

## **THE POLICYMAKER'S HANDBOOK TO ENTITLEMENT REFORM: A NEW APPROACH TO SAVING OUR SENIORS**

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*The Social Security and Medicare programs make up the entitlement system for the retired population in the United States, but as time progresses and the number of retired individuals increases, the future of these programs will be jeopardized. Social Security faces a real threat of insolvency as program payouts become higher than the system can support. The future of the Medicare Program faces its demise due to a smaller workforce having to fund a higher proportion of retirees, increasing medical costs, and a structure that fails to provide benefits necessary to meet certain individual's needs. Consequently, pressing concern exists to reform the entitlement system for elderly, retired persons. Proposed reforms generally have focused on privatizing both Social Security and Medicare in order to afford elderly individuals greater autonomy and control over their retirement savings and health coverage; however, the proposed reforms have failed for a variety of reasons. This Note proposes a four-step approach to fixing the United States entitlement system for the retired population. First, Social Security and Medicare should be combined into a Senior Assistance Personal Retirement Account that makes a fixed, single monthly payment. Second, the system should be funded partly through individual accounts that can be invested in the free market. Third, the government should implement a federal choice of law statute designed to increase competition and reduce health insurance costs. Finally, each change should be specifically designed to ensure that the entitlement system retains its main function of providing a safety net to needy individuals. Together, the author believes that these changes not only will prevent the future demise of the entitlement system but also significantly improve its effectiveness.*

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## I. Introduction

Millions of Americans are forced to agonize over whether they will have enough money to support themselves during their retirements.<sup>1</sup> With a Social Security system heading toward bankruptcy, a Medicare system that is confusing, restrictive, and wastefully bureaucratic, and a Congress that refuses to fix our broken entitlement system, these Americans have good reason to worry. The system must be changed to afford individuals control over their financial futures and help to alleviate these fears.

As a result of their similar structures, both Social Security and Medicare face many of the same problems.<sup>2</sup> Social Security faces the very serious and very real threat of insolvency due to its pay-as-you-go funding structure, the retirement of baby boomers, and longer life expectancies, all resulting in payouts higher than the system can support.<sup>3</sup> In addition, the government has been borrowing extensively from Social Security's surplus for the past two decades, meaning that when the system actually does fall into crisis, it will not have the safety net that it was expected to have when Social Security was reformed under the Reagan administration in the 1980s.<sup>4</sup> Medicare has become increasingly untenable due to rising medical costs, a higher proportion of retirees relying on a smaller workforce for funding, and benefits that are structurally insufficient to cover certain individual needs and benefits like long-term care.<sup>5</sup>

This Note will act as a handbook to policymakers on reforming our nation's entitlement system. Part II will look at the current design of the entitlement system for the retired population, focusing on the original purposes for which the programs were implemented and the goals that the programs have come to possess today. These are important considerations to keep in mind as any course of reform must retain the programs' purposes. Part III will analyze the serious issues facing the entitlement system designed to support the nation's retirees

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1. Sue Kirchhoff et al., *Pension Funding Problems Grow*, USA TODAY, May 15, 2005, available at [http://www.usatoday.com/money/perfi/retirement/2005-05-15-pension-cover\\_x.htm](http://www.usatoday.com/money/perfi/retirement/2005-05-15-pension-cover_x.htm).

2. See *infra* Part II.

3. June E. O'Neill, *Assuring the Future of Social Security: Privatization and Other Reforms: Why Social Security Needs Fundamental Reform*, 65 OHIO ST. L.J. 79, 80-81 (2004).

4. Henry H. Drummonds, *The Aging of the Boomers and the Coming Crisis in America's Changing Retirement and Elder Care Systems*, 11 LEWIS & CLARK L. REV. 267, 294 (2007).

5. *Id.* at 274.

and argue that the entitlement system is in desperate need of reform, not only for its long-term survival but also for its usefulness in light of the changing needs of today's retirees. This Part will go on to analyze certain reform proposals that have been made in response to the systematic problems faced by Social Security and Medicare.

Part IV will focus on Medicare, arguing that it is most at risk and requires the most significant and immediate overhaul. This Part will propose that Medicare be converted to individual vouchers, similar to the current Social Security system, which, when combined, will form a single Senior Assistance Personal Retirement Account (SAPRA). By drawing from this account, retirees can allocate their funds to meet their individual needs, including buying health insurance. This Part will further argue that the entitlement system must incorporate, although not exclusively rely upon, free market principles into its funding structure in order to ensure the long-term solvency of both Social Security and Medicare.

## II. Background

Entitlement reform is often referred to as "the third rail of politics: touch it and you die."<sup>6</sup> As the name suggests, many individuals now feel entitled to receive payments under Social Security and Medicare.<sup>7</sup> For most, this is completely justified, as they have spent years paying into the system, reducing their wages and present day spending capacity, and therefore should expect nothing less than a return of what they contributed.<sup>8</sup> All attempts to reform the system have been accompanied by trepidation on the part of retirees, who worry that their entitlements may be reduced, and those nearing retirement, who worry that they may have to work longer or face other changes.<sup>9</sup> As these individuals generally oppose reform plans of any kind, entitle-

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6. Kathryn L. Moore, *Reforming Retirement Systems: Why the French Have Succeeded When Americans Have Not*, 22 ARIZ. J. INT'L & COMP. L. 251, 286 (2005).

7. See generally David A. Super, *The Political Economy of Entitlement*, 104 COLUM. L. REV. 633 (2004) (offering six different definitions of entitlement).

8. *Id.* at 647 (citing an editorial pointing out that the entitlement system works when individuals earn their benefits through working).

9. Kathryn L. Moore, *Raising the Social Security Retirement Ages: Weighing the Costs and Benefits*, 33 ARIZ. ST. L.J. 543, 546 (2001) [hereinafter Moore, *Retirement Ages*]; Karen C. Burke & Grayson M.P. McCouch, *Perspectives on Social Security Reform*, 4 FLA. TAX REV. 417, 426 (1999) (book review).

ment reform is a major risk for any politician who wishes to address the issue.<sup>10</sup>

The argument for entitlement reform must include an examination of the historical underpinnings of both Social Security and Medicare, specifically as to the purposes behind the programs. It is equally important, however, to understand the current structures of the systems and how their purposes have evolved over time.

#### A. Social Security

The Social Security Act of 1935 established a system by which the nation's elderly could depart from the workforce as old age makes labor more difficult to perform.<sup>11</sup> The system assured that those who leave the workforce would have a source of income in the form of a government payout.<sup>12</sup>

While the Act did not specify how the program was to be constructed,<sup>13</sup> what emerged was the system still in place today. Social Security is structured as a pay-as-you-go (PAYGO) system, meaning that today's workers are currently supporting today's retirees.<sup>14</sup> The government deducts payroll taxes from the workforce's earnings and uses them to make payouts to the retired population.<sup>15</sup> The payroll taxes, therefore, only stay in the system to the extent to which they exceed the amount of payout, and that excess is kept ostensibly in the Social Security trust fund for future use.<sup>16</sup> The federal government, however, has continually borrowed from the trust fund, so the trust fund contains little actual money and instead consists primarily of IOUs.<sup>17</sup>

The motivations behind the Social Security system are more complicated than simple altruistic feelings toward the nation's elderly.

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10. See Moore, *Retirement Ages*, *supra* note 9, at 546; Burke & McCouch, *supra* note 9, at 426.

11. Social Security Act of 1935, Pub. L. No. 74-271, ch. 531, 49 Stat. 620 (codified as amended in scattered sections of 42 U.S.C.); see Soc. Sec. Admin., Social Security History, <http://www.ssa.gov/history/law.html> (last visited Feb. 15, 2010) (exploring an in-depth legislative history of the Social Security Act of 1935).

12. Social Security Act of 1935; Soc. Sec. Admin., *supra* note 11.

13. O'Neill, *supra* note 3, at 80.

14. Neil H. Buchanan, *Social Security and Government Deficits: When Should We Worry?*, 92 CORNELL L. REV. 257, 267 (2007) [hereinafter Buchanan, *When Should We Worry?*].

15. *Id.*

16. *Id.* at 271.

17. *Id.* at 272; Drummonds, *supra* note 4, at 294.

