycle account automatically allows a worker to earn the largest possible nest egg for retirement while reducing risk and volatility as retirement age approaches.

5. Convert the Funds into Annuities At Retirement, Unless the Employee Opts Out. Defined contribution plans should offer a lifetime annuity as the default payout option at retirement. As noted above, longer lifespans — and the need to draw from retirement savings for more years — will increase the risk of outliving one's retirement savings. A lifetime annuity is a financial product that can guarantee an individual a lifetime stream of income; basically, a paycheck for life.

"Protection from lawsuits would give employers an incentive to adopt 401(k) reforms."

The Quid Pro Quo. Because the NCPA/Brookings approach would be so beneficial to participants, employers should be given incentives to establish such plans. Legislation should provide that in exchange for providing a plan offering all the recommended features, an employer would have to meet only the basic coverage and nondiscrimination requirements. Additionally, the plan sponsor would receive "safe harbor" protection, exempting it from class action civil suits and similar actions alleging breach of fiduciary standards. Fear of lawsuits prompts many companies to adopt features — low-earning default options, for example — that are not in the employees' best interest.

3. Expanding IRAs

One of the most remarkable characteristics of our retirement system is the completely arbitrary limits that are placed on the opportunities of different people to engage in tax-deferred saving.

This year, workers can contribute up to $15,000 in a 401(k), regardless of income. Older workers — baby boomers age 50 or older — can make an additional "catch-up" contribution of $5,000. IRAs have different limits. Eligible individuals can make tax-deductible contributions to an IRA of only $4,000, or $5,000 if they are age 50 or older. In addition, the tax benefits of IRAs phase out for people with moderate to higher incomes. For example, IRA contributions are fully deductible for singles with incomes up to $32,000 and couples who are married filing jointly with incomes up to $52,000. The deductibility of IRA contributions phases out completely for singles earning $42,000 or more, and for couples who are married filing jointly earning $62,000 or more.

Some workers do not have access to a 401(k) plan because they work for an employer that does not offer one. Others may choose not to join, perhaps because the plan has too few options or is poorly administered. Either way, public policy should provide workers maximum flexibility to choose their retirement investment options. To that end, Congress should equalize the treatment of IRAs and 401(k)s by making the contribution levels to both investment vehicles the same.

"Income and contribution limits on Individual Retirement Accounts should be raised."

Tax-advantaged savings can produce more than twice as much retirement income as comparable taxable investments, depending on a person's tax bracket. Thus, an IRA is one of the best ways to save when one doesn't have access to an employer-sponsored plan. When deciding which investment vehicle is best, families also should consider the benefits of Roth IRAs. (See below.)

IRAs are particularly important for women because they are more likely than men to have shorter or inconsistent employment histories. The ability to save money independent of employer-sponsored plans is a challenge for everyone, but for women — who are more likely to be earning lower wages or to be out of the workforce — personal saving is more difficult. Putting discretionary income into a personal retirement savings account competes with setting aside money for preschool, the children's college expenses, medical emergencies or any of the many unplanned events in family life.

A step in the right direction has been the creation of spousal IRAs, which allow the spouse of a wage earner to set aside up to $4,000 of pretax income ($5,000 if age 50 or older) each year, which can grow tax-free until it is withdrawn during the retirement years. This is a viable option for married couples; however — as with traditional IRAs — the contribution limit is meager compared to allowable contributions to employer-sponsored plans. Under current law, a nonworking spouse can make a deductible IRA contribution as long as the couple files a joint return, and the working spouse has at least as much earned income as the contribution. As with traditional IRAs, the deductibility of the nonworking spouse's contribution is phased out for couples with higher incomes. As with regular IRAs, public policy should equalize contribution opportunities at home and work.

4. Removing Penalties on Work

One of the great accomplishments of the Contract with America[26] was the abolition of the Social Security retirement earnings test for people who reach the normal retirement age of 65. Such people no longer lose Social Security benefits if they earn wage income. The problem remains, however, for those below the normal retirement age.

The normal retirement age is rising for workers born after 1938. It began rising in 2003 by two months every year and will continue until it settles at age 67 for workers born in 1960 and later. People who receive Social Security benefits before normal retirement age are subject to an earnings test if they continue to work. In 2006, Social Security will withhold $1 in benefits for every $2 of non-Social Security earnings in excess of $12,480. While the benefits are restored later, some individuals may view the withholding as a tax.[27]

"The earnings test penalizes retirees who keep working."

Oddly, the earnings test applies only to wage income. One can receive millions of dollars per year in interest, dividends and capital gains without losing a penny of Social Security benefits. But someone who invested in human capital rather than financial capital is punished when he or she seeks a return on that investment by continuing to work.

Under current law, people can take "early retirement" and begin collecting reduced Social Security benefits as early as age 62. They can also delay their retirement and receive enhanced benefits up to age 70. Until relatively recently, the terms of this choice were not actuarially fair. They encouraged early retirement and discouraged delayed retirement — thus costing the nation by lowering output and costing the Treasury by increasing Social Security benefit payments.[28] Today, however, the tradeoff is thought to be actuarially fair for a healthy individual.[29] Furthermore, from the normal retirement age until age 70, there is no requirement that individuals actually be retired in order to receive Social Security benefits. So the decision to work (and how much to work) can be independent of the decision to draw benefits.

Accordingly, the Social Security earnings test is unfair and counterproductive. A recent study from the National Bureau of Economic Research concluded that the earnings test reduces the number of married men between 62 and normal retirement age in full-time work by 10 percent.[30] To encourage people to remain in the workforce longer and better prepare for their own retirement, Congress should repeal the earnings penalty for everyone who collects Social Security benefits.

5. Repeal the Social Security Benefits Tax[31]

The Social Security benefits tax inflicts some of the highest marginal tax rates in the federal tax code. Although nominally a tax on Social Security benefits, it is really a tax on other retirement income. Because of the benefits tax, the retirement savings of the vast majority of current and future retirees are much less valuable.

How Benefits Are Taxed. Taxes are imposed on up to half of benefits for single retirees with modified adjusted gross incomes higher than $25,000 and for couples with incomes above $32,000.[32] Affected retirees must add 50 cents in benefits to their taxable income for every dollar by which their income exceeds the threshold until half their benefits are subject to taxation. Thus, when retirees earn $1.00, they must pay taxes on $1.50. As a result, the marginal tax rate on their income is 50 percent higher than for young people with the same income.

"The Social Security benefits tax penalizes workers who save for retirement."

FIGURE III

Calculating Taxable Social Security Benefits for a Couple

Combine:	WAGES
	+
	INVESTMENT INCOME
	+
	TAX-EXEMPT INCOME
	=
	NON-SOCIAL SECURITY INCOME
Add:	1/2 SOCIAL SECURITY BENEFITS
	-
Subtract:[1]	$32,000
	x
A. Multiply difference up to $12,000 by:	0.50
B. Multiply additional difference by:[2]	0.85
Add A and B to get Taxable Benefits:[3]	TOTAL

[1] No tax is payable unless the total exceeds $32,000.

[2] If the result of "B" is more than 85 percent of benefits, do not add "A." Maximum taxable benefits are equal to 85 percent of Social Security Benefits.

[3] Treated as taxable income subject to ordinary income tax rates.

Source: Authors' analysis.

As income rises, the tax becomes more onerous. Single retirees with incomes above $34,000 and couples with incomes higher than $44,000 must add 85 cents in benefits to taxable income for every dollar of income above these thresholds until 85 percent of their benefits are subject to the tax. [See Figure III.] Thus, when these retirees earn $1.00, they must pay taxes on $1.85. As a result, the marginal tax rate on their income is 85 percent higher than for young people with the same income.

Who Pays the Tax? When first imposed, taxation of Social Security benefits affected less than one in ten beneficiaries. Today, however, it affects more than one of every five recipients, and it will affect many more people in the future, because the tax thresholds are not adjusted for inflation. By the time the children of the baby boomers retire, almost all beneficiaries will be paying tax on some portion of their benefits.

Taxing Savings. About 60 percent of the income of elderly taxpayers comes from investments (including pensions). For most younger people, the tax rate on investment income is 15 percent or 25 percent. For the elderly, the Social Security benefits tax makes the effective rate much higher.

- Elderly taxpayers in the 15 percent income tax bracket — and subject to the 50 percent benefits tax — pay an effective rate of 22.5 percent (15 percent x 1.50).
- Elderly taxpayers in the 25 percent tax bracket — and subject to the 85 percent benefits tax — pay an effective rate of 46.25 percent (25 percent x 1.85).

Taxing Wages. The Social Security benefits tax severely penalizes moderate-income elderly who collect early retirement benefits from Social Security and continue to receive wage income. As noted, the earnings penalty reduces Social Security benefits by $1.00 for every $2.00 of wage income earned above $12,480 per year (an effective marginal tax rate of 50 percent) for workers between age 62 and the normal retirement age.

Consider a single male whose earned income plus one-half his Social Security benefits equals $30,000. If he earns one additional dollar, he loses 50 cents of benefits, and he pays 15 cents in federal income taxes and 7.65 cents in FICA (Federal Insurance Contributions Act) payroll taxes. Since one-half of his previously tax-free Social Security benefits are now taxable, he pays an additional tax of 7.5 cents. Thus from each additional dollar of earned income, he nets less than 20 cents in spendable income. His marginal tax rate is 80 percent! [See Figure IV.]

