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An Overview of the U.S. Retirement Income Security System and the Principles and Values It Reflects

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AN OVERVIEW OF THE U.S. RETIREMENT INCOME SECURITY SYSTEM AND THE PRINCIPLES AND VALUES IT REFLECTS

Kathryn L. Moore†

I. INTRODUCTION

The U.S. retirement income security system is often referred to as a three-legged stool,1 with the three legs consisting of (1) Social Security,2 (2) employment-based pensions,3 and (3) individual savings.4 Social Security is the primary source of retirement income in the United States, with Social Security benefits accounting for 58% of retiree income in 2009.5 Pension income is the second most important source of retirement income, with pensions accounting for 26% of total retiree income in 2009.6 Finally,

† Laramie L. Leatherman Professor of Law, University of Kentucky College of Law. I would like to thank Paul Secunda for inviting me to participate in the AALS panel that led to my writing this Article. I would also like to thank Dana Muir for her many helpful comments and insights and Catherine Covington for her research assistance.

1. “Outside of the United States, the images of three pillars or three tiers are more commonly used.” JOHN TURNER & NORIYASU WATANABE, THE TREND TOWARD PRIVATE PENSIONS 1 n.1 (1995).

2. For purposes of this article, the term “Social Security” refers only to cash benefits provided by the U.S. federal Old-Age, Survivors, and Disability Insurance (“OASDI”) program.

3. The term “pension” is often used to refer to a traditional defined benefit plan while the term “retirement plan” is often used to refer to a defined contribution plan. See infra section III.A.3 for a discussion of the difference between defined benefit plans and defined contribution plans. This article uses the term “pension” to refer to both defined benefit plans and defined contribution plans, including 401(k) plans.


In addition, the federal means-tested program, Supplemental Security Income (SSI) is sometimes referred to as a fourth element of the U.S. retirement system. See, e.g., 1994–96 ADVISORY COUNCIL ON SOCIAL SECURITY, REPORT VOL. I: FINDINGS AND RECOMMENDATIONS 15 (1997); ROBERT J. MYERS, SOCIAL SECURITY 5 (4th ed. 1993). This Article will not discuss SSI.

5. Investment Company Institute, A Look at Private-Sector Retirement Income After ERISA, 16 RES. PERSP. 1, 24 (2010) [hereinafter referred to as “ICI”].

6. Id. at 24.
income from assets outside of retirement accounts represented 12% of retiree income in 2009.\(^7\)

Not surprisingly, the U.S. retirement income security system did not emerge fully formed at a single moment in time. Instead, it has grown and evolved considerably over the past century or so,\(^8\) and continues to grow and evolve. Moreover, there is no general agreement about the values underlying the system. Commentators sometimes discuss the “principles” underlying the U.S. Social Security system.\(^9\) Discussions of the “principles” or “values” underlying employment-based pensions are rare.\(^10\) In the European context, in contrast, discussions of values are more common.\(^11\) This article discusses the values of the U.S. retirement income security system from the lens of the European values of responsibility, protection, solidarity, nondiscrimination, and participation.\(^12\)

This article begins by providing an overview of the U.S. Social Security system and its guiding principles.\(^13\) It then discusses the principal elements of employment-based pensions in the United States.\(^14\) It then turns to individual savings and how the federal government encourages such savings.\(^15\) Finally, this article discusses how the U.S. retirement income security system does, and does not, reflect the European values of responsibility, protection, solidarity, nondiscrimination, and participation.\(^16\)

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7. Id.


9. See, e.g., David Schwartz et al., Social Security Programs in the United States, 52 Social Security Bulletin 1, 9–10 (1989) (identifying five principles that “have been adhered to throughout the development of the [Social Security] program”); Phillip Booth, Social Security in America 10 (1973) (identifying three basic principles on which Social Security system was founded); Martha Derthick, Policymaking for Social Security 21 (1979) (identifying social security’s “first principles”).


12. This article was written in connection with my participation in a program entitled, Lessons from Other Countries: Comparative Pension Law, held on January 7, 2011, by the Employee Benefits and Executive Compensation Section of the Association of American Law Schools. A European colleague, who was ultimately unable to participate in the program, suggested that we compare the values of pension systems throughout the world from the perspective of the European legal values of responsibility, protection, solidarity, nondiscrimination, and participation. Accordingly, this article addresses these five values.

13. See infra section II.

14. See infra section III.

15. See infra section IV.

16. See infra section V.
II. SOCIAL SECURITY

At its core, Social Security is a system of social insurance whose essential purpose "is to prevent hardship, poverty, or dependence that might be caused by the contingencies covered wherever and whenever these might occur among workers able to join their employers and the government in a national program." It is a mandatory, contributory defined benefit program with nearly universal coverage. It was never intended to be the sole source of retirement income. Instead, it was—and is—intended to provide workers with a basic floor of protection upon which the other forms of retirement income security could be built.

A relative latecomer to public pensions, the United States enacted legislation creating the Social Security system in 1935. As originally enacted, Social Security provided for the creation of a substantial reserve.

17. Although there is no single, universally accepted definition of social insurance, Lawrence Thompson and Melinda Upp assert that social insurance typically includes the following seven characteristics: (a) compulsory participation, (b) government sponsorship (and regulation), (c) contributory financing, (d) eligibility derived from contributions, (e) benefits prescribed in law, (f) benefits not directly related to contributions, and (g) separate accounting and explicit long-range financing. Lawrence H. Thompson & Melinda M. Upp, The Social Insurance Approach and Social Security, in SOCIAL SECURITY IN THE 21ST CENTURY 3 (Eric R. Kingson & James H. Schulz eds., 1997).

18. J. DOUGLAS BROWN, ESSAYS ON SOCIAL SECURITY 57–58 (1977). See also JACOB S. HACKER, THE DIVIDED WELFARE STATE: THE BATTLE OVER PUBLIC AND PRIVATE SOCIAL BENEFITS IN THE UNITED STATES 101–02 (2002) (stating that "[t]hough modeled in part on private plans, Social Security embodied a philosophy of social insurance that saw inclusive compulsory protections as essential safeguards against the risks of modern industrial life—preferable to both unassisted private action and to means-tested relief"); Dilley, supra note 8, at 1083 (stating that "Social Security's structure is a more or less deliberate attempt to separate social insurance, which is aimed at prospective needs in retirement, from needs-based welfare aimed at current needs that can be measured at the same time benefits are paid.").

19. Cf. President Roosevelt's Radio Address on the Third Anniversary of the Social Security Act (Aug. 15, 1938), in 50TH ANNIVERSARY EDITION OF THE REPORT OF THE COMMITTEE ON ECONOMIC SECURITY OF 1935 AND OTHER BASIC DOCUMENTS RELATING TO THE DEVELOPMENT OF THE SOCIAL SECURITY ACT 148 (1985) ("The act does not offer anyone, either individually or collectively, an easy life—nor was it ever intended so to do. None of the sums of money paid out to individuals in assistance or in insurance will spell anything approaching abundance. But they will furnish that minimum necessary to keep a foothold; and that is the kind of protection Americans want.").

20. The United States was the twelfth among the fifteen sovereign and developed nations at the onset of World War I to adopt an old age, disability, and survivors welfare program. See Alexander Hicks et al., The Programmatic Emergence of the Social Security State, 60 AM. SOC. REV. 329, 337 tbl. 1 (1995) (studying the following fifteen nations: Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Netherlands, Norway, New Zealand, Sweden, Switzerland, United Kingdom, and United States).

The United States’ first large scale federal social welfare program was the Civil War pension system. "By 1910 the Civil War pension system was paying benefits in some areas for up to 20% of all persons age sixty-five and over, a rate comparable to the coverage provided by German and Danish old-age social insurance programs at that time." Dilley, supra note 8, at 1097. "Perhaps in part because the Civil War pension system continued to pay benefits well into the second decade of the twentieth century, demand for social insurance was not strong enough to induce passage of Social Security until the economic crisis of the 1930s." Id. at 1112.


22. The reserve, expected to ultimately reach $47 billion, was to have accumulated because payroll tax revenues in the early years of the system were expected to greatly exceed expenditures. See
to fund two basic types of benefits: (1) monthly old-age benefits for retirees,23 and (2) lump-sum death benefits for workers.24 Four years later, before the first Social Security benefits were payable,25 Congress fundamentally restructured the Social Security system with the Social Security Amendments of 1939.26 The 1939 Amendments increased benefits to the first generation of retirees and thus eliminated the creation of a significant reserve27 and replaced lump-sum death benefits for workers with two new types of benefits: (1) benefits for the wife and minor children of retired workers,28 and (2) benefits for widows, surviving dependent children, and surviving dependent parents.29 The Social Security system has been amended multiple times in multiple ways since 1939, but it has retained this same basic structure since then.

The late Robert Ball, Commissioner of the Social Security under Presidents Kennedy, Johnson, and Nixon, identified “nine guiding principles” of the U.S. Social Security system: (1) universal, or nearly universal, coverage; (2) earned right; (3) wage related; (4) contributory and self-financed; (5) redistributive; (6) not means tested; (7) wage indexed; (8) inflation protected; and, (9) compulsory.30 This section discusses those principles.31

A. Universal, or Nearly Universal, Coverage

The U.S. Social Security system covers almost the entire U.S. workforce and provides benefits to almost the entire population aged sixty-five or older. Specifically, the Social Security system covers about 94% of the American workforce,32 with an estimated 162 million people

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24. Id. § 203.
25. Under the original Social Security Act, benefits were to begin to be paid in 1942. Id. § 202(a).
28. Supra note 26, §§ 202(b)-(c).
29. Id. §§ 202(c), (d), (e), (f).
31. This section is based on Part II, Principles Underlying the Current Social Security System, of Kathryn L. Moore, The Future of Social Security: Principles to Guide Reform, 41 J. MARSHALL L. REV. 1061, 1062–71 (2008). Robert Ball’s list of principles is neither free from criticism nor universally adopted. Id. at 1063–64. Nevertheless, I believe it fairly represents the principles underlying the U.S. Social Security system and helps to provide a clear understanding of the system.
32. The excluded workers fall into five categories: (1) civilian federal workers who were hired before January 1, 1984; (2) railroad workers who are covered under the railroad retirement system; (3)
contributing payroll taxes in 2009. In addition, about fifty-three million people were receiving Social Security benefits at the end of 2009, including 89% of the population age sixty-five and older.

Although Social Security as originally enacted only covered about 56% of the country’s labor force, since its inception Social Security’s drafters and supporters envisioned that the program would evolve over time to provide universal coverage. Indeed, President Roosevelt is reported to have said at cabinet meetings, “from cradle to grave [everyone] ought to be in a social insurance system.”

B. Earned Right

Perhaps the most uniquely American aspect of the U.S. Social Security system is the fact that benefits are characterized as an “earned right,” with “the right to income . . . created by personal effort, not awarded based on need or status.” According to Robert Ball, “[t]his principle sharply distinguishes Social Security from welfare and links the program, appropriately, to other earned rights such as wages, fringe benefits, and private pensions.”

Social Security’s characterization as an earned right arises from the fact that it is financed principally through payroll taxes. In recommending that Social Security be financed principally through payroll taxes, the Committee on Economic Security explained that “[c]ontributory annuities are unquestionably preferable to noncontributory pensions. They come to the workers as a right, whereas the noncontributory pensions [that is, welfare] must be conditioned upon a ‘means’ test.”