Social Security was developed at a time when the country was facing the extreme challenges of the Great Depression.<sup>18</sup> The elderly were the most severely harmed by the economic conditions, as they tend to be more susceptible to poverty as a result of their old age, greater frequency of medical problems, limited ability and opportunity to participate in the workforce, and diminished ability to support themselves.<sup>19</sup> These factors combined to result in disproportionate poverty among the elderly.<sup>20</sup>

As a program fighting poverty among the elderly, Social Security has had some success, as “the poverty rate of people age sixty-five and older has declined sharply over the years—from about 35 percent in 1959 to 10 percent in 1999.”<sup>21</sup> Social Security is at least partially responsible for that decline while the “general rise in income in the economy also contributed.”<sup>22</sup>

However, poverty reduction among the elderly is not Social Security’s sole purpose, as only a fraction of the program’s expenditures are actually needed to fight poverty.<sup>23</sup> Specifically, “in 1999, it would have required only 20 percent of total Social Security expenditures to eliminate poverty altogether among men and women age 65 and over.”<sup>24</sup> As it currently stands, Social Security permits many poverty-stricken elderly to fall through the cracks, providing no or low benefits to those who did not earn enough to qualify for benefits and were not married to someone who did qualify.<sup>25</sup>

If Congress was solely concerned with fighting poverty among the elderly, the program’s founders would have proposed a smaller system that covered just the poor.<sup>26</sup> However, with universal coverage of the workforce and the bulk of the benefits going to those who are not considered poor, only a small portion of the system addresses the goal of fighting poverty by going to “those whose incomes without any benefits would [be] below poverty by varying amounts.”<sup>27</sup>

Some justify Social Security’s universal coverage with the belief that the young are inherently disinclined to collect and save assets for

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18. O’Neill, *supra* note 3, at 89.

19. *Id.* at 90.

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

retirement, and without the government saving on their behalf, countless more individuals would be forced to face poverty in their retirement years.<sup>28</sup> From this perspective, Social Security serves as a safety net for America's workforce, attempting to ensure "a 'subsistence' standard of living" by providing enough money to obtain the bare minimums in terms of food, shelter, and other basic necessities.<sup>29</sup> The system protects those who do not anticipate financial struggles in the form of poverty and lack of medical care but for whatever number of reasons fail to or "are unable to accumulate adequate resources for their post working lives."<sup>30</sup>

In sum, the Social Security system has the purpose of creating a baseline standard of living for all retired workers, acting more as a method to prevent unexpected poverty than to pull those who are poor out of poverty in their old age.

## B. Medicare

In 1965, after many years of struggle and debate, Congress passed an addition to Social Security that would focus solely on medical care for the elderly,<sup>31</sup> and the United States became the first and only industrial democracy with mandatory health insurance exclusively for its elderly citizens.<sup>32</sup>

Medicare was passed in Congress only after much deliberation over its branding, specifically the desire to avoid the stigma that accompanies traditional welfare programs and public assistance.<sup>33</sup> Congress purposefully modeled Medicare after Social Security, as a social insurance program whose benefits were earned as a result of years working in addition to its underlying status as an entitlement program.<sup>34</sup> Medicare restricted "eligibility to persons over age sixty-five,

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28. *Id.*

29. Drummonds, *supra* note 4, at 293.

30. *Id.*

31. Social Security Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 286 (codified as amended in scattered sections of 42 U.S.C.); Health Insurance for the Aged Act, Pub. L. No. 89-97, 79 Stat. 290 (1965) (codified as amended in scattered sections of 42 U.S.C.); Old-Age, Survivors, and Disability Insurance Amendments of 1965, Pub. L. No. 89-97, 79 Stat. 361 (codified as amended in scattered sections of 42 U.S.C.).

32. Theodore R. Marmor & Gary J. McKissick, *Medicare's Future: Fact, Fiction and Folly*, 26 AM. J.L. & MED. 225, 227 (2000).

33. *Id.* at 228.

34. *Id.*

and their spouses, who had contributed to the Social Security system during their working life.”<sup>35</sup>

Because of the extensive costs involved in health care, Medicare requires a diverse funding structure. It is funded “by a combination of payroll taxes, general revenue and beneficiary premiums” in adjusting ratios that have, over time, tipped more heavily toward general revenue to cover program expenses.<sup>36</sup> With medical costs consistently rising since the inception of Medicare, Congress has raised payroll taxes six times since 1965 in an attempt to meet the funding gap.<sup>37</sup>

The benefits of the 1965 Act were originally structured in two parts. Part A provides acute hospital care “as well as home health visits by skilled caregivers and nursing home facilities where skilled medical care is provided, and is funded by a 2.9% payroll tax on all earnings”; Part B provides physician treatment, “ambulance charges, and some home health expenses, funded 75% from general tax revenues and 25% by annually adjusted premiums of the enrollees.”<sup>38</sup> The minimum Part B premium in 2010 is \$110.50 per month, up from \$54 per month in 2002.<sup>39</sup> This structure, however, was applicable more to medical care generally as opposed to the special medical needs of the elderly, specifically “the problems of the chronically sick elderly, those whose medical conditions would not dramatically improve and who needed to maintain independent function more than triumph over discrete illness and injury.”<sup>40</sup>

Congress attempted to address this concern in 1997 and 2003 when it supplemented Medicare with Parts C and D respectively. In 1997, Congress added Part C to Medicare, now known as the Medi-

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35. *Id.* at 229.

36. NAT'L BIPARTISAN COMM'N ON THE FUTURE OF MEDICARE, BUILDING A BETTER MEDICARE FOR TODAY AND TOMORROW, Mar. 16, 1999, available at <http://thomas.loc.gov/medicare/bbmtt31599.html> [hereinafter BUILDING A BETTER MEDICARE].

37. Tamara E. Russell, *Trav'lin' Light: Early Retirees and the Availability of Post-Retirement Health Benefits*, 22 AM. J.L. & MED. 537, 544 (1996).

38. Drummonds, *supra* note 4, at 294; see Marmor & McKissick, *supra* note 32, at 229.

39. Drummonds, *supra* note 4, at 294; CTRS. FOR MEDICARE & MEDICAID SERVS., MEDICARE AND YOU 2010, at 119 (2010), <http://www.medicare.gov/Publications/Pubs/pdf/10050.pdf> [hereinafter MEDICARE AND YOU] (indicating that the premium will be higher for those who are single with income higher than \$85,000 per year and those who are married with income higher than \$170,000).

40. Marmor & McKissick, *supra* note 32, at 229.

care Advantage Plans.<sup>41</sup> Part C permits recipients of Medicare Parts A and B to use a fixed amount paid by Medicare each month toward the purchase of private insurance from a limited list of approved plans.<sup>42</sup> Congress added Part D to Medicare in 2003, expanding coverage to reduce the cost of certain prescription drugs for seniors.<sup>43</sup> While the intention of expanding Medicare is laudable, many key elements of medical coverage for seniors escape current Medicare coverage.<sup>44</sup>

The purpose behind the adoption of the Medicare program stems from the idea that the elderly "could be presumed to be both needy and deserving."<sup>45</sup> Retirees face greater need as a result of the lower earning capacities and higher medical expenses inherently associated with old age, and they are presumed deserving due to the years they have spent working.<sup>46</sup> The actual structure of Medicare exists in a form far removed from welfare with "Social Security financing and eligibility for hospital care and premiums plus general revenues for physician expenses."<sup>47</sup> Congress designed Medicare this way to make the program politically palatable, but there is "no clear philosophical rationale," so the program is left without the persisting ideological support that most congressional programs have.<sup>48</sup>

Similar to Social Security, Medicare attempted to establish a safety net of care for retirees.<sup>49</sup> However, while Social Security was able to cast a broad net in the form of a standard payout, medical care for the elderly faces a wide variety of problems requiring careful consideration of the specialized needs of the elderly and the varying costs of medical care facing each individual.<sup>50</sup> The federal government ad-

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41. Balanced Budget Act of 1997, Pub. L. No. 105-33, § 4001, 11 Stat. 251, 275. Medicare Part C was originally called "Medicare+Choice" but was updated in 2003. Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, 117 Stat. 2066.

42. § 4001, 11 Stat. at 275; Rick Swedloff, *Can't Settle, Can't Sue: How Congress Stole Tort Remedies from Medicare Beneficiaries*, 41 AKRON L. REV. 557, 608 n.68, (2008); MEDICARE AND YOU, *supra* note 39, at 75.

43. § 4001, 11 Stat. at 275; Swedloff, *supra* note 42, at 608 n.69; MEDICARE AND YOU, *supra* note 39, at 78.

44. See generally Susan Adler Channick, *The Medicare Prescription Drug, Improvement, and Modernization Act of 2003: Will It Be Good Medicine for U.S. Health Policy?*, 14 ELDER L.J. 237 (2006) (arguing that Medicare Part D misses many key elements of adequate coverage for the elderly).

