Transforming Retirement: Introducing the 501k

Financial Sustainability and Massive Retirement Savings!

Our retirement system like every public pension system in the world is financial unsustainable and has been since its inception. Three major flaws in the initial design by FDR's brain trust assured financial malfunction. First, instead of floating the retirement age with life expectancy which had been increasing rapidly during the first four decades of the century, the retirement age was fixed at 65 years of age. Second, the intergenerational tax, that workers would pay for retiree benefits, presumed that the ratio of workers to retirees would remain relatively constant. Since its inception, the ratio has declined from over 150:1 to 2.3:1 workers to retirees today. Finally, Social Security and Medicare originally targeted the poor, but over the decades Congress continually expanded beneficiary pool to all Americans including the Bill Gates of the nation, that is rich citizens that do not need a check from the government.

The math sniff test for this an intergenerational tax may have seemed reasonable at 1% of the first $3,000 of income in 1940. A surplus of dollars took care of the poor quite easily. But with the expansion of benefits and beneficiaries, by the 1980s, the above three demographics created financial fire alarms. Sirens sounded regarding the future bankruptcy of Medicare and Social Security beginning in the late 1990s, but nothing was done.

Though a savings-based system would have created the best financial benefit for Social Security's initial launch, this approach was impossible in 1936 because of technology shortcomings – there was no technology! Banking transactions were done by hand. Putting dollars from paychecks into passbook savings accounts was impossible! The technology problem is now a technology opportunity. Savings and investment transaction that employed high commissions last century are zero today, smoothing a transition for an intergenerational tax to a savings/investment solution vastly easier and smarter. The financial benefit is stunning. Whereas one dollar taxed for retirement is returned to beneficiaries as 98 cents, dollar saved/invested by a worker today with a 4.5% annual is worth $174 dollars upon retirement, perhaps more. The question is how to get from a system with failing financials based on never ending tax increases, to a savings-based solution.

Proposals for fixing the underfunding of our retirement system have cropped up over the last two decades. Solutions have included: ignore the problem and borrow the money ($50 trillion or more); tax the rich (they don't have enough money to fix the problem); reduce benefits by a third; an not well flushed out savings carveout for young workers proposed by Bust; or a continuation of tax increase. The Social Security Trust Fund Annual Report recommended increasing Medicare and Social Security taxes to 15.1% from 7.65% to erase the nearly $50 trillion in unfunded mandates. The $50 trillion deficit assumes an increase in life expectancy of 11 years this century (SSA estimate.) Expectations that life-expectancy will only rise 11 years this century are low. Were life expectancy rise to 33 additional years by the end of the century, as recommended by Longevity Institute Director Sr. David Sinclair, retirement taxes would zoom from 15.1% (employee plus employer taxes) to nearly 45%. As raising retirement taxes to 15.1% would likely crash the economy, imagine what 45% would do.

If the reader has no memory of these options being proposed by Congresses or Presidents, it is because these solutions do not make for good campaign rhetoric. Taxes have not fixed the funding problem, and more taxes will do great harm to our economy.

To keep the system afloat for the last eighty years, though, the tool of choice has been raising taxes. Since the program's inception, retirement taxes have been raised 32 times. Social Security tax rates are up 765%, and Medicare taxes are up 414%. Congress needs a solution, as does America and our children, but the lack of evidence-based critical thinking and a dearth of innovative solution building, the following proposal is a way forward financial sustainability of our retirement systems.

CIVIL Governance proposes transforming the retirement system with the 501K, a complement to the 401K, but available to all workers.

The CIVIL's 501K rests on three pillars:

First, add two years to the retirement age as quickly as possible to account for the two-year increase in life expectancy that already occurred this century, then allow the retirement age to float up with life expectancy, replacing a static retirement age with a retirement age indexed to life expectancy. The equation for indexing retirement age would be written as current life expectancy (78.5) minus nine years or around 69.5 years. As life expectancy floats up, so too does the retirement age. Had FDR's brain trust done this is 1936, the system would be financially sustainable with retirement taxes of around 2% instead of today's 7.65% and there would be no future financing problem.