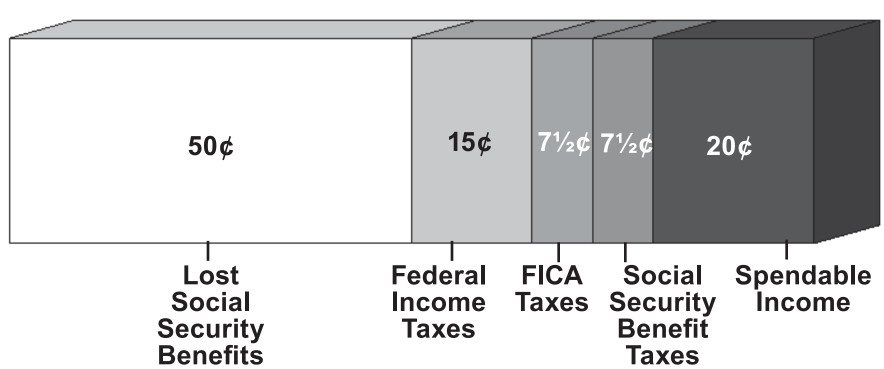
The situation is far worse for retirees above the 85 percent benefits tax threshold. Consider the previous scenario, but with a single male whose earned income plus 85 percent of his Social Security benefit equals $60,000. His effective marginal tax rate is greater than 100 percent! (If he earns one

"The marginal tax on seniors who work can reach 63 percent — or more!"

FIGURE IV

Marginal Taxes on an Additional Dollar of Wage Income for an Early Retiree

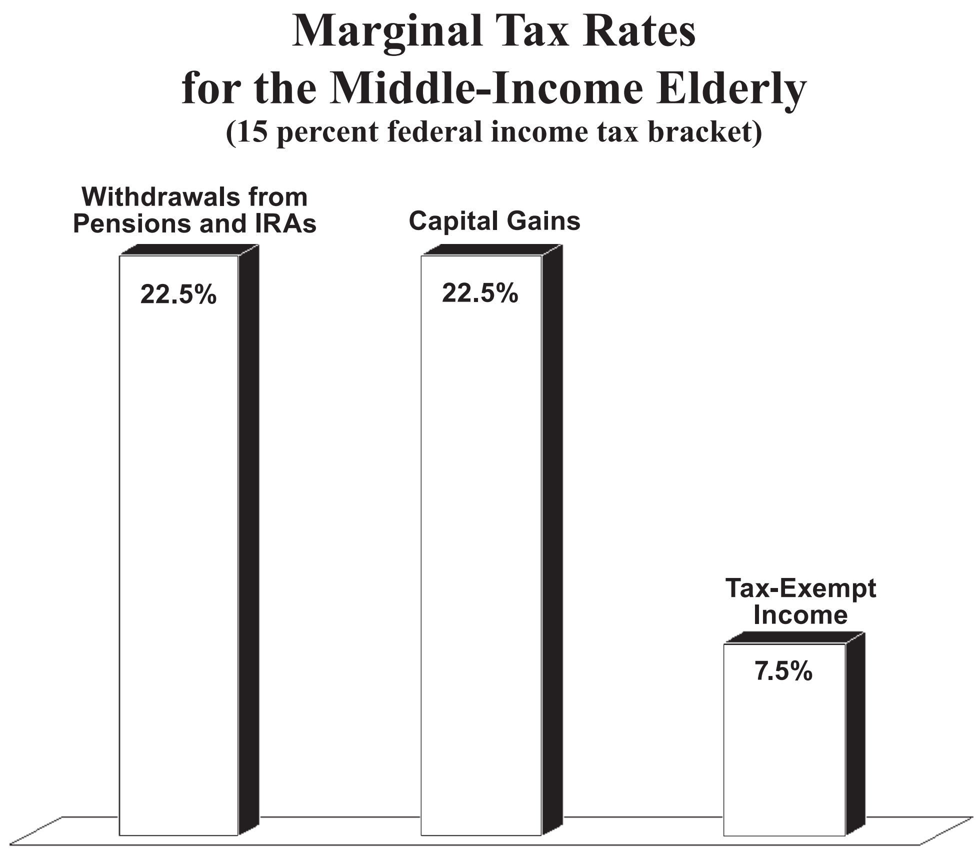
(15 percent federal income tax bracket)



Source: Authors' calculations.

"Retirees in the 15 percent tax bracket face a 22.5 percent marginal tax on income from savings."

FIGURE V



Note: Assumes 50 percent of Social Security benefits are subject to taxation.
Source: Authors' calculations.

additional dollar, he still loses 50 cents of benefits, pays 25 cents in federal income taxes, 7.65 cents in FICA payroll taxes, and 85 percent of his previously tax-free Social Security benefits are subject to taxation.)

Hidden Effects. Because of the way income tax returns are organized, many elderly taxpayers do not realize that the Social Security benefits tax actually taxes other income. And because many states accept the federal definition of taxable income, it increases some state and local income tax rates by 50 percent to 85 percent, depending on the income level.

Consider the effects for a single retiree in the 15 percent tax bracket whose post-retirement incomes raise them above the first threshold of the Social Security benefits tax, in which 50 percent of their benefits are subject to taxation. As Figure V shows:

- Withdrawals from pensions and capital gains income are subject to a 22.5 percent rate for Social Security recipients versus 15 percent for others.
- Tax-exempt income of the elderly can be taxed at a rate of 7.5 percent versus a zero rate for younger taxpayers.

Consider further the effects on a single retiree in the 25 percent tax bracket who is above the second Social Security benefits tax threshold. As Figure VI shows:

- Withdrawals from pensions are subject to a 46.25 percent rate versus 25 percent for others.
- Capital gains income is subject to a 36.25 percent rate versus 15 percent for others.
- Tax-exempt income of the elderly can be taxed at a rate of 21.25 percent versus a zero rate for younger taxpayers.

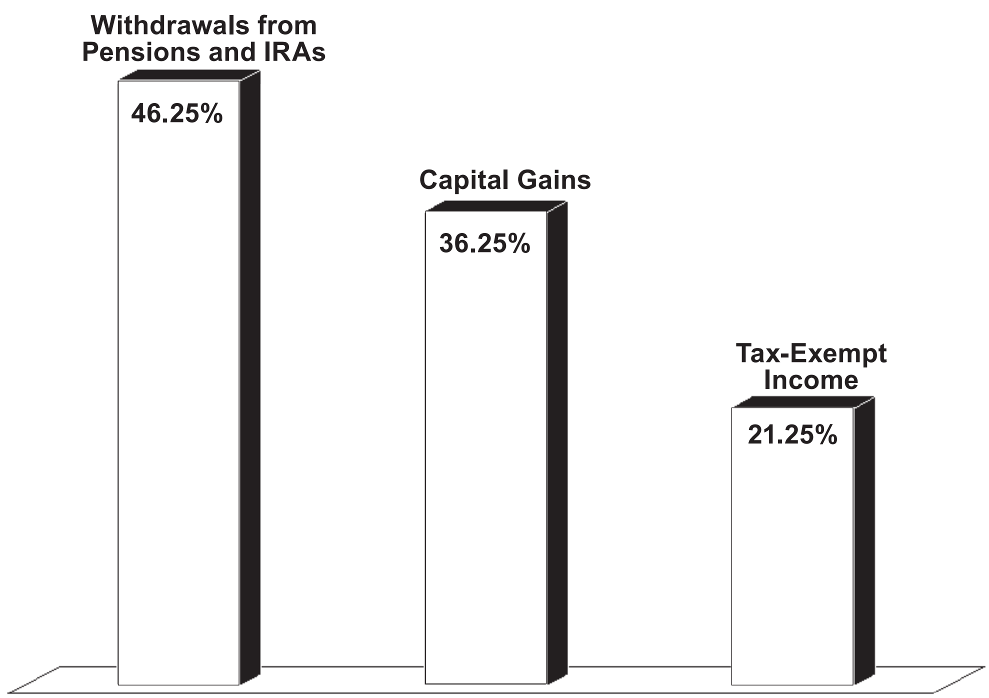
How the Social Security Benefits Tax Also Taxes the Young. As we have seen, the federal government grants a special tax status to employer-provided pensions, IRAs and 401(k) plans to encourage retirement savings. The law allows people to avoid taxes now and defer them until their retirement years on the assumption that most income will be taxed at lower rates after they retire. Yet that assumption is no longer true for many young workers because of the Social Security benefits tax. Thus, in a sense, the tax decreases the value of most American workers' retirement savings.

"Retirees in the 25 percent tax bracket face even higher marginal taxes on their income."

FIGURE VI

Marginal Tax Rates for the Middle-Income Elderly

(25 percent federal income tax bracket)



Note: Assumes 85 percent of Social Security benefits are subject to taxation.
Source: Authors' calculations.

Solution: Tax Social Security Benefits as Ordinary Income. To eliminate the odd effects of the Social Security benefits tax, Congress should repeal it. If there is an argument for taxing these benefits, the correct way to tax them is to include a portion of them in ordinary income and subject them to ordinary income tax rates. Middle-income seniors would pay taxes on some portion of their Social Security benefits the same way they pay taxes on IRA withdrawals and pension benefits — at the same tax rate faced by younger taxpayers.

6. Using the Roth Method of Taxation

Traditional retirement savings vehicles, such as 401(k)s and IRAs, are tax-deferred accounts. They allow people to invest pretax dollars, but taxes must be paid on the investment and accumulated earnings at the time of withdrawal. By contrast, deposits to Roth IRAs are made with after-tax dollars and withdrawals are tax-free.