45. Marmor & McKissick, *supra* note 32, at 229.

46. *Id.*

47. *Id.*

48. See *id.*

49. Drummonds, *supra* note 4, at 293-94.

50. *Id.* at 294.

dressed this concern in 1977 when Medicare's administration shifted from the Social Security Administration to the Department of Health and Human Services under what would eventually be known as the Center for Medicare and Medicaid Services (CMS).<sup>51</sup> This moved the program further from its original status as a social insurance program.

Any Medicare reform must retain three vital aspects of the program in order to maintain its purpose as both a social insurance and entitlement program: (1) its universal nature, (2) risk pooling, and (3) government protection of beneficiaries.

First, it is important to retain "the universal nature of the program and its consequent redistributive function."<sup>52</sup> The Medicare program permits improved access to health care by insuring all retirees, who no longer have to fear that illnesses, high medical expenses, and preexisting conditions will lead to a loss of coverage as they might in the private sector.<sup>53</sup> The health care offered also meets a base level of quality for all, even though "there is substantial variation in the ability of beneficiaries to supplement Medicare's basic benefits."<sup>54</sup>

Second, Medicare has been successful in providing health insurance for everyone by pooling the risks and sharing the burdens across those with varying qualities of health.<sup>55</sup> Without this structure, it is likely that only the healthy population would be able to find insurance at an affordable cost while the sicker would be eliminated as overly risky by insurance companies.<sup>56</sup>

Third, government protection of the rights of beneficiaries must be retained, consistent in the application of rules and availability of care to beneficiaries of the program.<sup>57</sup> This ideal has been explained by the U.S. General Accounting Office, which ruled that "authorization[s] for entitlements constitute a binding obligation on the part of the Federal Government, and eligible recipients have legal recourse if the obligation is not fulfilled."<sup>58</sup>

These three aspects of Medicare are often cited by those who oppose reform proposals that lean too much on privatization and argue

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51. Timothy S. Jost, *Governing Medicare*, 51 ADMIN. L. REV. 39, 82 (1999); Marmor & McKissick, *supra* note 32, at 229.

52. Marilyn Moon, *The Future of Medicare as an Entitlement Program*, 12 ELDER L.J. 225, 227 (2004).

53. *Id.* at 228.

54. *Id.* at 227.

55. *Id.* at 229.

56. *Id.* at 228.

57. *Id.* at 230.

58. *Id.* at 231.

that privatization proposals threaten the insurability of those with troubling health histories.<sup>59</sup> In order to be both politically and structurally feasible, these three aspects and the primary purpose of the program, providing a medical safety net for the elderly, must be balanced with the needs of the elderly that are currently unmet by Medicare and the significant difficulties that lie ahead for the program.

### III. Analysis

While the entitlement system may be adequately meeting its stated and apparent goals, the system as it currently exists is in a precarious position. Both Social Security and Medicare face a significant threat of financial insolvency in the coming years.<sup>60</sup> This section analyzes the shortcomings and need to reform both Social Security and Medicare and then analyzes potential reforms for averting insolvency. Special attention is given to what the programs have in common as a basis for reforms.

#### A. Shortcomings of the Current System

##### 1. SOCIAL SECURITY

For years, there has been a growing recognition that the PAYGO setup is financially unsustainable,<sup>61</sup> especially given that the current system is “highly vulnerable to swings in the birth rate, to changes in mortality rates, and to other variables that can cause major shifts in the ratio of beneficiaries to taxpayers.”<sup>62</sup> The system is currently facing a precarious surge in retired individuals brought on by the retirement of the baby boomer generation, those born between 1946 and 1964, and continually increasing life expectancies.<sup>63</sup>

With the taxes of current workers paying for current retirees, beneficiaries will soon exceed the workforce, meaning that it will be impossible to maintain benefits at their current levels without a funda-

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59. Adam B. Norlander, *Privatization of Social Security: An Acceptable Risk*, 1999 LAW REV. MICH. ST. U. DETROIT C.L. 959, 972–74. Part D of this Article is entitled “Policy Arguments Against Privatizing Social Security.”

60. See *infra* Parts III.A.1–2 (analyzing the shortcomings of the two programs).

61. O’Neill, *supra* note 3, at 89. But see Michael Lind, *Let’s Cut Social Security to Pay for Banker Bailouts!*, SALON, May 12, 2009, [http://www.salon.com/news/opinion/feature/2009/05/12/social\\_security/index.html](http://www.salon.com/news/opinion/feature/2009/05/12/social_security/index.html) (arguing that the Social Security system is not facing a crisis and any warning that it is should be met “with a yawn”).

62. O’Neill, *supra* note 3, at 80.

63. *Id.* at 81.

mental change.<sup>64</sup> Indeed, the Social Security Administration includes this warning on each Social Security recipient's annual statement: "For decades, America has kept the promise of security for its workers and their families. Now, however, the Social Security system is facing serious financial problems, and action is needed soon to make sure the system will be sound when today's younger workers are ready for retirement."<sup>65</sup>

There are many varying opinions on when the Social Security trust fund—the amount of excess payroll taxes that have been collected over the distributed benefits—will be exhausted. Most estimates put complete exhaustion at anywhere from twenty years<sup>66</sup> to thirty-three years<sup>67</sup> away, at which point the government would be unable to pay out benefits in excess of payroll taxes. Numbers offered by the Social Security Administration indicate that "[e]xhaustion of the trust fund means that, beginning the year that Americans born in 1975 would otherwise receive full Social Security benefits, retirees will receive, at most, a mere seventy-three percent of their entitled payments."<sup>68</sup>

However, trust fund issues aside, the bigger issue is arguably the date "when Social Security benefit payments exceed Social Security payroll tax receipts, and the program becomes a current liability to the federal budget," which is estimated to occur in 2018.<sup>69</sup> The excess of payroll taxes to benefits paid out, which structurally is required to be stored in the Social Security trust fund in order to pay future benefits, has been used by the government for other purposes.<sup>70</sup> This means that the trust fund contains only IOUs and, therefore, offers no financial security to the future of the system.<sup>71</sup>

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64. Drummonds, *supra* note 4, at 293–94.

65. Soc. Sec. Admin., Your Social Security Statement, Form SSA-7005-SM-SI 1 (2010), available at <http://www.ssa.gov/mystatement/currentstatement.pdf> (last visited Feb. 15, 2010) [hereinafter Your SS Statement].

66. Drummonds, *supra* note 4, at 294 (estimating that the trust fund faces exhaustion in 2029).

67. Matthew H. Hawes, *So No Damn Politician Can Ever Scrap It: The Constitutional Protection of Social Security Benefits*, 65 U. PITT. L. REV. 865, 866–67 (2004) (explaining that Social Security trustees in their 2003 annual report estimated complete exhaustion of the trust fund in 2042); O'Neill, *supra* note 3, at 85 (citing an actuarial estimate that puts exhaustion at 2042).

68. Hawes, *supra* note 67, at 867.

69. Drummonds, *supra* note 4, at 294; O'Neill, *supra* note 3, at 85.

70. Drummonds, *supra* note 4, at 294.

71. *Id.*

The Social Security Administration itself echoes these warnings by pointing out annually as of 2003 to each Social Security contributor that the nation will begin paying more in benefits than it collects in taxes by 2016.<sup>72</sup> The Social Security Administration warning is quite specific:

In 2016 we will begin paying more in benefits than we collect in taxes. Without changes, by 2037 the Social Security Trust Fund will be exhausted and there will be enough money to pay only about 76 cents for each dollar of scheduled benefits. We need to resolve these issues soon to make sure Social Security continues to provide a foundation of protection for future generations.<sup>73</sup>

Given the Social Security Administration's status as a nonpartisan, independent agency,<sup>74</sup> this warning carries greater weight as it escapes the partisan posturing that often defines the Social Security reform debate.<sup>75</sup>

## 2. MEDICARE

Social Security is only part of the problem facing this nation's retirees in light of the broken entitlement system. With the ever-increasing costs of medical care and the wide demand for it by the elderly, "the safety net funding problems grow even more severe. In any realistic appraisal of boomer retirement income security and the burdens of that security on non-boomers, the costs and funding of medical care must enter the calculus."<sup>76</sup>

As the vast majority of Medicare beneficiaries consist of the elderly, and the baby boomers are just beginning to retire, causing a surge in enrollment, "the Medicare program is under scrutiny for both its current level of spending and the promise of high rates of future spending growth. Indeed, many policymakers have referred to Medicare as 'unsustainable,' growing without constraints because it is an 'entitlement' program."<sup>77</sup> As an entitlement program, the Medicare

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72. Hawes, *supra* note 67, at 870 n.24; Your SS Statement, *supra* note 65, at 1.

