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The welfare state's a worthy Ponzi scheme

By John Kay

It is more than 30 years since I first attended a conference on the global welfare crisis. Rarely have a few months passed without an invitation to another. Last week, Tom Palmer, the American libertarian, came to London to denounce the “world-straddling engine of theft, degradation, manipulation and social control we call the [welfare state](#)”.

The content of these rants is familiar. Levels of welfare provision are unaffordable; government finance is a huge Ponzi scheme. A common conclusion is to provide an estimate of the discounted value of the cost of some hated item of expenditure if its current provision were continued into the indefinite future. Mr Palmer reported that the present value of unfunded liabilities of US medicine and social security is \$137tn.

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Social security is a means of inter-generational transfer. The only bread fit to eat is bread baked today: but why should today's bakers feed the retired bakers of yesteryear? Why should we look after old people, who can no longer do anything for us?

The obvious answer invokes Kant's categorical imperative: it would be good for everyone (including ourselves when we are old) if everyone acted in this way. We feed the generations of our parents and grandparents in the expectation future generations will come along and do the same for us. But the consequences of this arrangement do have the character of a Ponzi scheme. One day, the world will end and the last generation of workers will have been cheated of their expectation of a peaceful retirement. In the meantime it is

possible to calculate enormous measures of unfunded obligations, and it doesn't matter. The value of these obligations is offset by the implied commitments of future generations.

A brilliant analysis of the issues was provided half a century ago by Paul Samuelson, the great economist – an analysis that might have received wider attention had it not been written in mathematics and published under the uninviting title of “[An exact consumption-loan model of interest with or without the social contrivance of money](#)”.

The only individualistic solutions to the problem of ageing are to store bread to eat, or sell, when it is stale and you are old; or to take the opportunity when young to bribe younger people to look after you in your dotage. Samuelson showed these outcomes were inferior to the outcome of the social security contract for every generation except the one alive on judgment day.

That social contract can be implemented if future generations agree to recognise the financial claims created by their predecessors, in the expectation that their successors will do the same. That is what Samuelson meant by the “social contrivance of money”. Money acts not just as a medium of exchange but as a store of value. The other means of implementing this golden rule is a social security system through which successive generations of taxpayers agree to support their elders.

Both these types of social arrangement can fail, and often have done. Inflation can prevent money acting as store of value. Or the social contract can be reneged on through an announcement that previously understood commitments are now unaffordable. Both debasement and default benefit a current generation at the expense of its predecessors and successors.

If one generation asserts for itself a higher relative standard of living than it offers to those before or after it, the social contract between generations is threatened. [If life expectancy rises](#), that social contract can be sustained only if working lives and the length of retirement move in parallel. The rising cost of medical care, largely consumed by the elderly, is a problem everywhere.

But these issues are the product of economic fundamentals, not the particular social and institutional arrangements used to handle them. They would be

problems even if those improbable villains Otto von Bismarck and William Beveridge had never invented the welfare state.

Exaggeration can sometimes be forgiven when it is used to draw attention to a problem that has received insufficient attention. It is less easy to excuse when it threatens the fragile social arrangements on which economic security depends.

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