 ***ADVANCE SHEET– SEPTEMBER 4, 2020***

President's Letter

In this issue, we include three articles from different periods, of interest to the probate bar, and to citizens generally.

The first is an editorial published by former President William Howard Taft in 1918, during the nine-year interval while he was Professor of Law at Yale after departing the Presidency and before assuming the Chief Justiceship.

The second is a reflection by Professor John Langbein of the University of Chicago on the significance of the right of inheritance for today's middle classes.

The third is an article from the British Guardian newspaper on the consequence of the abolition of the Rule Against Perpetuities in South Dakota and some other states, the Rule itself having been a reaction against the unlimited accumulations of wealth, resentment which gave rise to the destruction of the English monasteries. The theme of the last article is that of John Maynard Keynes in his *Tract on Monetary Reform* (1923) at 56-57, as quoted in 2 R. Skidelsky, John Maynard Keynes (London: Allen Lane,1994), 160: "[N]othing can preserve the integrity of contract between individuals, except a discretionary authority in the State to revise what has become intolerable. The powers of uninterrupted usury are too great. If the accretions of vested interest were to grow without mitigation for many generations, half the population would be no better than slaves to the other half. . . The absolutists of contract... are the real parents of revolution."

Also included in this issue, through the good offices of our board member Henry R. Lord is a column, one of a long series, by the late Washington lawyer Jacob Stein; additional columns by him will appear regularly in future issues.

George W. Liebmann

Membership Renewal:
Now More Than Ever

Whether it is Luke Bryan singing it or Anna Quindlen writing it, the fact that "Days go slow and years go fast" clearly falls within the ambit of a self-evident proposition. Believe it or not, whether we look at the calendar on the wall or that space age device on our wrist, it is September. How many months now have we been doing (hopefully), our best impersonation of the Lone Ranger? Funny how wearing a mask seemed to lead to nothing but trouble for the guy, while not wearing a mask… Well, you can probably guess what I was going to say.

September marks the end of the Bar Library membership year. Since 1840, the year of its founding, the Library has seen a Civil War, two world wars and now a second horrible pandemic. It has tried to do its very best to carry on in the face of adversity and to contribute in any way possible to the continued operations of the judicial processes. During these last several months it has provided legal material to judges and lawyers, from firms both large and small, that otherwise would have been unavailable to them. Even during the closure of the courthouse the

Library was able to carry on, through e-mailing of materials, telephone reference and members picking up legal treatises at the door.

Many have been devastated by this most horrible disease that has enveloped our world, including the loss of life, loved ones and economic upheaval. There are few who have not been affected, including the local legal community. Now more than ever it is important to remember the economic advantages of a Bar Library membership. Whether it be circulating collections or access to the Library's extensive collection of Westlaw databases from a Library terminal or your own laptop, the Library is going to allow you to save money. Numerous and distinctive Library conference rooms can be utilized by members for everything from meeting clients to the holding of depositions.

If you have weathered the storm to date, we ask for your support not just for yourself, but also for those members of the legal community who have experienced economic hardship and need access to a collection or databases that they were previously able to obtain through other avenues that are now cutoff. We are "The Library Company of the Baltimore Bar" – of the Bar and for the Bar. Perhaps never in our history have those words had greater significance.

Take care, be well, and we hope to see you soon.

Joe Bennett

WILLIAM HOWARD TAFT
Collected Editorials, 1917–1921

EDITED BY
James F. Vivian

THE SOCIALIST IMPULSE

January 25, 1918

The resolutions of the labor unions of Great Britain and the remarks attributed to Mr. [Andrew] Bonar Law and Mr. Lloyd George in addressing a conference of the [trades] unions foreshadows a program of legislation of radical and socialistic character for England after the war.[1] Mr. Lloyd George before the war was the leader of a movement to secure a division of the great landed estates of Great Britain into farmer holdings. The heavy taxes in the form of death dues and otherwise have done much to bring about the sale of these estates and their consequent division. Late dispatches show that even the estate of Mr. [William E.] Gladstone is undergoing this change, due to mortgage indebtedness and heavy government dues.[2]

The program of the labor unions, however, goes further, and proposes to attack the accumulation of large fortunes as well and to secure government management of industries. Social conditions in England are very different from those in the United States, and socialistic principles have been much more rife among the labor men in England than here. The English Labor party has an independent status and a very considerable parliamentary representation. Indeed, were there to be an election now it is thought that the members of that party would be sufficient to form a government. While movements of this kind in England have an influence upon the politics of this country, we should not be misled into thinking that similar issues raised here would have the same formidable support. The abuses of large landed estates in England all have recognized for years. We do not have that kind of ownership here to any such degree as to impress the people with the necessity for a change. The accumulation of wealth on this side, of course, has been greatly criticized, but the opposition has been aroused rather by the corporate control of politics, public utilities and of markets than by the individual activities of rich men.

Our organized labor is veering toward political action as a party. It has been much encouraged by its success in securing the passage of the Adamson bill,[3] and its leaders are looking forward to greater political power and to some of the changes which form part of the platform of the English Labor party. There are other theorists, socialists in principle, who proclaim a fundamental change in our institutions and the division of wealth so as to produce greater equality. State socialism in the form of government ownership and operation, not only of public utilities, but of all industries conducted on a large scale, finds many vociferous supporters.

Accumulated wealth may be divided by means which would not be revolutionary or require a change of the Constitution. A limitation upon the testamentary power, in the discretion of legislatures, would in the course of ten years, or certainly in a generation, work a very material division of the great fortunes. Inheritance taxes, already heavy, are quite likely to be increased, and these, with the graduated feature of the income tax, may shift the burden of government on to the wealthy in such a way as to moderate the enthusiasm for accumulation. But actual direct limitation upon accumulation or the appropriation of what one man earns by confiscatory proceedings is so at variance with our constitutional limitations that it would require a long struggle to bring measures of this kind into operation.

That is the advantage of our written Constitution. It cannot prevent popular action, but a full discussion must be had before the change is made. The issue must be fought out. Politicians cannot in such an issue avoid meeting it squarely. Those who own property, however small in amount, will then be warned of what a destruction of the property right means. Socialism and its tyranny will be revealed to the public and to the saving and prudent wage-earner and small farmer who owns his own farm. In such a contest this country will be seen to be the most widely conservative in the world. The Constitution, battered as it has been by general and irresponsible abuse, will stand forth in all its admirable character as a preserver of individual rights and of liberty regulated by law. The examples that Russia and other countries are giving of the contrast between dreams and realizations of justice will furnish an admirable argument for those who, without being rigid in their adherence to what may be abuses of the present, will insist upon retaining the old landmarks which now measure the rights of individuals, essential to the pursuit of happiness of the entire community.

Members of organized labor who are looking forward to the exaction of higher and higher wages without regard to the merits do not see clearly the situation after the war. The great national burden of debt that we are assuming, the great expansion of nominal values that the financing of this war involves and the reaction and radical readjustment which peace must bring by a complete cutting of the great demand for war supplies will produce a halt in business and a period of hard times. Such jolts bring people to a realization of fundamental economic truth. It makes them know the value of prudential virtues and the advantage to the country of just treatment of capital in order that the wage fund to be distributed may be as large as possible. It will show the interdependence between capital and labor. It will have a tendency to produce sanity in legislation and in political action. Human nature is not going to be changed after the war. The love of comfort, the unwillingness to make sacrifices which have characterized our great prosperity, will be moderated, but economic laws dependent on the motive for gain will be in force, unaffected by the strain of war. There will then be neither the opportunity nor the disposition to reverse those laws and make water run up hill by legislation. More than this, the disaster to national interests in the war which a defection of labor would involve has given organized trades unions a greater power in this country than they have ever had. When peace comes, if intolerance growing out of present success characterizes the action of organized labor after the war, employers may be driven to an issue of justice. On this they can in the long run win.

The movement for a minimum wage and for a system of old-age pensions will doubtless progress and further regulation of terms of employment already far advanced may be expected. Some method of adjusting labor controversies will be adopted which may further curtail freedom of action by employers. We may look forward also to experimental changes in politics of the government in controlling some limited fields of activity now under private ownership and operation. Disastrous results may cure further experiment. The prospect of such radical changes as many prophesy, however, is not warranted by a consideration of the conservative character of our people and our post-war conditions.

1. The conference in Nottingham is reported in the *New York Times*, January 19, 1918, p. 1, and January 21, p. 1.

2. Gladstone was four times prime minister of Great Britain prior to his death in 1898.

3. The Adamson Act of 1916 mandated the eight-hour day on the nation's railroads.

Occasional Papers from
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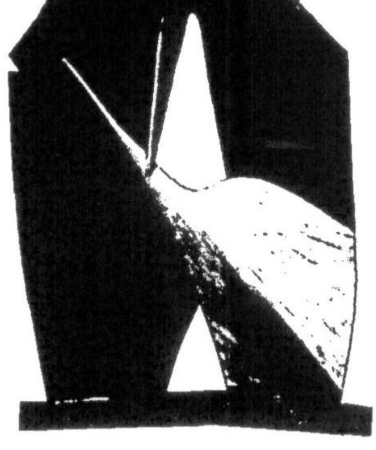
Number 25

The Twentieth-Century Revolution in Family Wealth Transmission

John H. Langbein



The Twentieth-Century Revolution in Family Wealth Transmission

John H. Langbein*

Over the last century or so, as a result of the vast technological forces that have transformed the way we produce goods and services, there has been a fundamental change in the very nature of wealth. Whereas wealth used to take the form mainly of tangibles (that is, realty, plant and equipment, inventory, and personal artifacts), wealth in advanced technological countries such as the United States is mostly intangible.

I shall be concerned in this article with private-sector wealth.[1] Into the eighteenth century, land was the dominant form of wealth, but no longer.[2] The technological forces that broke up older, family-centered modes of economic organization called forth two new forms of private-sector wealth. One category is what we today call *financial assets*—that is, stocks, bonds, bank deposits, mutual fund shares, insurance contracts, and the like. The other great form of modern wealth is what the economists call *human capital*. It is the skills and knowledge that lie at the root of advanced technological life.

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*Max Pam Professor of American and Foreign Law, University of Chicago Law School. This article is based on the Joseph Trachtman Lecture, originally presented to the American College of Probate Counsel in February, 1988. The speech text appears in 14 Probate Lawyer 1 (1988). A shorter version of the lecture was published in 87 Michigan Law Review 722 (1988). The research assistance of Kim Pierce and Nir Yarden and the suggestions of Walter Blum, Joel Dobris, Richard Epstein, Daniel Ernst, Lawrence Friedman, and Mary Ann Glendon are gratefully acknowledged.

1. More than twenty years ago in a notable law review article, Charles Reich called attention to one species of "new property" —claims to government largess, especially those we have come to call entitlement programs, such as Social Security and Medicare. Reich, The New Property, 73 Yale L.J. 733 (1964). Reich's "new property" will not much concern me in this article, because these entitlements lie mostly outside family dominion. You can neither give nor sell nor bequeath your Social Security claims.

2. Data from Bucks County, Pennsylvania, indicates that realty constituted more than half the wealth in seventeenth- and eighteenth-century probated estates. C. Shammas, M. Salmon & M. Dahlin, Inheritance in America from Colonial Times to the Present 19 (1987) [hereinafter cited as Inheritance in America]. For data evidencing a spectacular decline from colonial to modern times in the percentage of testators transmitting farms and firms, see *id.* at 106, 191.

