

A Brief History of Ponzi Schemes

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In 1920, Carlo Ponzi was sentenced to prison for a pyramid scheme that defrauded investors out of an estimated \$15 million, or \$159 million in today's inflated dollars.

After serving his sentence, he returned to his motherland, where he worked for Italian dictator Benito Mussolini, who subsequently fired him. Ponzi died penniless in Brazil, but his name lives on as an eponym for pyramid schemes.

In 1935, Franklin Delano Roosevelt started the Ponzi scheme of Social Security. Ironically, he was an admirer of Mussolini's corporatism early in his presidency. Then in 1965, Lyndon Baines Johnson took FDR's lead and started the Ponzi scheme of Medicare.

Both Social Security and Medicare deserve the "Ponzi" eponym because both were sold to the public under false pretenses and both pay off early participants at the expense of later ones. Unlike Carlo Ponzi's scheme, however, participation in the two programs is not voluntary.

The two Ponzi schemes continue to operate today with the blessing of members of Congress, all of whom are aware that the two pyramids will eventually collapse, having been forewarned about this inevitability by the former comptroller general of the United States, David M. Walker, whose sobering statistics are presented below.

Like all such collapsing pyramids, the Ponzi scheme of Wall Street financier Bernard Madoff collapsed in 2008, costing investors an estimated \$50 billion. If he is eventually tried and convicted of the alleged crime, he should be sentenced to a term in Congress instead of a term in a penitentiary. Why? For two reasons:

First, he has the most important qualification to be a member of Congress: experience in committing massive fraud. Second, by rubbing shoulders with other members of Congress, he might be able to convince his fellow legislators to lower the cost of their Ponzi schemes to the cost of his, thus reducing the economic harm to future generations by a considerable amount. Let me explain.

According to ex-comptroller general Walker, the unfunded liabilities for the Ponzi schemes of Social Security and Medicare are approximately \$53 trillion. (Some reliable sources estimate the unfunded liabilities to be as high as \$90 trillion, but the more conservative number will be used here.) The \$53 trillion comes to about \$99 billion for each member of Congress, an amount that is almost twice as large as Madoff's fraud on a per-crook basis.

Congress's Ponzi schemes are not only larger than Madoff's, but they also are more unethical. Where the primary targets of Madoff's fraud were wealthy adults, the primary targets of Congress's fraud are defenseless children who will inherit the unpaid bills of previous generations for Social Security and Medicare. The bills come to nearly \$720,000 for each American under the voting age of 18.

If current and projected federal deficits are added to the \$53 trillion unfunded liabilities for Social Security and Medicare, and if unfunded liabilities for public-sector pension plans are added to that sum, then total government indebtedness comes to about \$66 trillion, or approximately \$475,000 for each income-earning taxpayer. With the nation's average per-capita income being about \$45,000, that means that each taxpayer, on average, would have to give the government more than 10 years of income to pay off the indebtedness. No doubt to mask this problem, the government will resort to printing money, thus debasing the dollar and fueling inflation. But the effect will be the same: Taxpayers will lose more than 10 years of income.

If you still think it is overwrought to describe Congress as crooked, consider this: The Social Security Trust Fund exists in name only. It is an accounting fiction, for it contains nothing but IOUs. (Try buying groceries at the supermarket with an IOU.) The situation is akin to a burglar taking your silverware and leaving behind a promise to reimburse you later for the value of the stolen items.

The money from FICA taxes is not kept by the government in a "trust fund," in a "lockbox," under a mattress, or in an old shoe. Rather, it is commingled with other government revenue and spent as received on whatever the wise members of Congress have decided is important for the common good, including cross-country rides on a 200-seat Air Force jet for House Speaker Nancy Pelosi. The cost of each round trip is estimated to be \$120,000, which would be a nice retirement nest egg for the average worker. Sadly, the U.S. Supreme Court has been in collusion with the crooks in Congress. It ruled in the 1960 case of *Fleming v. Nestor* that retirees have no property rights, and no legal claim to the Social Security contributions that have been taken from them over their working lives. Also, as any high school student should learn in history class but probably doesn't, the Supreme Court acquiesced to FDR in 1937 over the constitutionality of the Social Security Act when he threatened to pack the Court; that is, he threatened to get a compliant Congress to expand the number of Supreme Court jurists from nine to 12 and to fill the new seats with supporters of the Act.

Fraud and unfunded liabilities aren't the only problems with Social Security and Medicare. Another is their huge opportunity cost. The entitlement programs drain money from the private sector, where it could be invested in new companies, in productivity improvements, in job creation, and in wealth creation. Then the money is sent to Washington, where some of it is chewed up in the gears of the bureaucracy, some of it is spent on free rides for Nancy Pelosi, and some of it is returned to workers after they retire, assuming they are near the front of the line. According to the Congressional Budget Office, Social Security and Medicare (and Medicaid) will consume nearly 19 percent of gross domestic product by 2050, a staggering increase from the current 8.4 percent. To look at the opportunity cost in a different way, GDP today would be about a third higher, or \$4 trillion higher, if it were not for Social Security, Medicare, and numerous welfare programs, according to economics professor Edgar K. Browning, whose latest book is reviewed in this edition of the Journal. This means that personal incomes would be a third higher in the absence of government redistribution and transfer payments.

Amazingly, President Barack Obama has promised to foist another Ponzi-like fraud on the American people: universal healthcare (a.k.a. nationalized healthcare). Like the investment returns promised by Bernard Madoff, the promised benefits of universal healthcare will not be realized by later participants, due to unfavorable demographics and bleak economic realities. Over time, it is a virtual certainty that taxes for the program will soar, medical care will be rationed, physician compensation and thus physician quality will be reduced, euthanasia will be encouraged under the guise of compassion, and medical facilities will become as shabby as state motor vehicle bureaus. French moralist and writer Francois de la Rochefoucauld said that hypocrisy is the homage vice pays to virtue. But it is difficult to see much virtue in the nation imprisoning Carlo Ponzi, and then emulating his pyramid scheme.

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