Both accounts grow tax-free and both allow withdrawals at age 59½ without penalty. However, there are other differences. People with ordinary IRAs must stop making deposits when they reach age 70 and begin making minimum withdrawals. People with Roth IRAs can contribute at any age and are not required to withdraw funds at any time. But there are income restrictions on who can participate: Taxpayers who file as a single with an adjusted gross income more than $110,000 cannot contribute to a Roth IRA, and cannot make the full contribution if their adjusted gross income is between $95,000 and $110,000. Taxpayers who are married filing jointly cannot contribute to a Roth IRA if their adjusted gross income is greater than $160,000, and can only make a partial contribution if their income is between $150,000 and $160,000.

"Roth IRAs allow workers to withdrawal funds tax-free."

New in 2006: Roth 401(k)s. Currently, 401(k) plans are taxed like ordinary IRAs. Contributions are made with pretax dollars and people pay income taxes on the contributions plus earnings when funds are withdrawn. Starting this year, however, employers can offer Roth 401(k)s. Workers can contribute after-tax dollars to an employer-sponsored Roth 401(k) plan, and the money will grow tax-free and eventually be withdrawn tax-free.

The new plan is similar to a Roth IRA, in that it lets savers contribute after-tax money that grows tax-free. But Roth 401(k)s differ from Roth IRAs in a few key areas: Roth 401(k)s have no income limits for participation, and the same higher contribution levels and penalties for withdrawals before age 59½ as traditional 401(k)s.

Who Benefits from Roth Taxation? Which is better, a regular account or a Roth account? The answer depends on a worker's marginal tax rate during the working years compared to the tax rate faced during retirement. In general, one wants to pay taxes when the tax rate is lowest. The traditional

TABLE I

Which Is Better: Regular 401(k) or Roth 401(k)?

At age 36			At age 65	
Annual Income [1]	Current Marginal Tax Rate	Annual Investment[2]	More or Less Spendable Income for Choosing a Roth 401(k)	Marginal Tax Rate at Retirement
$35,000	18%	$3,500	- $1,015	0%
$75,000	18%	$7,500	+ $809	24%
$125,000	28%	$12,500	- $1,476	23%

Note: Calculations were made by Pamela Villarreal of the National Center for Policy Analysis using ESPlanner™ financial planning software developed by Laurence Kotlikoff at Boston University. The model makes automatic adjustments to make the family's standard of living uniform over time.

[1] Assumes a married couple living in Illinois (state taxes apply) with one child and both parents working. Increases are assumed to grow with the rate of inflation.

[2] After paying taxes, the contributions to Roth IRAs are $2,803, $6,184 and $8,030, respectively.

"A Roth 401(k) would lower the tax burden for some workers."

assumption has been that people will be in a lower tax bracket after they retire, so investing pretax dollars and paying taxes when the money is withdrawn means they will pay less taxes over their lifetime. But there are two reasons this assumption may to be wrong — especially for many young people.

First, as we have seen, many moderate-income families will be pushed by the Social Security benefits tax into higher tax brackets after they retire than when they were working. Thus, paying taxes on accumulated savings after retirement may cost a family more over its lifetime.[33] Second, there are massive public policy changes on the horizon. As the baby boomers age and retire, the costs to society of providing Social Security, Medicare and Medicaid benefits will most likely lead to higher taxes across the board. So it is probably a safe bet that tax rates will be higher in the future.[34]

NCPA scholars used a financial planning model developed by economist Laurence Kotlikoff to determine whether a Roth account or a regular account is better for workers at different income levels.[35] Table I examines the outcomes at different income levels for one-child families in which both spouses work and are age 36. As Table I shows:

- A family earning $75,000 will face an 18 percent marginal tax rate while working and a 24 percent tax rate in retirement; thus, they are better off with a Roth.
- Families earning $35,000 and $125,000 face higher marginal tax rates while working than when retired; thus, they are better off with a traditional IRA.

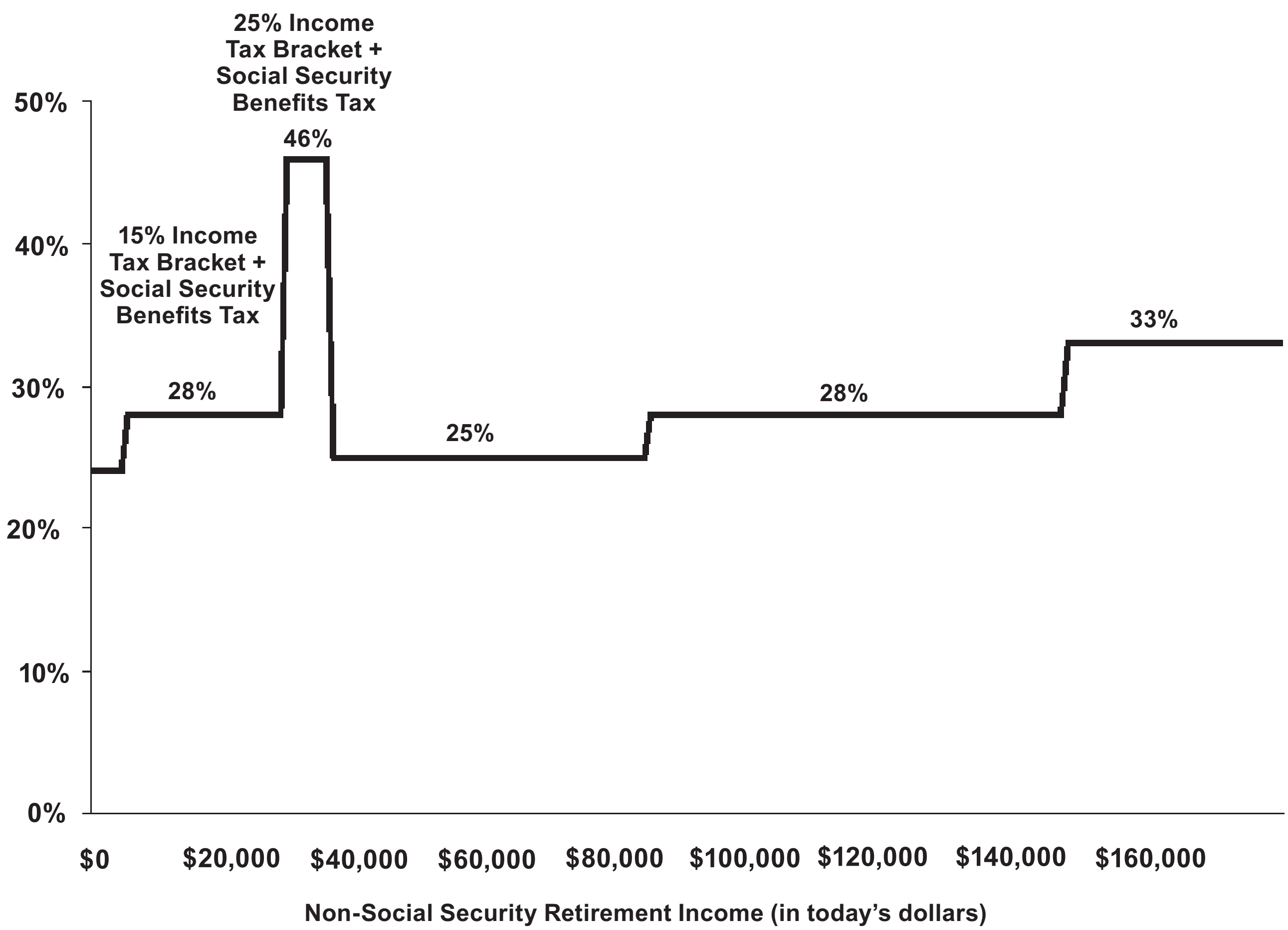
To understand why this is the case, see Figure VII**.** It illustrates the marginal tax rates for a two-earner couple retiring 30 years from now. Because of the Social Security benefits tax and the complexity of the U.S. Tax Code, a worker's marginal tax rate can range from 28 percent to 46 percent before the worker ever enters the 28 percent tax bracket.

"The Social Security benefits tax raises marginal tax rates on retirement income."

Needed: Parity for Roth IRAs. As noted, contribution levels are different for regular IRAs and 401(k)s. They are also different for Roth IRAs and Roth 401(k)s. The unequal contribution levels are unfair to people who do not have access to employer-sponsored plans. Why should workers fortunate enough to have access to a 401(k) benefit from tax-preferred treatment of up to $15,000, while those without a 401(k) can only contribute one-third of that amount? Congress should level the playing field.

FIGURE VII

Marginal Tax Rates for a Couple Retiring 30 Years from Now



Note: 36-year-old couple currently earning $125,000 a year.

Source: Authors' calculations.

7. Making Health Insurance Portable

One of the strange features of the U.S. health care system is that the health plan most of us have is not a plan that we chose; rather, it was selected by our employer. Even if we like our health plan, we could easily lose coverage because of the loss of a job, a change in employment or a decision by our employer. This lack of individually-owned, personal and portable health insurance affects all Americans, but especially older workers, who are more likely to have health problems.

"Workers can lose health insurance when they change jobs or retire early."

Problem: Lack of Continuity of Insurance. Virtually all employer health insurance contracts last only 12 months. At the end of the year, the employer — in search of ways to reduce costs — may choose a different health plan or cease providing health insurance altogether. Strangely, the only people with private health insurance guaranteed to last longer than one year are people who purchase insurance on their own, since federal law guarantees the renewability of individually-owned policies. Those policies, which are genuinely portable insurance, are actually penalized under the tax law.

Problem: Lack of Continuity of Care.[36] Employer-sponsored health care largely evolved at a time when most health insurance was fee-for-service. Fee-for-service meant an employee could see any doctor or enter any hospital and insurance paid all or most of the bills. As a result, a change of jobs usually did not cause undue disruption, provided that both the new and old employer had health insurance plans.

