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ABSTRACT

A Proposal for a Universal Personal Capital Account

Under the proposal outlined in this paper every person upon reaching age 18 would become entitled to an account on which he could draw for the purpose of buying either education or certain more-or-less discretionary medical services. To the extent that the account was not exhausted by the time an individual reached the age of 65 it could be used to purchase an annuity. The plan tries to take account of the public's inclination to offer certain benefits in kind. By preserving trade-offs it seeks at the same time to reduce overuse of educational or medical benefits. It affords the individual more freedom of choice than he would have with a series of strictly in-kind programs. And it achieves greater fairness in the distribution of nonbasic government benefits by assuring that a person who does not receive a benefit of one kind will be entitled to another of equal cost to the government.

A Proposal for a Universal Capital Account

Introduction[1]

In the recent past, many would-be welfare reformers (myself included) have focused their attention on plans that would relieve poverty and reduce economic inequality by increasing the cash income of poor people through noncategorical programs such as the negative income tax. Categorical programs (such as aid to the blind and old age assistance) and, even more so, in-kind programs have been viewed with disdain and the possibilities for redistribution of wealth or capital, rather than income, have been largely ignored (despite the honorable precedent for such transfers in programs such as the Homestead Acts). The fact is, however, that in-kind transfers (a term I shall use to include not only transfers of goods and services but also grants, subsidies or credits that can be used only for particular forms of consumption) and categorical programs have long been a central feature of both public and private attacks on poverty. Notable among programs relying on in-kind transfers have been those involving medical services and education. These benefits--medical care and education--along with aid to the aged are the ones that form the basis for the proposal to be offered here.

Objections to in-kind transfers as paternalistic and inefficient have been met by increasingly sophisticated, though often tautological arguments, turning on the presumed benefits derived from such transfers by the philanthropists or taxpayers who pay for them. I choose to shun this debate and the related debate over categorical programs. For my

[1]No effort has been made to survey the literature for antecedents to this proposal, though no doubt some could be found. Similarly, I have for the most part avoided comparing the proposal with myriad other benefit programs with which it may share certain elements and objectives.

part, it seems sufficient to note that very often money that is available to finance in-kind and categorical transfers simply is not available to finance cash or noncategorical transfers and that in most instances an in-kind or categorical benefit is far better than nothing at all. Once this view is accepted, the job becomes one of making the best of what is available.

Two of the most serious problems stemming from the use of in-kind transfers are overuse, or waste, and unfairness. The problem of overuse, vividly revealed in the current literature on medical-care programs, is easily delineated. A person who is not required to pay for his stay in a hospital will be likely to check in to the hospital far more readily and remain there longer than he would if he were required to pay. This potential for overuse leads to controls over utilization that are costly and arbitrary and often cumbersome and ineffective. As a result, the cost of providing the benefit gets out of hand. The same problem of overuse occurs in the field of education--as taxpayers forced to foot the bill for proliferating state colleges are coming to realize.

The problem of the unfairness of in-kind transfers is related to the problem of overuse. A poor person for whom certain non-essential, non-basic medical or educational services have relatively low utility may accept them despite their low utility to him; that is the problem of overuse or waste. If, on the other hand, he declines to accept those services, he receives no compensating benefit; he does not receive his "fair" share of benefits. That is the problem of unfairness--a very real problem, I suggest, to the extent that the services provided in-kind are not strictly essential. The notion that a benefit program should have something for everyone can have an ethical as well as a purely political foundation.