The main purpose of this article is to sound a pair of themes about the way in which these great changes in the nature of wealth have become associated with changes of perhaps comparable magnitude in the timing and in the character of family wealth transmission.

My first theme concerns human capital. Whereas of old, wealth transmission from parents to children tended to center on major items of patrimony such as the family farm or the family firm, today for the broad middle classes, wealth transmission centers on a radically different kind of asset: *the investment in skills, human capital.* In consequence, intergenerational wealth transmission no longer occurs primarily upon the death of the parents, but rather, when the children are growing up, hence, during the parents' lifetimes.

My second theme, which concerns financial assets, arises from the awesome demographic transformation of modern life. For reasons that I shall explore, those same parents who now make their main wealth transfer to their children inter vivos are also living much longer. The need to provide for the parents in their lengthy old age has put a huge new claim on family wealth, a claim that necessarily reduces the residuum that would otherwise have passed to survivors. A new institution has arisen to help channel the process of saving and dissaving for old age: the *private pension fund.*[3] The private pension system depends almost entirely on that new property in the instruments of financial intermediation. I shall emphasize a distinctive attribute of pension wealth, namely, the bias toward annuitization. When wealth is annuitized, virtually nothing is left for transfer on death.

At the outset, I must emphasize a pair of major exclusions from the trends that I shall be describing. For the most part, I shall be talking about the patterns of wealth transmission that characterize the broad generality of American wealth holders—roughly, the upper third to upper half of the populace. I mean, in short, the middle and especially the

3. To be sure, the business of providing retirement income, both in money and in the form of medical services, is the prototypical government transfer scheme. Social Security benefits epitomize Charles Reich's new property. Reich, *supra* note 1, at 734. But for propertied people, Social Security has always been something of a sideshow, and the recent revisions of the system that have begun to tax the benefits received by comparatively affluent distributees confirm that people of means will in the future have even less to expect from Social Security.

upper-middle classes, which is to say, the mostly white-collar, technical, managerial, and professional cohort—the people who propel the knowledge-based economy of our post-industrial age, and who command much of its wealth.[4] The trends I shall be discussing have had less influence on the wealth transmission practices at the extremes of our society—among the very rich and among the poor.

I. Prologue: Family Wealth Then and Now

It is often the case that the best way to broach the subject of the new is to identify the important characteristics of the old. Accordingly, I want to begin by flipping the calendar backward a century and more, to the days when Abraham Lincoln lived on the American prairie and when his contemporaries were building the cities of the Atlantic seaboard, the Great Lakes, and the Ohio and Mississippi Valleys. We want to remind ourselves of some central traits of wealth holding and wealth transmission in this period.

A. *The Nineteenth Century*

The family was prototypically a unit of production. Nineteenth-century America was overwhelmingly a nation of small farms. In the towns and cities, the predominant economic entities were small-firm producers and small shops. Farmers, artisans, and shopkeepers had in common the tradition that the entire family worked in the enterprise. In those circumstances, contemporaries had little occasion to distinguish between what we think of as earned income (income from one's labor) and investment income (the return to property). The two income streams were merged in a single endeavor. Both the generation of the parents and the generation of the children looked to the farm or the firm for their livelihood, with scant attention to idle accounting questions about how much of their income to apportion to labor and how much to property.

In emphasizing that the returns to labor and capital were composite, I do not mean that the property component was unimportant. Property was desperately important. Ownership of a farm or a firm rescued you from a mean life of stoop labor in someone else's field, mill, or household. In former times, it

4. See text at notes 35–6 *infra* for discussion of sector wealth data and its interpretation.

was vastly harder to live by your skills alone, without patrimony. Accordingly, people of means aspired to nothing so much as to leave their children similarly advantaged. You hoped to transmit the farm or the firm, and thus in the quaint phrase of the time, to make for your children "a provision in life."

There was little or no formal education. This was a low-tech age, and the transmission of skills, like so much else, could still occur within the family. You learned your trade alongside your parents and your relations, in the fields, in the firm, or at the hearth. Put differently, the family was not only the primary unit of production, it was the primary educational entity as well. Only a few crafts and learned professions required external education; and even in those pursuits, education was frequently assimilated to a domestic model through the apprenticeship system of training.

Succession to ownership rights in this multigenerational enterprise occurred at death—that is, the death of the parents, typically of the father. The tendency both in intestacy and for testate estates was to limit the widow to a life interest, in order to assure continuity of the enterprise in the hands of the next generation, whose members had already been long employed in the enterprise. Succession to the family farm or family firm typically occurred on the father's death. There was no reason for him to surrender dominion over the family patrimony inter vivos. Ownership until death reinforced parental control over the extended family and over its collective enterprise. Remember that, although wealth transmission occurred at death, life expectancies were shorter. The successors were typically young adults, as compared to the middle-aged children who typically succeed when parents die in modern circumstances.

Finally, to complete this little snapshot of important traits of nineteenth-century wealth transmission patterns, I wish to say something about the diminished expectations of daughters. Perhaps the easy way to make this point is to remind you how often you have come across some family firm from earlier decades in which the father associated the son or sons in the firm's name—for example, Steinway & Sons; but you have not seen firms called Steinway & Daughters. Although there were many exceptions, the wealth transmission process tended to favor the male line. The farm or the firm had to be worked. Except when a family had only a daughter or daughters, continuity within the patrimony emphasized the son.[5]

B. Contemporary Family Property Relations

In the late twentieth century, the family has in general ceased to be an important unit of production. To be sure, you can still find dribbles of cottage industry in America, and there is still a fair amount of Mom-and-Pop retailing, but in the main the production and sale of goods and services has forever left the home. The technological sophistication and marketing complexity of modern modes of production and distribution impose enormous capital requirements. Village blacksmiths cannot manufacture automobiles, airplanes, and oil rigs. The village entrepreneur can still sell a screwdriver or make a hamburger, but the evidence is overwhelming that the customer mostly prefers to patronize K-Mart or McDonald's. Thus, the characteristic unit of production in our age is corporate rather than domestic. It is the share company.

These trends extend to farming as well. American agriculture is ever more technology-driven and capital intensive. It has become a byword that we live in an era of corporate agriculture. Family farms still exist in America, indeed, in some farming areas it would be fair to say that family farms remain characteristic. But a large fraction of them are hobby farms, secondary enterprises conducted by people whose main livelihood derives from employment outside the home. As farms have grown in size and productivity, an astonishing agricultural depopulation has occurred. In what used to be a nation of farmers, we are now fed by a mere 5 percent of the population, down from 44 percent in 1880,[6] and it should be remembered that these people are not only feeding the rest of us, they are running our largest export industry as well.

5. In emphasizing this reason for preferring the male line, I do not wish to imply that it was the sole factor. Conceptions that we now find archaic about the needs and roles of women were also involved. But it is instructive to see that in Inheritance in America, *supra* note 2 (which is fully informed by modern feminist sensibilities), the authors point out that by the end of the nineteenth century, when the transmission of family enterprise had become markedly less common (*id.* at 106), the treatment of sons and daughters in the authors' Bucks County, Pennsylvania, sample became "nearly identical." *Id.* at 108.

6. Historical Statistics of the United States: Colonial Times to 1970, series K1-16, at 457 (1975) [hereinafter cited as Historical Statistics].

Thus, in the main, we neither farm nor manufacture at home. The family has undergone a specialization of function. In economic terms, the family remains a unit of consumption but no longer a unit of production. Enterprise is organized outside the home, and the worker now leaves the home for his employment. Such a worker contributes his labor to his employment, but he no longer supplies the plant and equipment as he did in the bygone day of the family enterprise. The reason that most workers use external capital is, of course, closely connected to the technological and marketing forces that have magnified the size and complexity of the productive processes, the forces that drove the worker out of the home in the first place. Modern modes of enterprise are capital intensive. The blacksmith could afford his anvil, but we cannot expect the autoworker to supply his factory or the airplane pilot to bring along his own Boeing 747.

The ever-larger capital requirements of technologically advanced enterprise required modes of financing that exceeded the capabilities of the family. Ownership of a small firm or a small farm could lie within the scope of family-based capital accumulation and capital transmission, but we understand why IBM, General Electric, and AT&T cannot be family firms.[7] The corporate form arose to facilitate the pooling and allocation of capital, as did the specialized institutions of finance. In the late twentieth century we recognize three dominant modes of financial intermediation: first, the corporation, and with it, the securities industry that makes the market in corporate shares and corporate debt; second, banking—commercial, investment, and savings and loan; and third, the insurance industry. All three were primitive in antebellum America.[8] Not only

7. See Daniel Bell's remarks about the "breakup of family capitalism" at the end of the nineteenth century, when bankers and later corporate managers gained control of large enterprises. D. Bell, The End of Ideology 40-42 (1960).

8. See R. Seavoy, The Origins of the American Business Corporation: 1784-1855, at 3-7, 191-223 (1982) (spread of industry-specific general incorporation statutes in New York in the 1840s and 1850s). The marketability of corporate shares increased significantly from the 1890s. See Navin & Sears, The Rise of a Market for Industrial Securities: 1887-1902, 29 Business Hist. Rev. 105 (1955). For an overview of the history of American banking, see Green, "Financial Intermediaries," in 2 Encyclopedia of American Economic History 707 (G. Porter, ed. 1980). A recent study of the history of the life insurance industry is V. Zelizer, Morals and Manners: The Development of Life Insurance in the United States (1979).

have these financial intermediaries now displaced the family's role as the unit of capital accumulation, they have also created the new forms of wealth in financial assets—the various securities, depositary claims, and other contract rights.

These instruments of financial intermediation now absorb the savings that the family previously devoted to the family enterprise. Because family wealth is no longer retained but rather invested externally, it now takes the form of claims on outside enterprises. This new property, paper property, has become the characteristic form of transmissible wealth. It is the stuff of the financial pages. As Roscoe Pound said in an arresting dictum that I never tire of quoting, "Wealth, in a commercial age, is made up largely of promises."[9] I shall have more to say about how the rise of the new property in financial assets has come to figure in the new patterns of family wealth transmission. For the moment, however, I want to direct attention to that other species of new property that is associated with the break-up of the family as a unit of production: human capital.

II. HUMAN CAPITAL

The same underlying technological and economic forces that caused the dissolution of family-based enterprise have also stripped the family of much of its role as an educational institution. This development, which is in a sense quite obvious to us all, has had enormous implications for family wealth transmission, implications that have not been adequately appreciated.

It is a truism that a technological age requires a technologically proficient workforce. The awesome expansion of human knowledge over the past century and more has made the family obsolete as a repository and transfer agent for this huge range of knowledge. The educational demands of modern economic life have become immense, and so has the cost of providing children with this educational endowment.

A central thesis of this article is that paying for this education has become the characteristic mode of intergenerational wealth transmission for most American families.

