The Financial Status of Social Security, Part 2, Or, Why Social Security is Not a Ponzi Scheme

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Why Social Security is Not a Ponzi Scheme

Some analysts and economists have claimed that the Social Security system is nothing more than a Ponzi scheme. I believe I can show that there are enough differences between the two to demonstrate that this claim is incorrect.

Let's begin by reviewing what Ponzi scheme is. It was named for Carlo Ponzi, a Boston businessman who talked people into investing in a plan to earn a profit through arbitrage of international reply coupons (IRC). An IRC is an international agreement by which nations agree to deliver mail from other nations within their postal system. Ponzi's plan was to take advantage of the difference in postal rates among the various nations participating in the IRC treaty. His plan fell through with great losses because the overhead on each transaction was too high. Ponzi's plan started as a legitimate enterprise, but he turned it into a fraud when he started realizing losses. He then diverted money provided by new investors by using it to pay off the original investors, while also taking a cut for himself. In honor of Mr. Ponzi, any investment plan in which early investors are paid off with funds provided by new investors instead of profits is now called a Ponzi scheme. Instead of earning money by wise investing, the fund managers camouflage their losses by sending out false financial statements. When necessary, they make payments to the original investors by robbing the newer investors. This continues until the management runs out of new investors, or the operators steal everything they can. Normally, Ponzi schemes attract investors by claiming to have invented some secret stock market advantage, or by claiming to have discovered some hidden trading tactic that is always profitable. With that background in mind, here are five reasons why Social Security is not a Ponzi scheme.

1. "Investing" in a Ponzi scheme is voluntary, "investing" in Social Security is not. If you are working, whether for wages or in business for yourself, you are inducted into the system except for some very narrow exceptions (usually involving employment by a religious institution).

2. A Ponzi scheme, although fraudulent, is ultimately subject to Securities regulation, thus incurring a legal obligation to conduct the business honestly (although they have no intention of doing so). Social Security is not subject to any regulation; the Social Security Administration is under no legal obligation to pay benefits: it operates solely on the whim of Congress.

3. Because a Ponzi scheme is set up to be nominally subject to regulation, an investor can demand to get his money back at any time. However, no one can get their Social Security "investment" back until they meet age or disability requirements set by Congress.

4. A Ponzi scheme is based on attracting a small number of wealthy people to invest in it; thus it robs the rich when it fails. Social Security is based on forcing a large number of poor and middle class people to participate; thus it will rob the poor and middle class when it fails.

5. Ponzi scheme managers send out false financial statements to give the illusion that it is solvent in the short run. The Social Security Administration publishes honest financial statements that prove that it is insolvent in the long run.

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