33. Id.
37. See Dilley, supra note 8, at 1107 (stating that “[w]ithin the framework of an expansive democratic capitalist ideal, the authors of Social Security based their approach to income security on the assumption—to which they firmly adhered even in the depths of the Great Depression—that economic rights based on earnings would eventually accrue to all members of society who would either be workers or dependents of workers in a family relationship.”).
38. HACKER, supra note 18, at 102.
39. Dilley, supra note 8, at 1086.
40. BALL, supra note 30, at 6.
41. REPORT OF THE COMMITTEE ON ECONOMIC SECURITY 1935 AND OTHER BASIC DOCUMENTS RELATING TO THE DEVELOPMENT OF THE SOCIAL SECURITY ACT, supra note 19, at 45.
C. Wage Related

Social Security benefits are related to past wages. Specifically, retirement benefits for everyone born after 1928 and retiring in 1991 or later are based on thirty-five years of earnings, which are indexed to increases in the average national wage.\footnote{42} Average adjusted earnings, or “average indexed monthly earnings” (AIME), are then calculated by taking the best thirty-five years of earnings and dividing by 420 (the number of months in thirty-five years).\footnote{43} Average adjusted earnings are then plugged into a progressive benefit formula to determine the “primary insurance amount” (PIA), or how much of earnings should be replaced.\footnote{44} For those reaching sixty-two in 2010, the formula replaces 90% of the first $761 of AIME, plus 32% of AIME between $761 and $4,586, plus 15% of AIME above $4,586.\footnote{45}

The fact that benefits are related to wages reinforces the concept that benefits are an earned right and recognizes “that there is a relationship between one’s standard of living while working and the benefit level needed to achieve income security in retirement.”\footnote{46} Moreover, basing benefits on past wages promotes “individual equity,” one of the fundamental goals of Social Security.\footnote{47} Social Security’s contributory-contractual approach justifies benefits on the basis of contributions.\footnote{48} Thus, logically, individual equity requires that benefits be related to wages.\footnote{49}

D. Contributory and Self-Financed

The U.S. Social Security system is financed principally through dedicated contributions under the Federal Insurance Contributions Act, or “FICA.”\footnote{50} In 2009, net FICA contributions accounted for 82% of the Social Security Trust Fund’s income.\footnote{51} Interest on the Trust Fund’s surplus accounted for 15% of the Trust Fund’s income, and revenue from the

\footnotesize{\begin{footnotes}
\item[45.] 2010 ANNUAL REPORT OF THE BOARD OF TRUSTEES, supra note 34, at 111 fig. V.C1.
\item[46.] BALL, supra note 30, at 7.
\item[47.] See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-05-193SP, SOCIAL SECURITY REFORM: ANSWERS TO KEY QUESTIONS 3 (2005) ("[A]nother goal of the program is to ensure that benefits bear some relationship to contributions. This goal is known as individual equity.").
\item[49.] Id. at 227.
\item[51.] 2010 ANNUAL REPORT OF THE BOARD OF TRUSTEES, supra note 34, at 4 (this figure refers solely to the income of the Old Age and Survivors' Insurance Trust fund and does not include the Disability Insurance Trust fund).
\end{footnotes}}
federal income tax imposed on certain Social Security benefits accounted for 3% of the Trust Fund’s income.\textsuperscript{52}

The U.S. Social Security system differs from most of its European counterparts in “its emphasis on the contributory-contractual principle.”\textsuperscript{53} One commentator has speculated that the contributory-contractual approach may have been the only practical way to get the program accepted in light of “the deeply rooted American suspicion that any state assistance to the ordinary citizen destroyed both his freedom and his thriftiness.”\textsuperscript{54} In introducing its Social Security proposal, the Committee on Economic Security explained that “[c]ontributions by the employees represent a self-respecting method through which workers make their own provision for old age.”\textsuperscript{55}

President Roosevelt explained that

[Those] taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program.\textsuperscript{56}

Social Security’s contributory financing reinforces the concept of benefits as an earned right\textsuperscript{57} and “gives contributors a moral claim on future benefits above and beyond statutory obligations.”\textsuperscript{58} This method of financing also protects the program from having to compete against other programs in the annual general federal budget and imposes fiscal discipline that protects the program from excessive liberalization because participants (and employers) know that any changes to the program depend on the contributions they make.\textsuperscript{59}

With little debate, this tradition was broken in the December 2010 tax compromise President Obama reached with Congress. Under the 2010 law, employee, but not employer, FICA contributions are reduced from 6.2% of
wages to 4.2% of wages for one year, 2011. According to Social Security's chief actuary, this change should have no long-term impact on Social Security because “every dollar of diverted money will be paid into Social Security from the government’s general fund and credited to the workers getting the break in 2011.” Proponents of the current Social Security system, however, fear that this change may become permanent and lead to the unraveling of Social Security. “[A] permanent reduction will turn Social Security into a ward of the Treasury forever, giving its enemies the opportunity to chip away at it year after year.”

E Redistributive

Social Security’s progressive benefit formula is redistributive in that it replaces a higher percentage of the earnings of lower-wage workers than that of higher-wage workers. To illustrate, for workers retiring at age sixty-five in 2010, Social Security replaces 55% of the earnings of a low-wage worker, 40.8% of the earnings of an average wage worker, and 33.8% of the earnings of a high-wage worker. The progressive nature of the formula is designed to further another one of Social Security’s fundamental goals, ensuring adequate retirement income, often referred to as “social adequacy.”

How effective Social Security is at redistributing income to the lower paid is subject to debate. The weighted benefit formula is undoubtedly progressive. Other elements of the system, on the other hand, are regressive. For example, Social Security imposes a flat tax on earnings up to the maximum taxable wage base and no tax on earnings above the taxable wage base. As a result, the system’s financing mechanism is regressive because lower wage workers are required to contribute a higher percentage of their earnings toward Social Security than are higher income workers whose wages exceed the taxable wage base. In addition, Social Security pays benefits in the form of a life annuity. Critics of the system contend that this element of the system makes it regressive because lower-

63. 2010 ANNUAL REPORT OF THE BOARD OF TRUSTEES, supra note 34, at 201 tbl. VI.F10.
64. BALL, supra note 30, at 8.
income workers tend to have shorter life expectancies than higher-income workers. 66

F. Not Means Tested

Social Security is not, and never has been, means tested despite the fact that one of its fundamental purposes is "to prevent destitution and dependency." 67 The absence of a means test distinguishes Social Security, a social insurance program, from welfare 68 which, by definition, provides benefits based on need. 69 Social Security is an earned right, and benefits "are paid regardless of income from savings, pensions, private insurance, and other forms of nonwork income." 70

One of the motives for the compulsory, contributory, and national scope of Social Security "was Roosevelt’s deep aversion to relying solely on means-tested relief." 71 "In essence, Social Security was structured to eventually eliminate the need for explicit needs-based poverty programs by

68. BALL, supra note 30, at 8.
70. Schwartz, supra note 9, at 9. Beneficiaries, however, may be subject to federal income tax on the Social Security benefits they receive. In essence, under section 86 of the Internal Revenue Code, single taxpayers with "combined income" of between $25,000 and $34,000 must pay income tax on 50% of their Social Security benefits, and single taxpayers with combined income that exceeds $34,000 must pay income tax on 85% of their Social Security benefits. Married taxpayers with combined income between $32,000 and $44,000 must pay income tax on 50% of their benefits and married taxpayers with combined income over $44,000 must pay income tax on 85% of their Social Security. For these purposes, "combined income" is the taxpayer’s adjusted gross income plus half of the taxpayer’s Social Security benefits plus any tax-exempt interest income. See Alicia H. Munnell & Dan Muldoon, The Impact of Inflation on Social Security Benefits, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE, ISSUE BRIEF NO. 8-15, at 4-5 (Oct. 16, 2008). See also MARTIN J. McMAHON, JR. & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 9.02 (2d ed. 2011) (providing more detailed explanation of taxation under IRC § 86); AVRAM L. SACKS, 2011 CCH SOCIAL SECURITY EXPLAINED ¶ 255 (2d ed. 2011).


71. HACKER, supra note 18, at 106.
providing weighted benefits to low-wage workers as a matter of earned right.\textsuperscript{72}

Most Americans, like President Roosevelt, have a deep aversion to means-tested programs, and recipients of means-tested benefits tend to be stigmatized.\textsuperscript{73} By making benefits an earned right rather than based on a means test, the U.S. Social Security system “promotes individual respect and dignity.”\textsuperscript{74} It “assur[es] the dignity and independence of the individual, the integrity of the family, and the stability and purchasing power of the community.”\textsuperscript{75}

G. Wage Indexed\textsuperscript{76}

Social Security is wage indexed. Specifically, when benefits are initially calculated, workers’ earnings are indexed by multiplying each year’s wages by an indexing factor equal to the ratio of the average national wage in the year the worker turns sixty to the average national wage in the year to be indexed.\textsuperscript{77} In addition, the dollar amounts, or “bend points” to which the progressive benefit formula is applied, are increased by the rate of the growth of the national average wage.\textsuperscript{78}

This method of calculating initial benefits ensures that benefits for each generation of workers grow at the same rate as their wages grow, and the replacement rate, that is, initial benefits as a percentage of workers’ career-average earnings, remains constant. “[W]ithout this principle, Social Security would soon provide benefits that did not reflect previously attained living standards.”\textsuperscript{79}

\textsuperscript{72} Dilley, supra note 8, at 1107.

\textsuperscript{73} Cf. Camilla E. Watson, Machiavelli and the Politics of Welfare, National Health, and Old Age: A Comparative Perspective Policies of the United States and Canada, 1993 UTAH L. REV. 1337, 1338 (1993) (“In general, Americans are more inclined to think in terms of how they can increase their personal wealth and possessions, rather than redistributing wealth to the poor and the less fortunate.”).


\textsuperscript{75} COHEN, supra note 55, at 5, 13.

\textsuperscript{76} One might argue that wage indexing should not be considered a fundamental guiding principle of Social Security because it was not a part of the original Social Security Act. Cf. Pub. L. No. 92-336 § 202, 86 Stat. 406, 493 (1972) (adding indexing provisions). Robert Ball, however, included it in his list of fundamental guiding principles. BALL, supra note 30, at 8–9.


\textsuperscript{78} Id. § 415(a)(1)(A).

\textsuperscript{79} BALL, supra note 30, at 8–9.
Once initial benefits are calculated, they are adjusted for increases in the consumer price index. Price indexing ensures that initial benefits do not decline in value as prices increase over time and that retirees' buying power remains the same. This inflation protection distinguishes Social Security from private pensions and state and local government pension plans.

I. Compulsory

Like the first tier pension in many countries, participation in the U.S. Social Security system is mandatory. The "Federal Insurance Contributions Act," or "FICA," requires that covered employees and their employers contribute to the system. The compulsory nature of the system protects against adverse selection, that is, the problem of "individuals deciding when and to what extent they want to participate, depending on whether their individual circumstances seem favorable." In addition, the compulsory nature of the system, along with its nearly universal coverage, helps stabilize the cost of the system and "assures virtually everyone in society a base of economic security."

III EMPLOYMENT-BASED PENSIONS

The second leg of the U.S. retirement income security system is employment-based pensions. Unlike in Europe, employment-based pensions predate the Social Security system. The American Express Company is credited with establishing the first private employment-based

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81. BALL, supra note 30, at 9.

82. Id.


84. Id. § 3111(a)

85. BALL, supra note 30, at 9.

86. Schwartz, supra note 9, at 9. When Congress was originally considering Social Security, Senator Bennett "Champ" Cark, introduced the "Clark amendment" that would have permitted employers that operated private pensions to opt out of Social Security. The Amendment easily passed the Senate, but the Roosevelt Administration insisted that it be excluded from the final legislation. See HACKER, supra note 18, at 101.

87. See Dilley, supra note 8, at 1112 ("In contrast to the European pattern, the American experience saw the development of individual annuities and employer-provided pensions to at least a limited extent well before the general employment-based system of Social Security was put in place in 1935.")
pension plan in the United States in 1875. By 1929, about 400 industrial pensions, covering about 3–4% of the workforce, had been established in the country. New York City is credited with establishing the first state or local plan in 1857, and during the second half of the nineteenth century, many municipalities created plans.

Although employment-based pensions predate the U.S. Social Security system, the U.S. private pension system is built on Social Security. Indeed, during the so-called “proliferation period” of private pensions in the United States (1940s and 1950s), most private pensions were expressly “integrated” with Social Security, that is, Social Security benefits were taken into account in determining benefits under the private pensions. Although most private plans are no longer integrated with Social Security, private pensions remain the second tier of retirement income in the United States.

Unlike private pensions, public sector pensions are not expressly “integrated” with Social Security. Indeed, many public sector employees are not covered by Social Security. Nevertheless, Social Security was a major impetus for the development of public pensions. During the 1930s and 1940s, almost half of the large state and local pension plans were established or significantly restructured. By the early 1960s, most state and local jurisdictions had established their plans.

Employment-based pension plans established in the private sector tend to be quite different from public plans. Accordingly, this section will discuss the two separately. It will begin by giving an overview of private sector employment-based pensions. It will then discuss public pensions.