9. R. Pound, An Introduction to the Philosophy of Law 236 (1922).

A. *Educational Expenditure*

Let us look at the statistics in order to get a sense of the underlying magnitudes. Total expenditures for formal education in the United States in 1840 have been calculated at $9.2 million. This sum increased over the nineteenth century, a period of relatively low inflation, to stand at $289.6 million in 1900.[10] By 1959 the figure had reached $23.8 billion, which amounted to 4.8 percent of gross national product.[11] Less than thirty years later, in the 1986–1987 academic year, the total expenditure on formal education stood at $282.1 billion, a figure that represented 7 percent of gross national product. Sixty percent of this money went to fund primary and secondary education, 40 percent went to higher education.[12]

While the official educational statistics are valuable for conveying a general sense of the magnitudes, they conceal many subtle issues of definition and measurement. Many sins pass under the label of education. Not every course in basketweaving deserves to be reckoned as investment in human capital. On the other hand, much of our financial investment in our children takes forms that, somewhat arbitrarily, fall outside the category of formal education. If you take your children to a nature preserve or on a tour of French cathedrals, that's private recreation, whereas when some educational institution takes your kid square dancing, that's education. Indeed, as my colleagues Walter Blum and the late Harry Kalven pointed out in a celebrated book some thirty years ago, the most important inheritance of all—the thing that decisively advantages middle class children—is the cultural bequest from their parents.[13] That parental transfer of language, of values, and of psychological well-being sets the stage for all the formal learning and achievements of later years. None of that gets captured in the educational statistics. Nevertheless, once due allowance is made for the shortcomings of what the statisticians deem to be education, the numbers that I have been reporting are so enormous that they bespeak an enterprise of daunting importance.

10. Fishlow, 26 J. Econ. Hist. 418, 420 (1966); see *id.* at 431 for inflation adjusted figures in 1958 dollars.

11. Center for Education Statistics, Digest of Education Statistics 1987, at 24 (1987) [hereinafter cited as Education Digest].

12. *Id.* at 4, 25.

13. W. Blum & H. Kalven, The Uneasy Case for Progressive Taxation 88 (1953).

In 1870, 2 percent of the population was graduating from high school; by 1970 the figure was 75.6 percent.[14] In 1870 institutions of higher learning in the United States conferred a total of 9,372 degrees, of which 9,371 were bachelors' degrees and exactly one was a doctorate. In 1970 the total number of degrees conferred showed an increase of more than a hundred fold over 1870. The figure stood at 1,065,000, of which almost thirty thousand were Ph.D or equivalent degrees. College enrollments as a percentage of the college age population reached 12.5 percent in 1946, 29.6 percent in 1970, and 31.3 percent in 1985.[15] As recently as 1940, only 4.6 percent of the American population had completed four or more years of university study. By 1985, almost 20 percent (19.4 percent, to be precise) had done so.

Economists who have examined this gigantic education industry have increasingly been of the view that expenditures on education ought not to be viewed as a simple consumption expense, like money spent on corn flakes or handkerchiefs.[16] Rather, they see educational expenditure as an investment, closely akin to conventional investment in plant, equipment, and inventory. Education produces skills, and skills are as much an input in the productive process as machines. Economists now routinely liken these skills to capital, the species of capital that they call human capital. Modern productive processes are skill-driven. Whether we speak of new fields such as aeronautics or ancient ones such as health care, the story is the same. While plant and equipment become increasingly sophisticated—robotics and computers and CAT scanners and all that—the skills of the workforce become still more decisive. Human capital thus substitutes for nonhuman capital. Skill embodies knowledge, and new knowledge not only displaces old knowledge, it displaces plant and equipment as well. Think of the advance in medical science that made polio a preventable disease and consigned the iron lung industry to the scrapheap. Skill displaced machines.

Human capital, being literally embodied in mortals, is distinguished from physical capital by the

14. Historical Statistics, *supra* note 6, series 598–601, at 379.

15. U.S. Bureau of the Census, Statistical Abstract of the United States, Table 192, at 118 (1987).

16. See, e.g. Campbell & Siegel, The Demand for Higher Education in the United States: 1919–1964, 57 Amer. Econ. Rev. 482 (1967).

frailty of the human condition. Human capital dies with the holder and thus needs to be created afresh in each generation. Of course, the highly transitory quality of human capital is really more a difference of degree than of kind. Machines and structures also fall apart or become obsolete, which is why we systematically account for the artifacts of physical capital by means of depreciation schedules.

Careful econometric study has documented that human capital has steadily increased over the twentieth century as a fraction of total capital and as a fraction of gross national product. The percent of GNP spent on both education and on job training grew by 80 percent from 1929 to 1969, in which year it stood at 15.4 percent of GNP.[17] A recent set of calculations "implies that education costs society approximately as much as investment in nonresidential physical capital."[18]

There is no mystery about who has been paying the bill for this vast expansion of education. The main burden falls upon the parents. Indeed, even childless people pay substantial sums in taxes to support the public educational establishment. But for present purposes, I want to focus on propertied families who are raising children.

My thesis is quite simple, and, I hope, quite intuitive. I believe that, in striking contrast to the patterns of last century and before, in modern times the business of educating children has become the main occasion for intergenerational wealth transfer. Of old, parents were mainly concerned to transmit the patrimony—prototypically the farm or the firm, but more generally, that "provision in life" that rescued children from the harsh fate of being a mere laborer. In today's economic order, it is education more than property, the new human capital rather than the old physical capital, that similarly advantages a child.

We know that income levels correlate powerfully with education. In 1985 the median annual income of full-time male workers aged twenty-five and over who had completed some years of high school but had not graduated was under $20,000; for those who had completed four years of college the figure was above $30,000; and for those with more than four years of college, the figure approached $40,000. The

17. John W. Kendrik, The Formation of Total Capital 66 (National Bureau of Economic Research, 1976).

18. Johnson, Investment in and Returns from Education, in The Level and Composition of Household Saving (P. Hendershott, ed., 1985).

comparable earnings figures for female workers were lower, but differences in educational attainment among women produced similar disparities in favor of the well-educated.[19]

Family wealth and its corollary, family income, are crucial determinants of access to education. A sociologist of education recently summed up the data in the following way: "The amount of schooling that individuals obtain and their school continuation decisions are strongly affected by characteristics of their families. Persons whose parents have more schooling, higher income and better jobs; whose families are smaller; and who were raised in urban areas typically obtain more schooling than persons from less advantaged backgrounds."[20]

The process of delivering educational advantage to children begins when they are very young. There has been a huge increase in formal preschool education in recent decades. In the years of primary and secondary education, propertied parents strive to locate in suitable school districts, or to send their children to private schools. By the way, the distinction between private and public schools is far less meaningful than might appear at first glance. Many of those distinguished suburban school districts that represent the high-water mark of quality in our public school tradition are in truth better understood as private schools with tax-deductible tuition—the tuition taking the form of relatively high real estate taxes that are deductible against income taxes. Parents tend to move into these school districts when they have school-age children, and to move out when they no longer need the schools.

And then there is college. The federal government's *Digest of Education Statistics 1987* reports that the average annual charge for tuition, room, and board for undergraduates in the 1985–1986 academic year was $3,640 at public colleges and $8,870 at private colleges. Because these numbers are averages, which lump low-cost local institutions with elite schools, they understate the bills that parents face

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19. Education Digest, *supra* note 11, at 4, 12. The *Wall Street Journal* reported data indicating much wider income disparities across the categories of educational attainment. Average monthly income for a person with only a high-school diploma is shown as $415; a vocational degree, $990; a bachelor's degree, $1,540; a doctoral degree, $2,747; and a professional degree, $3,439. Wall St. J. 21, col. 3 (March 17, 1988).

20. Mare, Trends in Schooling: Demography, Performance, and Organization, 453 Annals 96, 101 (1981).

when they send children to the major universities. At the premier private universities, the bill for tuition, room, and board now exceeds $15,000 a year; travel and incidentals can easily bring the figure to $20,000. In the graduate and professional schools, the price tag is higher still. This year, most of the major private law schools are charging above $14,000 in tuition alone. Tuition, fees, books, and supplies at the University of Chicago Law School this academic year are estimated to cost $14,445. At Chicago, we project total annual expenses for an unmarried law student at more than $24,000 per year, which puts the effective pricetag of a three-year Chicago degree near $75,000. By the way, it costs us a further $40,000 to deliver that degree to the student, money that comes from endowment income, a trickle of foundation and government grants, and a torrent of alumni support.

A story in *Newsweek* in May of 1987 supplied figures on the annual cost of undergraduate education at Johns Hopkins. The $15,410 that Hopkins charged in 1987 for tuition, room, and board constituted 31 percent of a family income of $50,000 per year. By contrast, the $2,000 that Hopkins charged in 1960 represented only 15 percent of the inflation-adjusted equivalent family income for 1960, which was $13,500.[21]

Now it is quite obvious that very few families can afford to pay 31 percent of family income, or anything near it, on what we would call—in an accounting sense—a current basis. That is especially true when the family has more than one child in the educational mill at the same time. For most families, therefore, these education expenses represent capital transfers in a quite literal sense: The money comes from savings, that is, from the family's capital; or debt is assumed, meaning that the money is borrowed from the family's future capital.

The guidelines that the universities use for calculating financial aid are quite explicit about taking into account all family wealth, not just current income, in deciding what fraction of the education bill the family should be made to pay. At the law school level for example, we are served by an organization called the Graduate and Professional School Financial Aid Service, known under its repulsive acronym of GAPSFAS, which analyzes the family

21. Fuming over College Costs, Newsweek 66 (May 18, 1987).

financial statements of applicants. GAPSFAS guidelines treat as available for defraying educational expenses not only the family's liquid assets, but also the family's home equity and the net worth of any family farm or family business. GAPSFAS publishes tables that indicate what percentage of home equity or of business or farm net worth should be utilized before the student qualifies for financial aid. These tables resemble the progressive bracket tables in the Internal Revenue Code: the greater the family wealth, the higher the fraction that the parents are expected to transfer to the child in support of the child's education.[22]

B. *Education Displaces Inheritance*

The same *Newsweek* article that discussed the education cost figures from Hopkins recounted the saga of a parent named C.Y. Lu, who had the financial misfortune to have one son attending Princeton while the other was at the Harvard Law School. Mr. Lu is reported to have sold off investments, taken out educational loans, and refinanced his home mortgage by $60,000, in order to raise a total of $140,000. Mr. Lu is quoted as saying, "I've told my sons, your education is going to be your inheritance."

There in Mr. Lu's words you see my theme encapsulated. Education is displacing inheritance, lifetime transfers are displacing succession on death. Back in the nineteenth century or earlier, Mr. Lu would have husbanded his wealth and left it to his sons at his death. Today, in mid-life, he cashes out and goes into debt in order to fork over his savings to Princeton and Harvard.

Nobody forces Mr. Lu to do this. It was quite open to him to say to his two sons, "Boys, I'll make you a deal. I'll buy you out of those admission letters from Princeton and Harvard. Stay away from those cauldrons of red ink, and content yourselves with attending the community college down the road—or better yet, go right to work in an accessible career like pumping gas at the corner filling station. Then, I'll have $140,000 more in family wealth that I can invest through Merrill Lynch. It will compound and be available for you on my death." Well, we all know

22. H. Flamer, D. Horch, & J. Bruno, Measuring the Financial Status of Graduate and Professional Students: GAPFAS Theory and Computation Procedures 1987-88 Award Year 9, 22-23, 48 (1987).

that virtually no parent behaves that way. Parents understand full well the point that the economists have been demonstrating with their studies of human capital. Those degrees from Princeton and Harvard are superior investments when compared to any class of financial assets, by virtue of a very conventional test: The degrees produce a far larger income stream.

