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Mrs. Colehill Thanks God For Private Social Security

by Stephen Glass

Opponents of plans to privatize the Social Security system often exploit the fear of the unknown. Testifying before the House Ways and Means Committee in October 1994, for instance, union official Gerald Shea criticized such privatization plans as too risky. Over and over again, the AFL-CIO said there is no evidence that privatization is better, no evidence that workers will save up more money, no evidence that workers will be protected if they become disabled, and no evidence that they could carry their savings from job to job.

Conjuring up images of senior citizens standing in line at soup kitchens, he said that passing privatization reform would eventually force a future Congress to reintroduce Social Security. "No private insurance product," he said, "can offer such protection."

Three weeks before Shea's testimony, in an equally passionate speech over the grave of her husband, Wendy Colehill offered just such evidence. A sanitation worker in Galveston, Texas, for 12 years, Bill Colehill had died in a car accident while driving Wendy and their three-year-old son home from the beach. He was 38. "I am normally a quiet person, but not at that cemetery I couldn't be," Wendy says. "I did what Bill would have wanted me to do. I thanked God that some wise men privatized Social Security here. If it wasn't for them, if I had regular Social Security, I'd be broke when he died — eating cat food or something." Within days of Bill's death, Wendy Colehill had received a death-benefit check for $126,000. With that money, she paid both for her husband's funeral and, since she could not raise Bill Jr. on a cashier's wages from Burger King, for her tuition at paralegal school. If Wendy Colehill had instead been relying on Social Security benefits, she would have received a check for a mere $255.

When Social Security was established in 1935, a loophole allowed states and municipalities to exempt their public employees from the federal retirement program. In a handful of states, governors and unions set up smaller versions of Social Security for teachers. They were virtually identical to the federal program. But in 1981, three counties in eastern Texas quietly withdrew from the Social Security system and set up their own privatized retirement program. Fearing a severe drop in Social Security tax revenues if others followed, Congress closed the loophole two years later. But the Texas experiment shows that Americans have nothing to fear from privatization.

The Texas program makes more money. It offers greater benefits to the disabled. It follows the worker from job to job. And upon the death of the beneficiary, it functions as a generous lifetime insurance policy, paying the survivors a minimum of $50,000. "For years, critics have been able to argue with computer projections and models against privatization, but this is real life," explains Merrill Matthews Jr., an analyst at the National Center for Policy Analysis in Dallas. "And real life shows us it works even better than anyone expected."

In 1979, Bill Decker was serving an uneventful term as Galveston's county attorney. As the county official responsible for personnel administration, however, he started to become concerned about all the newspaper reports of Social Security's looming insolvency. So he asked a financial analyst to design a program that would protect the county's workers. Don Kebodeaux, the president of Houston's First Financial Capital Corp., proposed privatization.

Under Kebodeaux's plan, the 5,000 public employees of Galveston, Brazoria, and Matagorda counties are still taxed 6.13 percent of their pay, just like employees everywhere, and the county kicks in an equal amount. But the money doesn't go to Washington. Instead the fund works like a private annuity. Every year, the counties ask large insurance companies to bid against each other for the right to manage their retirement funds for one year. Each insurance company offers the counties a guaranteed rate of return on their investments, and the counties choose the highest bidder.

The results have been far superior to Social Security. In some years, the guaranteed annual rate of return has been as high as 12 percent. Since 1981, it has averaged 6.5 percent. By contrast, Social Security's mean annual return on investment is 2.2 percent for a typical worker born in 1950. Burt Jamus, a Galveston County employee, voted against privatization, but now says it was "a blessing from God." The 40-year-old middle manager says that, under current projections, he will receive $5,474 a month after he retires, compared with $1,042 under Social Security.

What happens if the stock market falls? The insurance company assumes all the downside risk. Although the guaranteed rate of return deprives county employees of some of the fruits of bull markets, it also protects them from losing their retirement funds when markets drop.

County employees are vested immediately. They also own their retirement account, and can take it with them if they switch jobs. Employees are allowed to increase their contribution, which is all tax-deferred, to 20 percent of their income. When they retire, they can choose to receive a monthly check for the interest on their account (leaving the principal untouched, perhaps to be passed on to heirs), or receive all or part of the principal in a taxable, lump-sum payment (and reaping monthly interest on any principal they leave in the account). By contrast, Social Security benefits are paid by taxing current workers; since it isn't based on investments, beneficiaries never accrue any principal.

Among the features of the private system that county employees particularly love is its life insurance and disability benefits. Before landing an annual contract, a winning insurance company must agree to fund a richer version of Social Security's life insurance and disability benefits. While Social Security pays a one-time death benefit of $255, the private plan pays triple the worker's salary up to $150,000, but not less than $50,000.

Likewise, the private plan's disability insurance pays the worker 60 percent of his salary until recovery or retirement. Workers need not fear insurance companies will put up too many regulatory hurdles, because the private plan requires little more than a doctor's approval. "Our disability plan is designed to be easy," Kebodeaux says. "Under this program you will always get equal or better benefits than under Social Security. That's just not up for debate."

Most current proposals to privatize Social Security would allow direct investment of payroll contributions in the stock market. The investments would be managed by a government board or by the workers themselves. Hence critics say that privatization carries an unacceptable risk in pursuit of higher returns. The Texas model, however, increases returns over the current system substantially without tremendous risk. Since insurance companies have to guarantee a fixed rate of return in advance, the workers' principal is not subject to the winds of the market.

Despite improved benefits and investment returns, however, the private plan was actively opposed by top brass at the local chapter of the American Federation of State, County, and Municipal Employees (AFSCME). At debates throughout the counties, union officials predicted all the money would be squandered in bad investments. Unions urged their members to change jobs if the private plan passed so they wouldn't lose their retirement.

After a series of debates on the plan, the union's rank-and-file voted 78 percent to 22 percent in favor of privatization. "There seemed no logic to the union's leadership stance," one union member says. "It's clearly better for us. This is precisely what they should be advocating we get. They should like us getting more money. It seems basic."

Not so, according to Faye Cole, the executive director of the AFSCME local that represented the employees. Cole says that despite the system's guaranteed returns, one must be wary of the private sector. She says she will oppose any expansion of privatization because it's too risky. "Just because they have always gotten more money doesn't mean they're better off," Cole says. "Don't buy into that logic."

Maybe so, but union loyalists chuckle when they recall the debates over privatization back in 1979. This past January, *Policy Review* interviewed Meredith Kansan, a retired county worker in clerical jobs for more than 31 years. "I remember crying in my living room the day they voted to change to private," she said, pausing to laugh. "Can you believe that? I believed all that hooka that my retirement money was going out the window."

Twelve years later, Kansan retired. Although she worked for more than twice as long under the Social Security system as under the private plan, her private benefit check was twice as large. Kansan moved to Arizona and used the extra money to open a yarn shop. "I love to knit and that's my dream," she said. "I had just given up on the idea of opening the store. Privatization was no nightmare — it was a pure miracle."

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