Things changed after the introduction of managed care. Today, as in the fee-for-service era, employees who switch jobs must also switch health plans. All too often that means changing doctors as well, since each health plan tends to have its own network. For example, if an employee (or a member of the employee's family) has a health problem, there may be an interruption in the continuity of care. Additionally, different employer plans have different benefit packages. Thus, some services, like mental health, may be covered under one employer's plan but not under the next employer's plan.

These disruptions affect some families more than others. For people who are healthy, they may amount to minor inconveniences, but for others the problems can be severe. They can affect the decision to leave one job for another; for example, a study of chronically-ill workers found that those who relied on their employer for health coverage were 40 percent less likely to change jobs voluntarily than workers who obtain their health coverage elsewhere.[37]

Problem: Perverse Incentives for Employers and Employees. Most employees view health insurance as a fringe benefit. When they enter the job market, they primarily search for employment opportunities that reward them for their skills and abilities. But a growing minority of workers approach the job market very differently. These are individuals with a family member (often a spouse or child) who has very high health care costs. When these workers compare job opportunities, they are primarily comparing health plans. For them, health insurance is the main attraction, rather than the job or the pay.

Clearly it is not in the financial self-interest of employers to attract workers whose primary motivation is to get their medical bills paid. To protect themselves from such potential hires, employers are increasingly altering their health plans to attract the healthy and avoid the sick. Offering small copayments for routine office visits but high deductibles for hospitalization is one technique. Long waiting periods before employees become eligible for the company's health plan is another.

These reactions by employers are rational responses to a labor market that increasingly looks like a game of musical chairs. But what is good for the employer is not necessarily good for society as a whole.

Problem: Younger Spouses and Retirees on Medicare. The lack of individually-owned, portable insurance is particularly burdensome for many women who are married to older men. When a husband retires and enrolls in Medicare, wives may be left without coverage because underage spouses cannot enroll in Medicare. Until the wife qualifies for Medicare at age 65, the couple will have to purchase her insurance with after-tax dollars. She will also likely be charged higher premiums for health insurance, since health risks tend to rise with age. And she will pay even more (or possibly even be denied insurance altogether) if she has experienced a significant gap in coverage and subsequently develops an expensive-to-treat health condition.[38]

Problem: Federal Laws Designed to Encourage Portability Have Actually Outlawed It. Under the current system, employers cannot buy individually-owned insurance for their employees. Specifically, lawyers interpret the Health Insurance Portability and Accountability Act of 1996 (HIPAA) to say that the only employee health insurance employers can purchase with pretax dollars is group insurance. A better alternative would be to allow employers to purchase individually-owned, personal and portable insurance for their employees. Even though employers would pay some or all of the premiums, employees could take the insurance with them as they move from job to job.[39]

"Workers' health insurance need not be tied to their employer."

Source of the Problem: Tax Penalties for Portable Insurance. The main reason companies provide their workers with health insurance rather than pay higher wages (with which employees could buy their own insurance) is tax law.[40] Unlike taxable wages, employer-paid premiums avoid federal, state and local income taxes, as well as the FICA payroll tax. By contrast, workers who buy their own insurance get no tax break unless their medical costs exceed 7.5 percent of their adjusted gross income.[41] As a result, genuinely portable insurance — insurance owned by the person who is insured — is actually penalized under the tax law.

For a typical middle-class family, government is effectively paying half the cost of employer-provided health insurance. Suppose that one year's insurance for a family of four costs $6,000. If the insurance is purchased by an employer, the employee must produce and earn $6,000 to set aside as a pretax payment for insurance rather than as taxable wages. However, if the insurance is purchased directly by the family, the employee must earn $12,000 in order to pay both the taxes and the insurance premiums. In terms of the amount of pretax income needed, insurance purchased directly with after-tax dollars costs the family twice as much!

"Portable health insurance would travel with a worker from job to job."

Creating Personal and Portable Health Insurance. Just because employers pay all or most of the premium does not mean that health insurance must necessarily be employer-specific. As an alternative, why can't employees enroll in health plans that meet their needs, and then be allowed to stay in those plans as they travel from job to job? Personal and portable health insurance would solve many of these problems.

Even though employers initially would pay the premiums (as they do today), employees would own the insurance and it would travel with them as they move through the labor market. Thus employees would get portable insurance (a characteristic of individual insurance), but at premiums closer to the norms of group insurance. [See the sidebar on personal and portable insurance.]

Although employers are expected to initially buy all their employees into the same health plan, with the passage of time some of those employees will leave and go to work for other firms. Employers will also hire new employees who are members of other plans. And, in most cases, the employer's initial group of employees will be able to switch to other plans after a transition period. The typical employer, therefore, can eventually expect to have employees in different plans. Indeed, it is possible that every employee will be in a different plan.

Advantages of Portable Insurance. Portable health insurance promises a continuing relationship with an insurer and, therefore, a continuing relationship with doctors and health facilities. It also means that people can find a health plan they like and stay in it, without worrying whether they will be forced out of the plan by an employer's decision or by a change in employment.

For employers, portable health insurance means that small groups are no longer treated as self-contained pools and rated each year based on changes in the health status of their members. Instead, employees will be members of very large pools in which no one can be singled out because of a sudden large medical expense, and premium increases are the same for all. Under this system, employees can choose their own plan and employers can limit their contribution to a fixed-dollar amount. New hires will know how much the employer is going to contribute to health insurance, just as they know the amount of their salary. Because the employer's role is largely financial, in a real sense employers will get out of the "business" of health insurance.

The NCPA/Texas Blue Cross/Blue Shield Plan to Create Personal and Portable Insurance at the State Level [42]

How can we change the way health insurance is purchased to increase consumer satisfaction with their coverage? The idea is to combine the advantages of individual insurance with the advantages of group insurance and avoid the disadvantages of both. This new, hybrid form of insurance will be called New System Plans (NSPs). Employers who assist their employees in entering NSPs through the payment of premiums will be called Defined Contribution Employers (DCEs).

Transition. Most employees will enter NSPs by converting from group insurance through the actions of an employer. Specifically, an employer will choose an NSP for all its employees, much as employers choose group insurance today. Rules that apply to the group market today would probably still apply, including the requirement that (1) employers pay a substantial part of the premium, (2) a substantial percentage of employees elect to insure, and (3) new employees elect to insure on a certain date not of their choosing. In return the group could avoid the administrative cost of individual underwriting (although this would not be a legislative requirement).

A typical transition period might involve a three-year contract. After the three-year period, employees would be free to switch to another NSP if they were dissatisfied with their plan. However, an individual's entry into another NSP would not be guaranteed. During the three-year period, new employees who are not members of another NSP would be required to join the employer's selected NSP in order to qualify for an employer contribution.

Some employers may choose to have a longer-term relationship with an insurer. For example, an NSP may agree to take all of an employer's new employees without underwriting, provided that the employer will not contribute to the insurance of eligible employees (not insured elsewhere) unless they join the NSP.

Parallel Systems. No employer will be required to be a DCE, and no insurer will be required to offer an NSP. Therefore, for some time there will be parallel systems — with some employers and employees participating in the new system and others participating in conventional small group or large group markets.

Regulatory Status. Even though DCEs will pay premiums (to take advantage of the tax law), NSPs will be technically considered individual insurance.

Relation to HIPAA. Although federal law requires small group insurance to be guaranteed issue — meaning people cannot be denied coverage because of health status — states are free to choose their own mechanism to insure people who convert from group to individual insurance.[43] Most states have chosen to make such individuals eligible for their state risk pool. Under this proposal most employers who become DCEs will assist their employees in converting from group to individual insurance. Therefore, NSPs do not have to be guaranteed issue.

The Role of the Employer. Currently, employers cannot pay premiums for individual insurance for their employees. This proposal would allow them to do so. In return for this right, DCEs will have certain obligations. One such obligation is to offer a contribution toward premiums for every employee. The contribution could vary by age and other factors, but employers could not discriminate against employees based on health status. Employers would also be obliged to make a full monthly premium payment to each employee's NSP.

High-Cost Enrollees. There are several protections proposed for individuals with high medical costs. First, NSPs that cover employees converted from group to individual (NSP) insurance must accept or reject the entire group. If all NSPs reject a group, the group can still go to the conventional small group market, where acceptance is guaranteed. Second, as an inducement to NSPs, we propose that if an NSP accepts a group below a minimum size without individual underwriting, there will be a six month look-back period during which the NSP will have the opportunity to (a) move high-cost enrollees to a risk pool, (b) qualify for reinsurance, or (c) qualify for a direct subsidy.

It is important that all three subsidies (a thru c) be funded through general revenues and not from a tax on health insurance or health care. The reason: We want to encourage people to purchase health insurance and we want people to obtain health care when they need it — undeterred by taxes.

High-Cost Employees in a Mature System. In a mature system, most eligible employees would be members of NSPs, and their membership would be guaranteed renewable. Thus, an individual who develops an expensive-to-treat illness need not fear losing coverage because he switches jobs or is laid off, or because his employer switches health plans or arbitrarily changes the benefits covered in the existing plan.

However, some high-cost employees may fall through the cracks and become uninsured — because they failed to sign up for insurance when eligible, because they worked for an employer who did not provide insurance, because they previously had traditional insurance with another employer, and so forth. What happens to these individuals?

In some cases they will be able to enter an NSP without medical underwriting under the terms of a contract between an employer and an NSP that allows such entry. Moreover, anyone who is entitled to coverage under HIPAA will be able to obtain coverage from the state risk pool. If the individual works for a DCE, the DCE's premium contribution will be made to the risk pool — just like an ordinary insurance premium payment.

