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A PROPOSAL FOR A UNIVERSAL
PERSONAL CAPITAL ACCOUNT

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Personal Capital Account

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ABSTRACT

This proposal recommends that every person upon reaching the age of eighteen (or upon graduation from high school, if that is sooner) will receive a set of capital accounts, called Universal Personal Capital Accounts (UPCA), on which he or she will be allowed to draw for the purpose of buying either education or certain more or less discretionary medical services. To the extent that the individual does not draw down his UPCA accounts for education or medical services by the time he or she has reached the age of sixty-five, the remaining funds (with accumulated interest) will be used for the purchase of an annuity. The accounts themselves will be only bookkeeping items; the drawings will be financed by sum-sufficient Congressional appropriations financed by general revenues plus savings in other programs.

Like the negative income tax and other income maintenance proposals, the principal objective of the UPCA is to reduce poverty and its effects, and to achieve greater economic equality--in ways that simultaneously promote other important, though less fundamental, goals. In the case of the UPCA, it is recognized that these other goals are in conflict with one another and that a program that is to be socially optimal or politically viable should attempt to achieve a compromise among them.

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The UPCA accepts the proposition that a significant portion of the poverty-relief budget is subject to the following goal or constraint: it must provide taxpayers, nonrecipients, to some significant extent, with the satisfaction of knowing that their tax dollars are being spent for purposes that they consider, for paternalistic, selfish or whatever reasons, desirable or meritorious from their own perspective. Regardless whether this use-limitation constraint is described, for instance, in terms of achieving positive externalities or of enlisting essential political support, it cannot sensibly be ignored by would-be social planners. The UPCA's acceptance or endorsement of this use-limitation constraint or goal is reflected in the limitation it places on the purposes for which its funds can be drawn down. This basic feature in turn limits the extent to which other goals can be achieved. Thus, it is commonly assumed that a strict use limitation tends to lead to overuse of benefits. Clearly this is the case from the standpoint of recipients who would derive greater satisfaction from putting the available resources to other uses. But even from the perspective of taxpayer nonrecipients, significant overuse may occur because in a use-it-or-lose-it program there may be no effective device for limiting benefits to "deserving" claimants. Without totally ignoring the constraint imposed by the use-limitation objective, the UPCA attempts to mitigate the problem of potential overuse by presenting recipients with a choice among benefits and thereby enlisting their own self interest in the cause of efficient allocation of resources.

The UPCA also promotes, to an expectably limited extent, the desirable objective of providing recipients with the satisfactions associated with freedom of choice. At the same time, the three uses are better than one for purposes of promoting fairness. Where a benefit, such as education, is not strictly essential, the person who is unable or unwilling to accept that benefit in kind may feel--and justly so--that he has not received his "fair" share of benefits. Accommodation of the goal of fairness is, therefore, a very substantial virtue of the UPCA's three-benefit trade-off.

The following discussion of the proposal responds to the most obvious questions that might be raised about how the UPCA would work, illustrates how its various goals are served, and demonstrates that there are no simple, elegant solutions to complex social problems.

The Size of the Fund and Rate of Growth

The total amount of each individual's accounts at age eighteen is difficult to specify realistically. A minimum of $10,000 might be a near-term goal. The fact is, however, that the cost of the program would be extremely difficult to estimate, since cost would 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 would 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 three percent plus a cost-of-living escalator, the assumption being that this figure will approximate the market rate. (At three percent compounded annually, $10,000 at age eighteen would grow to about $40,000 at age sixty-five.) 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 three percent figure may be too high. It is of obvious importance, however, that the rate 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, "assignments that promote" 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.

Assuming that the accounts would not be transferable at death, the fund should also increase each year by some figure, corresponding to a life insurance premium for the amount of the balance from year to year. That figure would reflect the risk of loss of that balance in the event of death before age sixty-five. Otherwise there would be a bias in favor of present consumption in the form of education or medical care, as opposed to retirement benefits, and the allocative virtues of the trade-off would be diminished.