73. Your SS Statement, *supra* note 65, at 1 (quoting text from the Social Security Administration's 2009 version of its annual notice).

74. 42 U.S.C. § 901(a) (2006) (reestablishing the Social Security Administration as an independent executive agency as signed into law by President Bill Clinton in 1994).

75. See Lewis D. Solomon & Bryan L. Berson, *Private Market Reforms for Social Security: A Comprehensive Guide for Composing Reform Legislation*, 11 S. CAL. INTERDISC. L.J. 117, 161 (2001) (discussing the political posturing that accompanies the Social Security reform debate).

76. Drummonds, *supra* note 4, at 294.

77. Moon, *supra* note 52, at 226.

system is required by law to continue paying benefits to retirees, no matter how high the costs of health care and without regard to its own financial situation.<sup>78</sup>

Medicare faces a challenge similar to that confronting Social Security: the threat of insolvency by 2018.<sup>79</sup> Medicare's Board of Trustees readily recognizes the funding problem and has for years, pointing out in its 2008 annual report that the Hospital Insurance trust fund is not adequately funded over the next ten years, with assets predicted to drop from \$326 billion in 2008 to just \$96 billion in 2017, which is "far less than the recommended minimum level of 1 year's expenditures."<sup>80</sup> Just two years later, in 2019, the Medicare Board of Trustees predicts that the Hospital Insurance trust fund will be completely exhausted.<sup>81</sup> In addition, reasonable estimates of rising costs put hospital insurance costs at more than three times the level of tax revenues within seventy-five years, creating a substantial deficit, while "expenditures for Medicare's Supplemental Medical Insurance program . . . [have] outpaced the gross domestic product."<sup>82</sup> From these statistics, it becomes vital to both reform the underlying structure of the Medicare program and address health care costs in any reform plan.

Beyond its basic funding problems, Medicare also faces the problem of insufficient coverage, as it covers only part of "the medically related care costs of the elderly, and does not cover many long-term care needs at all (for example, assisted living and non-skilled nursing home care)."<sup>83</sup> In fact, Medicare's informational literature, *Medicare and You 2009*, includes an extensive list of what Medicare does not cover, such as custodial care, eye care, foot care, and physical exams.<sup>84</sup> With major changes already needed as a result of impending insol-

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78. See Marmor & McKissick, *supra* note 32, at 229, 232–33.

79. See Drummonds, *supra* note 4, at 294.

80. Russell, *supra* note 37, at 543 (pointing out that the Board of Trustees was concerned about Medicare's sustainability as early as 1996, estimating then that the trust fund would be exhausted as early as 2001); MEDICARE BD. OF TRS., ANNUAL REPORT 2008, at 2–3 (2008), <http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2008.pdf> [hereinafter MEDICARE ANNUAL REPORT].

81. MEDICARE ANNUAL REPORT, *supra* note 80, at 3.

82. Drummonds, *supra* note 4, at 294 (supporting the notion that Medicare's Supplemental Medical Insurance expenditures have outpaced GDP); Russell, *supra* note 37, at 543–44.

83. Drummonds, *supra* note 4, at 294 (referring only to non-skilled nursing home care, as Medicare Part A covers skilled nursing home care).

84. MEDICARE AND YOU, *supra* note 39, at 39, 100.

vency, policymakers have a unique opportunity to take these lapses in coverage into consideration in a reform plan.

### 3. THE ENTITLEMENT SYSTEM AS A WHOLE

In a 2003 report, the nonpartisan Congressional Budget Office (CBO) issued one of the strongest warnings of the serious problems facing the U.S. entitlement system to date.<sup>85</sup> The CBO argued that “Social Security and Medicare [are] two ‘looming strains’ on the country’s economy, and caution[ed], [w]ithout changes to federal programs for the elderly, the aging of the baby-boom generation will cause a substantial deterioration in the fiscal position of the United States government.”<sup>86</sup> This is a risk this nation cannot afford, especially given the precarious financial situation that struck the nation’s economy in 2008 and 2009.<sup>87</sup>

Even before the exhaustion of the Social Security and Medicare trust funds, costs will continue to skyrocket, with the CBO estimating that in the absence of

significant reform, payments under the current Social Security, Medicare, and Medicaid programs will consume fourteen percent of the gross national product in 2030, a cost predicted to grow to twenty-one percent by 2075. At that point, over one dollar in five generated by the economic output of the nation will be consumed in payments to retirees.<sup>88</sup>

Compare those figures with the nine percent of gross national product that the three programs made up in 2008.<sup>89</sup>

While the issues faced by both entitlement programs are alarming, Medicare is in a more dire position than Social Security, a fact that the Medicare Board of Trustees acknowledges in its 2008 annual report.<sup>90</sup> Looking seventy-five years into the future, there is a substantial difference in the shortfalls faced by each program, as “Social Security’s gap is \$1.6 trillion while Medicare’s gap is \$15.1 trillion, making

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85. Hawes, *supra* note 67, at 866–67.

86. *Id.* at 866.

87. See Soc. Sec. & Medicare Bds. of Trs., A Summary of the 2009 Annual Reports, <http://www.ssa.gov/OACT/TRSUM/index.html> (last visited Feb. 17, 2010) [hereinafter 2009 Annual Reports Summary].

88. Hawes, *supra* note 67, at 867; U.S. GOV’T ACCOUNTABILITY OFFICE, WORKING TO IMPROVE ACCOUNTABILITY IN AN EVOLVING ENVIRONMENT (2008), <http://www.gao.gov/htext/d08720cg.html> (offering the same statistics showing the dire financial position of the federal government in light of the retirement of the baby boomer generation).

89. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 88.

90. 2009 Annual Reports Summary, *supra* note 87.

Social Security's long-term shortfall roughly one-ninth that of Medicare."<sup>91</sup> Expanding the view to the future indefinitely, the overall fiscal gap is \$44.2 trillion, consisting of a \$7 trillion Social Security shortfall and a \$36.6 trillion Medicare gap; only \$0.5 trillion is attributable to the rest of the federal government.<sup>92</sup> From these numbers alone, it is clear that no other federal problem comes close to the magnitude of the problem facing this country if major changes to the entitlement system are not enacted in the near future.

Both Social Security and Medicare "face severe shortages . . . and many aspects of health care for the aging population, including long-term care, are not presently covered in the governmental support systems nor adequately covered by private insurance."<sup>93</sup> Due to the immediacy of the severe problems faced by both programs, reform is essential, and it is likely impossible for this nation to go forward without saving the Social Security and Medicare systems on which millions of Americans have come to rely. These necessary changes offer reformers the prime opportunity to save both systems, add essential benefits, and ensure the long-term survival of the entitlement system.

## B. Proposed Reforms

With the failures and the exponentially increasing costs of an unreformed entitlement system discussed in the preceding section, even the nonpartisan CBO argues that the nation should take action "sooner rather than later."<sup>94</sup> Several reform proposals have been made in hopes of mollifying the monumental threats facing Social Security and Medicare. Thus far, however, none have been adopted nor does it appear that Congress will take up the issue with any expediency in the near future, especially after the way it dismissed the reform discussion that the Bush administration attempted to start in 2001.<sup>95</sup> This

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91. Buchanan, *When Should We Worry?*, *supra* note 14, at 285.

92. Neil H. Buchanan, *Social Security, Generational Justice, and Long-Term Deficits*, 58 TAX L. REV. 275, 308–09 (2005) (noting that the Medicare gap is split roughly equally between Part A and Part B); Buchanan, *When Should We Worry?*, *supra* note 14, at 284.

93. Drummonds, *supra* note 4, at 274.

94. Hawes, *supra* note 67, at 866.

95. Benjamin A. Templin, *Full Funding: The Future of Social Security*, 22 J.L. & POL. 395, 395–96 (2006) ("After five years of debate, President Bush's proposal for private accounts has been tabled in the face of widespread opposition from both Democratic and Republican lawmakers.").

section argues in favor of market-based reforms, incorporating privatization plans for Social Security and voucher systems for Medicare.

As discussed earlier, upholding the purposes of the systems is vital, and “the extent to which fundamental change should be undertaken more importantly depends on whether the program as currently designed meets our goals and is worth sustaining.”<sup>96</sup> Both Social Security and Medicare act as “social programs that provide a minimum floor of income and medical care for all retired workers, disabled workers, and the dependents of those workers.”<sup>97</sup> Reform plans must be certain not to allow anyone to fall through the cracks.