Specialty Health Plans. We would like to encourage health plans to specialize in the treatment of expensive-to-treat illnesses, such as cancer, heart disease and so on. Specialization would encourage efficiency and quality, as it has in hospitals and clinics that treat specific conditions. It should be a goal of public policy to encourage arrangements whereby individuals can leave NSPs (and perhaps traditional health plans as well) and join a plan specializing in the treatment of their condition. Such movements will require the voluntary agreement of the patient and the two plans and will almost certainly involve a payment to the specialty plan from the original plan. But both plans should gain from the arrangement because of the substitution of more efficient for less efficient care. Patients should gain from better, specialized care.

8. Tax Relief for Post-Retirement Health Insurance

Because health costs tend to rise with age and because people who retire prior to Medicare eligibility often find health coverage unaffordable or unobtainable, they often seek help from former employers. Nearly four in 10 large employers (38 percent) provide health insurance for retirees (usually comparable to benefits available for active employees) from the time of retirement until age 65 (when they become eligible for Medicare).[44] Beyond age 65, many employers also provide insurance that supplements Medicare. Of large firms that offer retiree benefits, 93 percent offer them to early retirees while 78 percent offer them to Medicare-eligible retirees.[45]

Unfortunately, there are two major problems with way the current system treats early retirees: (1) The employer's decision generally must be all or nothing and (2) employees who do not receive employer-provided, post-retirement health care benefits get virtually no tax relief if they purchase their own coverage.

Suppose General Motors is spending $11,000 per year on health insurance for active employees, on the average. If the company decides it cannot afford an equivalent amount for each retiree, why not offer, say, half that amount to retirees to be applied to less comprehensive health insurance that they buy on their own, or that could be deposited in a Health Savings Account (HSA) to purchase health care directly?

"Tax law penalizes individuals who purchase their own health insurance."

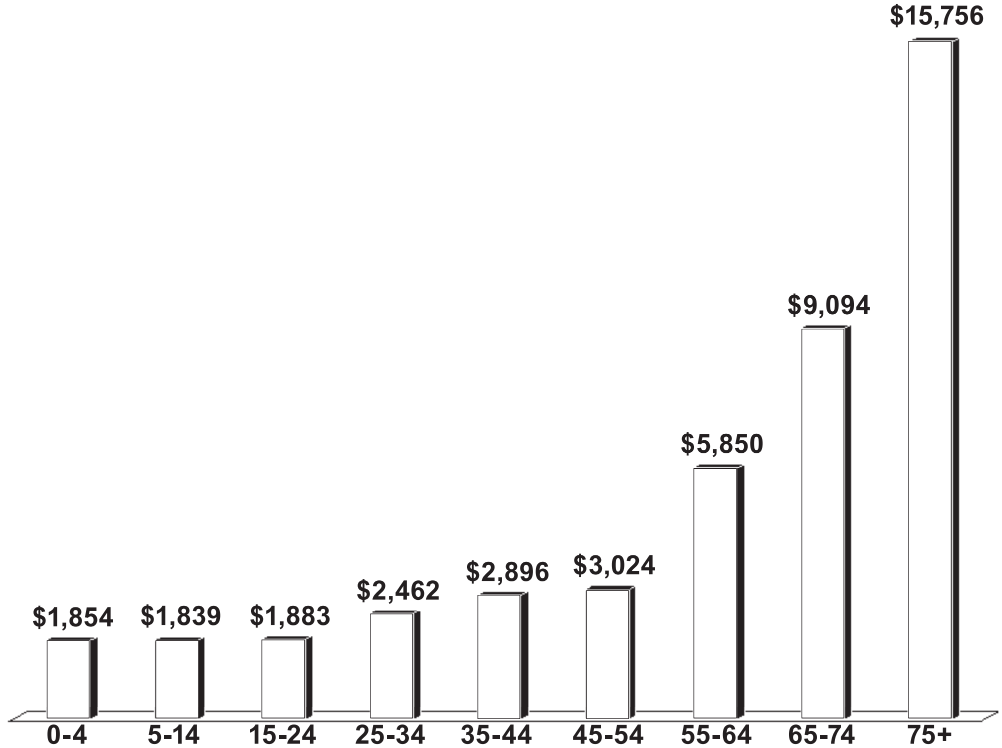
The problem is the tax law. Although GM can purchase health insurance with pretax dollars, it generally cannot give money to retirees to pay their own premiums with pretax dollars, nor can it give retirees pretax dollars to be deposited into an HSA. This all-or-nothing approach imposed by federal tax law may be one explanation why so many employers are ending post-retirement health care altogether. Nearly two-thirds (66 percent) of large employers offered retiree health benefits in 1988. By 2003 this proportion fell to 38 percent.[46]

Another problem with the tax law is that it gives virtually no tax relief for retirees who purchase their own insurance. One solution is the system of individually-owned, personal and portable health insurance discussed previously. Short of that reform, there are more limited reforms that would help. At a minimum, employers should be able to allocate pretax dollars to retirees up to the amount spent on active workers — provided that the funds are spent on health care. Retirees should be able to use the tax-free funds to purchase individual health insurance or deposit them in tax-free HSAs.

We also need tax relief for retirees' insurance costs not paid by employers. This tax relief could come in the form of an income tax deduction or a tax credit. The difference is that a tax deduction reduces the income upon which taxes are paid, whereas a tax credit is a dollar-for-dollar reduction in taxes owed. A tax deduction is more valuable to taxpayers in higher tax brackets be-

FIGURE VIII

Annual Medical Expenditures by Age



Source: Calculations based on Ellen Meara, Chapin White and David M. Cutler, "Trends in Medical Spending by Age, 1963-2000," *Health Affairs*, July/August 2004, Vol. 23, No. 4, p. 179, Exhibits 1 and 2.

"The elderly pay half their health care costs out of pocket."

cause they are taxed at a higher rate and they are more likely to itemize deductions (which is required in order to receive the tax benefit). A tax deduction is less valuable to families in lower income tax brackets because they are taxed at a lower rate and they are less likely to itemize. For those families, a tax credit for health insurance would be of more benefit.

9. Creating Health Savings Accounts for Seniors[47]

Currently, the elderly pay half their health care costs out of pocket. These expenditures often come from wages and other taxable income. Even with the new Medicare prescription drug benefit, seniors' health care costs will continue to climb. [See Figure VIII.]

HSAs could provide seniors a way to save pretax dollars to pay their health expenses. Unfortunately, seniors eligible for Medicare are not allowed to establish new HSAs or make additional deposits to existing accounts.[48] And there are other restrictions on HSAs that make it difficult for younger people to accumulate funds that could help meet their needs after retirement.

Flexible HSAs Prior to Retirement. Health Savings Accounts are needlessly restricted. Under current law, the annual HSA contribution is limited to the health plan deductible, up to a maximum of $2,700 per individual and $5,450 per family. But this may not be enough to accumulate funds sufficient to meet many people's health needs after retirement.

Ideally, reforms would allow unlimited contributions to HSAs and permit the accounts to wrap around third-party insurance — paying for any expense the insurance plan does not pay. Allowing nonseniors to deposit more funds into an HSA earlier in life would help build up balances for retirement, when health needs are greater. At the very least, people (and their employers) should be able to make an HSA deposit each year equal to their total out-of-pocket exposure, as President Bush has recently proposed.[49]

"Seniors should be able to contribute to Health Savings Accounts."

HSAs for Seniors. Allowing Medicare-eligible seniors to make HSA deposits would help them build balances for when the need arises. Individuals aged 65 to 74 years spent about $9,094 per year on health care in 2000. However, individuals aged 75 years and above spent nearly three-fourths more (about $15,756).[50] Thus, during later retirement most seniors will have higher medical bills than at any other time in their lives. If younger seniors were allowed to continue depositing funds — and accumulating interest — they could better afford the out-of-pocket portion of future medical bills.

Roth HSAs for Seniors. Another way to provide relief to the age-65-plus population is to let seniors turn their Roth IRAs into Roth HSAs. Today, funds in Roth IRAs may be withdrawn at any time without penalty for health care. Once a person turns 59½, any remaining funds not spent on health care can be withdrawn without penalty and spent on other goods and services or left to grow with interest. This levels the playing field between current and future spending, and between health care and other spending. However, while Roth IRAs represent an attractive way for seniors to build up savings for medical contingencies, they still have rules and restrictions that make them less flexible than they could be.

Allowing conversion of Roth IRAs into Roth HSAs could be accomplished by making three changes: 1) Lift the five-year waiting period before withdrawals for health expenses, 2) allow deposits even in the absence of wage income, and 3) remove income limits on participation.

Needed Change: Lift the Five-Year Moratorium on Withdrawals. Current law imposes a five-year moratorium on Roth IRA withdrawals. While that restriction may make sense if the goal is to encourage retirement savings, it interferes with planning for health expenses, where decisions ordinarily are made each year. If the moratorium were lifted specifically for health care purchases, senior citizens would be able to integrate their Roth IRA with Medicare and Medigap coverage.

Needed Change: Allow Roth HSA Contributions Irrespective of Wage Income. Under current law, deposits to a Roth IRA cannot exceed wage income in any given year. Yet the need for savings for health expenses is not limited to those who remain in the labor market. After all, most seniors are retired.

"Seniors should be able to convert their Roth IRAs into Roth Health Savings Accounts."