Mr. Lu happened to have sons, but if his children had been daughters, his financial predicament would scarcely have improved. One of the grand American social achievements, in which we led the world, was to extend the opportunity for formal education to women. That trend was epitomized in the nineteenth century with the proliferation of women's colleges. Today, more women than men now attend college. Accordingly, the twentieth-century revolution in family wealth transmission may ultimately come to be understood as having been even more consequential for women than for men.

From the proposition that the main parental wealth transfer to children now takes place inter vivos, there follows a corollary: Children of propertied parents are much less likely to expect an inheritance. Whereas of old children did expect the transfer of the farm or the firm, today's children expect help with educational expenses, and they sometimes receive help with initial housing and career expenses, but they do not depend on parental wealth transfer at death. Lengthened life expectancies mean that the life spans of the parents overlap the life spans of their adult children for much longer than used to be. Parents now live to see their children reaching peak earnings potential, and those earnings often exceed what the parents were able to earn. Today, children are typically middle-aged when the survivor of their two parents dies, and middle-aged children are far less likely to be financially needy. It is still the common practice within middle- and upper-middle class families for parents to leave to their children (or grandchildren) most or all of any property that happens to remain when the parents die, but there is no longer a widespread sense of parental responsibility to abstain from consumption in order to transmit an inheritance. Children no longer expect it, and parents no longer feel the obligation. This notion is epitomized by that exuberant bumper sticker that one sometimes sees on recreational vehicles in the camping grounds of middle America: "We're spending our children's inheritance."

C. *Consequences for the Ethos of Inheritance?*

At the outset of this article, I cautioned that the revolution in family wealth transmission would be seen to be less significant for dynastic wealth holders, that is, for the very rich. The reason is obvious. School bills make little dent in large fortunes. There are intrinsic limits to how much education an individual can absorb, and those limits are reached long before the holders of great wealth would notice.

Nevertheless, there is a deeper sense in which the forces that have transformed the patterns of wealth transmission for the broad middle classes have also touched the holders of great wealth. The new pattern has become a social norm, a norm so powerful that it has begun to chip away at the ethos of older notions of inheritance.

This is a phenomenon that I first became aware of as a result of talking with practicing estate planners. Later, I noticed *Fortune* magazine running a story on it. *Fortune* reported on the thinking of some extremely wealthy people who planned to leave their children only token inheritances. The story led off with the views of Warren Buffett, chairman of the Berkshire Hathaway holding company, whose personal wealth is estimated at $1.5 *billion*. Buffett is quoted as explaining why he plans to leave each of his three children only a few hundred thousand dollars. Having put the children through college, Buffett says he expects them "to carve out their own place in this world. . . ." It would be "harmful" and "antisocial" to set up his children with "a lifetime supply of food stamps just because they came out of the right womb."[23] Buffett's $1.5 billion will go to charity. So will the fifty-million dollar fortune of a New York entrepreneur named Eugene Lang, who sent his three children to college, gave each "a nominal sum" after college, and plans to disinherit them. He explained to the *Fortune* reporter: "To me, inheritance dilutes the motivation that most young people have to fulfill the best that is in them. I want to give my kids the tremendous satisfaction of making it on their own."

People like Messrs. Buffett and Lang are quite exceptional. Most people of great means prefer to leave most of their wealth to their descendants, hoping to shape the younger generations so that the wealth will be used responsibly. The hostility towards conventional succession expressed by

23. Kirkland, Should You Leave It All to the Children?, Fortune 18 (Sept. 29, 1986).

Messrs. Buffett and Lang is noteworthy not because such hostility is prevalent, but simply because it would have been inconceivable a century or more ago. Can you imagine the twelfth Earl of Carlisle arranging for the dissipation of the family seat, in order to stimulate the thirteenth Earl to the challenge of reacquiring it?

Messrs. Buffett and Lang are voicing an attitude toward conventional wealth transmission that is not only quite exceptional, it is historically recent and also very American. Behind it, I think, are two novel ideas. One is the assumption that wealth is largely fungible, that there is no great sentimental attachment nor any particular social significance to the family's existing patrimony. That is why Mr. Buffett could liken his fortune to a pile of food stamps, and why Mr. Lang could hope that his children would experience the satisfaction of "making *it* on their own." By *it,* he means, something *like it,* but not the identical property. This notion that wealth is fungible is an idea that fits the new forms of wealth better than the old, an idea that fits American circumstances better than English or European. You are much more likely to be sentimental about your ancestors' manor house than about the family's portfolio of marketable securities.

Further, the disdain for customary modes of wealth transfer that Messrs. Buffett and Lang are voicing presupposes that these gentlemen have already achieved for their children the characteristic wealth transfer of modern times, that investment in human capital through education. More and more, Americans expect personal wealth to take the form of earned income, that is, we expect it to be a return on human capital. Messrs. Buffett and Lang have taken that expectation to its limit; in their eyes, conventional wealth transfer has lost its legitimacy. The esteem associated with holding property really now applies only to earned income, to property that embodies the fruits of human capital. In this sense, the revolution in family wealth transmission, which is overwhelmingly an event of the broad middle classes, touches even the holders of great wealth.

D. Europe and England: A Comparative Aside

The substitution of human capital for older forms of property is less evident in the patterns of family wealth transmission in Europe than in the United States, even though the underlying technological and economic forces have been broadly comparable on both sides of the Atlantic. The main explanation surely has to do with differences in educational finance. As a generality, the Europeans have socialized education and educational finance much more than we.

England represents something of a middle case, because of the enormous importance of private, pre-university schooling in the English system. Propertied English families are just as prepared to sacrifice for Eton or Winchester as Americans are for Stanford or Dartmouth. On the other hand, this kind of private schooling is unimportant on the Continent; and both in England and on the Continent, the university systems are all but wholly socialized. Tuition is mostly negligible, and because the state tends to suppress quality differentials among universities, students are more likely than in the United States to live at home and attend the local institutions.

For Europeans, therefore, educational finance is not the cataclysmic event in family fortunes that it is for Americans. I do not want to overstate this point. It is far costlier for a European family to keep a child at home and in university than to send him out into the workforce. That is one reason why, there as here, levels of participation in higher education correlate strongly with levels of family income. There as here, education is costly, and paying for it means that less wealth will be available for other purposes. But in Europe the intermediation of the state distorts the process more and makes the phenomenon more difficult to discern. In Europe more of the wealth transfer becomes a branch of tax economics. Europeans pay materially higher taxes than Americans, and these taxes, which subsidize higher education as well as many other services, necessarily result in lower marginal incomes and lower accumulations of family wealth than would otherwise be the case. This is, of course, a difference of degree rather than of kind, since most of American education, both preparatory and university, is publicly operated and tax-subsidized. But as is often the case in matters of economics, differences at the margin matter a great deal. The United States is unique among advanced countries in the extent to which educational finance remains privatized, especially the kinds of education that are most sought-after by the upper-middle classes.[24]

24. See Education Digest, *supra* note 11, at 120, for percentage of American university budgets deriving from tuition revenue.

III. THE PENSION REVOLUTION

The other great chapter in the saga of fundamental change in family wealth transmission being told in this article concerns the phenomenon of retirement and the rise of the private pension system. The pension fund should be thought of as another artifact of the new forms of wealth that arose in consequence of the breakup of older family-centered modes of production. Neither on the prairie nor in the cities of Abraham Lincoln's day had anybody ever heard of a pension fund. Your life expectancy was such that you were unlikely to need much in the way of retirement income. If you did chance to outlive your period of productive labor, you were in general cared for within the family.

Not only is the need for a retirement income stream relatively recent, but so too is the mode of wealth that now supplies it. Pension funds are composed almost entirely of financial assets—the instruments of financial intermediation—that distinctively modern form of property that was still of peripheral importance in the last century.

As late as World War II, the private pension system was minuscule.[25] Today, the assets of nonfederal pension plans (that is, private plans plus the pension funds of state and local government employees) total two *trillion* dollars.[26] As of 1984, pension funds owned 22.8 percent of United States equities and about half of all corporate debt.[27] For many middle- and especially upper-middle-class families, pension wealth is their largest asset. But pension wealth has special traits that mark it off sharply from traditional property, especially when we look at it from the standpoint of family wealth transmission.

A. *The Enhancement of Life Expectancy*

The way to begin thinking about the pension revolution is to grasp the magnitude of the underlying demographic phenomena that brought it about. Life expectancy a hundred years ago was about forty-five

25. W. Greenough & F. King, Pension Plans and Public Policy 27-67 (1976).

26. "Pension Assets Total Nearly $2 Trillion," 13 BNA Pension Reporter 1918-19 (November 17, 1986).

27. R. Ippolito, Pensions, Economics and Public Policy 123-24 (1986).

years. Today, it is seventy-five years and climbing.[28]

Behind the awesome spurt in life expectancy over the last century or so is a phenomenon that has been called "the elimination of premature disease."[29] In a nutshell, the insight is that diseases belong in two categories—the infectious or acute diseases that we have now largely banished from the mortality tables; and those diseases of old age that appear to set intrinsic limits on human longevity. Some researchers think that they see age eighty-five as the approximate average norm of the human life span. In 1980 white females were living to within seven years of that ideal. Three of those seven years of what is called "average premature death" are accounted for by violent death—automobile accidents, bathtub falls, and so forth. Thus, from the medical viewpoint, it is being said that "the task of eliminating premature death . . . has been largely accomplished."

To understand what modern sanitation and modern medicine have achieved, it is instructive to consider the case of tuberculosis, which in the year 1840 was the leading cause of death in the United States. As late as the year 1900, one American in 500 died from tuberculosis *every year*. By 1970, mortality from tuberculosis had decreased by over 99 percent. Many factors account for this decline in tuberculosis mortality rates, including pasteurization of milk, inspection of cattle, improvement in nutrition and in living conditions, and the quarantine of diseased persons. "Epidemiologists are fond of pointing out that about nine-tenths of the present improvement . . . occurred before the discovery of any drugs that could kill the tuberculosis germ. Streptomycin was the first such drug, and it was first used in the late 1940s."

Declines in the mortality rates from other dread infectious diseases have been as dramatic. "Smallpox is entirely eliminated. Paralytic polio, diphtheria, tetanus, typhoid . . . and whooping cough have been reduced to negligible levels. Deaths from measles and from streptococcal infections have been eliminated, even though the diseases themselves still occur."

28. Dychtwald, The Aging of America: Overview, in Wellness and Health Promotion for the Elderly 1 (K. Dychtwald ed. 1986).

29. J. Fries & L. Crapo, The Elimination of Premature Disease, in The Aging of America, *supra* note 28, at 19.

Against the power of penicillin syphilis can no longer kill. "All these conditions have declined over 99 percent, and in some cases, 100 percent." For pneumonia and influenza, "the reduction has been only 85 percent. However, this statistic hides an equally dramatic result. Pneumonia and influenza deaths now occur almost exclusively among infirm, very old, or already ill individuals. Such deaths, which are attributed to a germ, in fact result from diminished defense mechanisms and lost organ reserve. Deaths from these conditions in otherwise healthy individuals in the early and middle years of life have declined by the same 99 percent as the other infectious diseases."

Needless to say, part of what makes the AIDS epidemic so haunting is that it has happened against this background of utter triumph over earlier forms of infectious disease. What we cannot yet know is whether AIDS will remain an exception in a world where other infectious diseases remain insignificant; or whether the elimination of the ancient infectious diseases has set the stage for the development of new ones that, like AIDS, are resistant to the environmental measures and to the antibiotics that vanquished the old ones.