### 1. SOCIAL SECURITY

Solutions such as raising the retirement age, cutting benefits, or raising the payroll tax have proven politically untenable.<sup>98</sup> Some argue that any potential shortfalls facing Social Security can be overcome by shifting the funding structure to include general revenue funding in addition to payroll taxes.<sup>99</sup> This is not, however, a permanent solution, as it would require constant tinkering with the funding formula that would ultimately have repercussions throughout the rest of the federal budget.

The most heated argument that takes place in the Social Security reform debate is the extent to which the system should be privatized.<sup>100</sup> Many reform proposals include some conversion of Social Security “from a federal entitlement program paying defined benefits to a pension system that is based, at least in part, on individual accounts funded by defined contributions.”<sup>101</sup> Any privatized or partially privatized system would, at least in part, prefund future benefits.<sup>102</sup> Even those who do not fully subscribe to privatization agree that “truly se-

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96. O'Neill, *supra* note 3, at 89; *see also supra* Part II.B.

97. Drummonds, *supra* note 4, at 299.

98. *See generally* Moore, *Retirement Ages*, *supra* note 9 (discussing the political opposition to such solutions).

99. Lind, *supra* note 61.

100. Patricia E. Dilley, *Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization*, 41 B.C. L. REV. 975, 984 (2000) (“The debate over ‘privatizing’ Social Security, in one form or another, has been raging for at least thirty years.”).

101. O'Neill, *supra* note 3, at 80.

102. *Id.*

cure retirement [is] grounded in private pension annuities, Social Security benefits, and private savings.”<sup>103</sup>

More than other reform plans, individual accounts on the basis of partial privatization, which means that some government oversight remains, are an especially promising plan for reform for a number of reasons. Partial privatization would give individuals “ownership of a significant component of their own pension assets,” offering greater control, flexibility, and options while substantially increasing individual “responsibility for their own consumption and saving patterns.”<sup>104</sup> This assumes that individuals both want control over and would be competent to manage their investments, and it is not clear that either is the case.<sup>105</sup> This is a problem that must be addressed in any reform plan that includes any degree of privatization, perhaps by the inclusion of a professional management option.<sup>106</sup>

Many privatization proposals retain a transfer component in addition to individual accounts.<sup>107</sup> This transfer component, funded on a PAYGO basis, “can be designed to provide a safety net that addresses anti-poverty and redistribution goals.”<sup>108</sup> It is important to note that the partial privatization of Social Security plan posited by President Bush in 2005 and “almost all similar proposals assume that a floor protection would exist to guarantee a minimum subsistence income whatever the accumulation in the proposed individual accounts.”<sup>109</sup>

Individual accounts could offer incentives to work and save by requiring individuals to contribute to their own retirements.<sup>110</sup> This puts greater emphasis on the notion of earning one’s benefits, helping to defeat the traditional welfare stigma that Congress has consistently sought to avoid with old age entitlement programs.

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103. Patricia E. Dilley, *Hope We Die Before We Get Old: The Attack on Retirement*, 12 ELDER L.J. 245, 291 (2004) (describing the downfall of the modern Social Security system and the need for significant changes).

104. O’Neill, *supra* note 3, at 80.

105. Richard L. Kaplan, *Enron, Pension Policy, and Social Security Privatization*, 46 ARIZ. L. REV. 53, 83–84 (2004) (arguing that individuals are often incapable and unwilling to manage their investments, and when they do, they perform significantly worse than professional investors).

106. *Id.* at 85 (pointing out that many defined contribution plans include a professional management option to aid with investing, and arguing that this shifts the plan “into the rough equivalent of a defined benefit plan,” which is what Social Security currently is).

107. O’Neill, *supra* note 3, at 93.

108. *Id.*

109. Drummonds, *supra* note 4, at 299.

110. *Id.*

Individual accounts would create a system without the need for an arbitrary age of retirement and with the possibility “for wealth accumulation with options for withdrawals and bequests.”<sup>111</sup> Many have argued that, by offering benefits at a politically determined age of retirement that was established without any scientific reason, individuals retire sooner than they would otherwise need to, causing a “sharp decline in work participation over time among [people] age sixty-two and older.”<sup>112</sup> This most strongly affects low-wage workers, who receive a return of a higher percentage of past earnings through their benefits.<sup>113</sup>

In its current state, Social Security benefits are not individually owned and controlled.<sup>114</sup> This is the case even though the benefits are derived from wages, which fundamentally should be owned and controlled by the taxpayer because they result from that individual’s labor. Without personally owned asset accumulation, workers with shorter life expectancies, “who are more likely to be low-wage workers, cannot receive a lump sum withdrawal” and take full benefit of their contributions, nor can earned Social Security benefits be left for future generations.<sup>115</sup>

Many also have argued that Social Security’s PAYGO system “has led individuals to reduce their own private savings, expecting to substitute Social Security benefits for those savings. Because the flow of funds each year is a direct transfer from young to old, the system is likely a deterrent to net savings and capital formation.”<sup>116</sup> For the nation’s savings as a whole, “[i]t is plausible that replacing part or most of the current system with a system of individual accounts in which individuals prefund their own retirement would increase national saving and contribute to economic growth.”<sup>117</sup> With individual accounts and wealth accumulation, the goal of increased savings can be

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111. O’Neill, *supra* note 3, at 92.

112. *Id.* at 91; Moore, *Retirement Ages*, *supra* note 9, at 547 (“Age sixty-five was not selected as the result of some scientific process; nor did it have some social or gerontological basis. Rather, there was simply general consensus that sixty-five was the most acceptable age.”).

113. O’Neill, *supra* note 3, at 90.

114. See generally Press Release, The White House, Strengthening Medicare: A Framework to Modernize and Improve Medicare (Mar. 4, 2003), available at <http://georgewbush-whitehouse.archives.gov/news/releases/2003/03/20030304-1.html> [hereinafter White House] (discussing the principles of Medicare reform and a framework to modernize and improve Medicare).

115. O’Neill, *supra* note 3, at 92.

116. *Id.* at 91.

117. *Id.*

more directly achieved.<sup>118</sup> These increased savings, when invested in the market, can actually result in a greater return on one's money than the current Social Security payments do.<sup>119</sup> Given the market sensitivities and risks of loss seen in the economic environment in 2008 and 2009,<sup>120</sup> it is important to have safeguards in place, which will be discussed in the next section of this Note.<sup>121</sup>

All of the issues facing the current Social Security system can be effectively addressed if Congress is willing to take action. By converting Social Security into personally owned accounts, the risk of insolvency can be averted, and the financial flexibility of the nation's retirees can be increased dramatically.

## 2. MEDICARE

Much like Social Security, many of the proposals to fix the Medicare problem have been based on principles of privatization. The private sector is uniquely situated, boasting success unseen by the public sector in "innovations in the organization, delivery, and financing of medical services."<sup>122</sup> These successes, coupled with "concerns over Medicare's financial viability, have led a broad spectrum of health-policy makers and analysts to conclude that there is an imperative to restructure Medicare through the adoption of market-driven reforms."<sup>123</sup> Even Bill Clinton, during his tenure as President, made the argument that "big government was no longer required and market devices were generally the most effective instruments of public policy."<sup>124</sup>

As argued in Part II, any reform plan must "be consistent with statutory objectives" of Medicare and should not violate the three ma-

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118. *Id.*

119. Solomon & Berson, *supra* note 75, at 121 ("In the generations since the Social Security system was born, financial markets have greatly evolved in the United States and throughout the rest of the world. The system's trustees now assume that if the trust funds are invested in Treasury securities, under intermediate assumptions, they will earn only 2.7% annually after inflation. Contrast the historical return of equities over the past one hundred years which is close to 7% per year.").

120. See Donald Luskin, *Stocks Have Bottomed, but Don't Get Too Excited*, SMARTMONEY, Apr. 17, 2009, <http://www.smartmoney.com/Investing/Stocks/Stocks-Have-Bottomed-But-Do-not-Get-Too-Excited>.