88. See id., at 1113 (mentioning that social security was a not “true” retirement plan “but rather paid benefits to disabled employees who had twenty years of service with the company, had reached age sixty, and were recommended for the pension by company management.”).
89. Id. at 1113–14.
90. See Alicia H. Munnell et al., What Do We Know About the Universe of State and Local Plans, 4 CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE STATE AND LOCAL PENSIONS PLANS 1, 2 (2008) (discussing state and local retirement plans).
91. See HACKER, supra note 18, at 124, 136–37.
92. See Pamela Perun, Social Security and the Private Pension System (Center for Retirement Research at Boston College Working Paper 2002-2, July 2002) (using Form 5500 data from 1,000,000 plans from 1993 to 1997, finding that one of every four plans is integrated and integration is a stable and persistent feature of the private pension system). For additional data on prevalence of integrated plans, see Kathryn L. Moore, The Effects of Partial Privatization of Social Security upon Private Pensions, 58 WASH. & LEE L. REV. 1255, 1258–59 (2001) and authorities cited therein.
93. See Munnell, supra note 90, at 3 (discussing the creation of state and local pension plans).
Overview of Private Employment-Based Pensions

In many ways, private-sector employment-based pensions are a “reverse image” of Social Security: they are voluntary; they only cover about half the working population; and most plans are now defined contribution plans rather than defined benefit plans. The federal government encourages employment-based pensions by offering them favorable income tax treatment and regulates them, principally through the Employee Retirement Income Security Act of 1974 (ERISA).

Voluntary Participation

Unlike the U.S. Social Security system, and private pensions in some countries, such as Australia, France, Sweden, and Switzerland, employment-based pension plans in the United States are voluntary. No law requires that employers provide their employees with retirement benefits nor does any law require that employees devote a portion of their earnings to retirement savings. The employer is free to decide what type of plan, if any, to offer as well as the amount of benefits to be offered. Moreover, as plans have shifted from defined benefit plans to 401(k) plans, the decision of whether to and how much to contribute to employment-based pension plans is increasingly a voluntary decision made by individual plan participants.

This is not to suggest, however, that all aspects of employment-based pensions are voluntary. Once an employer elects to offer a pension plan, the Employee Retirement Income Security Act (ERISA) regulates the terms of private pensions. Moreover, the federal government encourages the formation of employment-based pensions by providing tax favorable treatment to such plans. If an employer wishes to take advantage of this favorable tax treatment, the plan must satisfy the requirements imposed by the Internal Revenue Code.

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95. Muir, supra note 11.
99. Cf: Lockheed Corp. v. Spink, 517 U.S. 882, 887 (1996) (“Nothing in ERISA requires employers to establish employee benefits plans. Nor does ERISA mandate what kind of benefits employers must provide if they choose to have such a plan.”).
Over the years, policymakers\textsuperscript{101} and analysts\textsuperscript{102} have introduced proposals to mandate employment-based pensions in the United States. To date, however, the proposals have failed to generate significant political support,\textsuperscript{103} and employment-based pensions in the United States are, and are likely to remain, voluntary.

2 Limited Coverage

Unlike Social Security, employment-based pension plans cover\textsuperscript{104} only about half the U.S. workforce.\textsuperscript{105} Participation, however, is not divided evenly across the population. Instead, participation depends on factors such as income, the size of the employer, employment status (whether full-time or part-time), age, and industry.

Higher-income workers are much more likely to participate in an employment-based pension plan than are lower-income workers,\textsuperscript{106} and individuals working for large employers are more likely to participate in an employment-based pension plan than are individuals who work for a small employer.\textsuperscript{107} Individuals who work full-time are more likely to participate.

\textsuperscript{101} See, e.g., \textsc{President's Comm'n on Pension Policy, Coming of Age: Toward a National Retirement Income Policy} 42-43 (1981).

\textsuperscript{102} See, e.g., \textsc{Teresa Ghilarducci, When I'm Sixty-Four: The Plot Against Pensions and the Plan to Save Them} (2008); \textsc{Susan J. Stabile, Is It Time to Admit the Failure of an Employer-Based Pension System?}, 11 \textsc{Lewis & Clark L. Rev.} 305, 328-29 (2007). See also \textsc{Bruce Wolk, Discrimination Rules for Qualified Retirement Plans: Good Intentions Confront Economic Reality}, 70 \textsc{Va. L. Rev.} 419 (1984) (supporting mandatory universal pension system).

\textsuperscript{103} Cf. \textsc{Turner, supra} note 97, at 4 ("While U.S. employers have long provided pensions voluntarily, they also have a long tradition of staunchly opposing mandates."); \textsc{David A. Pratt, No Rhyme Nor Reason: Simplifying Defined Contribution Plans}, 49 \textsc{Buffalo L. Rev.} 741, 749 (2001) ("Mandated pensions, like other benefit mandates, are vehemently opposed by small businesses where most of the gaps in pension coverage exist.").

\textsuperscript{104} Coverage is synonymous with participation in defined benefit plans, but not in 401(k) plans. A 401(k) plan may cover a worker, but the worker may choose not to participate in the plan. Unfortunately, there is not a uniform definition of participation in 401(k) plans, and empirical studies and reports use four different definitions of participation. See \textsc{Turner, supra} note 97, at 35. This helps explain why different studies report different rates of participation.

\textsuperscript{105} See \textsc{Craig Copeland, Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data}, 2009, 30 \textsc{EBRI Notes} 2, 3 (2010) (finding that according to data from the 2009 SIPP, 59% of workers work for an employer who offers a pension plan while 45% of workers participate in such plans). See also \textsc{ICI, supra} note 5, at 4 (using data from the Current Population Survey finding that "[o]ver the entire time period from 1979 to 2009, the portion of workers who worked for employers that sponsored pension plans averaged 59 percent and ranged from 55 percent to 63 percent."); \textsc{David M. Walker, 21st Century Challenges: Economic Security in Retirement, in New York University Review of Employee Benefits and Executive Compensation} 26-1, 26-4 (2007) ("Since 1980, however, only about half the labor force has been covered by a private pension, a level of coverage that has remained flat.").

\textsuperscript{106} According to \textsc{EBRI} calculations of data from the 2010 SIPP, 78% of workers earning $50,000 or more (in 1993 dollars) participated in an employment-based pension plan in 2009 compared to 40% of workers earning between $15,000 and $19,999 (in 1993 dollars) and 11% of workers earning less than $5,000 (in 1993 dollars). \textsc{Copeland, supra} note 105.

\textsuperscript{107} \textsc{Craig Copeland, Employment-Based Retirement Plan Participation: Geographic Differences and Trends}, \textsc{EBRI Issue Brief} No. 348, at 10, fig. 2 (2010) (showing that in 2009 just over 50% of
in a retirement plan than are individuals who work part-time,108 and older workers are more likely to participate in an employment-based pension plan than are younger workers.109 In addition, individuals in certain industries, such as manufacturing, are more likely to participate in employment-based pension plans than are individuals who work in other industries, such as agriculture, mining, and construction.110

Policymakers and commentators have frequently criticized the U.S. employment-based pension system for its limited coverage and have expended considerable thought and energy in trying to find ways to expand coverage.111 Nevertheless, the limited coverage of the system appears to be the inevitable result of the voluntary nature of the system.112 Unless employment-based pensions are mandated, it is unlikely that coverage will ever exceed much more than 50% of the working population.113

workers employed by a firm with 500 or more employees participated in an employment-sponsored pension plan compared to 41.6% of workers employed by a firm with 100–499 employees, 31.8% of workers employed by firms with 25–99 employees, 21.6% of workers employed by firms with 10–24 employees, and only 11% of workers employed by firms with fewer than 10 employees).

108. Id. (showing that in 2009, 51.1% of full-time, full-year workers participated in an employment-sponsored pension plan compared to 27.3% of full-time, part-year workers, and 17.9% of part-time full-year workers, and 9.0% of part-time, part-year workers).

109. Id. (showing that in 2009, over 49% of workers age 45–64 participated in an employment-sponsored pension plan compared to 36.5% of workers age 25–34, and 17.7% of workers age 21–24).

110. Id. (showing that in 2009 among private sector workers 53.1% of workers in manufacturing participated in an employment-sponsored pension plan compared to 45.8% of workers in transportation, utilities, information, and financial, 38.0% of workers in professional services, 30.3% in wholesale and retail trade, 23.1% in agriculture, mining, and construction, and 14.7% in other services).

111. See, e.g., Alicia H. Munnell & Laura Quinby, Pension Coverage and Retirement Security, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE ISSUE BRIEF No. 9-26, at 4–5 (2009) (describing the Automatic IRA proposal by the Obama Administration); U.S. GOV’T ACCOUNTABILITY OFFICE, supra note 98, at 36–45 (describing four different proposals: (1) The Urban Institute’s Super Simple Saving Plan, (2) the ERISA Industry Committee’s New Benefit Platform for Life Security, (3) the New America Foundation’s Universal 401(k) Plan, and (4) the Economic Policy Institute’s Guaranteed Retirement Accounts Plan); Pratt, supra note 103, at 745–46 (noting that Congress has introduced employer-sponsored individual retirement accounts (IRAs), simplified employee pension plans (SEPs), salary reduction SEPs, (SARSEPs), SIMPLE IRAs, and SIMPLE 401(k) plans in an effort to increase coverage by small employers).

112. See Norman P. Stein, An Alphabet Soup Agenda for Reform of the Internal Revenue Code and ERISA Provisions Applicable to Qualified Deferred Compensation Plans, 56 SMU L. REV. 627, 650 (2003) ("The goal of providing meaningful and universal retirement security for working people is not plausibly attainable through a voluntary but regulated pension system."). See also Daniel I. Halperin, Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should it Continue?, 49 TAX L. REV. 1, 5 n.17 (1992) (noting that "there may be limits to how far one can push a voluntary program" and contending that certain events surrounding the legislative battle on Section 89 which would have extended the nondiscrimination requirements to health insurance “raise significant doubts concerning the ability of tax incentives to achieve the stated goal of widespread, perhaps universal, coverage for low and moderate income employees.”).

113. See TURNER, supra note 97, at 22 ("practically without exception, countries that have used this approach [voluntary participation, with tax incentives] have not raised pension coverage above 50 percent for private sector workers."). See also Muir supra note 11, § II(A)(b) (noting that before Australia enacted mandatory pension system only 32% of employees were covered compared to 94% of employees under current mandatory system); U.S. GOV’T ACCOUNTABILITY OFFICE, supra note 98, at
3 Shift from Defined Benefit to Defined Contribution Plans in General and 401(k) Plans in Particular

There are two basic types of pension plans: defined benefit plans and defined contribution plans. In a defined benefit plan, the benefit is expressed as a certain amount to be paid at the participant’s retirement. Typically, defined benefit plans provide for a fixed amount per month to be paid for the life of the retired participant and the participant’s spouse. The fixed amount is generally based on a formula that takes into account the participant’s years of service and salary. Plan assets are pooled together to meet the demands of all the participants, and the plan sponsor bears the investment risk.

Defined contribution plans, in contrast, do not promise participants a certain benefit upon retirement. Instead, benefits are based on contributions to the plan and any earnings or losses on those contributions. Often, the employer contributes a fixed amount to each individual account established on behalf of each participant, and the account is credited with any earnings or losses on those contributions. The participant’s benefit is based upon the amount held in the account rather than a fixed benefit based on the participant’s years of service and compensation, and the plan participant, rather than the plan sponsor, bears the investment risk.

Historically, defined benefit plans were the most common type of employment-based pension plan in the United States. For example, in 1975, the year after ERISA was enacted, 87% of active plan participants had primary coverage through a defined benefit plan. Over the last thirty years or so, however, coverage has shifted from defined benefit plans to defined contribution plans. Indeed, by 2009, defined contribution plans were the primary plan for 60% of workers while defined benefit plans were the primary plan for only 39% of workers.

Not only has coverage shifted from defined benefit plans to defined contribution plans in general, but coverage has shifted to 401(k) plans, a
particular subset of defined contribution plans. A 401(k) plan is a qualified cash or deferred arrangement that permits plan participants to choose between receiving a cash payment or having a contribution made on the participant's behalf to a qualified plan. Thus, the decision of whether to participate in a 401(k) plan rests with the individual employee. The employer may encourage participation by offering matching contributions or adopting an automatic enrollment plan under which plan participants must affirmatively opt out of the plan if they do not wish to be covered. Nevertheless, the ultimate decision of whether to participate rests with the individual plan participant. Like in all defined contribution plans, the employee bears the investment risk in a 401(k) plan. In addition, unlike in defined benefit plans and traditional defined contribution plans, in most 401(k) plans, the individual plan participant, rather than a professional investment manager, decides how to invest the plan assets.