Roughly three of every four deaths in the United States today stem from three causes: cardiovascular disease, cancer, and automobile accidents. The prominence of cardiovascular disease and cancer as killers is related to the elimination of infectious diseases. "Survival from the diseases that used to kill early in life allowed the diseases that occur in later life to increase in frequency as a cause of death."

I have traveled (I hope not detoured) into this demographic data, because I think that without it one cannot really grasp what the pension revolution is all about. The pension fund is a direct response to the new demographics, in the setting of the new property. That point is best made if we return for a moment to our baseline in antebellum America, in order to see how the phenomenon of aging transpired when family wealth relations centered on the common patrimony in farm or firm.

Why were there no pension funds? The most important explanation is that, on account of the lower life expectancy of the times, far fewer people outlived their period of productive employment. You were, so to speak, much more likely to die with your boots on. I do not want to exaggerate this point. The forty-five year life expectancy that prevailed a century ago is a composite figure, greatly distorted by infant mortality. As late as 1907, "1 of 7 newborns died in their first year of life, whereas in 1977, 1 of 67 died then; between the ages of one and four, 1 in about 17 of those born in 1907 died, whereas 1 in about 360 died among those born in 1977—representing a 21-fold reduction."[30]

Your chances of surviving to a reasonable age were much enhanced in the last century once you had navigated the shoals of infancy. A white male who lived to age 20 in the year 1900 had an ultimate life expectancy of 62.2 years; a white female aged 20 in 1900 had a life expectancy of 63.8 years; in 1980 the projected life expectancy for whites aged 20 was 72.7 years for the male, a gain of 10.5 years; and 79.7 for the female, a gain of 15.9 years.[31] The comparable figures for nonwhites are lower, but the rate of improvement across the twentieth century has been better, especially for women. Thus, we see that even after we correct for infant mortality, the diminished life expectancy of the last century was marked enough to explain why contemporaries so seldom had occasion to talk about what we call the retirement income problem. If you chanced to outlive your productive years, you did not in general do so for very long.

But what of the relative handful who did need retirement support? The well-known pattern was one of reverse transfer. Within the family, the children, now mature, would support superannuated parents. For propertied persons, however, this image of reverse transfer conceals an important point. In the age of family-centered economic organization, the parents still owned the farm or the firm. In a sense that defies accounting precision but that is nevertheless worth emphasizing, when the elders received support from the children, they were living from their capital in the family enterprise—that enterprise to which the children would succeed when the elders died.

Now return to the late twentieth century to see what has changed. Not only have the demographics altered so that the elders are routinely surviving for long intervals beyond their years of employment, but in consequence of the transformation in the nature of wealth, their property has taken on a radically

30. Urquhart & Heilmann, Risk Watch: The Odds of Life 6 (1984).

31. Inheritance in America, *supra* note 2, at 149.

altered character. That family farm or family firm that was the source of intrafamilial support in former times has become ever more exceptional. Most parental wealth (apart from the parents' own human capital) now takes the form of financial assets, that is, claims upon and investments in those large-scale enterprises that have replaced family enterprise.

B. *Pension Wealth*

In propertied families, today's elderly no longer expect much financial support from their children. The shared patrimony in farm or firm that underlay that reverse transfer system in olden times has now largely vanished. Instead, people of means are expected to foresee the need for retirement income while they are still in the workforce, and to conduct a program of saving for their retirement. Typically, these people have already undertaken one great cycle of saving and dissaving in their lives—that program by which they effected the investment in human capital for their children. Just as that former program of saving was oriented toward a distinctively modern form of wealth, human capital, so this second program centers on the other characteristic form of twentieth-century wealth, financial assets.

A priori, we might expect that individuals would be left to save for retirement without government guidance, much as they are left alone to save and spend for other purposes, but that has not been the case. Instead, the federal government has intervened by creating irresistible tax incentives to encourage people to conduct much or most of their retirement saving in a special mode, the tax-qualified pension plan.

There are three crucial advantages to conducting retirement saving through a tax-qualified pension plan. First, most contributions to the plan are tax-deferred. When my employer contributes to a qualified pension or profit-sharing plan on my behalf, or when I contribute to a defined contribution plan such as a 401(k) or, in the case of academic personnel, a 403(b), I am saving with pretax dollars. If I am in the 25 percent bracket, the Treasury is contributing to my pension savings plan 25 cents in forgone taxation for my 75 cents in forgone consumption.

The second great tax advantage is that the earnings on qualified plan investments accrue and compound on a tax-deferred basis. It is not until the employee retires and begins to receive distributions of his pension savings that he pays income tax on the sums distributed. The third major advantage associated with pension taxation is that, because most retirees have lower taxable income in their retirement years than in their peak earning years, they find that distributions from pension accounts are usually taxed at lower marginal rates. As the progressivity of the income tax has abated in recent years, however, this attribute of the system has become less significant.

I think that, as a matter of tax policy, it is open to serious question whether Congress should be granting the level of tax subsidy for pension saving that it now does,[32] but that is a topic for another day. My present point is that the tax attractions of conducting retirement saving through the medium of a tax-qualified pension plan are simply overwhelming. These advantages explain why employers incur the regulatory costs incident to sponsoring these plans; and why employees, especially those in higher tax brackets,[33] prefer to take compensation in the form of pension saving rather than cash wages. The private pension system—this two-plus-trillion-dollar savings scheme—is tax driven.

C. *Annuitization Eliminates Succession*

From the standpoint of our interest in the patterns of family wealth transmission, what is especially important about the pension system is that it has been deliberately designed to promote lifetime exhaustion of the accumulated capital. The same body of federal law that encourages pension saving also tries to ensure that pension wealth will be consumed over the lives of the worker and his spouse. I do *not* mean to say that the federal policy in favor of lifetime consumption of retirement savings cannot be defeated for particular clients using appropriately designed plans; indeed, that is one of the major avenues of tax and estate planning for the carriage trade that has arisen with the pension system. On the

32. See generally Wolk, Discrimination Rules for Qualified Retirement Plans: Good Intentions Confront Economic Reality, 70 Virginia L. Rev. 419 (1984).

33. Private pension coverage is strongly skewed to employees in the higher tax brackets. Whereas in 1983 only 24.3 percent of persons earning under $5,000 per year had pension coverage, 84.9 percent earning more than $50,000 were covered. E. Andrews, The Changing Profile of Pensions in America 52 (1985). For an account of why the antidiscrimination norm of federal tax policy fails to achieve breadth of coverage, see Wolk, *supra* note 32.

other hand, most of the room for maneuver lies in the area of defined contribution plans, whereas most of the pension money (especially the middle class money) is in defined benefit plans. My point is simply that, in the main, the federal policy to promote consumption of pension wealth achieves its goal, and only a negligible fraction of pension wealth finds its way into intergenerational transfer.

The mechanism by which pension wealth is consumed is annuitization. Just as life insurance is insurance against dying too soon, annuitization insures against living too long. Annuitization allows people to consume their capital safely, that is, without fear of running out of capital while still alive. Annuitization requires a large pool of lives, which is achieved by various methods of aggregating the pension savings of many workers. Sometimes the employer runs the pool, sometimes an intermediary such as an insurance company or (for multiemployer plans) a labor union. Annuitization requires assets that can be liquidated predictably as distribution requires. That is a trait characteristic of marketable securities—that is, of the new property in financial assets. Annuitization is wonderfully effective in allowing a person to consume capital without fear of outliving his capital, but the corollary is also manifest: accounts that have been annuitized disappear on the deaths of the annuitants. Not so much as a farthing remains for the heirs.[34]

From this brief tour of the private pension system, I hope it will be clear why I place this topic alongside my other main topic, wealth transfer by means of investment in human capital, as the two central chapters in what I have been calling the twentieth-century revolution in family wealth transmission. Both are developments of enormous magnitude, and both lead away from traditional wealth transfer on death. Propertied parents used to live from their patrimony in farm or firm and then transmit the patrimony at death. Modern parents tend to possess nontransmissible human capital rather more than older forms of property. Using their human capital to create lifetime income streams, modern parents now undertake two cycles of saving and dissaving, one for the children's education, the other for retirement. The investment in the children necessarily

34. Unless the plan offers and the participants elect a mode of annuitization that provides a guaranteed income stream (typically 10 or 20 years); in such cases, successors take the remainder of the stream if the annuitants die within the period.

occurs in the parents' lifetimes. And especially when the retirement saving program is channelled through the enticing format of the qualified pension plan, the pressures for annuitization cause this enormous component of modern family wealth to be largely exhausted upon the parents' deaths. Transfer on death, the fundamental pattern of former times, is, therefore, ceasing to characterize the dominant wealth holding and wealth transmission practices of the broad middle classes.

IV. WEALTH TRANSFER ON DEATH

A. *The Carriage Trade*

The trust-and-estate bar survives, and the main reason is the carriage trade. As I said at the outset of this article, the revolution in family wealth transmission stops short of really substantial accumulations of wealth. The carriage trade remains to be served, and it is hugely important. One study of data for the half century from the early 1920s through the late 1960s focused on the top half of the top one percent of wealth holders. Throughout the period the share of national wealth held within this tiny cohort was consistently above 20 percent.[35] A different study reckons that as of 1983, the top 840,000 households each possessed wealth amounting to $1.4 million or more. According to computations that originated in Democratic Party policy circles and whose accuracy has been questioned, this group of households accounted for 42 percent of the country's net wealth.[36] These calculations presuppose that financial instruments, business interests, and real property are the only important components of wealth. Because this way of measuring wealth excludes the capitalized value of the income streams generated by human capital, and because it excludes the capitalized value of private-pension and Social Security income streams, it materially overstates the disparity between the top wealth holders and the rest of the populace. These calculations also overlook what

35. Smith & Franklin, The Concentration of Personal Wealth: 1922–1969, 64 Amer. Econ Rev. (Proceedings) 162, 163 (1974).

36. Democratic Staff, Joint Economic Committee, U.S. Congress, The Concentration of Wealth in the United States: Trends in the Distribution of Wealth among American Families 23–26 (1986). For skepticism about this computation, see J. Thomas Eubank, A.D. 2001: Estate Planning in the Future, in Twenty-first Annual Philip E. Heckerling Institute on Estate Planning, ch. 20, at 20-4 to 20–11 (J. Gaubatz ed. 1987).

economists call the life-cycle effect: A law student who will have a six-figure income within a decade can be reckoned currently as a pauper. Nevertheless, the underlying point is undeniable. The top sliver of wealth holders is indeed very affluent, and among these people the need for estate planning services will continue unabated.

To be sure, the transformation in the nature of property has also affected great wealth-holders. The family enterprise is less common, the portfolio of financial assets is vastly more prevalent. But the changes in the patterns of wealth transfer that I have been describing for the middle and upper-middle classes are much less important for the very well-to-do. As regards the investment in human capital that preoccupies the middle classes, I have already made the point that because the amount of educational investment that can be made in any one set of children is constrained, the educational expenditures that loom so large for conventionally propertied families constitute for dynastic wealth holders a much smaller drain on family wealth.