121. See *infra* Part III.B.2.

122. Jonathan B. Oberlander, *Managed Care and Medicare Reform*, 22 J. HEALTH POL. POL'Y & L. 595, 596 (1997).

123. *Id.*

124. Marmor & McKissick, *supra* note 32, at 237.

for benefits of the Medicare program in its current iteration: its universal nature and redistributive function, risk pooling so as to avoid adverse risk selection problems in the Medicare market, and government protection of beneficiaries.<sup>125</sup> Reform plans based on free market principles are designed “to put Medicare on surer financial footing by creating savings due to competition, efficiency and other factors, and by slowing the growth in Medicare spending.”<sup>126</sup> In addition to these ideals, free market reforms would improve the quality of benefits that Medicare could offer, drawing them closer to the benefits offered by private sector insurers, and could expand the benefits to include currently uncovered needs such as long-term care.<sup>127</sup>

One of the most controversial reform plans was the idea to replace Medicare insurance entirely with a set payout from the government in the form of a voucher to be used toward the purchase of either public or private insurance.<sup>128</sup> This system of vouchers, promising cost control and consumer choice, was first pushed, unsuccessfully, by members of Congress in 1995.<sup>129</sup>

This was followed by a Bipartisan Commission on the Future of Medicare, which was authorized by the 1997 Balanced Budget Act.<sup>130</sup> The commission revised the 1995 voucher plan and relabeled it as “premium support.”<sup>131</sup> The authors of the plan used the term “premium support” in lieu of the term “vouchers” to “illustrat[e] the search for euphemisms that excited less controversy. Voucher proposals are notoriously conflictual in the world of public education, and the language of supporting premiums seemed more neutral.”<sup>132</sup> In one report by the Commission, its members argued that without the implementation of vouchers “quality of care could suffer, and significantly greater revenues and/or beneficiary sacrifices would be re-

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125. BUILDING A BETTER MEDICARE, *supra* note 36.

126. *Id.*

127. *Id.*

128. Marmor & McKissick, *supra* note 32, at 238.

129. Oberlander, *supra* note 122, at 619.

130. Balanced Budget Act of 1997, 42 U.S.C. § 1395(b) (2006).

131. Marmor & McKissick, *supra* note 32, at 236 (“The Commission’s leaders, Senator John Breaux (D-LA) and Congressman Bill Thomas (R-CA), were both well-known critics of the growth of entitlements generally and social insurance programs like Medicare particularly. For the most part, they used the Commission’s work to advance their own vision of Medicare reform—the voucher plan of 1995 revised and relabeled as ‘premium support.’”).

132. *Id.*

quired. Beneficiaries and the taxpayers would not receive the greatest value for the total health dollars spent on seniors' behalf."<sup>133</sup>

Although it was ultimately unsuccessful, the voucher plan had many noteworthy merits. The health care voucher system was similar to the Social Security system in that Medicare beneficiaries would get a fixed payment to use to buy health insurance of their choice.<sup>134</sup> This substantially reduces the government's control over health care plans and increases the power of individuals to make choices specifically tailored to their needs.<sup>135</sup> In addition, vouchers would make beneficiaries and insurers more conscious of costs, as individuals would hold the voucher as an asset to be rationed rather than a government payout from which they derive no benefit if they do not use.<sup>136</sup>

A voucher plan would maintain a base level of coverage, consisting "of all services covered under the existing Medicare statute."<sup>137</sup> The free market competition among insurance companies would drive down costs and improve benefits; "for example, individuals might be able to opt for larger deductibles or co-insurance in return for coverage of other services such as drugs or long-term care."<sup>138</sup> As opposed to the bare bones coverage currently offered by Medicare, "plans would be able to offer additional benefits beyond the core package and plans would be able to vary cost sharing, including copay and deductible levels, subject to [Medicare] Board approval."<sup>139</sup>

Vouchers would also reduce complications for consumers who choose to supplement Medicare with private insurance, as many Medicare recipients now do.<sup>140</sup> Such a system allows beneficiaries to combine their own assets with the voucher and buy one comprehensive plan as opposed to finding private insurance that acts as a supplement only.<sup>141</sup> With vouchers, "persons with employer-provided supplemental coverage could remain in the health care plans they had as em-

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133. BUILDING A BETTER MEDICARE, *supra* note 36.

134. Moon, *supra* note 52, at 236.

135. See White House, *supra* note 114.

136. Douglas J. Besharov, *Creating a Marketplace for Social Welfare Services*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 519, 549-50 (2002) ("Besides maximizing recipient choice, cash assistance also tends to make recipients extremely cost conscious."); Moon, *supra* note 52, at 236-37 ("Supporters of this approach believe that vouchers would make beneficiaries and insurers more conscious of costs.").

137. BUILDING A BETTER MEDICARE, *supra* note 36.

138. Moon, *supra* note 52, at 237. This article was written before the introduction of Medicare Part D, which covered some prescription drugs for retirees.

139. BUILDING A BETTER MEDICARE, *supra* note 36.

140. Moon, *supra* note 52, at 237.

141. *Id.*

ployees" without worrying about unnecessary overlap from Medicare coverage.<sup>142</sup> The voucher system also helps with government accounting, "enabling a predictable rate of growth in the program."<sup>143</sup>

Although controversial, a voucher system for old age health insurance offers the most promise in fixing the issues facing today's Medicare system. Many of the concerns arise from a lack of faith in individuals' ability to manage their finances responsibly. However, few have ever doubted the responsibility of retirees to properly appropriate their Social Security payouts, and trust in the individual has been at the heart of the American Dream since the inception of this nation.

#### **IV. Recommendation**

In light of the difficulties facing the Social Security and Medicare programs, the entitlement system as a whole must be restructured so that the government can maintain its promise to the nation's senior citizens. Given the similarities in the problems faced and the similarities in the free market responses to these problems, a single solution for both programs would be the most efficient fix.

This Note's reform proposal consists of four essential elements. The first step is to combine Social Security and Medicare into a Senior Assistance Personal Retirement Account, offering a single, fixed, monthly payout to individuals to spend as they see fit to meet their individual needs, effectively converting Medicare to a voucher system. The second step is to permit the entitlement system to be funded, in part, by individual accounts with investments in the market. Third, the Medicare portion will be substantially aided by a federal choice of law statute for health insurance companies, promoting nationwide competition and thereby a reduction of insurance costs. Finally, these changes are all guided by the desire to uphold the purpose of the current entitlement system, retaining its safety net function.

Each of these elements interacts to offer the beneficiary an improvement from the current system by introducing greater personal choice, a higher rate of return on investment, and reduced insurance costs, all without sacrificing the original purpose for which the old age entitlement programs were designed.

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142. *Id.*

143. *Id.*

### A. Rationale

Combining the two programs makes sense for three reasons. First, as shown in Part II of this Note, the Social Security and Medicare programs have similar purposes. Most importantly, both were designed to act as a social safety net, preventing any individual from being forced to work long into his old age or to retire in poverty.<sup>144</sup> Both cover the elderly, those who need the help most and are deserving of the help after spending their lives as productive members of society by working.<sup>145</sup> Indeed, Medicare was in many ways modeled after Social Security in both financing and eligibility, and its creators attempted to sell the program to the public by comparing it to Social Security and having it run, initially, by the Social Security Administration.<sup>146</sup> By engaging in a single reform encompassing both programs, Medicare would be returned to its original alignment with Social Security after having strayed closer to the welfare concept following the shift in its administration to the Department of Health and Human Services.<sup>147</sup> This realignment would in turn place a greater emphasis on the original purpose of acting as a social safety net.

The second reason why this singular solution to the problems facing both programs makes sense is that it addresses the shortcomings of both programs. This plan targets the broken funding structure and the impending insolvency, the lack of coverage of vital aspects of health care, sharply rising medical costs, bloated bureaucratic costs, and the risk of receiving no return on one's payments into the system, all of which are discussed below in Parts IV.B and IV.C.

The final reason why this plan makes sense is the simple, fundamental reason that it is more efficient to engage in one reform for two problems than it is to pursue two separate reforms, especially when the problems facing these programs require such a significant overhaul of both Social Security and Medicare. The costs associated with pursuing any legislative action are staggering in terms of the research required and the time that it takes Congress to debate, agree, and approve anything. In addition, even more substantial costs are associated with the implementation of legislative action, and the administrative costs of altering the system can be reduced by unifying

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144. See *supra* Part II.A–B.

145. See *supra* Part II.A–B.

146. See *supra* Part II.B.

147. See *supra* Part II.B.

the solution. Given the dire nature of the problems with the old age entitlement system, this nation may not have time to engage in two separate, drawn out debates over each program. Holding the debates simultaneously, including both debates distinct to each program and joint debates about the common threads between the necessity of both reforms, will save time in the race against insolvency.

### **B. One Payout for Personal Control**

The current system offers each beneficiary a single monthly payout in Social Security benefits and government-purchased and defined insurance to cover some medical care from Medicare. The SAPRA eliminates the government insurance offered by Medicare and replaces it with a single monthly payout, increased by the amount the government would otherwise spend to purchase insurance for an individual. As a planning tool for the beneficiary, the payout earmarks the amount on each payout, listing a portion as Social Security income and a portion as Medicare income.