Needed Change: Allow Roth HSA Contributions without Income Limits. Under current law, taxpayers who file as a single with an adjusted gross income more than $110,000 cannot contribute to a Roth IRA, and cannot make the full contribution if their adjusted gross income is between $95,000 and $110,000. Taxpayers who are married filing jointly cannot contribute to a Roth IRA if their adjusted gross income is greater than $160,000, and can only make a partial contribution if their income is between $150,000 and $160,000. Yet the burdens of health care expenses do not end when income exceeds these limits. Accordingly, an expanded Roth IRA for health care should be available to all seniors regardless of income. Even if the annual contribution limits for Roth IRAs are maintained under current law, deposits to Roth HSAs should be available to all.

A Roth HSA would be designed as a wraparound account. It would provide funds with which to pay medical bills not paid by third-party insurance. For seniors who have only Medicare coverage, the Roth HSA could be used to pay expenses not paid by Medicare. For those who have both Medicare and Medigap insurance, the Roth HSA could be used to pay expenses not paid by either.

10. Paying for Long-Term Care[51]

The demand for long-term care is projected to grow rapidly as the Baby Boom generation begins to retire. The population over age 65 will grow by nearly two-thirds (64 percent) by 2020, and the number of seniors over age 85 will grow by 84 percent by 2025.[52] About 9 million seniors needed long-term care in 2005, according to the Centers for Medicare and Medicaid Services. This is expected to increase to 12 million seniors by 2020. As a group, seniors have about a 40 percent chance of entering a nursing home, and of those, about 10 percent will stay five years or more.[53]

Most nursing home stays are short and provide recuperative or rehabilitative care following an illness or hospital stay. For patients too sick to care for themselves at home but no longer in need of hospitalization, nursing homes are an important component in the continuum of care. However, the only nursing home care that Medicare will reimburse is medically necessary skilled nursing of a limited duration. Most long-term care provided in the United States assists disabled seniors with daily living activities such as bathing, dressing, meals and so forth. These services, commonly referred to as custodial care, are not paid for by Medicare.

Seniors in need of custodial care — whether in their home or in a nursing facility — must either pay for it out-of-pocket or purchase long-term care insurance. Although private insurance is available to cover the cost of long-term care, including home care, most seniors do not purchase coverage. Low-income seniors, and those who exhaust their savings, depend on Medicaid to cover their long-term care. Today, Medicaid pays for more than half of all long-term care.

In general, people must spend down their assets and meet certain income requirements before they qualify for Medicaid.[54] This gives people incentives to arrange their financial affairs just to meet asset and income tests for Medicaid long-term care benefits. There is a large elder law industry that assists middle-income seniors in sheltering assets to qualify for Medicaid.

Protecting Assets Through Long-Term Care Insurance. A pilot project in four states — Indiana, New York, Connecticut and California — called the Partnerships for Long Term Care, gives people financial incentives to purchase private long-term care insurance. There are currently two versions of this program.[55] A dollar-for-dollar asset shelter model is used in California, Connecticut and Indiana. Consumers purchase any amount of long-term care coverage they wish. In the event a policyholder requires nursing home care, he or she first relies on the long-term care insurance. When the insurance is exhausted, special eligibility rules allow the purchaser to receive Medicaid benefits while retaining assets equal to the value of the policy. For instance, a long-term care policy with $120,000 in benefits allows an individual to shelter $120,000 in assets and still qualify for Medicaid long-term care. Since most nursing home stays are a little less than one year, very few of those who have purchased policies have had to apply for Medicaid benefits.

"Seniors should protect their assets with private long-term care insurance."

New York Partnership policies are required to cover the cost of three years of nursing home care or six years of home care. This potentially means seniors must insure for more than $200,000 worth of services. In return, participants can shelter all their assets, not just an amount equal to the coverage received.[56] (Indiana uses a hybrid of the two approaches.) However, New York Partnership policies are more expensive.

Such lengthy (and expensive) coverage may be unnecessary. The average length of stay for discharged nursing home residents is just under one year (272 days).[57] A study by the actuarial firm Milliman USA of people with unlimited long-term care coverage found that less than 8 percent of claims were for periods lasting more than 48 months. More than three-fourths of claims (76.7 percent) were less than two years' duration.[58] This suggests that a more limited amount of coverage would pay the cost of nursing home care for most seniors. As little as one year might suffice.

Recent federal legislation allows all states to establish Partnership programs. Now they need to act.[59]

Making Long-Term Care Premiums Tax-Deductible. Few seniors purchase long-term care insurance, and even fewer working-age adults — even though 40 percent of nursing home residents are under age 65. One reason is that long-term care insurance is not given the same tax treatment as other health insurance.[60] The amount of long-term care premiums that are tax deductible is limited based on age. For instance, individuals under 40 years of age can only deduct $260 per year while those 41 to 50 years old can deduct $490, 51- to 60-year-olds can deduct $980, 61- to 70-year-olds can deduct $2,600, and seniors over 70 can deduct $3,250.[61] These limits are too low to cover the cost of insurance for older workers.

People can also use their HSAs or Flexible Spending Accounts (FSAs) to pay a limited amount of long-term care premiums tax-free. Unfortunately, many people don't have access to either HSAs or FSAs. Theoretically, current law allows any American under age 65 to establish an HSA. But the law requires the HSA to be accompanied by a high-deductible health plan. Individuals (and their employers) should be allowed to set up HSAs regardless of their insurance coverage. Just as there are a variety of accounts available to save for retirement, there should be a variety of HSAs in which individuals can save for future medical expenses.

Conclusion

The 10 steps outlined in this paper would make many of the institutional changes needed to prepare for the retirement of the baby boomers and succeeding generations. Current public policies encourage underfunding of corporate pension plans, discourage labor market mobility, discourage workers from saving on their own, and discourage personal and portable insurance.

"These reforms would help baby boomers and younger workers prepare for retirement."

If Congress implements these reforms, federal government and corporate policies will instead encourage flexible and sensible arrangements when it comes to saving for retirement, paying for health care or deciding whether or not to work, all the while helping workers build the largest possible nest egg in a way that reduces risk and volatility as retirement age approaches.

NOTE: Nothing written here should be construed as necessarily reflecting the views of the National Center for Policy Analysis or as an attempt to aid or hinder the passage of any bill before Congress.

Notes

[1] Andrew J. Rettenmaier and Thomas R. Saving, "The 2004 Medicare and Social Security Trustees Reports," National Center for Policy Analysis, Policy Report No. 266, June 4, 2004. Available online at http://www.ncpa.org/pub/st/st266/. Also see John C. Goodman, "The Coming Fiscal Deluge," National Center for Policy Analysis, Brief Analysis No. 502, February 15, 2005. Available online at http://www.ncpa.org/pub/ba/ba502/.

[2] William Ford, "2004 Comparative Study of Major Public Employee Retirement Systems," Wisconsin Legislative Council, December 2005. Also see Dennis Cauchon, "Public Workers' Pensions Swelling," *USA Today*, January 17, 2006.

[3] "2005 Annual Performance and Accountability Report," Pension Benefit Guarantee Corporation, November 15, 2005. Available online at http://www.pbgc.gov/docs/2005par.pdf.

[4] Alix Nyberg Stuart, "Promises, Promises," *CFO Magazine*, February 22, 2005. Available online at http://www.cfo.com/article.cfm/3665052/c_2984396/?f=archives. About 60 percent of large U.S. employers still offer retiree medical benefits. Few companies have enough assets to offset the liabilities, because they are not legally required to do so. The S&P 500's "other post-retirement employee benefits" obligations were only 12 percent funded in 2003, leaving companies with unfunded liabilities of $339 billion at the end of that year.

[5] See the discussion of this and other examples in Edward J. Harpham, "Private Pensions in Crisis: The Case for Radical Reform," National Center for Policy Analysis, Policy Report No. 115, January 1984.

[6] The law was the Employee Retirement Income Security Act (ERISA) of 1974.

[7] The existence of federal pension insurance does not guarantee all pension promises will be kept, however. The reason is that the PBGC sets a maximum on the amount it will pay to each retiree. For example, after Braniff filed for bankruptcy in 1982, retired teamsters receiving monthly pension checks of $665 saw their benefits reduced to $434. Retired machinists saw their monthly pension checks cut from $700 to $590. Harding Lawrence, former CEO of Braniff, had been counting on a $306,000-a-year pension. Under the bail-out, his pension was reduced to $16,568 a year. See Harpham, "Private Pensions in Crisis," page 7.

[8] "The Risk Exposure of the Pension Benefit Guaranty Corporation," Congressional Budget Office, September 2005. Available online at http://www.cbo.gov/ftpdocs/66xx/doc6646/09-15-PBGC.pdf.

[9] "Testimony of Bradley D. Belt, Executive Director of the Pension Benefit Guarantee Corporation," U.S. Senate, Committee on the Budget, June 15, 2005. Available online at http://www.dol.gov/ebsa/pdf/ty061505.pdf.

[10] Dennis E. Logue, "Pension Plans at Risk: A Potential Hazard of Deficit Reduction and Tax Reform," National Center for Policy Analysis, Policy Report No. 119, October 1985. Also see Celeste Colgan and John Goodman, "Saving and Investing: A Challenge for Women," National Center for Policy Analysis, Policy Backgrounder No. 161, April 13, 2004. Available online at http://www.ncpa.org/pub/bg/bg161/.

[11] Based on William B. Conerly, "The Defined Benefit Pension Crisis," National Center for Policy Analysis, Brief Analysis No. 540, December 21, 2005. Available online at http://www.ncpa.org/ba/ba540/ba540.html.