Serious consideration should be given to the possibility of allowing people to elect to invest their UPCA accounts in approved, privately managed funds. In other words, they would be given the same kind of option available to self-employed people with tax-deferred retirement plans. Such an election would, in the short term, increase program costs, since the Treasury would be required to make immediate transfers into the private money market (to extent that people opted for privately managed investment and the managers bought other than U.S. securities). 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 could 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 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 eighteen after the adoption of the program would seem excessively arbitrary. A compromise seems in order: full coverage for all those reaching eighteen 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 would want to make a withdrawal. Assuming that there must be some limitation on use, the list probably should be kept quite narrow; to expand it would invite quibbling over the meritoriousness and the scope of each added use and such quibbling could undercut support for the program. For example, it seems unnecessary to provide greater incentives for home ownership or for the establishment of small businesses--though it is true that the UPCA would simply provide people with options not otherwise available. There would probably be a consensus, however, that education and medical care at the level of expenditure proposed are plainly meritorious uses, and the UPCA proposal seems to work peculiarly well in providing such services. I would suggest therefore that adhering to 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

Thus far the UPCA has been described in terms of a single account for each individual. It might be best to divide each 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 use-limited transfers and might, as a practical matter, increase the government's freedom to limit 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) weakens the trade-off effect, thereby reducing the value of the account to its beneficiary and weakening 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 or her 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. People with families legally dependent on them would be permitted to draw out enough to support their dependents as well as themselves, so they could easily return to school after normal school-going age. Existing poverty-oriented subsidies would be abandoned but bendfits 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. Such use would 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. Thus, he or she 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 student's knowledge that he or she was spending his or her own money. In short, access to education would be increased while wasteful use of education would be discouraged.

Some of the same effects could be achieved with a simple loan program; indeed, the proposal could have been cast in the form of an amount available as an annuity at age sixty-five against which a person might borrow before that age for purposes of education or medical care. But that seems a rather strained format for developing the nature and objectives of the proposal. And, of course, a simple loan program does not produce the basic, direct redistributive effect sought by the UPCA.

Even if the UPCA proposal is adopted, public vocational and university training should continue to receive subsidies to reduce tuitions. The subsidy would be calculated to take into account the benefits that society at large may be thought to derive from such training. The availability of the UPCA funds should permit 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 would be 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 by other means.

Medical Use

The principal objective when 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 assumes the existence of a basic medical insurance program with deductibles and coinsurance, together 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 us 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, medical services coverage at the most minimal level for all people covered by the UPCA--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 system"--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 eighteen and over sixty-five 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. This would also give patients more incentive to shop around and would 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 otherwise impoverished patients.

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 upon becoming ill, he or she could still buy the extra service, either out of his or her own funds, if any, or out of the UPCA account. Perhaps more important, the UPCA account would be available 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 whose overuse may be particularly 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 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 are not now tolerable for a large part of the population.

The Retirement Benefit

The potential UPCA annuity obviously would not be available to people who had fully drawn on their funds for medical or educational purposes. Accordingly, the UPCA would not replace other programs designed to provide a basic income for all the elderly, though the existence of the UPCA might argue for keeping the minimum support level for retirement relatively low.

Universality of Coverage and Financing

Every person would be eligible at age eighteen (or upon earlier high school graduation) without regard to personal or family wealth or income.

While this proposed rule ignores need and makes the program truly universal, its likely effect may not be nearly as significant as might be imagined. Very few people have significant wealth at age eighteen. Attributing a parent's income or wealth to an eighteen-year-old child may be unfair to 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 for them or their parents in the long run, 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.) Viewed in this way, the UPCA may be seen as a device by which the nonpoor spread the costs of their own or their children's education and/or medical expenses over time.

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. For the nonpoor a tax on amounts not previously taken into income seems entirely appropriate in light of the basic objective of relieving poverty and promoting economic equality. The inclusion of withdrawals in income seems much simpler mechanically than reducing the amount withdrawn by the amount of the tax that would be paid. 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 non-living expenses of education. And certainly there should be an averaging device that includes a carryover of unused deductions and exemptions; this would tend to reduce (though unfortunately not eliminate) the tendency of anticipated changes in tax rates to distort the trade-offs.

Conclusion

The UPCA seeks to reduce economic inequality while at the same time pursuing other goals that are not entirely compatible with one another: limitation of use, discouragement of misuse, freedom of choice and fair distribution of welfare benefits. It should replace or require a modification of various existing means of providing benefits. But it is not a panacea. 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, freedom to make their own choices about vital matters and incentive to avoid making wasteful choices--while at the same time taking cognizance of the public's inclination to attach strings to gratuitous transfers.