By giving individuals the payout directly, they will have the personal control to make the choice to spend that money on their own individual needs. For one's health care, the SAPRA beneficiary can choose what type of health plan he or she wants. The individual could choose to shop for his own private health insurance, comparing the variety of benefits offered by different private health insurance companies and choosing the package of benefits that best suits one's individual needs. If the individual has employer-based health insurance that carries on into retirement, he can keep that insurance rather than be forced to give up either the employer-based or government insurance to avoid the inevitable, unnecessary overlap that occurs with the two plans. That same individual could then choose to purchase a supplemental insurance plan to add benefits to the employer-based plan. Purchasing private health insurance, however, would assume that a retired individual would actually be able to receive health insurance, but insurance companies are reluctant to issue policies to the elderly, and when they do, the plans are often prohibitively expensive.<sup>148</sup> As a result, the federal government would likely have to issue regulations requiring insurance coverage of retirees, an admittedly controversial proposition.

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148. Shawn Patrick Regan, Comment, *Medicaid Estate Planning: Congress' Ersatz Solution for Long-Term Health Care*, 44 CATH. U. L. REV. 1217, 1258-59 (1995).

A third option offers an individual the opportunity to buy a standardized plan, designed either by private insurers or the government, but either way approved as sufficient medical care by the administration overseeing the SAPRA. This would be similar to the current Medicare system, offering a base level of required benefits while obviating the need for the individual to shop for his own plan. The amount earmarked for Medicare dollars on the SAPRA payout must be equal to the amount it would cost an individual to purchase this minimum level plan. By structuring the SAPRA with this base level support, the system will retain the safety net function of the entitlement system and assure that everyone is able to retire securely.

Perhaps the most important function of paying out Medicare benefits as a part of this fund is that it permits beneficiaries to exercise control over their spending and prioritize their personal needs.<sup>149</sup> Under the current system, “the elderly face significant uncovered liabilities”<sup>150</sup> as a result of the many unfunded retirement needs, such as custodial care, eye care, foot care, physical exams, and a variety of other individualized needs, all of which could be accounted for by the SAPRA, with each individual shopping for the benefits he or she most needs.<sup>151</sup>

Perhaps no medical expense is more in need of coverage than long-term care, which is not currently included in either Medicare or Social Security. The National Bipartisan Commission on the Future of Medicare made a point to recognize that its reform proposal was only “focused on acute care, and does not address the issue of long-term care.”<sup>152</sup> Long-term care makes up a great portion of retiree spending, with Americans spending “an estimated \$91 billion on long-term

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149. O'Neill, *supra* note 3, at 80 (noting that a system based partly or mainly on individual ownership would “give individuals ownership of a significant component of their own pension assets” and consequently “more control but also more responsibility of their own consumption and saving patterns,” thereby “improv[ing] incentives to work and to save”).

150. BUILDING A BETTER MEDICARE, *supra* note 36.

151. Bruce C. Vladeck, *The Struggle for the Soul of Medicare*, 32 J.L. MED. & ETHICS 410, 412 (2004) (discussing solutions to the Medicare problem); Mark Jewell, *Save \$85,000 for Long-Term Care, Fidelity Says*, S.F. CHRON., June 26, 2008, at C3, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/06/25/BUNM11EVMA.DTL&feed=rss.business>; MEDICARE AND YOU, *supra* note 39, at 31; Law Office of Donald D. Vanarelli Blog, *Social Security Statements Now Are Advising Recipients that Medicare Does Not Cover Long-Term Care / Nursing Home Costs*, June 30, 2008, <http://www.dvanarelli.com/blog/?p=355>.

152. BUILDING A BETTER MEDICARE, *supra* note 36.

care” as of 1995.<sup>153</sup> In fact, long-term care is deemed so important by the Social Security Administration that they include a notice to the recipient on every annual statement reading: “Medicare does not pay for long-term care, so you may want to consider options for private insurance.”<sup>154</sup> As life expectancies continue to grow, long-term care becomes increasingly important to more and more individuals, and its coverage by insurance is vital to many.<sup>155</sup>

### C. Partial Privatization for Structural Solvency

This single payout will only work if there is actually money to pay out, and under projections for the current system, the system is nearing a time where that will not be the case.<sup>156</sup> Partial privatization of the entitlement system based on free market funding principles will have the effect of saving both Social Security and Medicare from their impending financial crises, ensuring that the SAPRA payouts can occur.<sup>157</sup> Partial privatization will allow individuals the option to take a portion of their payroll taxes and invest them in low-risk mutual funds, stocks, or government-backed securities. This money and the resulting return on investments are stored in an individual account, meaning that each individual will ultimately receive back his or her own money, as opposed to each retiree being funded entirely by the current workforce. For individuals that are either unwilling or incapable of making their own investment choices, they can utilize a professional management option or elect not to invest any of the money.

Two oft-cited concerns about any privatization plan are the riskiness of the market and the transition from a PAYGO system to an account-based system. In addressing the first concern, and in an effort to uphold the idea of the old age entitlement system as a safety net, it is important for the government to back these investments, especially for those individuals with few assets to support their retirements outside of Social Security and Medicare, if for no other reason than to ensure that enough consumer confidence will exist to permit such a plan to go forward. Such confidence may result from offering investment in government-backed securities.

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153. *Id.*

154. Your SS Statement, *supra* note 65, at 4.

155. Moon, *supra* note 52, at 237.

156. *See supra* Part III.A.1.

157. *See generally* O’Neill, *supra* note 3, at 89 (discussing plans to partially privatize Social Security).

Some argue that there is little risk involved in the government backing these investments, as the market is consistently, historically far more profitable than the government, though this argument is often disputed.<sup>158</sup> Even over the worst financial period in this nation's history, the Great Depression, the average rate of return on a free market stock was still greater than the average rate of return that individuals receive from Social Security today.<sup>159</sup> Assuming this argument to be true, only in rare occasions will the government ever have to compensate an individual for retirement monies lost on the free market, a fair exchange for the creation of enough public confidence in their investments to establish this plan.

The other major concern about the implementation of partial privatization is the transition from a PAYGO to an account-based system. Individuals currently working would not have contributed enough to their account to rely on for their retirements, and current retirees would no longer have a workforce supporting them. This is a valid concern and one which deserves a careful, detailed approach in response. First, any new system must be phased in, rather than instituted abruptly, which would put tremendous strain on the federal government. Second, in regards to Medicare Part B, at least temporarily, the ratio of funding will have to shift to a greater portion coming from general tax revenues as opposed to payroll taxes, which would be going to the individual accounts. In fact, general tax revenues, in addition to exhausting the Social Security and Medicare trust funds, may have to cover a substantial portion of the funding gap in order to

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158. See MICHAEL TANNER, CATO PROJECT ON SOC. SEC. CHOICE, THE 6.2 PERCENT SOLUTION: A PLAN FOR REFORMING SOCIAL SECURITY 4 (2004), <http://www.socialsecurity.org/pubs/ssps/ssp32.pdf>. *But cf.* Kaplan, *supra* note 105, at 88–89; Jason Zweig, *Does Stock-Market Data Really Go Back 200 Years?*, WALL ST. J., July 11, 2009, at B1; Luskin, *supra* note 120.

159. TANNER, *supra* note 158, at 11 (“[O]ver the worst 20-year period of market performance in U.S. history, which included the Great Depression, the stock market produced a positive real return of more than 3 percent. At the same time, we know that, even under the best of conditions, Social Security will provide below-market returns. . . . [E]ven with recent stock market declines, a worker investing all of his payroll taxes in stocks would receive benefits 2.8 times greater than he would receive had he ‘invested’ the same amount of money in Social Security.”). *But cf.* Kaplan, *supra* note 105, at 88–89 (disputing figures that put Social Security’s rate of return artificially low); Zweig, *supra* note 158, at B1 (explaining the difficulty in analyzing past stock market performance, specifically citing the fact that most indices “cherry-picked” which data to include, and suggesting that Treasury bonds have in fact offered a higher rate of return than the stock market); Luskin, *supra* note 120 (pointing out that stocks have dropped more points over the same number of days in the current recession than they did during the Great Depression).

transition to the more sustainable plan, and the government would have to reallocate its funds accordingly. This solution is not perfect and will require extensive congressional research into and consideration of the best way to solve the transition problem.