Although the shift from defined benefit plans to defined contribution plans in general, and 401(k) plans in particular, is undeniable, and seemingly permanent, it is not the result of an explicit policy choice. Rather, it is the result of a variety of factors ranging from ERISA's burdensome regulations on defined benefit plans to an increasingly mobile workforce.

Professor Edward Zelinsky contends that this shift has been part of "a quiet, largely unheralded revolution, a revolution [that] has been, incrementally but fundamentally changing the manner in which Americans think about tax and social policy and in which their governments formulate such policy." Under this so-called new defined contribution paradigm, "the policies more likely to be adopted are those that channel government

119. See U.S. Dep't of Labor, Private Pension Plan Bulletin Historical Tables and Graphs Tables E5, D6(a) & D6(b) 5, 48–49 (Mar. 2010) (showing that in 2007, of the 123,854 participants covered by a pension plan, 42,280,000 were covered by a defined benefit plan while 81,574,000 were covered by a defined contribution plan, and, among active participants, 7,308,000 were active participants in a non-401(k) defined contribution plan and 59,566,000 were active in a 401(k) type plan).
120. In order for a cash or deferred arrangement to be "qualified," it must meet satisfy specific statutory requirements related to eligibility, coverage, nondiscrimination, vesting, and nondiscrimination, among other things. See 26 U.S.C. § 401(k)(2) (2006).
121. For a discussion of automatic enrollment plans and their effect on participation, see Stabile, supra note 102, at 317–19.
122. See U.S. Dep't of Labor, supra note 119 (showing that participants in 418,491 of the total 490,917 401(k) type plans were responsible for directing all of the investments in their individual accounts while participants in another 19,999 401(k) type plans were responsible for investing a portion of their assets (typically employee contributions) and only in 52,428 of the 401(k) type plans do participants not direct any investments).
subsidies through individual accounts controlled by the taxpayer herself.” Professor Zelinsky credits American “cultural receptivity” with this shift because “[individual] accounts resonate with some of the strongest-held values of American culture, namely, personal autonomy, private property, and self-support.”

It is important to note, however, that the United States is not alone in seeing a shift from defined benefit plans to defined contribution plans. The United Kingdom has experienced a similar shift. In addition, there has been an increase in the number of defined contribution plans relative to defined benefit plans in Canada, though defined benefit plans remain the dominant form of employment-based pension in Canada.

4 Eligibility for Tax Favorable Treatment

Like all countries with a well-developed voluntary private pension system, the United States provides favorable income tax treatment to employment-based pension plans that qualify for such treatment. Specifically, the employer may deduct contributions to the plan at the time they are made, regardless of when the participants include the benefits in their income. In addition, even though the employer is permitted an immediate deduction, plan participants are not required to include contributions in income until the benefits are distributed to the plan.

125. Edward A. Zelinsky, The Origins of the Ownership Society: How the Defined Contribution Paradigm Changed America 97 (2007). See also Stabile, supra note 102, at 309 (“401(k) plans are also more consistent with the individualist/consumer approach that has become so prevalent in so many areas of law and society. Employers argue that 401(k) plans give employees personal autonomy over their financial future and many have bought into this way of thinking.”).

126. On the other hand, not all countries have seen a shift from defined benefit plans to defined contribution plans. For example, defined benefit plans remain the predominant type of plan in the Netherlands and Switzerland. See Private Pension, supra note 98, at 20.

127. See Bailey & Kirkegaard, supra note 123, at 427 (noting that most public sector workers are covered by defined benefit plans in United Kingdom but that only 16% of private sector workers covered by defined benefit plans and declaring that “the shift from defined benefit provision among UK companies has been at least as precipitous as among their US brethren”).

128. See id. at 408 (noting that share of Canadian private sector workers covered by defined contribution plans rose from 9% to 15%).

129. See id. (noting that essentially all Canadian public sector workers are covered by a defined benefit plan and 85% of the covered private sector workforce covered by a defined benefit plan).

130. Turner, supra note 97, at 6.

131. Section 401(a) of the Internal Revenue Code sets forth thirty-seven requirements that a pension, profit-sharing, or stock bonus plan must satisfy in order to qualify for favorable tax treatment. See 26 U.S.C. § 401(a) (2006). Plans that satisfy these requirements are commonly referred to as “qualified” plans. The Internal Revenue Code also accords favorable tax treatment to other plans and arrangement, such as Section 403(b) annuities for tax exempt entities and Section 457 plans for state and local governments and tax exempt organizations.

participants. Finally, the trust that holds plan assets is not required to pay income tax on the earnings from the investment of the contributions.

According to Joint Committee on Taxation estimates, the combined net exclusion of pension contributions and earnings for employer plans represents the third largest tax expenditure for the years 2009 through 2013, with an estimated $460 billion in forgone tax revenues between 2009 and 2013.

The orthodox justification for the favorable tax treatment accorded employment-based pension plans is that it promotes retirement income security by encouraging retirement savings by individuals who would not otherwise save for retirement. At first blush, using tax incentives to encourage lower- and middle-income workers to save for retirement might seem irrational in light of the progressive tax rates in the United States. The value of the tax deferral to an individual worker depends on the worker’s marginal tax rate, the higher an individual’s income, the higher the individual’s tax rate and thus the greater the tax benefit. Thus, the system provides a greater tax benefit to a higher-income worker, who is in a better position to save for retirement, than a lower-income worker who is less able to save for retirement.

133. Id. § 402(a).
134. Id. § 501(a). So-called Roth treatment permits an alternative form of favorable tax treatment for employee contributions to pension plans. Under this method, plan participants must include in income their plan contributions, but no is imposed on plan earnings or plan distributions. Assuming no tax change in tax rates, this form of favorable tax treatment is economically equivalent to the traditional form of favorable tax treatment. See Daniel Halperin, Interest in Disguise: “Taxing the Time Value of Money,” 95 YALE L.J. 506, 519 (1986); Gregg D. Polsky & Grant J. Hellwig, Taxing Structured Settlements, 51 B.C. L. REV. 39, 47 n.31 (2010).
135. Tax expenditures are defined as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.” See Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2009–2013, at 3. For an argument that the tax deferral for employment-based pensions should not be treated as a tax expenditure, see Edward A. Zelinsky, The Tax Treatment of Qualified Plans: A Class Defense of the Status Quo, 66 N.C. L. REV. 315 (1988).
136. Joint Committee on Taxation, id. at 43.
137. Not all commentators accept this orthodox view. See Stein, supra note 112, at 628 and authorities cited therein; Zelinsky, supra note 135.
138. See Halperin, supra note 112, at 7 (“tax incentives traditionally have been provided to encourage employers to offer retirement protection for rank and file employees”); Michael W. Melton, Making the Nondiscrimination Rules of Tax-Qualified Retirement Plans More Effective, 71 B.U. L. REV. 47, 48–49 (1991) (“The departure from general tax principles in the case of qualified plans is justified by the nontax, social policy goal of providing retirement income (as a supplement to Social Security benefits) for lower- and middle-income employees who find it particularly difficult to save for retirement on their own.”); Norman P. Stein & Patricia E. Dilley, Leverage, Linkage, and Leakage: Problems with the Private Pension System and How They Should Inform the Social Security Reform Debate, 58 WASH. & LEE L. REV. 1369, 1374 (2001) (“[t]he orthodox explanation for the subsidy is that it provides retirement income security for employees who would not otherwise save adequately for retirement”). See also Walker, supra note 105, at 26-3 n.2. (“One purpose of tax preferences for employer-sponsored pensions is to encourage savings for workers’ retirement.”
139. Stein & Dilley, supra note 138, at 1374.
This favorable tax treatment, however, is accompanied by, among other things, nondiscrimination rules that require that qualified plans provide sufficient benefits to the non-highly compensated relative to the benefits provided to the highly compensated. The claim is that by providing favorable tax treatment, the highly paid individuals who own and manage businesses will elect to establish employment-based pensions, and the nondiscrimination rules will force the plans to provide meaningful benefits to the non-highly compensated.

In recent years, Congress has added a more direct tax incentive to encourage retirement savings by low-income individuals. Specifically, the Savers Credit provides an income tax credit for as much as 50% of the first $2,000 of elective contributions to an IRA or elective deferrals to a 401(k) plan. In 2011, individuals with an adjusted gross income of $34,000 are entitled to the full credit, and the credit is reduced to 20% and 10% as income increases. Individuals with an adjusted gross income that exceeds $50,000 are ineligible for the credit.

The Saver’s Credit has been decried as “mostly an illusion” because most of the individuals eligible for the credit have little or no income tax liability. In order to make the credit workable, Professor Daniel Halperin recommends that the credit be made refundable and the cliff reduction in the credit be replaced with a gradual phase-down of the maximum credit. Indeed, President Obama has proposed a refundable credit of 50% of contributions up to $500 per individual or a maximum credit of $250 per person.

140. Professor Halperin refers to the favorable tax treatment as a “carrot.” Halperin, supra note 112, at 6–7.
141. As noted above, section 401(a) of the IRC requires that qualified plans meet thirty-seven separate requirements, including the nondiscrimination requirements.
142. Professor Halperin refers to the nondiscrimination rules as a “stick.” Halperin, supra note 112, at 6–7.
143. 26 U.S.C. §§ 401(a)(26) (2006) (minimum participation requirement applicable only to defined benefit plans); 410(b) (minimum coverage requirement applicable to all qualified plans); 401(a)(4) (minimum benefit or contribution requirement applicable to all qualified plans); 401(k)(3) (special nondiscrimination rule applicable to 401(k) plans).
144. Stein & Dilley, supra note 138, at 1375. See also Bankman, supra note 65, at 800–04 (providing legislative history of nondiscrimination rules and noting that in support of nondiscrimination rules adopted in 1942, Treasury “reiterated its belief that the subsidy inherent in the pension provisions had led to plans which gave too many benefits to highly compensated employees and too few benefits to rank-and-file employees.”).
147. Id. § 25B(1)(D).
148. Daniel Halperin, Retirement Income Security After the Fall, in NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION 11-9 (2009) (noting that in 2005, only one in seven of the eligible income group actually paid income taxes and less than one in 1,000 paid enough tax to take advantage of the maximum credit).
149. Id.
150. Id.
5. ERISA’s Regulatory Requirements

On September 2, 1974, President Gerald Ford signed the Employee Retirement Income Security Act of 1974 (ERISA) into law. “[A]n enormously complex and detailed statute,” ERISA was the culmination of more than ten years of debate on the problems and weaknesses with the then mostly unregulated private pension system. As discussed above, ERISA does not mandate that employers provide pension plans. If, however, an employer elects to offer a pension plan, Title I of ERISA protects pension plan participants in three principal ways: (1) it imposes vesting requirements, (2) it imposes fiduciary obligations, and (3) it mandates minimum funding standards. In addition, title IV of ERISA establishes the Pension Benefit Guaranty Corporation (PBGC) to guarantee the payment of pension benefits of defunct employers.

When ERISA was enacted, defined benefit plans were the principal type of employment-based pension plan. Accordingly, ERISA’s provisions were enacted with defined benefit plans in mind. Some of its protections, such as the vesting rules and fiduciary obligations, apply to both defined benefit and defined contribution plans. On other hand, some of the protections, specifically the minimum funding standards and PBGC guaranty, apply solely to defined benefit plans. Moreover, the fiduciary provisions protect the interests of defined benefit plan participants more effectively than they do defined contribution plan participants.

a. Vesting Requirements

When private pensions were originally introduced in the United States, they were viewed as “gratuities,” and the employer had no obligation to pay benefits to plan participants. By 1974, 88% of plans provided for the

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153. Title I of ERISA also imposes reporting and disclosure requirements, see ERISA §§ 101-05, 29 U.S.C. §§ 1021-25, and includes administrative and enforcement provisions, see ERISA 501-514, 29 U.S.C. 1131-44. This Article will not address these provisions. Nor will it discuss the provisions solely regulating group health plans. See ERISA §§ 601-609, 29 U.S.C. §§ 1161-69, ERISA §§ 701-733, 29 U.S.C. §§ 1181-1191b.
155. See McNevin v. Solvay Process Co., 53 N.Y.S. 98 (1898), aff’d per curiam, 60 N.E. 1115 (N.Y. 1901) (holding employer had no obligation to pay pension benefit because pensions are a gift from the employer to the employee). See also Dilley, supra note 8, at 1114–15 (discussing gratuity theory of early pension promises).
vesting of benefits, but the vesting schedules ranged widely, with some plans imposing both age and lengthy service requirements. According to one account, due to the lengthy service requirements and numerous disqualifying events, fewer than 10% of plan participants ever attained benefit eligibility prior to the enactment of ERISA.