Likewise, the qualified pension-plan account is not an acceptable vehicle for great fortunes. Only earned income, not investment income, is eligible for qualified-plan tax deferral. Furthermore, section 415 of the Internal Revenue Code sets ceilings on the amount of saving that anyone is allowed to do within a qualified-plan account. Currently, the ceiling is $30,000 per year in saving for defined contribution plans; for defined benefit plans, the cap applies when the annual benefit reaches $90,000 per year. For people of middle-class and even upper-middle-class means, these ceilings scarcely pinch, but for the really well-to-do, such ceilings represent a significant barrier. The simple truth is that dynastic wealth cannot be stuffed into a pension account.

B. The Middle Classes

Turning to the middle and upper-middle classes, we can identify a variety of factors that explain why the trust-and-estate lawyer survives even where he can no longer thrive. The personal circumstances of some propertied decedents fall outside the prototype that I have described—they are childless, for example, or their employers did not offer much opportunity for pension saving. But even people who fully experience the two cycles of saving and dissaving that I have described will have additional property outside the pension accounts. This wealth is likely to comprise both financial assets and real estate, especially residential real estate (although much of the real estate is likely to be held in probate-avoiding forms of concurrent ownership). As of 1983, residential realty accounted for about 30 percent of the gross wealth of American families. Data from 1975 indicates that over 70 percent of Americans aged between sixty-three and sixty-nine owned their homes; almost 80 percent of the elderly owned their homes free of mortgage.[37] I do not have good data on the nonresidential wealth of the elderly, but I would certainly stipulate that their aggregate holdings are extensive.

Whether the relative affluence of the present generation of American elders is likely to be reproduced in the future is a harder question. Americans who came of age during and shortly after World War II experienced unexampled prosperity. The generation that won the war profited hugely from the fifteen-year Pax Americana that endured roughly from 1952 to 1967. As the war-torn economies of Europe and the Far East rebuilt, America's comparative advantage declined, and our relative affluence has declined apace. Furthermore, the generation that benefited from the one-time windfall of postwar prosperity also received the one-time windfall of the huge increase in Social Security transfer payments. It is worth remembering that as late as 1950, the average monthly Social Security benefit for a retiree was only $29.03. In 1987, that benefit was $491.75. The present generation of elderly voted itself a multi-trillion-dollar treat in the form of transfer payments extracted from succeeding generations.[38] We should not be surprised that some of these people have some wealth left over to transmit at death.

C. *The Nonprobate System*

Quite apart from whether future generations of elderly will be able to accumulate as much wealth as the present generation, it is important to recognize that much of the nonpension wealth that survives for

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37. A. Munnell, The Economics of Private Pensions 27 (1982) (citing Social Security Administration data).

38. See Lawrence Kotlikoff, Deficit Delusion, The Public Interest 53, 62 (Summer 1986), describing Social Security as "a Ponzi scheme," because "the first generation receives benefits without having to finance the retirement of its immediate predecessors.... In contrast, middle-income household heads in the cohort to be born in 1990 are projected over their lifetimes to lose, on net, roughly $60,000 in present value as a consequence of participating in Social Security."

transfer on death in middle- and upper-middle class families is deeply affected by another great trend that has fundamentally diminished the lawyerly role in transfer on death for persons of moderate means. I refer to the explosive growth in the use of nonprobate modes of transfer. Residential real estate is widely held in joint tenancy, under which a death certificate suffices to clear title without probate or court proceedings. The more interesting phenomenon is the rise of the mass will substitutes that employ noncourt transfer systems—life insurance, pension accumulations prior to annuitization, POD accounts, joint accounts, and so forth. The numbers for life insurance alone are staggering: In 1986, American insurers had $6.72 *trillion* of insurance in force, averaging $81,200 per insured family; payments on death in that year amounted to $19.5 billion.[39]

The financial intermediaries who administer the new paper property (especially insurance companies and banks, but also investment companies, brokerage houses, stock transfer agents, and many others) have taken to offering transfer-on-death services because they have a comparative advantage in doing so. "Financial intermediation is, as the term signifies, instrinsically administrative. Administrators intermediate between savers and borrowers, between passive owners and active users of capital. Pooling wealth and servicing the resulting liabilities involves recurrent transactions and communications. Once a bureaucracy appropriate to such tasks is in operation, only a scant adaptation is necessary to extend its functions and procedures to include the transfer of account balances on death." Thus, the main financial intermediaries have become powerful free-market competitors, competing against the probate system in arranging for wealth transfer on death.

The nonprobate system takes on a heightened significance when viewed from the perspective of the themes that I have been developing in this article. Even when middle-class or upper-middle-class people emerge from their two cycles of saving and dissaving in possession of other wealth, and even when they hold that wealth until death, much of it—indeed most of it—now passes to survivors with little or no need for lawyer-administered transfer-on-death services. I do not mean to imply that lay persons are well advised to do their own estate planning through the medium of the nonprobate system.

39. American Council of Life Insurance, 1987 Life Insurance Fact Book Update 4 (1987).

Quite to the contrary, I think that one of the worst consequences of the nonprobate system is that it tempts people into the mistake of thinking that avoiding probate is the equivalent of estate planning. Lay persons rarely understand the range of contingencies that can arise in the wealth transfer process—for example, issues such as lapse; and the nonprobate system often handles those contingencies less well than the probate process.

Nonprobate property is, of course, still subject to the federal transfer taxes, but the drastic 1981 reduction in those taxes has diminished the demand for estate planning services among the middle and upper middle classes.

Apace with the decline in demand for lawyer-assisted planning services is the diminution of demand for lawyer-assisted transfer services even when probate or administration of an estate must occur. The probate reform movement of the 1960s, epitomized in the Uniform Probate Code's provisions for simplified probate and for nonadministration of very small estates,[40] has further reduced the need for court-operated transfer services.[41]

A comprehensive account of the patterns by which inter vivos wealth transfers now displace transfers that in former times occurred on death would also embrace the huge twentieth-century increase in the divorce rate. Dissolution upon divorce has replaced dissolution upon death as the predominant mode of terminating a marriage.[42] The property transfers

40. Uniform Probate Code 3-301 and following, 3-1201 to 3-1204, 8 U.L.A. 245, 412-16 (1982).

41. In a five-state study conducted under the auspices of the American Bar Foundation in the mid-1970s, it was found that "the average percentage of decedents' estates that underwent estate administration ranged from [a low of] twenty percent in California to [a high of] thirty-four percent in Massachusetts . . . ." Stein & Fierstein, The Demography of Probate Administration, 15 U. Baltimore L. Rev. 54, 61 (1985). Earlier data of this sort is conveniently collected in Fletcher, Probate in England, A Blueprint for the Future (book review), 46 Wash. L. Rev. 619, 624–25 n.14 (1971). Most administered estates are small, and most are now processed through the simplified administration schemes. Simplified probate and administration procedures significantly reduce the percentage of estates requiring full-dress administration. Stein & Fierstein, *supra* at 75–77. As the ABF study concluded, "relatively few decedents leave a substantial estate requiring judicial administration." *Id.* at 87.

42. The official comment to the Uniform Marital Property Act reports that, of marriages terminated in 1979, 42.77 percent were terminated by death, compared to 57.23 percent that ended in divorce. Uniform Marital Property Act, prefatory note (1983).

that divorce precipitates, both transfers to spouses and transfers to children, supplant in some measure a wealth transfer process that used to occur through succession.

Increasingly, I think, estate planning services for the middle and upper-middle classes have the quality of contingency planning. The client is motivated largely by concern to make arrangements for his family in the unlikely event that he should die prematurely. He does not expect property actually to pass under the instrument he executes. In this sense, he views his estate plan somewhat like his term life insurance policy. It is catastrophe insurance, worth having even though it is unlikely to be needed.

V. Conclusion

I am more confident in studying the past than in predicting the future, but I am confident in insisting that the underlying forces that have transformed family wealth transmission over the last century will not abate. The modern expectation is that for middle-class wealth, the main intergenerational transfer will occur in mid-life, in the form of educational expenditures. The characteristic wealth of later years, the income streams from the public and private pension systems, do not give rise to heirship. Thus, wealth transfer on death is ever less important to the middle classes. When it does occur, it is ever more likely to be channelled through the nonprobate system.

Thanks to the carriage trade, the trust-and-estate bar will not go the way of the blacksmith, but the precipitous decline of the middle-class market is likely to continue. The days of routine, lawyer-guided wealth-transfer-on-death for the middle classes have largely passed.

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The great American tax haven: why the super-rich love South Dakota

It's known for being the home of Mount Rushmore – and not much else. But thanks to its relish for deregulation, the state is fast becoming the most profitable place for the mega-wealthy to park their billions.

By Oliver Bullough

Late last year, as the Chinese government prepared to enact tough new tax rules, the billionaire Sun Hongbin quietly transferred $4.5bn worth of shares in his Chinese real estate firm to a company on a street corner in Sioux Falls, South Dakota, one of the least populated and least known states in the US. Sioux Falls is a pleasant city of 180,000 people, situated where the Big Sioux River tumbles off a red granite cliff. It has some decent bars downtown, and a charming array of sculptures dotting the streets, but there doesn't seem to be much to attract a Chinese multi-billionaire. It's a town that even few Americans have been to.

The money of the world's mega-wealthy, though, is heading there in ever-larger volumes. In the past decade, hundreds of billions of dollars have poured out of traditional offshore jurisdictions such as Switzerland and Jersey, and into a small number of American states: Delaware, Nevada, Wyoming – and, above all, South Dakota. "To some, South Dakota is a 'fly-over' state," the chief justice of the state's supreme court said in a speech to the legislature in January. "While many people may find a way to 'fly over' South Dakota, somehow their dollars find a way to land here."

Super-rich people choose between jurisdictions in the same way that middle-class people choose between ISAs: they want the best security, the best income and the lowest costs. That is why so many super-rich people are choosing South Dakota, which has created the most potent force-field money can buy – a South Dakotan trust. If an ordinary person puts money in the bank, the government taxes what little interest it earns. Even if that money is protected from taxes by an ISA, you can still lose it through divorce or legal proceedings. A South Dakotan trust changes all that: it protects assets from claims from ex-spouses, disgruntled business partners, creditors, litigious clients and pretty much anyone else. It won't protect you from criminal prosecution, but it does prevent information on your assets from leaking out in a way that might spark interest from the police. And it shields your wealth from the government, since South Dakota has no income tax, no inheritance tax and no capital gains tax.

A decade ago, South Dakotan trust companies held $57.3bn in assets. By the end of 2020, that total will have risen to $355.2bn. Those hundreds of billions of dollars are being regulated by a state with a population smaller than Norfolk, a part-time legislature heavily lobbied by trust lawyers, and an administration committed to welcoming as much of the world's money as it can. US politicians like to boast that their country is the best place in the world to get rich, but South Dakota has become something else: the best place in the world to *stay* rich.

At the heart of South Dakota's business success is a crucial but overlooked fact: globalisation is incomplete. In our modern financial system, money travels where its owners like, but laws are still made at a local level. So money inevitably flows to the places where governments offer the lowest taxes and the highest security. Anyone who can afford the legal fees to profit from this mismatch is able to keep wealth that the rest of us would lose, which helps to explain why – all over the world – the rich have become so much richer and the rest of us have not.