#### D. Health Insurance Choice of Law Statute for Reduced Costs

The SAPRA is also predicated on a change in the current system of laws facing insurance companies. Currently, insurance companies are subject to different laws in all fifty states and the District of Columbia, which has two effects.<sup>160</sup> First, it drives up the transactional costs of national insurance companies by forcing them to be experts in the laws of all states and subjects them to personal jurisdiction in each state.<sup>161</sup> Second, because the differing state laws tend to isolate insurance companies in states, competition among insurance companies can only happen on a statewide level.<sup>162</sup>

What is needed is a federal choice of law statute permitting insurance companies to choose the state's laws to which they wish to be subject, similar to the way this country addresses corporations, allowing them, often, to choose the laws of Delaware.<sup>163</sup> There are numerous benefits associated with permitting choice of law in the health insurance context. First, there would be substantially decreased transaction costs and increased economies of scale, reducing the cost of insurance.<sup>164</sup> Second, insurance companies would be able to engage in nationwide rate competition.<sup>165</sup> Third, increased competition will also encourage innovation in developing new health benefit packages, which allows individuals to find the package that most closely fits their own needs.<sup>166</sup> Fourth, consumers would have access to increased information in national advertising.<sup>167</sup> Similarly, individuals will no

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160. ERIN A. O'HARA & LARRY RIBSTEIN, *THE LAW MARKET* 151–52 (2009).

161. *See id.* at 151–52, 199–200.

162. *Id.* at 151–52.

163. *Id.*

164. Theodore R. Marmor & Jerry L. Mashaw, *Understanding Social Insurance: Fairness, Affordability, and the "Modernization" of Social Security and Medicare*, 15 *ELDER L.J.* 123, 148 (2007) ("Medicare beneficiaries would obtain drug coverage, but in a 'choice of plans' form that relies on private insurance provision, competition, and consumer choice.").

165. Henry N. Butler & Larry E. Ribstein, *A Single-License Approach to Regulating Insurance* 7 (Univ. of Ill. Law & Econ. Research Paper No. LE08-015, 2008), available at <http://ssrn.com/abstract=1134792>.

166. *Id.*

167. *Id.*

longer be confined to shopping for insurance plans within their home state, but instead, nationally competitive insurance companies will be able to reach out to those individuals who are either unable or unwilling to move to other states where those companies are licensed.

With such a statute, there is a concern that states will compete to offer the fewest regulatory restrictions in order to attract insurance companies, and the companies will in turn race to those states with minimum restrictions, allowing them to offer the worst possible deal to consumers.<sup>168</sup> In the health care context, however, there are pressures that could convince states not to impose such weak restrictions and that could convince health insurance companies not to engage in such a race to the bottom. States have the incentive to avoid overly lax regulations due to the threat of federal intervention. As federal regulation in the insurance industry is already prevalent and the trend is toward increased federal regulation, this may be the states' last opportunity to maintain some regulatory autonomy over insurance companies.<sup>169</sup>

The incentives for insurance companies are even stronger. First, in the SAPRA, health insurance companies will be significantly entangled with the federal government. Federal regulation over insurance plans would establish minimum standards, covering traditional state areas, such as "rates, policy forms, insurer and producer licensing, market conduct, surplus lines, reinsurance, solvency oversight, and receivership of insolvent insurers."<sup>170</sup> Moreover, the proposed reform requires at least one government-backed plan to act as a minimum level of care for consumers to choose if they do not wish to shop for their own.<sup>171</sup> There could be competition by insurance companies to offer the best benefits for the least cost in order to become the government-recommended plan.

Finally, such a system would involve careful monitoring of insurance plans by both individual consumers and the federal government. Individuals have a strong incentive to monitor the conduct of their insurance companies due to the direct impact those companies can have on an individual's life. With careful monitoring, insurance companies will be unable to offer poor deals to consumers without the

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168. See O'HARA & RIBSTEIN, *supra* note 160, at 33.

169. Timothy S. Jost & Mark A. Hall, *The Role of State Regulation in Consumer-Driven Health Care*, 31 AM. J.L. & MED. 395, 399 (2005).

170. Butler & Ribstein, *supra* note 165, at 12.

171. See *supra* Part IV.B.

threat of losing business. A federal oversight system may include a federal agency analyzing the performance of health insurance companies. The federal government could report these findings to the public, grading the performance of insurance companies and rating certain plans. Insurance companies would be encouraged to compete and produce the best possible plans in order to receive a type of "seal of approval" on which consumers could rely. Both the threat of federal intervention into state regulation and the government entanglement and oversight of insurance companies should be sufficient to avoid the race to the bottom.

Health care costs have been rising exponentially for many years and are forecasted to continue doing so for the foreseeable future.<sup>172</sup> Although the SAPRA does not directly address these rising costs, the choice of law statute can put indirect pressure on medical costs. With the insurance companies able to compete on a nationwide level, they can use their enhanced bargaining power to negotiate down costs with suppliers, such as pharmaceutical companies, which currently operate on a national level. This assumes, of course, that insurance companies will be willing to pass the savings along to the consumers.

Health insurance companies act as the intermediary between individual consumers and the source of their health care. Therefore, if the costs of operating this system can be reduced, more individuals will be able to afford health insurance, reducing the burden on both individuals and the federal government.

#### **E. Other Benefits**

In addition to the vast benefits stemming from the single payout, partial privatization, and nationally competitive insurance companies, the SAPRA also alleviates much of the waste that exists in the current structure. Specifically, it addresses the problems of bloated bureaucratic costs, the risk of receiving no return on one's payments into the system, and the artificially defined retirement age.

By combining the administration of these two old age entitlement programs, the bureaucratic costs associated with their adminis-

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172. Eleanor Bhat Sorresso, *A Philosophy of Privatization: Rationing Health Care Through the Medicare Modernization Act of 2003*, 21 J.L. & HEALTH 29, 30 (2007).

tration would be reduced.<sup>173</sup> For one, the SAPRA would require only one body responsible for its oversight. Additionally, the government would no longer have to monitor the health activity of each individual citizen, as many would turn to private insurance companies. There would be few additional costs, as the government would be required to mail out one check per month, just as it does now for Social Security.

Unlike the current system, those who are healthy and do not use the health care system will receive a return on what they have put into the system with the SAPRA. Individuals who would otherwise not make use of the health care system receive a return on the investment they have made through the Medicare payroll tax. This will discourage waste in the form of unnecessary doctor visits that are often at the expense of the federal government under the present system and that are encouraged, perhaps subconsciously, by a desire to receive a return on one's investment.<sup>174</sup> Under the SAPRA, individual ownership of program benefits will force individuals to act more cost consciously. A reformed system will guarantee a return on the investment individuals have made in regard to Medicare as well as Social Security.

By converting to a system of individual accounts, individuals will no longer be forced to retire at the politically determined age of sixty-five, as discussed in Part III.B.1. As life expectancies increase, so too does the number of years in which an individual can be a productive member of the workforce. With individual accounts, the beneficiary can elect to continue contributing toward his own account for as long as he wishes, building it to the point where he feels secure enough to retire.

## V. Conclusion

This plan, admittedly, is not perfect and is based heavily on principle, with several details yet to be established. Moreover, many advocate against any plan incorporating principles of privatization and argue that Social Security is not actually in trouble, at least not in the short term. On the other hand, many advocates of privatization

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173. Jonathan B. Forman, *Designing a Work-Friendly Tax System*, 2 PIERCE L. REV. 131, 153 (2004) (discussing integrating the income tax with the Social Security tax as a way to make the tax system more worker-friendly).

interpret the numbers differently and make different assumptions, arriving at the conclusion that without a significant overhaul, this nation's entitlement system is destined to fail.

With the debate currently on the backburner, it is unlikely that the two sides will come to any agreement in the near future. It appears that only an immediate crisis will be sufficient to spur anyone into action. An immediate crisis, however, would have dire effects on the country's financial sustainability, and if Congress cares about the nation's long-term future, it must not wait to address these problems.

They can do so by implementing the plan recommended in this Note. By partially privatizing the input funding and by shifting from a PAYGO system to one based on individual accounts, the imminent insolvency facing both Social Security and Medicare will be permanently averted. Shifting Medicare to a voucher system combined with Social Security will offer individuals freedom to address their specific needs and cover health care needs that currently escape coverage. A federal choice of law statute can make health insurance affordable for all under this program by expanding competition among health insurance companies nationwide. Under the SAPRA, all of this takes place while upholding the goal that has persisted since the creation of the Social Security and Medicare systems, to establish a safety net for all older Americans.

The SAPRA will avert the crisis facing the current entitlement system and will ensure the long-term survival of both Social Security and Medicare. With the numerous benefits offered by the SAPRA, this solution is in the best interests of the nation, and this Note may act as a handbook for any policymaker who chooses to grab hold of the third rail and tackle the American entitlement crisis.