

**BRIEF ANALYSIS**

No. 296

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## Would a Private Social Security System Be Good for the Disabled?

Social Security is not just a retirement system; it is social insurance that also provides disability income for individuals who are injured and cannot work, as well as a death benefit and survivors benefits for widows and widowers age 60 or older and children under age 18.

Any plan to substitute a system of private retirement accounts for the current Social Security program needs to take these ancillary benefits into consideration. Fortunately, three Texas counties changed to a private system in 1981 and 1982, and their program could serve as a model for federal Social Security reform.

**How Big Is the Problem of Disabled Workers?** Two Social Security programs currently provide income assistance for the disabled. Disability Insurance (DI), established in 1956, provides income to 4.7 million disabled workers who worked long enough to qualify for Social Security benefits.

Supplemental Security Income (SSI), established in 1974, provides cash assistance to 3.6 million working-age disabled people. SSI is a means-tested program that covers disabled people who have never qualified for Social Security. Thus SSI functions primarily as welfare rather than as disability insurance.

**What Three Texas Counties Did.** The original Social Security Act permitted municipal governments to opt out of the system — a loophole Congress closed in 1983. In 1981 employees of Galveston County, Texas, voted 78 percent to 22 percent to leave Social Security for a private alternative. Brazoria and Matagorda counties followed in 1982, and today the private plan has about 4,500 participants. In the private plan, contribu-

tions are similar to those for Social Security but returns are quite different. For example, in Galveston:

- Each employee is required to contribute 6.13 percent of income, while the county contributes 7.65 percent — for a total contribution of 13.78 percent.
- Of that 13.78 percent, 9.8 percentage points goes to the employee's individual retirement account, which pays a fixed interest rate, compounded daily (the average over the years has been about 6.5 percent).
- Of the remainder, 1.18 percentage points pays for disability insurance, with the rest going to a "self-completion" premium — which requires the insurer to create a second retirement account for a disabled

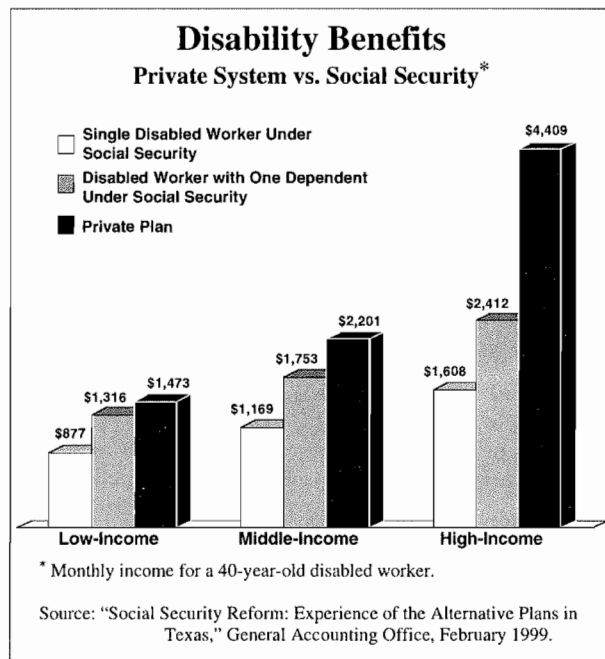
worker and continue to make deposits into that account as long as the worker remains on disability — and a life insurance premium to cover the employee in case of death.

- Workers continue to pay their Medicare payroll taxes and to receive Medicare benefits upon retirement.

**Disability Benefits under the Private Plan.** Both DI and the private disability program have advantages and disadvantages. Under both programs, workers must wait six months before they can apply for disability benefits. One advantage of DI is that it is indexed to the rate of inflation so that payments grow over

time, while the private plan's reimbursement, though usually higher, is not indexed. In addition, those who receive cash benefits under DI for 24 months qualify for Medicare coverage to pay for health care expenses. Disabled workers in the private plan can continue in their employers' plan for 18 months under federal law, then purchase an individual policy, but they are responsible for the premiums.