In recent years, countries outside the US have been cracking down on offshore wealth. But according to an official in a traditional tax haven, who has watched as wealth has fled that country's coffers for the US, the protections offered by states such as South Dakota are undermining global attempts to control tax dodging, kleptocracy and money-laundering. "One of the core issues in fighting a guerrilla war is that if the guerrillas have a safe harbour, you can't win," the official told me. "Well, the US is giving financial criminals a safe harbour, and a really effective safe harbour – far more effective than anything they ever had in Jersey or the Bahamas or wherever."

Those of us who cannot vote in South Dakota elections have little hope of changing its laws. But if we don't do something to correct the imbalance between global wealth and local legislation, we risk entrenching today's inequality and creating a new breed of global aristocrat, unaccountable to anyone and getting richer all the time – with grave consequences for the long-term health of liberal democracy.

South Dakota is west of Minnesota, east of Wyoming, and has a population of 880,000 people. Politically, its voters enthusiastically embrace the Republicans' message of self-reliance, low taxes and family values. Donald Trump won more than 60% of the vote there in 2016, and the GOP has held a super-majority in the state's House of Representatives since the 70s, allowing the party to mould South Dakota in its image for two generations.

Outsiders tend to know South Dakota for two things: Mount Rushmore, which is carved with the faces of four US presidents; and Laura Ingalls Wilder, who moved to the state as a girl and wrote the Little House on the Prairie series of children's books. But its biggest impact on the world comes from a lesser-known fact: it was ground zero for the earthquake of financial deregulation that has rocked the world's economy.

The story does not begin with trusts, but with credit cards, and with Governor William "Wild Bill" Janklow, a US marine and son of a Nuremberg prosecutor, who became governor in 1979 and led South Dakota for a total of 16 years. He died almost eight years ago, leaving behind an apparently bottomless store of anecdotes: about how he once brought a rifle to the scene of a hostage crisis; how his car got blown off the road when he was rushing to the scene of a tornado.

In the late 70s, South Dakota's economy was mired in deep depression, and Janklow was prepared to do almost anything to bring in a bit of business. He sensed an opportunity in undercutting the regulations imposed by other states. At the time, national interest rates were set unusually high by the Federal Reserve, meaning that credit card companies were having to pay more to borrow funds than they could earn by lending them out, and were therefore losing money every time someone bought something. Citibank had invested heavily in credit cards, and was therefore at significant risk of going bankrupt.

The bank was searching for a way to escape this bind, and found it in Janklow. "We were in the poorhouse when Citibank called us," the governor recalled in a later interview. "They were in bigger problems than we were. We could make it last. They couldn't make it last. I was slowly bleeding to death; they were gushing to death."

At the bank's suggestion, in 1981, the governor abolished laws that at the time – in South Dakota, as in every other state in the union – set an upper limit to the interest rates lenders could charge. These "anti-usury" rules were a legacy of the New Deal era. They protected consumers from loan sharks, but they also prevented Citibank making a profit from credit cards. So, when Citibank promised Janklow 400 jobs if he abolished them, he had the necessary law passed in a single day. "The economy was, at that time, dead," Janklow remembered. "I was desperately looking for an opportunity for jobs for South Dakotans."

When Citibank based its credit card business in Sioux Falls, it could charge borrowers any interest rate it liked, and credit cards could become profitable. Thanks to Janklow, Citibank and other major companies came to South Dakota to dodge the restrictions imposed by the other 49 states. And so followed the explosion in consumer finance that has transformed the US and the world. Thanks to Janklow, South Dakota has a financial services industry, and the US has a trillion-dollar credit card debt.

Fresh from having freed wealthy corporations from onerous regulations, Janklow looked around for a way to free wealthy individuals too, and thus came to the decision that would eventually turn South Dakota into a Switzerland for the 21st century. He decided to deregulate trusts.

Trusts are ancient and complex financial instruments that are used to own assets, such as real estate or company stock. Unlike a person, a trust is immortal, which was an attractive prospect for English aristocrats of the Middle Ages who wished to make sure their property remained in their families for ever, and would be secure from any confiscation by the crown. This caused a problem, however. More and more property risked being locked up in trusts, subject to the wishes of long-dead people, which no one could alter. So, in the 17th century, judges fought back by creating the "rule against perpetuities", which limited the duration of trusts to around a century, and prevented aristocratic families turning their local areas into mini-kingdoms.

That weakened aristocratic families, opened up the British economy, allowed new businessmen to elbow aside the entrenched powers in a way that did not happen elsewhere in Europe, and helped give the world the industrial revolution. "It's a paradoxical point, but it wasn't a bad thing when the scion of some family from out in the counties came down to London and pissed away his fortune. It was redistribution of wealth," said Eric Kades, a law professor at William & Mary Law School in Virginia, who has studied trusts.

English emigrants took the rule to North America with them, and the dynamic recycling of wealth became even more frenetic in the land of the free. Then Governor Janklow came along. In 1983, he abolished the rule against perpetuities and, from that moment on, property placed in trust in South Dakota would stay there for ever. A rule created by English judges after centuries of consideration was erased by a law of just 19 words. Aristocracy was back in the game.

In allowing trusts to last for ever, South Dakota did something genuinely revolutionary, but sadly almost everyone I contacted – from current governor Kristi Noem to state representatives to members of the South Dakotan Trust Association – refused to talk about it. For an answer to the question of what exactly prompted the state to ditch the rule against perpetuities, I was eventually directed to Bret Afdahl, the director of the state administration's Division of Banking, who wanted the question in writing. A week later, back came a one-word response: "unknown".

Initially, South Dakota's so-called "dynasty trusts" were advertised for their ability to dodge inheritance tax, thus allowing wealthy people to cement their family's long-term control over property in the way English aristocrats had always wanted to. It also gave plenty of employment to lawyers and accountants.

"It's a clean industry, there are no smokestacks, we don't have to mine anything out of the earth or anything, and they're generally good paying jobs," said Tom Simmons, an expert on trust law at the University of South Dakota, when we chatted over coffee in central Sioux Falls. Alongside his academic work, Simmons is a member of South Dakota's trust taskforce, which exists to maintain the competitiveness of the state's trust industry. "Janklow was truly a genius in seeing this would be economic development with a very low cost to the government," he said. (By "the government", he of course means that of South Dakota, not that of the nation, other states or indeed other countries, which all lose out on the taxes that South Dakota helps people avoid.)

As the 1990s progressed, and more money came to Sioux Falls, South Dakota became a victim of its success, however, since other states – such as Alaska and Delaware – abolished the rule against perpetuities, too, thus negating South Dakota's competitive advantage. But, having started the race to the bottom, Janklow was damned if any other state was going to beat him there. So, in 1997, he created the trust taskforce to make sure South Dakota was going as fast as it could. The taskforce's job was to seek out legal innovations created in other jurisdictions, whether offshore or in the US, and make them work in South Dakota.

Thanks to the taskforce, South Dakota now gives its clients tricks to protect their wealth that would have been impossible 30 years ago. In most jurisdictions, trusts have to benefit someone other than the benefactor – your children, say, or your favourite charity – but in South Dakota, clients can create a trust for the benefit of themselves (indeed, Sun Hongbin is a beneficiary of his own trust). Once two years have passed, the trust is immune from any creditor claiming a share of the assets it contains, no matter the nature of their claim. A South Dakotan trust is secret, too. Court documents relating to it are kept private for ever, to prevent knowledge of its existence from leaking out. (It also has the useful side effect of making it all but impossible for journalists to find out who is using South Dakotan trusts, or what legal challenges to them have been filed.)

This barrage of innovations has allowed lawyers to create structures with complex names – the South Dakota Foreign Grantor Trust, the Self-Settled Asset Protection Trust, etc – which have done two simple things: they have kept the state ahead of the competition; and they have made South Dakota's property protections extraordinarily strong. "The smart people want privacy," explained Harvey Bezozi, a Florida financial adviser and tax expert who blogs under the name Your Financial Wizard. "South Dakota offers the best privacy and asset protection laws in the country, and possibly in the world, for the wealthy to protect their assets. They've done a pretty good job in making themselves unique; a real boutique place where the people in the know will eventually gravitate to."

Among those in the know were the lawyers of Leona Helmsley, the legendarily mean hotel heiress, who coined the phrase "only the little people pay taxes". When Helmsley died in 2007, she left $12m in trust for the care of her dog, a maltese called Trouble. Trouble dined on crab cakes and kobe beef, and the trust provided her with $8,000 a year for grooming and $100,000 for security guards, who protected her against kidnappings, as well as against reprisals from the people that she bit. When a New York court – not entirely unreasonably – decided to restrain this expenditure, trustees moved the trust to South Dakota, which had crafted "purpose trusts" with just such a client in mind. Other states impose limits on how a purpose trust can care for a pet, on the principle that perhaps there are better things to do with millions of dollars than groom a dog, but South Dakota takes no chances. The client is always right.

Despite all its legal innovating, South Dakota struggled for decades to compete with offshore financial centres for big international clients – Middle Eastern petro-sheikhs perhaps, or billionaires from emerging markets. The reason was simple: sometimes the owners' claim to their assets was a little questionable, and sometimes their business practices were a little sharp. Why would any of them put their assets in the US, where they might become vulnerable to American law enforcement, when they could instead put them in a tax haven where enforcement was more … negotiable?

That calculation changed in 2010, in the aftermath of the great financial crisis. Many American voters blamed bankers for costing so many people their jobs and homes. When a whistleblower exposed how his Swiss employer, the banking giant UBS, had hidden billions of dollars for its wealthy clients, the conclusion was explosive: banks were not just exploiting poor people, they were helping rich people dodge taxes, too.

Congress responded with the Foreign Account Tax Compliance Act (Fatca), forcing foreign financial institutions to tell the US government about any American-owned assets on their books. Department of Justice investigations were savage: UBS paid a $780m fine, and its rival Credit Suisse paid $2.6bn, while Wegelin, Switzerland's oldest bank, collapsed altogether under the strain. The amount of US-owned money in the country plunged, with Credit Suisse losing 85% of its American customers.

The rest of the world, inspired by this example, created a global agreement called the Common Reporting Standard (CRS). Under CRS, countries agreed to exchange information on the assets of each other's citizens kept in each other's banks. The tax-evading appeal of places like Jersey, the Bahamas and Liechtenstein evaporated almost immediately, since you could no longer hide your wealth there.

How was a rich person to protect his wealth from the government in this scary new transparent world? Fortunately, there was a loophole. CRS had been created by lots of countries together, and they all committed to telling each other their financial secrets. But the US was not part of CRS, and its own system – Fatca – only gathers information from foreign countries; it does not send information back to them. This loophole was unintentional, but vast: keep your money in Switzerland, and the world knows about it; put it in the US and, if you were clever about it, no one need ever find out. The US was on its way to becoming a truly world-class tax haven.

The Tax Justice Network (TJN) still ranks Switzerland as the most pernicious tax haven in the world in its Financial Secrecy Index, but the US is now in second place and climbing fast, having overtaken the Cayman Islands, Hong Kong and Luxembourg since Fatca was introduced. "While the United States has pioneered powerful ways to defend itself against foreign tax havens, it has not seriously addressed its own role in attracting illicit financial flows and supporting tax evasion," said the TJN in the report accompanying the 2018 index. In just three years, the amount of money held via secretive structures in the US had increased by 14%, the TJN said. That is the money pouring into Sioux Falls, and into the South Dakota Trust Company.

