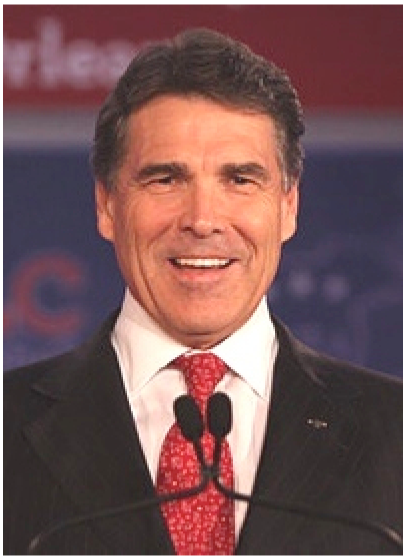
# Is Rick Perry Right? Is Social Security a Ponzi Scheme?



Presidential candidate Rick Perry (left) opined in the first Republican debate that Social Security is a ?failure? and a ?Ponzi scheme,? and then reiterated the charge in the second debate on Monday night. At the first debate, Perry said Social Security is a ?Ponzi scheme for these young people. The idea? that the current program is going to be there for them is a lie.? When pressed by the moderator, Perry reiterated, saying Social Security is a ?monstrous lie to our kids.?

On Monday night Perry refused to back down: It is a Ponzi scheme to tell our kids that are 25 or 30 years old today, youre paying into a program thats going to be there. Anybody thats for the status quo with Social Security today is involved with a monstrous lie to our kids, and its not right. But in his op-ed piece in *USA Today* on Sunday, Perry backed off, writing instead that the system could still be salvaged somehow: Social Security benefits for current recipients and those nearing retirement must be protected. For younger workers, we must consider reforms to make Social Security financially viable. He failed to mention the words Ponzi scheme nor did he explain just what reforms would be required.

According to economist Don Boudreaux, a true Ponzi scheme must meet six criteria:

1. It promises that contributions made today will pay off handsomely in the future to each investor.
2. Current contributions are not invested but are spent in repaying previous contributors.
3. The manager of the scheme successfully persuades new contributors to invest new monies into the program.
4. The manager doesnt tell his contributors that the funds are not being invested but are in fact being used to pay off earlier contributors.
5. The scheme fails when not enough new money comes into the program to pay off those earlier contributors.
6. In short, the manager successfully persuades histargets that the scheme is financially something that it really is not.

Boudreaux concludes that, based on this definition, Social Security strikes me [as] having a great deal of Ponzi-ness about it.

Boudreaux may safely be considered a part of the classical economic thinking (i.e., Austrian) school, which uses reason and common sense to build its case against Social Security. Among those would be Milton Friedman, a research fellow at the Hoover Institution for 30 years and a recipient of the Nobel Memorial Prize for economic science. Friedman concluded that Social Security is a massive confidence game, with the managers of the fund calling the program equivalent to private insurance, claiming that the workers themselves contribute to their own future retirement benefit by making regular payments into a joint fund.  Said Friedman:

> Balderdash. Taxes paid by todays workers are used to pay todays retirees. If money is left over, it finances other government spending though, to maintain the insurance fiction, paper entries are created in a trust fund that is simultaneously an asset and a liability of the government. When the benefits that are due exceed the proceeds from payroll taxes, as they will in the not very distant future [he wrote this in 1999], the difference will have to be financed by raising taxes, borrowing, creating money, or reducing other government spending.
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> And that is true no matter how large the trust fund. The assurance that workers will receive benefits when they retire does not depend on the particular tax used to finance the benefits or on any trust fund. It depends solely on the expectation that future Congresses will honor promises made by earlier Congresses what supporters [of the system] call a compact between the generations and opponents call a Ponzi scheme.

In moments of undiminished clarity, however, several statist economists have come to the same conclusion. One is Nobel Prize winner Paul Samuelson,
the author of the standard introductory economics textbook *Economics: An Introductory Analysis* widely used to indoctrinate legions of college freshmen in the principles of Keynesianism. In 1967, Samuelson wrote:

> The beauty of social insurance is that it is actuarially unsound. Everyone who reaches retirement age is given benefit privileges that far exceed anything he has paid in exceed[ing] his payments by more than ten times!
>
> How is it possible? It stems from the fact that the national product [GDP] is growing at a compound interest rate and can be expected to do so for as far ahead as the eye cannot see. Always there are more youths than old folks in a growing population. More important, with real income going up by 3% per year, the taxable base on which benefits rest is always much greater than the taxes paid historically by the generation now retired.
>
> A growing nation is the greatest Ponzi game ever contrived.

Now that his assumptions about GDP growth, population growth, and the consequent growth of the tax base have melted in the face of the present reality, it can be seen that these assumptions temporarily covered up the basic flaws in the system.

And Samuelson is not alone. Another Nobel-prize winning economist  wrote in the December/January 1996-97 issue of *Boston Review* that:

> Social Security is structured from the point of view of the recipients as if it were an ordinary

> retirement plan: what you get out depends on what you put in. So it does not look like a redistributionist scheme. In practice it has turned out to be strongly redistributionist, but only *because of its Ponzi game aspect,* in which each generation takes more out that it put in. Well, *the Ponzi game will soon be over*, thanks to changing demographics, so that the typical recipient henceforth will get only about as much as he or she put in (and todays young may well get less than they put in.) (Emphases added.)

When Paul Krugman wrote those words, little did he know just how soon the game would be over, nor did he know that classical economists would soon delight in hanging his words around his neck during the current debate.

Patrick Buchanan summed up the Social Security scheme nicely:

> If Ford Motor did what the U.S. Government has done borrowed and spent all the cash the company, its employees and workers had contributed to their pension fund, and used it for wages, salaries and expenses, leaving IOUs in the vault the executives would go to prison.

Perry is right and wrong. He is right when he calls Social Security a Ponzi scheme. He is wrong in thinking it can somehow be reformed and made "financially viable."