However, the private plan provides a number of benefits not included under Social Security's Disability Insurance program. For example:



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- Disabled workers get 60 percent of their pay, up to a maximum of \$5,000 per month, which is generally more than the benefit under DI.
- The private insurer continues paying life insurance premiums for a death benefit that is three times the employee's annual salary, with a minimum of \$50,000 and a maximum of \$150,000. Social Security pays only a \$255 death benefit plus survivors benefits to certain individuals.
- Disabled workers are eligible to draw on money from their private retirement account if needed.
- Finally, the self-completion premium ensures that the disabled worker's retirement savings continue to accumulate in a second account from which funds cannot be withdrawn until age 65.

**Which Is Better, Social Security or the Private Plan?** Disabled workers in the private plan do significantly better financially than those receiving Disability Insurance from Social Security. For example:

- A 60-year-old low-income worker is likely to receive more than twice as much in monthly disability income from the private plan as from Social Security (\$2,106 vs. \$1,013), while a high-income worker is likely to receive 3.4 times as much (\$6,304 vs. \$1,869).
- A single, 40-year-old middle-income worker receives \$1,169 monthly under Social Security, and \$1,753 if there is a dependent spouse, but that worker gets \$2,201 a month under the private plan, regardless of marital status. [See the figure.]
- A low-income, 21-year-old disabled worker under the private plan gets \$829 a month, compared to \$2,479 for a high-income worker, but a 21-year-old disabled worker under Social Security gets nothing.

Thus a 40-year-old disabled Galveston County employee who had been making \$45,000 a year would receive \$27,000 in disability income, compared to about \$14,000 for a single disabled worker and \$21,000 for a disabled worker and a dependent under DI. The disabled Galveston employee also would have his premiums paid on a life insurance policy worth \$135,000. In addition, \$4,400 would be deposited annually (\$45,000 x 9.8 percent normal retirement deposit) in a second retirement account until he returns to work. The disability income plus the retirement deposit means that a Galveston employee receives about 30 percent more than a disabled worker with a dependent under DI, and more than twice

what a single worker receives (\$31,400 vs. \$21,000 and \$14,000, respectively).

Moreover, while DI cost the federal government \$39.9 billion in cash benefits in 1998, *those working under the private plan cost the government nothing.*

**Problems with the Disability Insurance Program.** DI has provided millions of working-age Americans with minimal income, but it has encountered numerous problems. The program is hard to get into, and people are often reluctant to leave it. According to March 1999 testimony by Cynthia M. Fagnoni, Director of Income Security Issues for the Social Security Administration:

"Because a disability determination results in either a full award of benefits or a denial of benefits, applicants have a strong incentive to overstate their disabilities to establish their inability to work and thus qualify for benefits. Conversely, applicants have a disincentive to demonstrate any capacity to work because doing so may disqualify them for benefits. Furthermore, many believe that the documentation involved in establishing one's disability can create a 'disability mind-set,' which weakens motivation to work. Compounding this negative process, the length of time required to determine eligibility can erode the skills, abilities and habits necessary to work."

**How the Private Plan Addresses Work Disincentives.** Under the private plan, the disability insurer monitors disabled workers' medical progress. When the medical reports demonstrate that the disabled person can return to work, the insurer expects him or her to do so. Since the federal government does not have the same financial incentive as the private insurer, government monitoring is almost nonexistent.

**Making the Private Plan Better.** The federal government could permit disabled workers on the private plan to buy into Medicare. They pay Medicare premiums, and they should get Medicare disability coverage. In addition, the private sector could index benefits, especially for those unable to work for extended periods.

**Conclusion.** Nearly 20 years of experience in three Texas counties prove that a private disability plan works. If Congress reforms Social Security, it should consider remodeling DI to resemble the private plan — which provides better benefits for the disabled, is easier to qualify for and costs the federal government nothing.

*This Brief Analysis was prepared by NCPA Vice President of Domestic Policy Merrill Matthews Jr.*