"The easy takeaway is that people are trying to hide. But wanting to be private, to be confidential, there's nothing illegal about that," said Matthew Tobin, the managing director of the South Dakota Trust Company (SDTC), where Sun Hongbin parked his $4.5bn fortune. We were sitting in SDTC's conference room, which was decorated with a large map of Switzerland, as if it were a hunting trophy.

Tobin added that many foreign clients had wealth in another jurisdiction, and worried that information about it could be reported to their home country, thanks to CRS. "That could put them at risk. They could be at risk of losing their wealth, it could be taken from them. There's kidnapping, ransom, hostages. There is risk in a lot of parts of the world," he explained. "People are saying: 'OK, if the laws are the same, but I can have the stability of the US economy, the US government, and maintain my privacy, I might as well go to the US.'" According to the figures on its website, SDTC now manages trusts holding $65bn and acts as an agent for trusts containing a further $82bn, all of them tax-free, all of them therefore growing more quickly than assets held elsewhere.

When I spoke to the official from one of the traditional tax havens, who asked not to be identified, for fear of wrecking what was left of the jurisdiction's financial services industry, he was furious about what the US was doing. "One of the bitter aspects of this, and it's something we haven't said in public, is the sheer racism of the global anti-money laundering management effort," he said. "You will notice that the states that are benefiting from this in America are the whitest states in the country. They've ended up beating the shit out of a load of black and Hispanic places, and stuffing all the money in South Dakota. How does that help?"

I put those comments to a South Dakotan trust lawyer who agreed to speak to me as long as I didn't identify them. The lawyer was sympathetic to the offshore official's argument, but said this is how the world is now, and everyone is just going to have to get used to it. It is, after all, not just South Dakota and its trust companies that are sucking in the world's money. Banks in Florida and Texas are welcoming cash from Venezuela and Mexico, realtors in Los Angeles are selling property to Chinese potentates, and New York lawyers are arranging these transactions for anyone that wants them to. Perhaps under previous administrations, there might have been some appetite for aligning the US with global norms, but under Trump, it's never going to happen.

"You can look at South Dakota and its trust industry, but if you really want to look at CRS, look at the amount of foreign money that is flowing into US banks, not just into trusts," the lawyer said. "The US has decided at very high levels that it is benefiting significantly from not being a member of CRS. That issue is much larger than trusts, and I don't see that changing, I really don't."

We have no idea yet what this means in the long term, because the revolution in trust law that began in South Dakota and spread throughout the US is only a generation old. But the implications are ominous.

Here is an example from one academic paper on South Dakotan trusts: after 200 years, $1m placed in trust and growing tax-free at an annual rate of 6% will have become $136bn. After 300 years, it will have grown to $50.4tn. That is more than twice the current size of the US economy, and this trust will last for ever, assuming that society doesn't collapse altogether under the weight of this ever-swelling leach.

If the richest members of society are able to pass on their wealth tax-free to their heirs, in perpetuity, then they will keep getting richer than those of us who can't. In fact, the tax rate for everyone else will probably have to rise, to make up for the shortfall caused by the wealthiest members of societies opting out, which will just make the problem worse. Eric Kades, the law professor at William & Mary Law School, thinks that South Dakota's decision to abolish the rule against perpetuities for the short term benefit of its economy will prove to have been a long-term catastrophe. "In 50 or 100 years, it will turn out to have been an absolute disaster," said Kades. "Now we're going to have a bunch of wealthy families, and no one will be able to piss away that wealth, it will stay in the family for ever. This just locks in advantage."

So far, most of the discussion of this development in wealth management has been confined to specialist publications, where academic authors have found themselves making arguments you do not usually find in discussions of legal constructs as abstruse as trusts. South Dakota, they argue, has struck at the very foundation of liberal democracy. "It does seem unfair for some people to have access to 'property plus', usable wealth with extra protection built in beyond that which regular property owners have," noted the Harvard Law Review back in 2003, in an understated summation of the academic consensus that South Dakota has unleashed something disastrous.

And if some people have access to privileged property, where does that leave the equality before the law that is central to how society is supposed to function? Another academic, writing in the trade publication Tax Notes two decades ago, put that unfairness in context: “Perpetual trusts can (and will) facilitate enormous wealth and power for dynastic families. In the process, we leave to future generations some serious issues about the nature of our country’s democracy.”

With Washington unconcerned by what is happening, and the rest of the world incapable of doing anything about it, is there any prospect of anyone in South Dakota moving to repair the damage? The short answer is that it is too late. Two-dozen other states now have perpetual trusts too, so the money would just move elsewhere if South Dakota tried to tighten its rules. The longer answer is that South Dakotan politics appears to have been so comprehensively captured by the trust industry that there is no prospect of anything happening anyway.

The state legislature is elected every even-numbered year, and meets for two months each spring. It last updated the law governing trusts in 2018, and brought in Terry Prendergast, a trust lawyer, to explain the significance of the changes. “People should be allowed to do with their property what they desire to do,” Prendergast explained. “Our entire regulatory scheme reflects that positive attitude and attracts people from around the world to look at South Dakota as a shining example of what trust law can become.”

There were a few questions from the representatives, but they were quickly shut down by Mike Stevens, a Republican lawyer, and chairman of the state’s judiciary committee. “No more questions. I didn’t understand perpetuities in law school, and I don’t want to understand it now,” he said, laughing.

Susan Wismer, one of just 10 Democrats among the House’s 70 members, attempted to prolong the discussion by raising concerns about how South Dakota was facilitating tax avoidance, driving inequality and damaging democracy. Her view was dismissed as “completely jaded and biased” by a trust lawyer sitting for the Republicans. It was a brief exchange, but it went to the heart of how tax havens work. There is no political traction in South Dakota for efforts to change its approach, since the state does so well out of it. The victims of its policies, who are all in places like California, New York, China or Russia, where the tax take is evaporating, have no vote.

Wismer is the only person I met in South Dakota who seemed to understand this. “Ever since I’ve been in the legislature, the trust taskforce has come to us with an updating bill, every year or every other year, and we just let it pass because none of us know what it is. They’re monster bills. As Democrats, we’re such a small caucus, we’re the ones who ought to be the natural opponents of this, but we don’t have the technical expertise and don’t really even understand what we’re doing,” she confessed, while we ate pancakes and drank coffee in a truck stop outside Sioux Falls. “We don’t have a clue what the consequences are to just regular people from what we’re doing.”

That means legislators are nodding through bills that they do not understand, at the behest of an industry that is sucking in ever-greater volumes of money from all over the world. If this was happening on a Caribbean island, or a European micro-principality, it would not be surprising, but this is the US. Aren't ordinary South Dakotans concerned about what their state is enabling?

"The voters don't have a clue what this means. They've never seen a feudal society, they don't have a clue what they're enabling," Wismer said. "I don't think there are 100 people in this state who understand the ramifications of what we've done."

LEGAL SPECTATOR & MORE

Jacob A. Stein

CLIENTS

You cannot practice law without them. You cannot establish independence in a law firm these wonderful days without a group of clients who will follow you from firm to firm.

There are two main categories of clients: the client who pays a reasonable bill when rendered and the client who does not. Those who pay and accompany their payment with a letter of thanks are the rare species.

The dominant species is the client who turns belligerent when the time comes to pay. He is all for litigation, no matter the cost, until the computer clicks out the bill. Then all that the lawyer was encouraged to do to get at the adversary is called into question. Why so many depositions? Why so many motions? The terms of engagement now change. The lawyer is the adversary.

The ups and downs of the real estate market brought into existence another client type, the underfunded commercial litigator. He wants to litigate his deals for whatever advantages litigation produces. He wants to be in the game, so to speak. He sees the big players litigating each deal in order to get a better deal. It is he who thought up the concept of lender liability. No lawyer, on his own, would have the imagination to create a cause of action against a lender because the lender has the audacity to want to be paid as promised.

The underfunded commercial litigator puts up just enough money to pay the retainer, the entrance fee. His lawyer files the original pleadings—the complaint or the answer and obligatory counterclaim. In a few discovery waves the retainer is used up. By this time the lawyer and the client are litigation friends. They dine together and the client puts it on his credit card. They may take vacations together. The lawyer is in the process of being manipulated just the way the client manipulated those involved in the real estate deal that is the subject of the pending litigation.

What makes the arrangement particularly onerous for the lawyer is the client's rejection of the settlement offer that would provide a little money for the client and would pay the lawyer's bills. The client's strategy is to push the issue to the point where the lawyer begs the client to settle. The client then says, "But why should I settle? You get paid but what is in it for me? Reduce your bill and we can do some business." The trap is sprung.

I have often wondered why it is that lawyers take on clients known within the profession to be slow-pay or no-pay. Perhaps the lawyer who signs on believes he can outfox the client. He is wrong. The client does not have to play by any rules. The lawyer does. The lawyer loses. Well, maybe not always. There is a story concerning Max Steuer, a leading New York trial lawyer in the 1920's and 1930's. He was involved in an arbitration hearing. He represented a client interested in overzealous representation and underpaid legal services. Steuer said not a word at the hearing until a white envelope passed from the client to Steuer's co-counsel, who made a count of the cash. When co-counsel nodded, Steuer announced he was ready.

The client I find interesting is the one who interviews lawyers before committing. He says his case is a sure thing. There are five lawyers bidding for the case. One letter and there will be a huge settlement. Experience has taught me to tell such a client that I do not accept sure things. I have never had a sure thing. I would not know how to deal with a sure thing. The client should consult a sure-thing specialist.

And what of the client who quivers with suspicion concerning everything and everybody? I enjoy spending time with such people, not because I wish to represent them but to study the symptoms of an incurable disorder. Such a person is hesitant to tell me the facts because I might have as a client the person he wishes to sue. He is reluctant to show me the documents for fear I may misplace them. My pleasure is in taking all the letters with the envelopes attached. I tear off the envelopes and toss them into the trash as I pronounce that in over forty years of practice I have never seen a case where the envelope was of any evidentiary importance. I have had the potential client run over to the trash basket, retrieve the envelopes, and flee the office.

The wish to litigate, for some people, can be an obsession. Piero Calamandrei, in his book *Eulogy of Judges*, describes such a person.

> I know a venerable litigant, now more than ninety years old, who after the age of sixty brought a suit over a disputed inheritance. His adversaries, who were then

young, thought the best tactics were to wear the old man out by dilatory methods in order to hasten his death, which they expected in the near future. Thus began an epic duel between Civil procedure and longevity. As the years have passed generations of lawyers have defended the parties, and one by one the judges who handed down the early decisions have gone to their last rest. The old gentleman, instead of aging, seems to take on new life from every procedural objection which further postpones the final decision.

I have met and represented the type. At heart he is a born gambler. Lawsuits and the lottery are his source of stimulation. Gambler that he is, he would rather lose a lawsuit than not to be in litigation at all. And there is always the appeal.

Jacob Stein took part in the Bar Library Lecture Series on January 21, 2009 with a presentation on "Perjury, False Statements & Obstruction of Justice." Generous with his time, Mr. Stein was generous in other ways as well as indicated by the language in the preface to the third volume of *Legal Spectator* from which the following was taken. Mr. Stein wrote "This book is not copyrighted. Its contents may be reproduced without the express permission of, but with acknowledgement to, the author. Take what you want and as much as you want." The works featured in the *Legal Spectator*, originally appeared in the *Washington Lawyer*, the *American Scholar*, the *Times Literary Supplement*, the *Wilson Quarterly*, and the ABA Litigation Section's publication