Recognizing that "many employees with long years of employment [were] losing anticipated retirement benefits owing to the lack of vesting provisions," ERISA dramatically altered the landscape by imposing minimum vesting requirements. Under current law, benefits derived from an employee’s own contributions (elective deferrals and after-tax contributions) must be fully vested at all times. The vesting rules for benefits attributable to employer contributions depend on the type of plan. Benefits attributable to employer contributions to defined benefit plans must either (1) be fully vested after five years of service, or (2) vest under a graded vesting schedule pursuant to which benefits must be 20% vested after three years of service, 40% after four years of service, 60% after five years of service, 80% after six years of service, and 100% after seven years of service. Benefits attributable to employer contributions to defined contribution plans must either (1) be fully vested after three (rather than five) years of service, or (2) vest under a more accelerated graded vesting schedule pursuant to which benefits must be 20% vested after two years of service, 40% after three years of service, 60% after four years of service, 80% after five years of service, and 100% after six years of service.

b. Fiduciary Obligations

Prior to the enactment of ERISA, "kickbacks, embezzlement, outrageous administrative costs, and excessive investments in the securities

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156. ICI, supra note 5, at 11.
158. ERISA § 2(a), 29 U.S.C. § 1001(a).
163. Contributions to top-heavy defined benefit plans are also subject to the accelerated vesting schedule applicable to defined contribution plans. 26 U.S.C. § 416(b)(1). Top-heavy plans are plans for which 60% or more of benefits or contributions are held for the benefit of key employees (highly compensated officers and owners). See IRC §§ 416(g)(1)(A), 416(f)(1)(A).
of plan sponsors/employers were a serious problem with many employee benefit plans. Accordingly, ERISA added explicit fiduciary duties. Specifically, ERISA imposes four separate fiduciary duties: (1) the duty to act for the exclusive benefit of plan participants, also known as the duty of loyalty; (2) the duty to act with care, skill, prudence, and diligence of the prudent person, also known as the duty of prudence; (3) the duty to diversify plan assets so as to minimize risks, also known as the duty to diversify; and, (4) the duty to act in accordance with plan documents and instruments.167

The fiduciary provisions have done a reasonably good job of resolving problems with respect to defined benefit plans. The fiduciary provisions, however, have not resolved some of the most fundamental problems with respect to 401(k) plans. First, in most 401(k) plans, the plan participant, rather than a professional investment manager, decides how to invest the plan assets.168 While the ability to decide how to invest plan assets may be a boon to the highly educated and sophisticated few, “most people simply don’t have the time or inclination to become experts on managing financial portfolios, even their own.”169 As a result, plan participants frequently make excessive investments in company stock and other fundamental investment mistakes170 and earn lower investment returns than do institutional investors.171 ERISA’s fiduciary provisions do not resolve this fundamental

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167. ERISA § 404(a)(1)(A)-(D), 29 U.S.C. § 1104(a)(1)(A)-(D). ERISA imposes co-fiduciary liability for a breach of fiduciary duty by another plan fiduciary if the co-fiduciary participates in or enables the breach by the other fiduciary, ERISA § 405, 29 U.S.C. § 1105. In addition to ERISA’s general fiduciary duties, section 406 of ERISA prohibits certain transactions between a fiduciary and a “party in interest.” ERISA § 406, 29 U.S.C. § 1106. Section 408 of ERISA sets forth a number of statutory exemptions from these prohibited transaction rules. ERISA § 408, 29 U.S.C. § 1108. In addition, ERISA authorizes the Department of Labor to issue both class and individual exemptions. Id.

168. See supra Section III.A.3.


171. See Stabile, supra note 123, at 88 (noting that “investment returns by defined contribution plan participants are 2% per year lower than those achieved by institutional investors.”).
problem. Indeed, the fiduciary provisions generally do not apply to investment decisions made by plan participants in self-directed plans.172

Second, despite the fact that the fiduciary provisions were added, in part, in response to “outrageous administrative costs,” excess plan fees have been a problem for 401(k) plans.173 A plethora of fees are imposed on 401(k) plans, ranging from administrative fees to pay for the services needed to operate the plan, such as record-keeping and trustee service fees, to investment fees to pay for the cost of managing the assets of the plan.174 The fees tend to be “so complex, confusing, or obscure that many sponsors and participants report that they do not understand their magnitude or their consequences.”175 The Department of Labor has focused on plan fees for more than a decade and recently embarked on three new initiatives to require greater disclosure of plan fees.176 While imposing greater fiduciary disclosure obligations may reduce some of the problems with excess plan fees, it will not eliminate the fundamental issue behind the plan fee controversy: the propriety of the business model underlying the current private employer-based retirement system. A huge industry has developed to “service” 401(k) plans. Proponents of the current system contend that the marketplace effectively regulates service providers’ behavior and ensures that service providers do not make undue profits from plans.177 Critics of current system, on the other hand, contend that it results in the provision of many unnecessary costly services178 and we should return to a

175. See Kopcke et al., supra note 174, at 1.
176. See Moore, supra note 173, at 17-2-17-16. In addition, a multitude of cases have been filed in recent years alleging that 401(k) plan fiduciaries breached their fiduciary duties by paying excessive plan fees for plan investments. In fact, a single law firm, Schlicter Bogard & Denton, filed about dozen such cases in 2006 and 2007. See Joel J. Myer, Court Awards $5M to St. Louis Firm Credited With Bringing Attention to Plan Fee Issues, 37 Pens. & Ben. Rep. (BNA) 2592 (Nov. 30, 2010). Although not all of the cases have been successful, three of the cases have reached multimillion dollar settlements. Id. According to the judge awarding the firm $5.05 million, or one-third of the $15.15 million settlement, plus almost $700,000 in costs in one case, “these cases, collectively, have swept changes to fiduciary practices within 401(k) plans and have changed the 401(k) industry for the benefit of employees and retirees throughout the country.” Will v. General Dynamics Corp., 2010 U.S. Dist. LEXIS 123349 *8 (2010).
177. See, e.g., The SPARK Institute, Inc., The Case for Employer-Sponsored Retirement Plans: Fees and Expenses (May 2009).
178. Common services include “24-hour access to account information” and “phone/call center support with representatives available to assist participants at least 10 hours per day.” Id. at 7.
system where experts invest retirement savings rather than requiring individuals to direct their own individual accounts.179

c. Minimum Funding Requirements

Prior to the enactment of ERISA, many pension plans were underfunded.180 If an employer elected to terminate an underfunded defined benefit plan, the participants risked losing most or all of their benefits. In the most famous instance, the Studebaker automobile plant terminated its underfunded defined benefit plan in 1963, and almost 7,000 employees lost most or all of their benefits.181

In order to address this problem, ERISA imposed minimum funding standards on defined benefit plans.182 Those standards proved to be inadequate,183 and the minimum funding standards were repealed and replaced by new minimum funding standards in the Pension Protection Act of 2006.184

The new minimum funding rules are less flexible than the old rules and are intended to tighten the funding requirements.185 Under the new minimum funding rules, the minimum required contribution generally depends upon a comparison of the value of the plan’s assets (reduced by any prefunding balance and funding standard carryover balance) to the plan’s funding target and target normal cost.186 A plan’s funding target is the present value of all benefits accrued or earned as of the beginning of the plan year.187 A plan’s target normal cost is the present value of benefits expected to accrue or be earned during the plan.188 Shortfalls must
generally be amortized over seven years. Thus, the goal of the new rules is to have defined benefit plans fully funded after seven years.

Although the minimum funding rules are designed to shore up the funding of defined benefit plans, critics contend that they may contribute to a further shift from defined benefit plans to defined contribution plans, particularly among companies with healthy plans, because they are too volatile and require most companies to contribute more money to their plans each year. Unlike defined benefit plans, most defined contribution plans, including 401(k) plans, are not subject to the minimum funding requirements.

d. Pension Benefit Guaranty Corporation (PBGC) Insurance

In addition to imposing minimum funding standards, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to protect the pensions of American workers and retirees participating in private-sector defined benefit plans. The PBGC guarantees “basic pension benefits” (up to certain limits) earned before the plan terminates. For plans terminating in 2011, the maximum guaranteed benefit is $4,500 per month (or $54,000 per year) for employees who begin receiving payments from the PBGC at age sixty-five. The guaranteed amount is reduced for workers who begin to receive benefits before age sixty-five or who receive benefits in the form of a joint and survivor annuity and is increased for workers who begin to receive benefits after age sixty-five.


190. Stanley D. Baum, Sweeping Changes for Pension Plan Funding and Other Rules: Part 1—Defined Benefit Plans, 105 J. TAX’N 208, 2006 WL 2942992 (2006). Cf. Gerald M. Levinson, Funding of Qualified Plans—Requirements, Offsets, and Design Alternatives, in Bender’s Federal Income Taxation of Retirement Plans 10-6 (2010) (Under the PPA, the “principle that plans should be treated as ongoing enterprises is defunct. The goal is not equity among generations of shareholders and workers but solvency in the short run. The ideal is for every plan always to be fully funded, on a termination basis, for all accrued benefit.”).


192. Money purchase plans and target benefit plans are subject to the minimum funding rules. See Jefferson, supra note 123, at 673, n.294.


194. Basic pension benefits include (1) pension benefits at normal retirement age, (2) most early retirement benefits, (3) disability benefits, and (4) annuity benefits for survivors of plan participants. [PBGC, Your Guaranteed Pension], available at http://www.pbgc.gov (last visited Sept. 26, 2011).


196. Id.
The PBCG administers two separate programs: (1) the single-
employer program, and (2) the multiemployer program.\textsuperscript{197} The single-
employer program protects nearly 33.8 million employees in about 26,100
pension plans.\textsuperscript{198} In 2010, the PBGC paid nearly $5.5 billion in benefits to
about 748,000 retirees in 4,140 failed plans under the single-employer
program.\textsuperscript{199} The multi-employer program protects about 10.4 million
employees and retirees in about 1,460 pension plans.\textsuperscript{200} The PBGC
provided about $97 million of financial assistance to fifty multi-employer
plans in 2010 under the multiemployer program.\textsuperscript{201}

The PBGC is financed from three main sources: (1) insurance
premiums that it receives from employers that sponsor insured pension
plans, (2) assets it receives from terminated pension plans, and (3) investment income it earns from those assets.\textsuperscript{202} In 2011, the premium for
single-employer plans is $35 per worker or retiree, plus underfunded plans
must pay an additional premium of $9 for each $1,000 of unfunded vested
benefits; the premium for multiemployer plans is $9 per worker or
retiree.\textsuperscript{203}

The U.S. Government Accountability Office (GAO) has designated the
PBGC’s single-employer program a “high risk” program since 2003 when it
moved from an accumulated surplus of $9.7 billion in 2000 to an
accumulated deficit of $3.6 billion in 2002.\textsuperscript{204} In recent years, Congress has
increased the PBGC’s premiums and tightened the minimum funding
standards in order to address the PBGC’s deficit.\textsuperscript{205} These changes are
expected to improve the PBGC’s financial situation but not completely
eliminate its financial difficulties.\textsuperscript{206} Among other things, these changes do
not address the fact that the PBGC, unlike private insurers, cannot decline
to provide insurance coverage or adjust premiums to reflect actual or
expected claims exposure.\textsuperscript{207} As of September 30, 2010, the PBGC held

\textsuperscript{197} PBGC, FY 2010 PBGC Annual Report, at 2.
\textsuperscript{198} Id. at 2.
\textsuperscript{199} Id. at 19.
\textsuperscript{200} Id. at 2.
\textsuperscript{201} Id. at 20.
\textsuperscript{203} Fact Sheet, supra note 195.
\textsuperscript{204} United States Government Accountability Office, supra note 202, at 6. The PBGC added the high risk designation to the multiemployer program in 2009. Id.
\textsuperscript{205} See id.
\textsuperscript{206} Id. at 5–6; Martin & Rafsky, supra note 191, at 551–53; Eric D. Chason, Outlawing Pension-Funding Shortfalls, 26 VA. TAX REV. 519 (2007).
\textsuperscript{207} United States Government Accountability Office, supra note 202, at 4–5. See also PBGC Annual Report, supra note 197, at iv (attributing PBGC’s deficit to two principal factors: (1) inadequate plan funding and misfortunes that have befallen plan sponsors; and (2) PBGC’s inadequate premium rates).
about $79.5 billion in assets and about $102.5 billion in liabilities, for an accumulated deficit of about $23 billion. The PBGC currently has sufficient assets to make scheduled benefit payments for a number of years but faces long-term financing difficulties. Reform of the PBGC appears inevitable.