Second, update Medicare to a fixed benefit solution. To execute the final pillars, a fixed Medicare benefit produces the framework for means-testing retirement benefits.

Employing means-testing, today's top five percent of retirees, the richest of the rich, would need little or no dollars from the safety net as they have considerable wealth upon which to retire. The reasonable politician may be more inclined to accommodate fixed benefits for Medicare (a notion proposed in the past and rejected) because providing benefits to the rich was never necessary. The top 5% of earners consume about 12% of the benefits from the retirement system. An elderly billionaire recently suggested that the government sends him a $3,000 check for social security each month that he does not need. The government should not be in the business of making the rich richer.

Altering the intergenerational tradeoff between workers and retirees from an expensive high tax for workers and universal benefits for the elderly, changes with mean-testing. The budget reductions produced by increasing the retirement age 2.5 years, retirement-age indexing with life-expectancy and means-testing are significant. These changes will reduce the outlays from retirement programs that will allow a reduction of worker payroll taxes to be saved. Over time, the more Americans save translates into increasing financial sustainability as fewer people need less help from government this improving the finances for Social Security and Medicare trust funds. Over 40 years, nest eggs in 501Ks will grow to around $100 trillion in 40 years which gives a big lift to economic growth as well. Instead of a few percent of workers retiring as millionaires, over the long term as much as fifty percent of the population will retire rich.

Budget reductions from these three changes (indexing, means-testing and a 2.5-year retirement age increase) with some variance on how each is implemented, will range from 36% to 43%. These estimated budget savings will allow the individual tax rate to drop to 3.15% (from 7.65%) with 4.5% moved to personal 510K accounts. The business tax of 7.65% will remain for about 20 years, but as the retirement system becomes more financial sustainable the business tax will gradually be reduced.

What are the program requirements?

- 501K guaranteed return on investments from private financial institutions. Only qualified institutions will participate and establish accounts not unlike the 401K. Individuals will choose from a menu of financial tools from private and public bonds, mutual funds and special Retirement Bonds. The guaranteed rate of return over rolling 7 years periods and must exceed 4.5%. Institutions that fail to meet this target will be removed from the list providers. Any shortfalls from failed institutions will be covered by the government.

What are the benefits?

- The CIVIL 501K will produce the biggest tax cut in history for the poor and middle class. Most important, the nest eggs of the poorest – consider the minimum wage worker for the last fifty years – would have *$100,000 in the 501K*. This is more savings than two-thirds of workers retiring today.
- National wealth (the total of personal nest eggs) will grow to $100 trillion dollars over the next forty years. At a minimum, increasing wealth and decreasing retirement program costs will improve economic growth another 1% - 2%. The increased investment base will also increase employment.
- Overall cost reductions in the system will vastly reduce retirement underfunding if not erase it.
- The cost of the retirement programs will decline over time, reducing deficit pressures. Over the first forty years, half of retirees will need no help from the safety net, reducing the cost of the safety by more than 70%. Under the most optimistic of metrics, this number could rise to 90%.
- The initial savings rate would be 4.65% of the current 7.65% retirement taxes, reducing the tax portion to 3%. With more wealth created for workers each year, after twenty years, savings rates will grow to 6% (of the current 7.65% tax) and a 1.65% tax for the safety net. The employer tax contribution would begin to fall from 7.65% at year 20 and by year 40 should be around 1.65%
- Net-net: Fewer and lower taxes, a highly served safety-net for the poor, gains in wealth for all, and an economy with increased growth between 1% and 2% annually, doubling the average GDP average this century of a little more than 2%.

That politicians over the last 80 years expanded the footprint of the beneficiary population from the poor to everyone, the continued requirement for increasing taxes should have rung a cautionary financial bell with Congress. The political snif test, that everyone was covered, certainly had political merit. Rising life expectancy that occurred in front of all our eyes including and our increasing scientific understanding of the human genome, should have set off financial warnings that called for innovation and transformation, but politics intruded. Social Security and Medicare became a third rail. 'Touch it and you die.' Why? Because instead of working together to seek a remedy, each political party used any potential remedy as campaign invective against opponents. As older voters go to the polls in large numbers the only solutions that meant ignoring the problem.