The proposal that is presented here is designed to mitigate these twin problems of overuse and unfairness, within the general context of a modified in-kind approach to the distribution of benefits. At the same time, the proposal reflects another thought, which is that certain needs that are regarded as important and meritorius but not as absolutely essential and are likely to be nonrecurring can perhaps best be viewed as a manifestation of inadequate wealth rather than inadequate income. In other words, an income adequate to meet only the minimal needs of all will not permit access to certain services that we are not quite prepared to deny completely to the poor but at the same time we are prepared to ration. One obvious device for enabling people to cope with such expenses is a simple loan program; the prospects for success in the use of loans for meeting unusual expenses would be improved considerably by the existence of an adequate income guarantee. The possibilities for loan programs in combination with an income guarantee, strike me as interesting and respectable. That approach is, in fact, closely akin to the one that I propose. But there are some serious difficulties with the loan solution. If the income guarantee is minimal, repayment of a loan for medical care could become extremely harsh. Forcing people to borrow to finance their education may tend seriously to undercut the goal of equality of opportunity as well as other goals such as the encouragement of retraining. The poor might tend to underuse training and education, and to meet the problem of potential underuse by underpricing education is to encourage overuse by the nonpoor. Though highly speculative, these dangers seem to me serious enough to justify a search for an alternative.

The alternative that I propose--called the Universal Personal Capital Account (UPCA)--attempts to arrive at an improved reconciliation of the conflicting strains reflected in these introductory observations. It does not meet perfectly all the objectives of or objections to present programs; like most other realistic approaches to complex social problems, it is a compromise. Just as the negative income tax was intended to supplant existing income-maintenance programs, the UPCA can be expected to displace or require modification of certain existing means of providing benefits. It will do so in ways that enhance individual dignity and self-respect by increasing personal freedom of choice. At the same time it will permit us to give people incentives to make choices that are at once rational for themselves and for the system as a whole.

The Proposal

The idea is simple: every person upon reaching the age of 18 (or upon graduation from high school, if that is sooner) would receive from the federal government a set of capital accounts[2] on which he would be allowed to draw at any time for certain broadly specified purposes. Those purposes would not include normal living expenses; the need for income-maintenance programs would not be eliminated. To the extent that the individual did not draw down his UPCA accounts they would be available (with accumulated interest) for the purchase of an annuity (or perhaps for other purposes) upon retirement. Pre-retirement drawings might be viewed as a form of "borrowing against" or an advance payment of retirement income--which reflects the kinship of the UPCA to a loan program. Since a UPCA retirement annuity would not be available to people who had fully drawn on their funds for medical or educational purposes, obviously the UPCA would not replace other programs designed to provide a basic income

[2] These accounts would be only bookkeeping items, not actual funds. The distributions or drawings would be financed by sum-sufficient appropriations by Congress.

for all retired people. The existence of the UPCA might, however, argue for keeping the minimum support level for retirement relatively low.

The Size of the Fund and Rate of Growth

The total amount of each individual's accounts at age 18 is difficult to specify realistically. I should think that a minimum of $10,000 would be a near-term goal. The fact is, however, that the cost of the program would be extremely difficult to estimate, since cost will depend on the exercise of individual options. For this and other reasons (common to most new programs) a far more modest beginning must be expected. It may be noted, though, that the costs of the UPCA may be partially offset by savings elsewhere and that the uses to which the accounts may be put may seem so patently worthy as to largely overcome cost considerations.

Costs will be a function not only of the initial size of individual accounts, but also of the interest rate and the initial coverage. I suggest an interest rate of about 3 percent plus a cost-of-living escalator. A 3 percent real rate of interest may be on the low side; but at that rate compounded annually $10,000 at age 18 would grow to about $40,000 at age 65. The 3 percent reflects in part a desire to keep the initial amount as high as possible without making the ultimate amount too large for the person who makes few, if any, withdrawals. Arguably, the annual increment in the value of the accounts should be treated as taxable income each year (with the individual having an option to pay the tax out of the accounts), but if the more customary tax pattern is followed the increments will escape taxation until withdrawn. Assuming an escape from current taxation, the 3 percent figure may not seem low at all. It is of obvious importance, however, that the rate of growth not be too low. To the extent that it is, one of the prime objectives of the UPCA--forcing people to make rational choices about use of resources--will be undercut. Also, if the rate is too low a pernicious inequity will arise as the wealthy draw down their UPCA accounts to finance education or medical care while preserving or augmenting private funds that would have been used for such purposes except for the fact that such funds produce a higher return than the UPCA. Indeed, a private money market could offer the same kind of option to the poor--though prohibitions against assignment of the UPCA to creditors will no doubt substantially impede such arrangements. A prohibition against such assignment (except, possibly, in furtherance of the purposes for which the UPCA could be drawn upon) will be essential, of course; without it the limitations on the use to which the accounts can be put would be meaningless.