B. Overview of State and Local Government Employment-Based Pensions

Public sector employment-based pensions differ significantly from private sector pensions. First, public sector employees are less likely to be covered by Social Security than are private sector employees. While Social Security covers about 94% of the U.S. workforce, and virtually all private sector employees, it only covers about 72% of state and local government employees.

Second, public sector employees are much more likely to be covered by an employment-based pension plan than are private sector employees. For example, in 2006, 76% of state and local government employees aged twenty-five to sixty-four participated in an employment-based plan compared to 43% of private sector employees.

Third, the public sector has not experienced the same shift from defined benefit plans to defined contribution plans as has the private sector. Defined benefit plans remain the dominant form of employment-based pension in the public sector. For example, in 2004, 80% of state and local workers relied solely on a defined benefit plan while 64% of private sector employees relied solely on a defined contribution plan that year.

208. PBGC Annual Report, supra note 197, at 19–21.
209. Cf. United States Government Accountability Office, supra note 202, at 6 (declaring that GAO believes that the PBGC needs urgent congressional and agency action).
210. This section focuses on state and local government plans. For an overview of federal employee pension plans, see Employee Benefit Research Institute, EBRI Databook on Employee Benefits Chapter 18 (updated Feb. 2006); U.S. Gov’t Accounting Office, GAO/AIMD-96-6 PUBLIC PENSIONS: SUMMARY OF FEDERAL PENSION PLAN DATA (1996).
211. This is not to suggest that all public sector plans are the same. Some states, such as Hawaii and Maine, have a single plan covering all employees. Other states, such as Florida, Illinois, Michigan, Minnesota, and Pennsylvania, have more than one hundred different systems covering different types of employees. See Munnell et al., supra note 90, at 2.
212. Alicia H. Munnell & Mauricio Soto, State and Local Pensions are Different from Private Plans, 1 CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE STATE AND LOCAL PENSIONS PLANS 3 (2007). Most of the uncovered workers are employed in seven states: California, Colorado, Illinois, Louisiana, Massachusetts, Ohio, and Texas. Id.
213. Id. at 2.
214. For a discussion of the reasons why defined benefit plans remain the dominant form of pension in the public sector, see Alicia H. Munnell et al., Why Have Defined Benefit Plans Survived in the Public Sector? 2 CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE STATE AND LOCAL PENSIONS PLANS 2 (2007).
Fourth, unlike private sector plans, public sector pension plans are exempt from ERISA.\textsuperscript{216} Thus, ERISA's regulatory requirements do not apply to public sector plans.

Although the public pension world differs significantly from the private sector world, they do share some similarities. For example, like private sector pensions, public sector pensions are eligible for favorable tax treatment.\textsuperscript{217} In addition, although public sector pensions are not subject to ERISA, like private pensions, they tend to be financed on a funded basis rather than on a pay-as-you go basis like Social Security.\textsuperscript{218} This is not to suggest, however, that public pensions do not face funding difficulties. Indeed, they do.\textsuperscript{219}

IV. INDIVIDUAL SAVINGS

The third and final leg of the three-legged retirement income security stool in the United States is individual savings. The United States is not known for its high level of individual savings. Indeed, it "has the lowest saving rate of any major industrialized nation. The U.S. saving rate as a percentage of disposable personal income fell to zero in the fourth quarter of 1998 and actually turned negative in 2005."\textsuperscript{220} The U.S. personal savings rate has increased since the real estate bubble burst in 2007, but it remains relatively low.\textsuperscript{221}

Prior to 1962, individual retirement savings was dependent entirely on individual initiative. Since 1962, the federal government has, to a limited extent, encouraged individual retirement savings through favorable tax treatment.

\begin{itemize}
\item \textsuperscript{216} ERISA § 4(b)(1), 29 U.S.C. § 1003(b)(1).
\item \textsuperscript{217} 26 U.S.C. § 457 (2006).
\item \textsuperscript{218} See Munnell et al., supra note 90, at 3 (noting that a 1978 study on public pensions mandated by ERISA documented the status of public pensions and spurred an increase in funding efforts).
\item \textsuperscript{220} Walker, supra note 105, at 26-4. For a discussion of individual savings in this country, see Befort, supra note 94, at 959-62.
\item \textsuperscript{221} See U.S. Dep’t of Commerce, Bureau of Economic Analysis, News Release, Personal Income and Outlays: March 2011 (stating that “[p]ersonal saving as a percentage of disposable personal income was 5.5 percent in March [2011]”) (Apr. 29, 2011); Though Personal Income Rises, Spending Increases Only Slightly, N.Y. TIMES, 2011 WLNR 392368 (Mar. 1, 2011) (noting that personal savings rate was 5.8% in 2010 and 5.9% in 2009); OECD Economic Outlook No. 89, Economic Outlook: Statistics and Projections (database), Household saving rates—forecasts (showing that at 5.5% in 2011, U.S. has eighth lowest savings rate of 20 OECD countries) (2011).
\end{itemize}
In 1962, Congress created the so-called Keogh plan to extend tax favorable retirement savings to the self-employed. Initially, the contribution limits for Keoghs were lower than the contribution limits available to qualified plans. Since 1982, however, there has been substantial parity between the treatment of plans for the self-employed and qualified plans for employees. According to the Joint Committee on Taxation, the tax expenditure for Keogh plans is estimated to be $73.4 billion in forgone tax revenues between 2009 and 2013.

In 1974, Congress created the Individual Retirement Account (IRA) to extend favorable tax treatment for retirement savings to individuals who did not participate in an employment-based retirement plan. The taxation of IRAs mirrors that of qualified employment-based pension plans with neither contributions nor earnings subject to tax until the money is withdrawn from the IRA. According to the Joint Committee on Taxation, the tax expenditure for IRAs is estimated to be $59 billion in forgone tax revenues between 2009 and 2013.

Initially available only to individuals who were not active participants in an employment-based plan, the rules governing IRAs have evolved considerably over the years. Under current law, individuals who do not participate in an employer-sponsored plan may make tax deductible contributions of up to $5,000 to an IRA. Depending on income, individuals covered by an employment-based plan may also make tax deductible contributions to IRAs. In 2011, tax deductible contributions are phased out for single taxpayers with modified adjusted gross income of between $56,000 and $66,000, and for married taxpayers with modified adjusted gross income between $90,000 and $110,000. Taxpayers with income that exceeds these limits may make nondeductible contributions to IRAs.

223. See Graetz, supra note 65, at 895; Edward W. Morse, Travails of the Entrepreneurial Ant: Reforming Tax-Favored Retirement Saving for Small Business Owners, 50 DEPAUL L. REV. 49, 74–75.
226. 26 U.S.C. §§ 219(a), 408(d), 408(e) (2006). Current law authorizes both traditional IRAs and Roth IRAs. In a Roth IRA, contributions are not deductible when made, but earnings accrue tax free and no tax is due when the money is withdrawn. 26 U.S.C. § 408A. As an economic matter, the value of a Roth IRA is virtually identical to that of a traditional IRA. See also Frolik & Moore, supra note 154, at 489. This Article will only discuss traditional IRAs. For a comparison of traditional and Roth IRAs, see IRA-Based Employer Plans, in Federal Taxation of Retirement Plans 8-7–8-16.
227. See Morse, supra note 223, at 71–74; Graetz, supra note 65, 895–99.
The IRA contribution limits are considerably lower than the limits for employer-sponsored plans. For example, in 2011, individuals can contribute up to $16,500 to a 401(k) plan while they are limited to a $5,000 contribution to an IRA.

According to the Employee Research Institute's (EBRI) IRA Database, IRAs hold more than 25% of all retirement assets in the United States. Not all of these assets, however, are attributable to individual savings through an IRA. Instead, almost half of all IRA assets are attributable to rollover IRAs; that is, IRAs originating from assets rolled over from tax-favored employment-based pensions.

Not surprisingly, IRA assets are not divided evenly across the population. Rather, as might be expected, higher income individuals are more likely to have an IRA than lower-income individuals, and the IRA balances of high-income individuals are likely to be higher than those of lower-income individuals. For example, while 30.6% of U.S. families had an IRA (or Keogh) in 2007, less than 7% of families with income of less than $10,000 had such an account compared to over 60% of families with income of more than $100,000.

Most recently, as discussed above, Congress enacted the Savers Credit to provide a tax credit to encourage retirement income savings by low-income individuals. Under the Savers Credit, low-income individuals may receive an income tax credit for as much as 50% of the first $2,000 of elective contributions to an IRA (or elective deferrals to a 401(k) plan). In 2011, individuals with adjusted gross income of up to $34,000 are entitled to the full credit, and the credit is reduced to 20% and 10% as income increases. Individuals with adjusted gross income that exceeds $50,000 are ineligible for the credit. Nevertheless, as discussed above,
the Saver's Credit is mostly an "illusion" because most of the individuals eligible for the credit have little or no income tax liability.\footnote{239}

V. VALUES REFLECTED IN THE U.S. RETIREMENT INCOME SECURITY SYSTEM

This section discusses how the U.S. retirement income security system does, and does not, reflect the European values of responsibility, protection, solidarity, nondiscrimination, and participation. Perhaps not surprisingly, these values are not subject to a single definition. For example, the term "solidarity" is sometimes defined narrowly to refer solely to the willingness to share resources through redistribution while at other times it is defined more broadly to include other traits as well.\footnote{240} The term "nondiscrimination" sometimes refers to equal treatment between men and women\footnote{241} while at other times it refers to equality of treatment based on nationality.\footnote{242} Moreover, discrimination may also refer to discrimination between full-time and part-time work.\footnote{243} This section does not attempt to specify a single exact definition of the terms, but instead uses the terms in an intuitive sense that reflects U.S. culture.\footnote{244}

A. Responsibility

For the most part, workers and their employers share financial responsibility for retirement income security in the United States. The federal government provides little direct funding of retirement benefits;
although, it does provide considerable indirect funding through favorable income tax treatment.

The U.S. Social Security system is financed principally through dedicated employee and employer "contributions" to the Federal Insurance Contributions Act.\textsuperscript{245} Until the December 2010 tax compromise, general revenues played little role\textsuperscript{246} in the financing of Social Security.\textsuperscript{247} Instead, workers and their employers were required to make equal contributions to fund Social Security.\textsuperscript{248} The 2010 tax compromise breaks with this tradition, at least for one year, and reduces the employee contribution from 6.2\% of taxable wages to 4.2\% of taxable wages, and requires that general revenues be transferred to the Social Security Trust Fund to offset this reduction in employee contributions.\textsuperscript{249} Whether this partial general revenue financing will become a permanent feature of Social Security remains to be seen.

