Written by Bob Adelmann on January 2, 2010

Ponzi Schemes and Social Security

More than $16 billion of investors' money evaporated in Ponzi schemes in 2009, according to the Associated Press. Although the names Bernie Madoff and Allen Stanford were in the headlines in 2009, many other Ponzi schemes were uncovered as the economy declined, making continued payouts to investors impossible.

As Warren Buffet said, "Only when the tide goes out do you discover who's been swimming naked."

Although Charles Ponzi is often credited with creating the first Ponzi scheme, Charles Dickens first described the basic operation in his 1857 novel *Little Dorrit*. It consists simply of making promises that can't be kept to investors who want to believe them.

Charles Ponzi's scheme consisted of promising high returns to investors and then paying the early investors the promised returns with later investors' money. The feint (a maneuver designed to distract or mislead, done by giving the impression that a certain maneuver will take place, while in fact another, or even none, will) was an arbitrage of the difference between postage stamps and international reply coupons, although such arbitrage was never carried out. But it did provide "cover" for his scheme since most investors had little or no idea what was involved.

Bernie Madoff started his scheme in the mid-90s and built his operation around his credibility, personal magnetism and salesmanship, network of wealthy friends, and the "feint" consisting of purchasing blue chip stocks and then buying options on them, sometimes called a split-strike conversion, or a collar.

He stated that his feint was "too complicated for outsiders to understand," and obviously fooled many others who should have known better, including the Securities and Exchange Commission. Calling it a "regulatory failure" on its website, the SEC overlooked numerous red flags on the Madoff scheme for years. It wasn't until Madoff himself admitted in December 2008 that his scheme had run out of money due to demands from his investors that the entire fraud was laid bare.

By defrauding his clients of nearly $65 billion, Madoff was sentenced to 150 years in jail and ordered to pay restitution of $170 billion.

According to the AP, more than 150 such schemes and frauds were uncovered in 2009, but the actual number may never be known. At Wikipedia eight pages of Ponzi schemes are available for review, including some of the more notorious:

• Allen Stanford, $7 billion?

• Scott Rothstein, $1.2 billion?

• Ioan Stoica of Romania, $1 billion?

- European Kings Club in Germany, $1 billion?
- Gerald Payne, of Greater Ministries International, $500 million?
- Enver Hoxha, Communist leader in Albania, $1.2 billion?
- Reed Slatkin, Scientology minister, $600 million?
- Peter Lombardi, $1 billion?
- Sibt-e-Hassan Shah, aka “Double Shah,” of Pakistan, $1 billion?
- Tom Peters, $3.5 billion

The largest Ponzi scheme of all, according to scholar Walter Williams, “collects about $785 billion annually from 163 million [investors] and pays out $585 billion annually to 50 million [other investors].”

The scheme in question is, of course, Social Security. Says Williams, “According to Social Security trustee estimates, around [the year] 2016 the amount of Social Security benefits paid will exceed taxes collected.” Social Security is unsustainable because the pool of new “investors” is shrinking, while the number of beneficiaries is increasing. ??
That Social Security is a Ponzi scheme is confirmed by Thomas Sowell:

> Social Security has been a pyramid [Ponzi] scheme from the beginning. Those who paid in first received money from those who paid in second — and so on, generation after generation. This was great so long as the small generation when Social Security began was being supported by larger generations resulting from the baby boom. But, like all pyramid schemes, the whole thing is in big trouble once the pyramid stops growing. When the baby boomers retire, that will be the moment of truth.

Gary North agrees:

> There is no statistical escape from bankruptcy or default, either open or through inflation, yet Congress pretends that this is not inevitable. Why? Because voters will remove from office any Congressman who tells the truth about what is statistically irreversible. The question today is the form that the bankruptcy will take: outright default, mass inflation, or a salami-slicing reduction of benefits.