Serious consideration should be given to the possibility of allowing people with UPCA accounts to elect to have their accounts invested in approved, privately managed funds. In other words, they would be given the same kind of option that is available to self-employed persons who have adopted the so-called Keogh retirement plans. Such an election would, in the near term, increase program costs, since the Treasury would be required to make immediate transfers into the private money market (to the extent that people opted for privately managed investment and the managers bought securities other than those of the U.S.). Depending on the method of financing, the effect of such transfers could, in certain circumstances, be considered desirable. To preclude the possibility, in other circumstances, of unavoidable adverse effects, the Treasury might be given the authority to allow the election to be exercised only when it deemed that the transfers would have a favorable economic effect. The operation of the election would, of course, tend to protect the private sector of the economy. More important for the success of the UPCA program, however, the election might give the individual a greater sense of ownership, a greater awareness of the value of his accounts, and thus a greater appreciation of the cost of current use.

Initial Coverage

The question of initial coverage also is a thorny one. To cover people of all ages at the outset (even without any built-in growth factor) would be extremely costly and might be viewed as an unwarranted windfall. To cover only those who reach the age of 18 after the adoption of the program would seem excessively arbitrary. A compromise seems in order: full coverage for all those reaching 18 after the adoption of the program and coverage for others declining with increasing age, to zero at the age of, say, 30.

Scope of Permissible Uses

The broadly specified purposes for which a person could draw on the accounts would be education and medical care.

It might be suggested that the list of permissible uses should be expanded to include, say, the purchase of a home or a business or of legal services. The arguments for such expansion are forceful; it is difficult to draw lines based on what is wanted most and how wants can best be met. On balance, however, I think expansion of the list of permissible uses at this point in time would be inadvisable. More potential uses means greater current outlays, since the greater the number of possible uses the greater the chance that a person will want to make a withdrawal. Assuming that there must be some limitation on use, it seems to me that the list should be kept quite narrow; to expand it is to invite quibbling over the meritoriousness and the scope of each added use and such quibbling could undercut support for the program. I am not so sure, for example, that we really should provide greater incentives for home ownership or for the establishment of small businesses--though it is true that all the UPCA would do is provide people with options that would not otherwise be available. If home purchase were permitted, what about cooperative purchase of an apartment building? If that were permitted, what about use of the fund to pay part of the rent for a better-than-average apartment? For any apartment? For any living expense? As for purchase of a business, the veto power of an agency like the Small Business Administration may be a good thing: most businessmen must subject themselves to constraints of the professional money lenders. And as to legal services, not enough has yet been done in working out the problems of providing basic services free of charge. It does strike me that there would be a consensus that education and medical care at the level of expenditure I am proposing are plainly meritorious uses and the UPCA proposal seems to work peculiarly well in providing such services. I would suggest therefore that sticking with such a simple set of uses is desirable for much the same reason that it may be desirable to stick to a comprehensive tax base for purposes of individual income taxation (though there I am persuaded by the arguments for sacrificing purity for other goals).

Division of the Fund

I have thus far described the UPCA in terms of a set of accounts for each individual. It might be best to divide the total account into two equal parts, one for each purpose, permitting each part to be used in full for one purpose and to a limited extent for the other. For example, a $10,000 total could be divided into two $5,000 parts. All of part one and 40 percent of part two could be made available for education; all of part two and 50 percent of part one could be made available for medical expenses. Such segregation and restriction on interchangeability would tend to enhance the kinds of satisfactions associated with any insistence on in-kind transfers and might, as a practical matter, increase the government's freedom to limit very stringently the level of other subsidies for medical care and education. Segregation also permits greater precision and flexibility in legislative efforts to tailor amounts available to needs and costs. It allows, for example, the cutting back on one use without cutting back on the other. On the other hand, segregation (like any restriction on the use of funds) reduces the value of the account to its beneficiary and thereby weakens his incentive to economize.