No law requires that employers establish employment-based pensions, nor does any law require that employees contribute to such plans.\textsuperscript{250} If, however, a private sector employer elects to establish a defined benefit plan, federal law requires that the plan meet minimum funding standards,\textsuperscript{251} and those funding requirements are typically satisfied solely by employer contributions.\textsuperscript{252} Employees typically do not fund private sector defined benefit plans.\textsuperscript{253} Employee contributions, however, are the principal source of funding for 401(k) plans,\textsuperscript{254} the most common type of private sector plan in the United States today. Employers may, but are not required to, contribute to 401(k) plans.\textsuperscript{255}

\textsuperscript{245} See supra section II(D).
\textsuperscript{246} Currently, revenue from the federal income tax imposed on certain Social Security benefits accounts for 3\% of the Social Security Trust Fund's income. See supra section IID. For a discussion of the role general revenues have played in financing Social Security over the years, see Kathryn L. Moore, Social Security Reform: Fundamental Restructuring or Incremental Change, 11 LEWIS & CLARK L. REV. 341, at 360 nn. 111–112 (2007).
\textsuperscript{247} The Committee on Economic Security recommended that Social Security's legacy cost be financed by general revenues beginning in 1965. President Roosevelt, however, rejected this suggestion, and since its inception, general revenues have played little role in financing Social Security benefits. See Moore, supra note 246, at 357.
\textsuperscript{249} See supra Section II(D).
\textsuperscript{250} See supra Section III(A)(1).
\textsuperscript{251} See supra section III(A)(5)(c).
\textsuperscript{252} See U.S. Dep't of Labor, Empl. Benefits Security Administration, Private Pension Plan Bulletin: Abstract of 2008 Form 5500 Annual Reports Table A4, at 8 (Dec. 2010) (showing in 2008, employers contributed over $104 billion to defined benefit plans compared to employee contributions of only $954 million)
\textsuperscript{253} See id.
\textsuperscript{254} See U.S. Dep't of Labor, supra note 252, at tbl. A4, at 8 (showing that in 2008, employees contributed almost $172 billion to defined contribution plans compared to employer contributions of just over $120 billion).
\textsuperscript{255} In fact, most employers do elect to offer matching contributions. See Mauricio Soto & Barbara A. Butrica, Will Automatic Enrollment Reduce Employer Contributions to 401(k) Plans? 10 (Urban...
With the exception of the Savers Credit, the federal government does not directly subsidize employment-based pensions. It does, however, provide considerable indirect financing through favorable tax treatment. To illustrate, the combined net exclusion of pension contributions and earnings for employer plans represents the third largest tax expenditure for the years 2009 through 2013, with an estimated $460 billion in foregone tax revenues between 2009 and 2013.

As might be expected, individual savings depend principally on individual initiative and individual effort. Again, with the exception of the Savers Credit, the federal government does not directly subsidize individual retirement savings. It does, however, provide indirect financing through favorable tax treatment. According to the Joint Committee on Taxation, the combined net exclusion for contributions and earnings on Keoghs and IRAs (which includes rollover IRAs originally attributable to contributions to employer plans) is estimated to be $132.4 billion between 2009 and 2013.

B. Protection

Social Security benefits are not explicitly guaranteed. Instead, they are determined by federal law that, at least in theory, could be repealed at any time. Opponents of the current Social Security system point to this "political risk" and contend that Social Security should be restructured to include individual accounts to protect against this risk. Proponents of the

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256. See supra section III(A)(4).
257. See id.
258. See id.
259. See supra section IV.
260. See id.
261. In fact, over Social Security’s seventy-five year history, Congress has never directly reduced the current benefits of workers already receiving benefits, and in only one instance, during an extreme financial crisis, has Congress directly reduced a scheduled increase in benefits for beneficiaries already in pay status. Congress has, however, on a number of occasions, reduced or eliminated benefits promised to future beneficiaries. See Patricia E. Dilley, Through the Doughnut Hole: Reimagining the Social Security Contribution and Benefit Base Limit, 62 ADMIN. L. REV. 367, 398–99 (2010). In addition, Congress arguably indirectly reduced the Social Security benefits of beneficiaries in pay status when it introduced a new income tax on the Social Security benefits of relatively high-income beneficiaries in 1983, P.L. No. 98-21, § 121, 97 Stat. 65, 80 (1983) (adding IRC § 86), and increased that tax in 1993, P. L. No. 103-66 § 13215, 107 Stat. 312, 475 (1993) (amending IRC § 86 to impose second tier of tax). Cf. Virginia Reno et al., Social Security Beneficiaries Face 19% Cut; New Revenue Can Restore Balance, NASI Social Security Brief No. 37, at 2 (June 2011) (describing taxation of benefits as reduction in benefits); Watson, supra note 73, at 1397 (stating that 1993 tax increase on benefits “amounts to a benefit cut for most taxpayers”). For a discussion of IRC § 86, see supra note 70.
current system, in contrast, believe that such political risk pales in comparison to the "investment risk" of individual accounts. Nevertheless, proponents of the current system recognize that Social Security's long-term funding deficit makes changes in the system inevitable. Whether Social Security's long-term deficit should be addressed by reducing benefits, increasing revenues, or some combination of the two is subject to considerable debate.

Unlike Social Security benefits, benefits from private sector defined benefit plans are explicitly guaranteed by the Pension Benefit Guaranty Corporation (PBGC). Specifically, the PBGC guarantees "basic pension benefits," which include (1) pension benefits at normal retirement age, (2) most early retirement benefits, (3) disability benefits, and (4) annuity benefits for survivors of plan participants. The guarantee is limited to benefits earned before a plan terminates and is capped, in 2011, at $4,500 per month (or $54,000 per year) for employees who begin receiving benefits from the PBGC at age sixty-five. The guaranteed amount is reduced for workers who begin to receive benefits before age sixty-five or who receive benefits in the form of a joint and survivor annuity and is increased for workers who begin to receive benefits after age sixty-five.

Unlike benefits under defined benefit plans and defined contribution plans in some countries, benefits from defined contribution plans in the United States are not guaranteed. Participants in 401(k) plans are subject to market risk as well as the risk of making poor savings and/or investment decisions. Commentators have argued that a guarantee should be extended to defined contribution plans, but it is unlikely that Congress will enact such a guarantee any time soon.

In addition to the PBGC guarantee, ERISA protects participants in employment-based pensions through its fiduciary rules. Generally, the

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Paper No. 12135, 2006) (contending that political risk is inevitable in traditional Social Security and debate over personal accounts is one of portfolio choice, not one of “safe” versus “risky” benefits).


264. Cf. Moore, supra note 246, at 343 (noting that in light of fact that Social Security faces long-term deficit, virtually all lawmakers and commentators agree that the system must be reformed).

265. For a discussion of the range of options available to reform Social Security, see id. and authorities cited in note 6 therein.

266. See supra section III(A)(5)(d).

267. See id.

268. Id.

269. Id.

270. See Muir, supra note 11, § III(B)(1) (noting that Holland, Belgium, and Switzerland provide minimum guarantees of investment returns).

271. Plan participants are notorious for making poor savings and investment decisions. See authorities cited in supra note 170.

272. See Jefferson, supra note 123.

273. See supra section III(5)(b).
fiduciary rules are effective in protecting against mismanagement in the case of defined benefit plans.274 The rules, however, generally do not apply to investment decisions made by plan participants in self-directed 401(k) plans and thus are less effective in protecting 401(k) plan participants.275

C. Solidarity

Unlike in Europe,276 the term "solidarity" is not commonly used in connection with the U.S. retirement income security system.277 Individual rights and individual responsibility are much more quintessential American values than is solidarity.278 That is not to say, however, that the U.S. retirement income security system is devoid of redistribution and collectivist principles. Rather, they play an important role in the current U.S. Social Security system. Indeed, Social Security's weighted benefit formula is explicitly intended to redistribute income, and one of the program's fundamental goals is to ensure "income adequacy."279

The notion of solidarity may be said to lie at the heart of the long-standing debate on the so-called privatization of Social Security.280 Proponents of fundamentally restructuring Social Security to incorporate personal or individual accounts rely on notions of individual choice, individual responsibility, and individual ownership to support such a change.281 Proponents of the current system, in contrast, contend that

274. See id.
275. Id.
276. See European Commission, Towards Adequate Sustainable and Safe European Pension Systems 8 (Green Paper 2010) (stating that "[e]nsuring adequate retirement income is the purpose of pension systems and is a matter of fundamental inter- and intra-generational solidarity").
277. That is not to say that the term is never used in connection with the U.S. retirement system. For an instance in which the term is used, see Helvering v. Davis, 301 U.S. 619, 641 (1937) ("The purge of nationwide calamity that began in 1929 has taught us many lessons. Not the least is the solidarity of interests that may once have seemed to be divided.").
278. See Marc A. Rodwin, The Metamorphosis of Managed Care: Implications for Health Reform Internationally, 38 J. L. MED. & ETHICS 352, 355 (2010) (stating that private medical insurance "followed the American tradition of volunteerism and self-help rather than the European tradition of social solidarity, which called upon the state to finance or supply social services"); Muir, supra note 10, at 20 (noting that of the fifty-three countries and regions surveyed in a study of cultural dimensions, the United States ranked first in individualism); Kathryn L. Moore, Lessons from the French Funding Debate, 65 OHIO ST. L.J. 5, 25 (2004) (comparing the role of individual choice and individual responsibility in French and U.S. retirement systems).
279. See supra section II(E).
Social Security is and should remain primarily a system of social insurance whose essential purpose is to prevent hardship, poverty, or dependency by workers joining their employers and government in a national program.282

Although collectivist principles play a fundamental role in the U.S. Social Security system, individual responsibility also plays a role. Indeed, Social Security is often said to balance individual equity with social adequacy.283 One of Social Security's nine guiding principles is that benefits are characterized as an “earned right,” with “the right to income created by personal effort, not awarded based on need or status.”284 The U.S. Social Security system differs from most of its European counterparts in “its emphasis on the contributory-contractual principle.”285

Notions of solidarity play little role in employment-based pensions in the United States, particularly 401(k) plans, the most common form of employment-based pension today. Individual responsibility and individual choice are the cornerstone of 401(k) plans.286 In most 401(k) plans, employees choose whether, and how much, to contribute to their 401(k) plans, and how to invest the assets in their plans.287 There is little sharing of risk or reward in 401(k) plans.

So too, the individual savings component of the U.S. retirement income system is based on notions of individual choice and individual responsibility.

D. Nondiscrimination

A number of federal statutes and Constitutional provisions prohibit a variety of forms of discrimination in the U.S. retirement income security system. For example, Title VII of the Civil Rights Act of 1964288 prohibits discrimination on the basis of race, color, national origin, sex, and religion with respect to retirement benefits, and the Federal Age Discrimination in Employment Act of 1967 (ADEA)289 prohibits discrimination against any individual over the age of forty with respect to pension benefits. Moreover,

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282. See Moore, supra note 280, ¶ 5.06 and authorities cited therein.
284. Dilley, supra note 8, at 1086.
286. See supra Section III(A)(3).
287. See id.
the Internal Revenue Code\textsuperscript{290} prohibits qualified pension plans from discriminating in favor of highly compensated employees.

This is not to suggest that there is no differential treatment in the U.S. retirement income security system. For example, since it was enacted, Social Security has treated higher-income workers differently than lower-income workers. Moreover, despite the numerous nondiscrimination mandates, there are considerable differences in the receipt of retirement income. For example, men tend to have higher retirement income than do women\textsuperscript{291} and whites tend to have higher retirement income than do blacks\textsuperscript{292}.

This section discusses the nondiscrimination norms that apply to the U.S. retirement income security system. It first addresses Social Security and the ways in which it does, and does not, discriminate. It then turns to employment-based pensions and the nondiscrimination provisions that apply to such benefits. Finally, it considers individual savings.

1. Social Security

Social Security has always treated higher-income workers differently than lower-income workers. For example, since it was enacted, Social Security has included a maximum taxable wage base.\textsuperscript{293} Indexed to the increase in average wages nationwide, the maximum taxable wage base is $106,800 in 2011.\textsuperscript{294} Payroll taxes are imposed on wages up to the taxable wage base,\textsuperscript{295} and benefits are based on earnings up to the taxable wage base.\textsuperscript{296} No taxes are paid or benefits received based on wages that exceed the maximum taxable wage.\textsuperscript{297}

\begin{thebibliography}
291. Cf. Social Security Administration, Income of the Aged Chartbook, 2008, at 23 (Apr. 2010) (showing that family median income in 2008 for men aged 65 or older was about one-third higher for men than it was for women: $40,757 compared to $29,972). For a discussion of the reasons why women tend to have lower retirement income than men, see U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-105, RETIREMENT SECURITY: WOMEN FACE CHALLENGES IN ENSURING FINANCIAL SECURITY IN RETIREMENT 12–28 (2007); Lorraine Schmall, Women and Pension Reform: Economic Insecurity and Old Age, 35 J. MARSHALL L. REV. 673 (2002).
294. See supra Section II(C).
297. For an analysis of proposals to decouple the taxable wage base for financing purposes from the base for benefit accrual purposes, see Dilley, supra note 261.
\end{thebibliography}
In addition, Social Security uses a weighted benefit formula to calculate benefits. For those reaching age sixty-two in 2011, the formula replaces 90% of the first $761 of average indexed monthly earnings (AIME), plus 32% of AIME between $761 and $4,586, plus 15% of AIME above $4,586, capped at the maximum taxable wage base. The formula is explicitly intended to redistribute income to the lower-paid.

