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Galveston County: A Model for Social Security Reform

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The current debate over Social Security reform is reminiscent of the discussions that occurred in Galveston County, Texas, in 1980, when county workers were offered a retirement alternative to Social Security: At the time they reacted with keen interest and some knee-jerk fear of the unknown. But after 24 years, folks here can say unequivocally that when Galveston County pulled out of the Social Security system in 1981, we were on the road to providing our workers with a better deal than Franklin Roosevelt's New Deal.

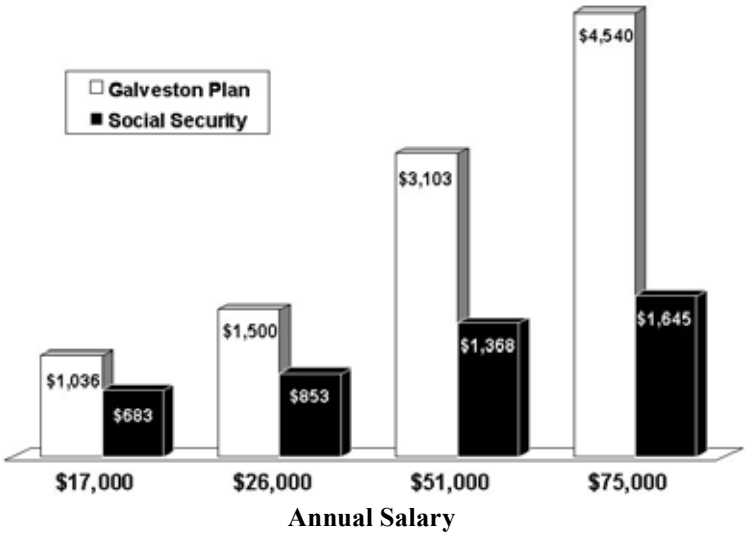
The Problem with Social Security. Social Security is a pay-as-you-go system under which taxes collected from today's workers are used to pay today's retirees. That was sustainable in the past; for example, in 1950 there were 16 workers providing benefits for each retiree. However, today the ratio has dropped to 3 workers for each retiree, and by the year 2030 the ratio will be 2 to 1.

America's demographic changes and the program's expansion have driven the initial Social Security tax rate from 2 percent (1 percent each from employer and employee) to 12.4 percent today, and threaten to drive it even higher. This unsustainable trend is why policy makers are looking for ways to reform the system.

One of the most prominent proposed reforms would allow younger workers to divert some of the payroll taxes they already pay to create personal retirement accounts. The burden on future taxpayers would decline as retirees draw retirement benefits from their personal accounts, reducing the demand for taxpayer-funded benefits. Current and near-retirees would be unaffected and would continue to receive currently scheduled benefits. But how should the new accounts be structured? Some point to Chile, Britain, Australia or one of almost 30 countries that have incorporated personal investments into their public pension programs. But there are examples much closer to home.

The initial Social Security Act permitted municipal governments to opt out of the system — a loophole that Congress closed in 1983. In 1981, employees of Galveston County, Texas, chose by a vote of 78 percent to 22 percent to leave Social Security for a private alternative. Brazoria and Matagorda counties soon followed, swelling the private plan to more than 5,000 participants today. In the private plan, contributions are similar to those for Social Security but returns are quite different.

Retirement Benefits: Galveston Plan vs. Social Security



Source: Author's calculations and the Social Security Administration.

The Galveston Plan. In 1979, many county workers were concerned about the soundness of Social Security, as many people are today. We could either stay with it — and its inevitable tax increases and higher retirement ages — or find a better way. We sought an "alternative plan" that provided the same or better benefits, required no tax increases and was risk-free. Furthermore, we wanted the benefits to be like a savings account that could be passed on to family members upon death.

Our plan, put together by financial experts, was a "banking model" rather than an "investment model." To eliminate the risks of the up-and-down stock market, workers' contributions were put into conservative fixed-rate guaranteed annuities, rather than fluctuating stocks, bonds or mutual funds. Our results have been impressive: We've averaged an annual rate of return of about 6.5 percent over 24 years. And we've provided substantially better benefits in all three Social Security categories: retirement, survivorship and disability.

Galveston officials held meetings that included debates with Social Security officials and put it to a vote:

Galveston County employees passed it by a 3-to-1 margin in 1981 — just in time.

The Galveston Plan was implemented just before the U.S. Congress passed a reform bill in 1983 that closed the door for local governments to opt out of Social Security.

To be sure, our plan wasn't perfect, and we have made some adjustments. For instance, a few of our retired county workers are critical of the plan today because they say they are making less money than they would have on Social Security. This is because our plan allowed workers to make "hardship" withdrawals from the retirement plan during their working years. Some workers withdrew funds for current financial problems and consequently robbed their own future benefits. We closed that option in January 2005.

Galveston vs. Social Security. Upon retirement after 30 years, and assuming a 5 percent rate of return — more conservative than Galveston workers have earned — all workers would do better for the same contribution as Social Security:

- Workers making $17,000 a year are expected to receive about 50 percent more per month on our alternative plan than on Social Security — $1,036 instead of $683. [See the Figure.]
- Workers making $26,000 a year will make almost double Social Security's return — $1,500 instead of $853.
- Workers making $51,000 a year will get $3,103 instead of $1,368.
- Workers making $75,000 or more will nearly triple Social Security — $4,540 instead of $1,645.
- Galveston County's survivorship benefits pay four times a worker's annual salary — a minimum of $75,000 to a maximum $215,000 — versus Social Security, which forces widows to wait until age 60 to qualify for benefits, or provides 75 percent of a worker's salary for school-age children.

In Galveston, if the worker dies before retirement, the survivors receive not only the full survivorship but get generous accidental death benefits, too. Galveston County's disability benefit also pays more: 60 percent of an individual's salary, better than Social Security's.

Two government studies of the Galveston Plan — by the Government Accountability Office and the Social Security Administration — claim that low-wage workers do better under Social Security. However, these studies assumed a low 4 percent return, which is the minimum rate of return on annuities guaranteed by the insurance companies. The actual returns have been substantially higher.

Guidance for Today's Reformers. Congress could consider making participation in any privatization plan voluntary at first. We made our plan voluntary in the beginning and 70 percent joined. It later became mandatory, and now there is full participation. Also, if some workers remain uncertain about investing a portion of their contributions, the plan could include a guarantee that low-income earners receive the same funds they would get with total participation in Social Security.

Our experience has shown that even though low-income workers would do better, a guarantee would ease their worries. Moderate- and higher-income workers would do much better, as ours do, because they have invested more in the plan and are not prejudicially punished or "topped out" on retirement benefits, as they are in Social Security.

In today's debate about whether to partially privatize Social Security, the Galveston County plan is sometimes demagogued. But our experience should be judged factually and fairly, not emotionally, politically or on the basis of hearsay. We sought a secure, risk-free alternative to the Social Security system, and it has worked very well for nearly a quarter-century. Our retirees have prospered, and our working people have had the security of generous disability and accidental death benefits.

Most important, we didn't force our children and grandchildren to be unduly taxed and burdened for our retirement while these fine young people are struggling to raise and provide for their own families.

What has been good for Galveston County may, indeed, be good for this country.

Judge Ray Holbrook was Galveston County judge from 1967 to 1995, and oversaw the creation and administration of the Galveston County alternative plan. Alcestis "Cooky" Oberg is on USA Today*'s board of contributors.*