Educational Use

An educational purpose would include university or vocational training. Perhaps the G.I. Bill would provide a good model for acceptable programs. The individual could draw on his account to the extent necessary to pay tuition and other such costs and to support himself at some minimum level--on the assumption that he had no other source of support. In other words, there would be no needs test. Persons with families legally dependent on them would be permitted to draw out enough to support their dependents as well as themselves, so that people could easily return to school after normal school-going age. Existing poverty-oriented subsidies would be abandoned but benefits such as the G.I. Bill that are not based on need could be maintained, since such benefits may be intended more as a reward than as a welfare benefit. Existing loan funds and scholarships would continue to be available, but presumably would be awarded only to people who had exhausted their UPCA funds. In other words, scholarships and loans presumably would be needed and used mostly by those who had progressed reasonably far in their training--and such use seems to make a good deal of sense. Because of the UPCA the initial financial barrier to social and economic advancement through education and training would be virtually eliminated. At the same time, however, the individual would be confronted with a trade-off between present and future benefits and between educational and medical benefits and thus would be required to take account of the costs as well as the benefits of further formal training. Hopefully, motivation to make good use of the educational opportunity would be enhanced by the knowledge of the student that he was spending his own money. In short, access to education would be increased while wasteful use of education would be discouraged.

As suggested earlier, very similar effects would be achieved with a simple loan program. The UPCA approach has the advantage of taking a more positive approach--the money is likely to seem more available and the psychological barrier of incurring a debt that must be repaid is removed. In other words, under the UPCA there is a disincentive to wasteful use of education, but, for many poor people, probably not as much disincentive to useful education as there is under a loan program (though that would depend on the conditions for repayment of the loan). In addition, the UPCA, because of its basic concept, would probably involve less governmental supervision and constraint than would a loan program--though there is no reason why this would necessarily be so. And, perhaps more important, the UPCA is more equitable: the person who cannot or does not go to school gets something else of value in place of education.

Despite the availability of UPCA funds, public vocational and university training should continue to receive subsidies to reduce tuitions. The subsidy would be calculated to take account of the benefits that society at large may be thought to derive from such training. The availability of the UPCA funds should permit the states to take a hard look at such subsidies, however, and raise tuitions as they see fit, without too great a fear of imposing undue hardships. To the extent that tuitions were raised it might become necessary to increase the account size--or at least the education part of it. The federal government would thus assume much of the burden of public (and private) post-high-school training, as it has already done to some extent through its loan programs and in various other ways.

Parenthetically, it may be noted that the UPCA system seems to fit nicely with Social Security's retirement benefits. Increased investments in most worthwhile education should bring about increased earnings, which should in turn bring about increases in retirement benefits, which should in turn offset the decreased amount available for purchase of an annuity.

Medical Use

The principal objective of making an account available for purchase of medical care is to allow the poor certain options in this area while at the same time preserving an incentive to avoid overuse of medical services. This part of the UPCA proposal contemplates a basic medical insurance program with deductibles and coinsurance and with optional added coverage at added cost. Many kinds of insurance plans would be compatible with the present proposal, but for purposes of illustration let me specify some basic elements of the kind of approach that is a necessary corollary of the UPCA. The federal government, either directly or through private intermediaries, would provide, without charge, for all people covered by the UPCA, medical services coverage at the most minimal level--that is, at a level equivalent to what we have traditionally provided to charity patients. It would be important for the basic free coverage to include everything other than services that we are prepared to allow people to do without if they are unwilling to pay for them. Otherwise, the fund would not really enhance choice since purchase of such basic services is likely to be nearly involuntary. Moreover, misers and people who have been profligate and used up all their UPCA funds would, in a sense, be able to "beat the sytem"--or would present an extremely serious administrative problem because they could rely on public charity to provide extra services that others would be expected to pay for with UPCA funds. (Minimal coverage for persons under 18 and over 65 would presumably be broader than coverage for others.) Even for the minimal kind of trek-to-the-clinic, wait-all-day, bed-in-a-ward kind of service that would be provided to everyone without cost, there would be some kind of deductible and/or coinsurance feature to discourage overuse as well as to give patients more incentive to shop around and thereby provide incentives for doctors and hospitals to operate efficiently and keep their prices down. Presently it is difficult to adopt such a plan for the poor (and even for the not-so-poor) because in many cases people simply do not have the money to pay the deductibles and coinsurance (at least not without great hardship) or to buy the better care others can buy. The availability of the UPCA funds would substantially eliminate this impediment to imposing some reasonable part of the cost of medical care on the patient.