Initially, Social Security discriminated against men in the provision of spouse and surviving spouse benefits. Specifically, when Social Security spouse and surviving spouse benefits were originally introduced in 1939, only wives and widows were eligible for such benefits. In 1950, Congress extended spouse and surviving spouse benefits to husbands and widowers, but the eligibility rules were stricter for husbands than for wives. For example, the husband or widower had to show that he had been receiving at least one-half of his support from his wife before he was eligible for benefits. In 1977, the U.S. Supreme Court affirmed a district court opinion that held that the dependency requirement applicable to husband, but not to wife, benefits violated the Equal Protection guarantee of the Due Process Clause of the Fifth Amendment to the U.S. Constitution. In a separate opinion, the Court held that the dependency requirement applicable to widower benefits, but not to widow benefits, also violated the Equal Protection guarantee. Along a similar vein, a district court held that the Equal Protection guarantee requires that husband benefits be provided to divorced husbands under the same rules and conditions as benefits provided for divorced wives. As a result of these decisions, Congress amended the Social Security Act to subject men and women to identical rules in the determining eligibility for spouse and surviving spouse benefits. Thus, since 1983, Social Security has incorporated

298. See supra Section II(C).
299. See id.
300. See supra Section II(E).
302. Id. amending § 202(d), 53 Stat., 1365.
304. Without addressing the different dependency requirements, the Senate Finance Committee Report explained that the extension of benefits to dependent husbands was designed to make the “protection given to dependents of women and men more comparable.” S. REP. NO. 81-1669 (1950), as reprinted in 1950 U.S.C.A.A.N. 3287, 3317. A program analyst for Social Security explained that “[t]he new law retains the concept of deemed dependency of the wife on the husband [because it] fits the usual family situation.” Riches, supra note 303, at 11.
nondiscrimination norms in its spouse and surviving spouse benefits. Nevertheless, women are far more likely to claim spouse and surviving spouse benefits than are men.

2. Employment-Based Pensions

Title VII of the Civil Rights Act of 1964 prohibits discrimination on the basis of race, color, national origin, sex, and religion with respect to "compensation, terms, conditions, or privileges of employment." The term "compensation" has been interpreted to include "retirement benefits." Thus, imposing a different vesting schedule on men than women clearly violates Title VII. Similarly, having different retirement ages for black and white employees also violates Title VII. Moreover, the Supreme Court has held that employers may not take women's longer life expectancy into account in calculating employee contributions to and benefits from defined benefit pension plans.

Specifically, in City of Los Angeles Dep't. of Water & Power v. Manhart, the U.S. Supreme Court held that a defined benefit pension plan that provided men and women with equal monthly benefits but required women to make greater contributions during their working lives violated the Title VII prohibition on sex discrimination. The Court acknowledged that "[a]s a class, women live longer than men." Nevertheless, the Court found that Title VII focuses on individuals rather than classes and prohibits the employer from taking class distinctions into account in determining employee contributions to plans. In Arizona Governing Committee for Tax Deferred Annuity & Deferred Compensation


310. See SOCIAL SECURITY ADMINISTRATION, ANNUAL STATISTICAL SUPPLEMENT TO THE SOCIAL SECURITY BULLETIN, 2009 tbl. 5.F1 & 5.F8, at 5.61 & 5.70 (2010) (showing that in 2008 of the 2,370,611 beneficiaries who received benefits as spouses of retired workers, only about two percent (47,029) were husbands and of the 4,150,157 nondisabled surviving spouse beneficiaries, just over one percent (55,254) were widowers).


313. The EEOC guidelines define "compensation" to include fringe benefits and include retirement benefits and profit-sharing and bonus plans within the definition of "fringe benefits." See, e.g., 29 C.F.R. § 1604.9 (guidelines on sex-based discrimination).


317. Id. at 704.

318. Id. at 708-09.
Plans v. Norris, the Court extended Manhart’s reasoning to the benefit payout stage and held that an employer could not take the longer life expectancy of women as a class into account in determining annuity payments under a defined benefit pension plan.

The Title VII prohibition extends to third-party private insurance companies that operate or administer employee benefit plans. It does not, however, apply to private insurance companies that sell annuities on the individual market. Thus, if an employer-sponsored pension plan distributes benefits in the form of a life annuity, benefit payments to female employees may not be reduced to reflect their longer life expectancy. On the other hand, if an employer-sponsored pension plan distributes benefits in the form of a lump sum distribution and the employees elect to purchase annuities on the individual market, the insurance company may (and typically does) take women’s longer life expectancy into account and charge women more than men women for life annuities.

The Federal Age Discrimination in Employment Act of 1967 (ADEA) prohibits discrimination against any individual over the age of forty with respect to “his compensation, terms, conditions, or privileges of employment.” In 1989, the Supreme Court held that the ADEA does not cover employee benefits. The following year, Congress enacted the Older Workers Benefit Protection Act (OWBPA) to make it clear that the ADEA does cover discrimination with respect to employee benefits. In addition, the OWBA restored the “equal benefit or equal cost” principle that requires an employer to provide older workers with benefits that are at least equal to those provided to younger workers unless the employer can prove that the cost of providing an equal benefit is greater for the older worker than for the younger worker.

320. Id. at 1079–86. For a detailed discussion of these cases and the lack of retroactive relief for such violations, see Susan M. Omilian & Jean P. Kamp, 1 Sex-Based Employment Discrimination § 16:2 (updated Oct. 2010), SBEDIS § 16:2.
321. See 463 U.S. at 1086–91. See also Omilian & Kamp, supra note 320, at § 16:2 (discussing issue).
323. See Lawrence A. Frolik, Paying for Long-Term Care, 17 EXPERIENCE 35 (2006) (“Women pay more for annuities because of their longer life expectancies. At age 65, for example, the cost of an annuity that will pay $1,000 a month for life for a male from an A++ rated insurer is approximately $156,000, for a women age 65, the cost is approximately $170,000.”). For additional discussion of sex-based classifications in the sale of individual annuities, see Kathryn L. Moore, Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers, 65 MO. L. REV. 341, 373 (2000). For a discussion of the use of sex-based actuarial tables in occupational pensions and the private annuities market in Europe, see Stevens, supra note 241, at 1223–24.
325. Id. § 623.
Section 510 of ERISA\(^\text{329}\) prohibits an employer from discharging or discriminating against plan participants for exercising their rights under an employee benefit plan or under ERISA. Section 510 prohibits two distinct types of acts. First, it prohibits employers (or any other persons) from discharging or in any other way discriminating against plan participants and beneficiaries in retaliation for exercising rights under an employee benefit plan or under ERISA. Second, it prohibits “[interference] with the attainment of any right to which the participant may become entitled.”\(^\text{330}\)

Finally, unlike in Europe,\(^\text{331}\) the Internal Revenue Code requires private sector employment-based pensions to satisfy express, complex nondiscrimination rules in order to qualify for favorable tax treatment.\(^\text{332}\) Subject to considerable criticism,\(^\text{333}\) the rules require that qualified plans provide sufficient benefits to the non-highly compensated relative to the highly compensated.\(^\text{334}\) The rules, however, do not ensure uniform treatment of all employees. Instead, the rules allow for considerable flexibility. For example, the rules permit employers to exclude part-time workers\(^\text{335}\) and to take Social Security benefits into account\(^\text{336}\) in applying the nondiscrimination rules. As a result, higher-income workers are far more likely to participate in an employment-based pension than are lower-income workers, and higher-income workers are likely to receive more in benefits than are lower-income workers.\(^\text{337}\)

3. Individual Savings

As discussed, individual retirement savings are the result of individual effort and individual initiative. Thus, perhaps not surprisingly, the issue of discrimination rarely comes up in the context of individual savings.

Generally, all taxpayers, regardless of race, color, national origin, sex, and religion, are eligible for the favorable tax treatment accorded individual savings. Some distinctions, however, are imposed based on income. For example, only lower-income individuals are eligible for the Savers Credit,
and income limitations are imposed on tax deductible contributions to IRAs for individuals who also participate in an employer-sponsored plan.\textsuperscript{338}

Perhaps the most significant discrimination issue to arise in the context of individual savings is the use of sex-based actuarial tables in the sale of life annuities. Although employers are banned from using sex-based actuarial tables in calculating contributions to and life annuity benefit payments from employer-sponsored plans, insurance companies can and typically do apply sex-based actuarial tables in the sale of individual annuities.\textsuperscript{339}

\textbf{E. Participation}

In Europe, the term "participation" typically refers to the ability of employees to participate in plan governance.\textsuperscript{340} In the United States, in contrast, it sometimes refers to whether an individual has an opportunity to participate in a pension plan (sometimes referred to as coverage) while at other times it focuses on whether an individual chooses to take advantage of the ability to participate in a pension plan.\textsuperscript{341} As a result of this and other technical distinctions,\textsuperscript{342} different studies in the U.S. report different rates of plan participation.\textsuperscript{343} This section uses the term participation in the general U.S. sense of either having the right to participate in a plan or choosing to participate in a plan.\textsuperscript{344} It does not discuss participation in the European sense because, with the exception of collectively bargained plans,\textsuperscript{345} plan participants typically do not have the right to participate in plan governance in the United States.

With few exceptions, participation in Social Security is mandatory.\textsuperscript{346} As a result, about 94\% of the U.S. workforce is covered by Social Security.\textsuperscript{347}

\footnotesize{\textsuperscript{338} See supra section IV.
\textsuperscript{339} See supra section V(D)(2). For a discussion of the prohibition on the use race-based classifications, see Moore, supra note 323, at 371–72.
\textsuperscript{340} Muir, supra note 11, at III(E)(2).
\textsuperscript{341} See TURNER, supra note 97, at 35 (discussing four definitions of participation used in empirical studies and reports).
\textsuperscript{342} For example, some studies may focus only on active plan participants while others may take into account all plan participants.
\textsuperscript{343} Compare Copeland, supra note 105, at 6 (reporting that by 1998, 56.7\% of plan participants reported a defined benefit plan as their primary plan and only 25.8\% of plan participants reported a defined contribution plan as their primary plan) with ICI, supra note 5, at 4 (reporting that by 1998, 56\% of active participants in private-sector retirement plans were covered by primary defined contribution plans, and 39\% had a supplemental defined contribution plan).
\textsuperscript{344} The distinction between coverage and participation only arises in the case of plans, principally 401(k) plans, that permit employees to choose whether or not to take advantage of the right to participate in the plan.
\textsuperscript{345} Plan participants may be said to have the right to participate in plan governance through their unions in collectively bargained plans.
\textsuperscript{346} See supra section II(f).}
Employment-based pensions, in contrast, are voluntary.348 As a result, private pensions cover about half the U.S. workforce, and that half tends to be the higher paid half.349

Like employment-based pensions, individual retirement savings are voluntary.350 About 30% of U.S. families have individual retirement savings, and those families are more likely to have higher incomes.351

VI. CONCLUSION

As the World Bank recommends,352 the United States has a three pillar, or three legged, pension system, consisting of (1) a state-run Social Security system, (2) employment-based pensions, and (3) individual savings. Thus, superficially, the U.S. retirement income security system resembles that of many around the world.

Yet, in some ways, the U.S. retirement income security system is unique. For example, the U.S. system is “employer-centric.”353 Not only are employment-based benefits related to employment, but Social Security benefits are tied to an individual’s working status and wages.

More importantly, individual rights and responsibility play a much greater role in the U.S. retirement income security system than in many European countries. For example, while solidarity plays an important role in the current Social Security system, notions of individual rights and responsibility also underlie the current system. Indeed, Social Security benefits are characterized as an “earned right” created by individual effort, rather than based on need or status.

The role of individual rights and responsibilities can be seen most starkly in employment-based pensions in the United States. Over the last thirty years or so, employment-based pensions have shifted from defined benefit plans to 401(k) plans. Such plans rely almost entirely on individual choice and individual responsibility. Individual workers decide whether to participate, how much to contribute, and how to invest their assets. These plans “resonate with some of the strongest-held values of American culture, namely, personal autonomy, private property, and self-support.”354

347. See supra section II(A).
348. See supra section III(A)(1).
349. See supra section III(A)(2).
350. See supra section IV.
351. See id.
354. ZELINSKY, supra note 125, at 97