**SOCIAL SECURITY IS A PONZI SCHEME**

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Rick Perry made news a few weeks ago by calling social security a Ponzi scheme. This proposition has been under the microscope ever since and has generated a seemingly unending amount of heat. Actually, we should call it entropy because most of the heat is dysfunctional.

What we find disturbing is that most folks are allowing their political beliefs to shape the debate regardless of economic truth. If they employed logic instead, they would review the definition of a Ponzi scheme and investigate whether the social security system meets those attributes. If one would do that, he or she would conclude that Rick Perry is mostly correct about his observations, though the present-day social security system does have a few features that distinguish it from traditional financial Ponzi schemes.

So what is a Ponzi scheme? A Ponzi scheme, named after the fraudster Charles Ponzi, is a method to steal funds from investors. While variations exist, it generally works like this. The first class of investors is persuaded to buy into an investment plan, attracted usually by above market yields or some guaranteed minimum rate of return. But, this “return” is not a return *on* capital, nor is it generated from profits earned by the organization. Instead, these investors are paid using funds raised by the fraudster from new investors. This new capital is raised from a second class of investors, who also are enticed by high or guaranteed minimum rates of return. Thus, the return to the first class of investors is a return *of* capital since it is supplied by the second set of investors. The second set of investors is paid their returns by swaying yet a third group of investors to hand over their money, and the process continues. All the time, the schemer makes money by taking a “commission” on the funds generated, a management fee if you will.

The essential feature of the Ponzi scheme, indeed the defining feature, is the payoff of a promised return to an investor class using funds acquired from a later class of investors. ***This is exactly how social security works.***  Retirees are paid benefits not from the actual funds that they put into the system (which were “misappropriated” for other government purposes), but rather from funds supplied by current workers. In turn, these current workers presumably will receive social security benefits when social security taxes are contributed by later workers. This works only as long as the government can con future workers (“new investors”) into funding the social security promise. So, yes, social security *is* a Ponzi scheme.

One difference between a financial Ponzi scheme and social security is that the latter does not have a schemer who profits by way of commissions or management fees. The analogy is not completely without merit, since these politicians breached their fiduciary responsibility by accessing these social security contributions to fund other projects that no doubt benefited their constituencies and their reelection chances. Instead of being identified as the fraudsters that they are, they are deemed heroes for continuing social security’s promise despite dramatic demographic, economic, and social changes. For this they get re-elected and enjoy the perquisites of continued employment in Washington. So, in a sense, social security does have a collective group of schemers, who ignore the economic reality of an unsustainable pledge. While diffuse, these politicians nevertheless gain at our expense.

Ponzi schemes generally unravel in one of three ways. First, the schemer vanishes, perhaps because he has stolen enough money or he thinks the scheme is close to collapsing. A second way for the scam to end is for existing investors to get cautious or distrustful and opt out. The schemer then has to disburse not only promised returns but also the original investor contribution, thus putting a strain on his plans. Third, a Ponzi scheme may implode when the schemer is unable to provide the promised minimum rates of returns because he or she can no longer attract enough new investors to the scheme. The falling returns cause even more people to be wary of joining, and so it becomes impossible to pay off previous investors.

The politician schemers in the social security scam are not as easily run off as most Ponzi fraudsters. Individually, they leave the system at some point or another, but they almost always are replaced by others who are willing to maintain social security’s status quo by using current period tax revenues to satisfy old promises. Unfortunately, there is no judicial recourse against our elected officials for dumb decisions.

So, what will trigger an end to this financial fraud? The government’s Ponzi scheme will not unravel because the public opts out of the system and demands repayment. The government no longer allows taxpayers to opt out; neither can anybody get a refund. Moreover, today’s rates of return on social secu**ri**ty are very low and, in fact, negative for some workers. Even so, today’s workers are forced into the system, even though there is an increasing likelihood that many younger workers will never receive a dime.

Don’t allow the politicians or their shamans trick you—social security will be bankrupt soon (if not so already). In part, this is because retirees are living much longer than when the system was devised in the 1930s. Changing demographics also contribute to the problem. When originally conceived, 16 workers supported each retired person on social security; today only 1.75 workers support a retiree. That today’s social security system is neither social nor secure is not news. So says the [President's Commission to Strengthen Social Security](http://govinfo.library.unt.edu/csss/members/index.htm).

As an aside, we find it curious that some of the members of this commission are former members of Congress. What we would like to know is why are they speaking so ominously now, but refused to sound alarms when they were elected officials.

One of the few politicians who got it right was Senator Ernest “Fritz” Hollings (D-South Carolina). He had both the wisdom and the courage to tell whoever would listen the truth about social security. Two decades ago in 1991, [he stated:](http://socialsecurityinstitute.com/blog/the-raid-on-social-security)

*The truth is that the Social Security Trust Fund has already been stripped bare. There is no trust and no fund.*

*It is a lot like the S&Ls. The savings and loans had a lot of real estate on the books, a lot of property, a lot of shopping centers, a lot of deposits, and everything else, until you looked inside and found out there was nothing there. The assets were mostly on paper.... Meanwhile, the Social Security cupboard is bare.*

If he were alive today, Fritz would not have objected to calling social security a Ponzi scheme. We wish we had more Congressmen like him who are willing to talk turkey instead of just trying to dance the turkey trot. Only when we unmask the social security system for what it really is will there be a chance of reforming it for future generations. Only then can we put a stop to this intergenerational Ponzi scheme.

*This essay reflects the opinion of the authors and not necessarily the opinions of The Pennsylvania State University, The American College, or Villanova University.*