[12] Under current law, workers are subject to one of two vesting schedules: "cliff" vesting, which gives the employee a nonforfeitable right to employer matching contributions after three years, and "graded" vesting, under which employees gradually acquire a nonforfeitable right to employer contributions until finally reaching full vesting after six years. See "What You Should Know About Your Retirement Plan," Employee Benefits Security Administration, U.S. Department of Labor, October 2003. Available online at http://www.dol.gov/ebsa/pdf/wyskgreenbook.pdf.

[13] U.S. Bureau of Labor Statistics, "Number of Jobs Held, Labor Market Activity, and Earnings Growth Among Younger Baby Boomers: Results from More Than Two Decades of a Longitudinal Survey," USDL 02-497, August 27, 2002, as reported in the *Statistical Abstract of the United States: 2004-2005* (Washington, D.C.: U.S. Department of Commerce, October 2004), Table No. 591, page 382.

[14] "401(k)-Type Plan and IRA Ownership," Employee Benefits Research Institute, *EBRI Notes*, Vol. 26, No.1, January 2005. Available online at http://www.ebri.org/pdf/notespdf/0105notes.pdf.

[15] David Wessel, "Rule Keeps Returns Low for Some in 401(k)s," *Wall Street Journal*, August 4, 2005. The Hewitt Associates survey included 458 "large U.S. employers."

[16] "Utilization of Tax Incentives for Retirement Saving," Congressional Budget Office, August 2003. Available online at http://

www.cbo.gov/showdoc.cfm?index=4490&sequence=0&from=0.

[17] Well under 10 percent of participants contribute as much as is allowed by law. See Peter R. Orszag, "Progressivity and Saving: Fixing the Nation's Upside-Down Incentives for Saving," Brookings Institution, Testimony before the House Committee on Education and the Workforce, February 25, 2004. Available online at http://www.brookings.edu/views/testimony/orszag/20040225.pdf.

[18] "Trends and Experience in 401(k) Plans," Hewitt Associates, 2003.

[19] David Wessel, "Rule Keeps Returns Low for Some in 401(k)s," *Wall Street Journal*, August 4, 2005. The Vanguard Associates survey included 1,694 plans.

[20] See Brooks Hamilton and Scott Burns, "Reinventing Retirement Income in America," National Center for Policy Analysis, Policy Report No. 248, December 2001.

[21] "The 2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds," U.S. Social Security Administration, March 2005.

[22] Hewitt Associates, "Survey Findings: Trends and Experience in 401(k) Plans 2003," 2003, page 71. Also see "Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy," National Academy of Social Insurance, Study Panel Final Report, 2005, page 54. Available online at http://www.nasi.org/publications2763/publications_show.htm?doc_id=212927.

[23] For more information, see John C. Goodman and Peter R. Orszag, "Retirement Savings Reforms on which the Left and the Right Can Agree," National Center for Policy Analysis, Brief Analysis No. 495, December 1, 2004. Available online at http://www.ncpa.org/pub/ba/ba495/.

[24] Brigitte Madrian and Dennis Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics,* Vol. 116, No. 4, November 2001, pages 1,149-87. Also see Sarah Holden and Jack VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulation at Retirement," Employee Benefits Research Institute, Issue Brief No. 283, July 2005. Available online at http://www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=3565; and William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Automatic 401(k): A Simple Way to Strengthen Retirement Savings," Retirement Security Project, March 2005. Available online at http://www.brookings.edu/views/papers/20050228_401k.htm.

[25] David Wessel, "Rule Keeps Returns Low for Some in 401(k)s," *Wall Street Journal*, August 4, 2005.

[26] The Contract with America was a document released by the Republican Party during the 1994 Congressional elections. The Contract had several provisions, including tort reform, a reduction in the capital gains taxation rate, repeal of taxes on Social Security benefits and elimination of the Social Security earnings limit, among others.

[27] Originally, the Social Security earnings test applied to all beneficiaries who received wage income, regardless of age. In 2000, the law was changed and now applies only to Social Security beneficiaries who have not yet attained normal retirement age and who earn wage income that exceeds a certain threshold (which is adjusted for inflation each year). One of two different thresholds applies, depending on whether or not it is the year in which the worker reaches normal retirement age. Social Security withholds $1.00 in benefits for every $2.00 of earnings in excess of the first threshold ($12,480 in 2006) for people who will attain normal retirement age in a future year. A second threshold applies to the wage income of early retirees who will reach normal retirement age in the current year; in 2006, this threshold is $33,240. Social Security withholds $1.00 in benefits for every $3.00 of earnings above this second threshold in the months prior to the month in which the retiree reaches the normal retirement age. When an early retiree reaches normal retirement age, benefits lost to the earnings test are restored in a manner that is considered actuarially fair by recalculating the retiree's Social Security benefit payments and providing him a higher payment for the rest of his life. Thus, from the government's perspective, regardless of when a person retires, the lifetime Social Security benefits paid will, on average, be the same. However, from the individual's perspective the earnings test can be perceived as a tax: First, many individuals are present-oriented, placing a much greater value on benefits today than benefits promised in the future. Second, many individuals may prefer the certainty of benefits today versus an uncertain stream of benefits stretching over many years. Third, in making the calculation of how much to increase benefits in the future, the government discounts future payments at its own borrowing rate. Since that rate is much lower than the rate at which an individual can borrow in the marketplace, individuals are likely to view benefits forgone today as more valuable than the increased payments in future years. For more information, see "Exempt Amounts Under the Earnings Test," Social Security Administration Web site feature, October 2005. Available online at http://www.ssa.gov/OACT/COLA/rtea.html.

[28] Alan L. Gustman and Thomas L. Steinmeier, "The Social Security Retirement Earnings Test, Retirement and Benefit Claiming," National Bureau of Economic Analysis, Working Paper No. 10905, November 2004. Available online at http://www.nber.org/papers/w10905.

[29] Michael V. Leonesio, Denton R. Vaughan and Bernard Wixon, "Early Retirees Under Social Security: Health Status and Economic Resources," Social Security Administration, Office of Research, Evaluation and Statistics, ORES Working Paper Series Number 86, August 2000. Available online at http://www.socialsecurity.gov/policy/docs/workingpapers/wp86.pdf.

[30] Alan L. Gustman and Thomas L. Steinmeier, "The Social Security Retirement Earnings Test, Retirement and Benefit Claiming," National Bureau of Economic Analysis, Working Paper No. 10905, November 2004. Available online at http://www.nber.org/papers/w10905.

[31] Stephen J. Entin, "Reducing the Social Security Benefits Tax," National Center for Policy Analysis, Brief Analysis No. 332, August 10, 2000. Available online at http://www.ncpa.org/ba/ba332/ba332.html. Also see "Understanding the Benefits," Social Security Administration, SSA Publication No. 05-10024, January 2006. Available online at http://www.ssa.gov/pubs/10024.pdf.

[32] For the purpose of the benefits tax, modified adjusted gross income includes all ordinary adjusted gross income plus half of Social Security benefits plus income from tax-exempt bonds.

[33] Stephen J. Entin, "Reducing the Social Security Benefits Tax," National Center for Policy Analysis, Brief Analysis No. 332, August 10, 2000.

[34] Jagadeesh Gokhale and Laurence J. Kotlikoff, "Tax-Favored Savings Accounts: Who Gains? Who Loses?" National Center for Policy Analysis, Policy Report No. 249, January 2002. Available online at http://www.ncpa.org/pub/st/st249/.

[35] *ESPlanner*, the financial planning software developed by Laurence Kotlikoff. The model evens out consumption over a person's lifetime.

[36] Adapted from "Women in Health," a special online feature of the National Center for Policy Analysis's "Women in the Economy" project. Available online at http://www.womenintheeconomy.org/healthcare.pdf.

[37] Kevin T. Stroupe, Eleanor D. Kinney and Thomas J. Kniesner, "Chronic Illness and Health Insurance-Related Job Lock," Center for Policy Research, Syracuse University, Working Paper No. 19, August 2000.

[38] HIPAA guarantees the right to obtain health coverage to people who have "credited prior coverage." However, a significant gap in coverage is enough to remove protections and allow insurers to require a waiting period for a pre-existing condition. A significant gap is defined at 63 days or more. State laws may provide longer protections. See "Frequently Asked Questions about Portability of Health Coverage and HIPAA," Employee Benefits Security Administration, U.S. Department of Labor, February 7, 2006.

[39] For more information, see John Goodman, "A Proposal to Create Personal and Portable Insurance at the State Level," a special online feature of the National Center for Policy Analysis's "Debate Central" project. Available online at http://www.debate-central.org/topics/2002/pers_port.html.

[40] Employer-sponsored health insurance is paid with pretax funds. The employee receives a subsidy because health insurance premiums are excluded from the 15 percent payroll tax, an additional subsidy equal to their marginal tax bracket and a subsidy of any state or local income tax. An employee in the 25 percent federal income tax bracket and a 5 percent state and local tax bracket would receive a subsidy of about 45 percent.

[41] Federal law allows all taxpayers to deduct health (and health insurance) expenses above 7.5 percent of adjusted gross income. Although fewer women than men work in small businesses, of those who do, fewer women are given the option of job-based health insurance (44 percent versus 47 percent). See "National Health Care by Type of Expenditure: Calendar Year 2001," Centers for Medicare and Medicaid Services, November 2003.

[42] Adapted from John Goodman, "A Proposal to Create Personal and Portable Insurance at the State Level," a special online feature of the National Center for Policy Analysis's "Debate Central" project. Available online at http://www.debate-central.org/topics/2002/pers_port.html.

[43] Although all group insurance is guaranteed issue, it is not a requirement for individual insurance in most states.