By paying a premium the individual would be able to buy more extensive coverage, freedom of choice of physicians, more amenities at the hospital, lower deductible amounts, and so forth; UPCA funds could be used for this purpose. Again, deductibles and coinsurance would be preserved. If the individual chose not to buy the added coverage, then when he got sick he could still buy the extra service, either out of his own funds, if he had any, or out of his UPCA account. Perhaps more important, he could use his UPCA account for such services as dentistry and out-patient psychiatric care and for other more-or-less elective services that typically are not covered by insurance. These are the kinds of services that may not be essential, whose value can best be estimated by each individual, and overuse of which may particularly be encouraged by insurance. With the availability of the UPCA it seems reasonably palatable to control the use of such services by making individual access to them dependent on a financial sacrifice. There would be no reason, of course, to prohibit private insurance coverage of such services, but one would expect the cost of such insurance to be prohibitively high to the extent that it is true that insurance leads to overuse.

In short, with the UPCA we would be free to design a medical insurance system for everyone with the kinds of desirable options and incentives that now cannot be adopted for a large part of the population because of their harsh effects.

Universality of Coverage and Financing

Every individual would be eligible at age 18 (or upon earlier high school graduation) without regard to his own or his parents' wealth or income. While my own preference, as indicated by this suggested rule, is to ignore need factors and make the program truly universal, it strikes me that this is not nearly as significant an issue as might be imagined. Very few people have significant wealth at age 18. Attributing a parent's income or wealth to his 18-year-old children is increasingly a proposition of doubtful fairness, from the viewpoint of both parent and child. It may be objected that many children of well-to-do parents would not need the fund, but generally speaking there would be no net benefit in the long run for them or their parents, since increased income taxes for financing the UPCA would more than offset benefits received. (This assumes, of course, that the UPCA would be financed by income taxation--which is my strong preference.) Viewed in this way, the UPCA may be seen as a device by which the nonpoor spread over time the costs of their own or their children's education. It may be that estate or inheritance taxes would be viewed as a peculiarly appropriate source for financing the UPCA, but I would avoid making the funding of the proposal dependent on such a relatively meager source of revenue. Moreover, it does not follow from the fact that one favors one form of wealth redistribution (UPCA) with a certain set of effects that one must favor another form of wealth redistribution (death taxes) with other effects.

Taxability of Withdrawals

Amounts withdrawn from a UPCA account should be treated as taxable income. For persons who are truly poor this will result in no tax, because of deductions, and for the nonpoor a tax on amounts not previously taken into income seems entirely appropriate. Taxation may be objected to on the grounds that a UPCA payment is like a gift or an inheritance, both of which are exempt from taxation. But that exemption makes little if any sense and should not be expanded upon. A better analogy is to the exemption of scholarships. Again, that exemption (a descendant itself of the gift exemption) is probably unwise, at least to the extent that the scholarship provides for living expenses. Perhaps if withdrawals are treated as income there should be a deduction for nonliving expenses of education. And certainly there should be an averaging device that includes a carryover of unused deductions and exemptions.

Conclusion

The general effect of the proposal is to reduce inequalities of opportunity and of free choice in the same way that the negative income tax reduces inequalities of income and restrictions on use of welfare benefits. The UPCA should not be looked upon as a panacea, any more than the negative income tax should be. For some people--such as those with a catastrophic illness--the fund could prove inadequate, just as with a negative income tax the income guarantee can prove inadequate. Not all people would use the fund wisely--some would be profligate, others miserly. But for many people access to a capital fund would provide a sense of security, some important options, and some freedom to make their own choices about vital matters--while at the same time preserving some incentive to avoid making wasteful choices.