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Yes, It Is a Ponzi Scheme

In fact, Social Security is a bit worse than that.

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Texas governor Rick Perry is being criticized for calling Social Security a "Ponzi scheme." Even Mitt Romney is reportedly preparing to attack him for holding such a radical view. But if anything, Perry was being too kind.

The original Ponzi scheme was the brainchild of Charles Ponzi. Starting in 1916, the poor but enterprising Italian immigrant convinced people to allow him to invest their money. However, Ponzi never actually made any investments. He simply took the money he was given by later investors and gave it to his early investors, providing those early investors with a handsome profit. He then used these satisfied early investors as advertisements to get more investors. Unfortunately, in order to keep paying previous investors, Ponzi had to continue finding more and more new investors. Eventually, he couldn't expand the number of new investors fast enough, and the scheme collapsed. Ponzi was convicted of fraud and sent to prison.

Social Security, on the other hand, forces people to invest in it through a mandatory payroll tax. A small portion of that money is used to buy special-issue Treasury bonds that the government will eventually have to repay, but the vast majority of the money you pay in Social Security taxes is not invested in anything. Instead, the money you pay into the system is used to pay benefits to those “early investors” who are retired today. When you retire, you will have to rely on the next generation of workers behind you to pay the taxes that will finance your benefits.

As with Ponzi’s scheme, this turns out to be a very good deal for those who got in early. The very first Social Security recipient, Ida Mae Fuller of Vermont, paid just $44 in Social Security taxes, but the long-lived Mrs. Fuller collected $20,993 in benefits. Such high returns were possible because there were many workers paying into the system and only a few retirees taking benefits out of it. In 1950, for instance, there were 16 workers supporting every retiree. Today, there are just over three. By around 2030, we will be down to just two.

As with Ponzi’s scheme, when the number of new contributors dries up, it will become impossible to continue to pay the promised benefits. Those early windfall returns are long gone. When today’s young

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workers retire, they will receive returns far below what private investments could provide. Many will be lucky to break even.

Eventually the pyramid crumbles.

Of course, Social Security and Ponzi schemes are not perfectly analogous. Ponzi, after all, had to rely on what people were willing to voluntarily invest with him. Once he couldn't convince enough new investors to join his scheme, it collapsed. Social Security, on the other hand, can rely on the power of the government to tax. As the shrinking number of workers paying into the system makes it harder to continue to sustain benefits, the government can just force young people to pay even more into the system.

In fact, Social Security taxes have been raised some 40 times since the program began. The initial Social Security tax was 2 percent (split between the employer and employee), capped at $3,000 of earnings. That made for a maximum tax of $60. Today, the tax is 12.4 percent, capped at $106,800, for a maximum tax of $13,234. Even adjusting for inflation, that represents more than an 800 percent increase.

In addition, at least until the final collapse of his scheme, Ponzi was more or less obligated to pay his early investors what he promised them. With Social Security, on the other hand, Congress is always able to change or cut those benefits in order to keep the scheme going.

Social Security is facing more than $20 trillion in unfunded future liabilities. Raising taxes and cutting benefits enough to keep the program limping along will obviously mean an ever-worsening deal for younger workers. They will be forced to pay more and get less.

Rick Perry got this one right.

— Michael Tanner is a senior fellow at the Cato Institute and author of Leviathan on the Right: How Big-Government Conservatism Brought Down the Republican Revolution.

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