[44] Firms employing 200 or more workers in 2003. Of small firms with only three to 24 workers, only 9 percent offer retiree benefits. See "Section 11: Retiree Health Benefits," in "Employer Health Benefits: 2003 Annual Survey," Kaiser Family Foundation, 2003.

[45] Ibid.

[46] Firms employing 200 or more workers in 2003. See "Section 11: Retiree Health Benefits," in "Employer Health Benefits: 2003 Annual Survey," Kaiser Family Foundation, 2003.

[47] Adapted from John C. Goodman, "Ten Easy Health Reforms," National Center for Policy Analysis, Brief Analysis No. 497, January 14, 2005. Available online at http://www.ncpa.org/pub/ba/ba497/. Also see John C. Goodman, "Prescription Drugs

for Seniors: The Roth IRA Solution," National Center for Policy Analysis, Brief Analysis No. 315, March 16, 2000. Available online at http://www.ncpa.org/ba/ba315/ba315.html.

[48] However, if they have HSA accumulations prior to age 65, Medicare enrollees can use unexpended HSA funds to pay Medicare premiums, deductibles, copays and coninsurance, premiums for an employer's retiree medical insurance, or other out-of-pocket medical expenses. The one restriction is that HSA funds cannot be used to purchase Medicare supplemental insurance, known as "Medigap" policies.

[49] See "State of the Union: Affordable and Accessible Health Care," Office of the Press Secretary, White House Fact Sheet, January 31, 2006. Available online: http://www.whitehouse.gov/news/releases/2006/01/20060131-7.html.

[50] Ellen Meara, Chapin White and David M. Cutler, "Trends in Medical Spending by Age, 1963-2000," *Health Affairs*, Vol. 23, No. 4, July/August 2004, page 179.

[51] Much of this section is taken from John Goodman et al., "Medicaid Empire: Why New York Spends so much on Health Care for the Poor and Near Poor and How the System Can Be Reformed," National Center for Policy Analysis, Policy Report, forthcoming.

[52] Statement of Raymond C. Scheppach, Executive Director, National Governors Association, before the Medicaid Commission on Short-Term Medicaid Reform, August 17, 2005.

[53] "Long Term Care," Centers for Medicare and Medicaid Services, March 31, 2005. Available online at http://www.medicare.gov/LongTermCare/Static/Home.asp. Access verified January 4, 2006.

[54] Ibid.

[55] Robyn I. Stone, "Long-Term Care for the Elderly with Disabilities: Current Policy, Emerging Trends, and Implications for the Twenty-First Century," Milbank Memorial Fund, August 2000.

[56] Mark R. Meiners (Director, Partnership for Long-Term Care), University of Maryland. Available online at http://www.hhp.umd.edu/AGING/PLTC/overview.html.

[57] United States data for 1999. Average length of stay for current residents was significantly longer than for discharged – about 892 days. See A. Jones, "The National Nursing Home Survey: 1999 Summary," National Center for Health Statistics, Vital and Health Statistics, Series 13, No. 152, June 2002.

[58] Claims include those for nursing home care, assisted living and home care services. See Dawn Helwig, Milliman USA, April 2005. Also see discussion in Susan B. Garland, "Long-Term-Care Insurance: How Much Is Too Much?" *New York Times*, July 24, 2005.

[59] "The Deficit Reduction Omnibus Reconciliation Act of 2005" allows expansion of Long Term Care Partnership Programs to all states.

[60] Long-term care premiums are a medical expense under section 213(d) of the tax code, but those expenses are only deductible to the extent that they exceed 7.5 percent of adjusted gross income.

[61] "Medical and Dental Expenses," IRS Publication 502, 2004. Available at http://www.irs.gov/publications/p502/.

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Moore recently returned from Washington, D.C., where he headed the NCPA's satellite office and was responsible for government affairs and outreach, ensuring that NCPA's research and findings get into the hands of members of Congress and their staffs. He also represented NCPA with associations, coalitions and organizations in Washington.

Moore earned a Master's degree in Public Policy from Georgetown University in Washington, D.C. He also earned a Bachelor of Arts in Political Science and a Bachelor of Arts in Corporate Communications and Public Affairs from Southern Methodist University in Dallas, Texas.

About the NCPA

The NCPA was established in 1983 as a nonprofit, nonpartisan public policy research institute. Its mission is to seek innovative private sector solutions to public policy problems.

The center is probably best known for developing the concept of Medical Savings Accounts (MSAs), now known as Health Savings Accounts (HSAs). The *Wall Street Journal* and *National Journal* called NCPA President John C. Goodman "the father of Medical Savings Accounts." Sen. Phil Gramm said MSAs are "the only original idea in health policy in more than a decade." Congress approved a pilot MSA program for small businesses and the self-employed in 1996 and voted in 1997 to allow Medicare beneficiaries to have MSAs. A June 2002 IRS ruling frees the private sector to have flexible medical savings accounts and even personal and portable insurance. A series of NCPA publications and briefings for members of Congress and the White House staff helped lead to this important ruling. In 2003, as part of Medicare reform, Congress and the President made HSAs available to all non-seniors, potentially revolutionizing the entire health care industry.

The NCPA also outlined the concept of using tax credits to encourage private health insurance. The NCPA helped formulate a bipartisan proposal in both the Senate and the House, and Dr. Goodman testified before the House Ways and Means Committee on its benefits. Dr. Goodman also helped develop a similar plan for then presidential candidate George W. Bush.

The NCPA shaped the pro-growth approach to tax policy during the 1990s. A package of tax cuts, designed by the NCPA and the U.S. Chamber of Commerce in 1991, became the core of the Contract With America in 1994. Three of the five proposals (capital gains tax cut, Roth IRA and eliminating the Social Security earnings penalty) became law. A fourth proposal — rolling back the tax on Social Security benefits — passed the House of Representatives in summer 2002.

The NCPA's proposal for an across-the-board tax cut became the focal point of the pro-growth approach to tax cuts and the centerpiece of President Bush's tax cut proposal. The repeal by Congress of the death tax and marriage penalty in the 2001 tax cut bill reflects the continued work of the NCPA.

Entitlement reform is another important area. With a grant from the NCPA, economists at Texas A&M University developed a model to evaluate the future of Social Security and Medicare. This work is under the direction of Texas A&M Professor Thomas R. Saving, who was appointed a Social Security and Medicare Trustee. Our online Social Security calculator, found on the NCPA's Social Security reform Internet site (www.TeamNCPA.org) allows visitors to discover their expected taxes and benefits and how much they would have accumulated had their taxes been invested privately.

Team NCPA is an innovative national volunteer network to educate average Americans about the problems with the current Social Security system and the benefits of personal retirement accounts.

In the 1980s, the NCPA was the first public policy institute to publish a report card on public schools, based on results of student achievement exams. It also measured the efficiency of Texas school districts. Subsequently, the NCPA pioneered the concept of education tax credits to promote competition and choice through the tax system. To bring the best ideas on school choice to the forefront, the NCPA and Children First America published an *Education Agenda* for the new Bush administration, policymakers, congressional staffs and the media. This book provides policy makers with a road map for comprehensive reform. And a June 2002 Supreme Court ruling upheld a school voucher program in Cleveland, an idea the NCPA has endorsed and promoted for years.

The NCPA's E-Team program on energy and environmental issues works closely with other think tanks to respond to misinformation and promote commonsense alternatives that promote sound science, sound economics and private property rights. A pathbreaking 2001 NCPA study showed that the costs of the Kyoto agreement to halt global warming would far exceed any benefits. The NCPA's work helped the administration realize that the treaty would be bad for America, and it has withdrawn from the treaty.

NCPA studies, ideas and experts are quoted frequently in news stories nationwide. Columns written by NCPA scholars appear regularly in national publications such as the *Wall Street Journal*, the *Washington Times*, *USA Today* and many other major-market daily newspapers, as well as on radio talk shows, television public affairs programs, and in public policy newsletters. According to media figures from Burrelle's, nearly 3 million people daily read or hear about NCPA ideas and activities somewhere in the United States.

The NCPA home page (www.ncpa.org) links visitors to the best available information, including studies produced by think tanks all over the world. Britannica.com named the ncpa.org Web site one of the best on the Internet when reviewed for quality, accuracy of content, presentation and usability.

What Others Say about the NCPA

"...influencing the national debate with studies, reports and seminars."

- TIME

"Oftentimes during policy debates among staff, a smart young staffer will step up and say, 'I got this piece of evidence from the NCPA.' It adds intellectual thought to help shape public policy in the state of Texas."

- Then-GOV. GEORGE W. BUSH

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As Baby Boomers age, they often struggle to find the motivation to embrace a healthy lifestyle. Here are tips on how to make changes and keep them.Â Boot camp after 60: Ten steps to turn around unhealthy habits. Bruce Horovitz.Â He says most baby boomers approach retirement age unwilling to follow basic healthy lifestyle goals established by the American Heart Association. Kaiser Health News asked three professionals who focus on aging and health for advice on how seniors can find the will to adopt better habits. â€œPeople do financial planning for retirement, but what about retirement health planning?â€ King said. Motivated seniors can begin by following KHNâ€™s 10-step program: 1. Buy great sneakers. Baby Boomers are retiring in large numbers. Many do not have enough saved for their retirement. Beyond a lack of planning, a key reason Baby Boomers lack retirement savings is due to the 2008 financial crisis, as well as the chronic low interest rates since. The stock market losses of the COVID-19 pandemic are adding to the shortfall. How Much Have Baby Boomers Saved for Retirement? Baby Boomers have an average of $152,000 saved for retirement, according to the 19th Annual Retirement Survey of Workers conducted by the TransAmerica Center for Retirement Studies. This is not nearly enough to las