America's Largest Ponzi Scheme:
And Bernie Madoff does not run it

Since mid-December of last year, the American public has become quite familiar with the Madoff Ponzi scheme. The media has spent countless hours hashing away at how it happened, why it happened and who was to blame. I can give you an answer on each of these questions:

I. He used other peoples' money to fund his lifestyle and to provide a return to other shareholders.
II. GREED and self-importance. Mr. Madoff needed the money to sustain the appearance of wealth and success amongst his peers.
III. Mr. Madoff is first and foremost to blame. There is no excuse for this type of behavior. Second are the regulators. These people have been asleep at the switch, giving Bernie Madoff a pass for over 10 years. Finally, Mr. Madoff's clients share some of the blame. They failed to adhere to the old adage, "when it seems too good to be true, then it probably is." Now some of these clients' money was invested with Madoff through hedge funds and other vehicles, but it was still the responsibility of these hedge fund managers to do due diligence on these firms.

Despite the brazenness of this scheme and its $50 billion price tag, it pales in comparison to the largest Ponzi scheme in America. This dubious honor goes to our Social Security System.

How did it happen?

According to the Social Security Administration publication number 05-10024:[1]

> **The money you pay in taxes is not held in a personal account for you to use when you get benefits. Your taxes are being used right now to pay people who now are getting benefits. Any unused money goes to the Social Security trust funds, not a personal account with your name on it.**

Simply stated, the money that you contribute is given to someone else. In 2007, we distributed $595 billion in Social Security benefits.

What makes this story even better is the Social Security trust fund. Currently, any unused payments go to this trust fund, which at the end of 2007 had a balance of $2.2 trillion. Makes reasonable sense so far, but that's where the sense stops. By law, this trust fund has to loan any balance to the U.S. government. Talk about a sub-prime loan. We are loaning individuals' retirement money to an entity that spends money like...well, I guess the common analogy is "drunken sailors", but I do not want to insult those who are protecting our country, so I will leave the sailors out of this.

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[1] Publication Number 05-10024: "Understanding the Benefits." United States Social Security Administration, May 2008.

Did you know?
The government collects six weeks worth of an average American worker's salary for Social Security Benefits.

Why did it happen?

There are several factors that are contributing to the demise of Social Security. Like a Ponzi scheme, however, the concept is fundamentally flawed. They both need things to work perfectly in order to maintain the promised benefits and expectations. In the Madoff case, clients observed Madoff funds as safe and dependable. When the market started dropping, people needed their funds so they chose to redeem from an account that was not decreasing. In a scheme that is built on taking the next person's money to pay the interest to others, redemption provided stress on the system.

Social Security was built on the concept that you would provide funds into a system for your future benefit; however, as stated above, your money is not earmarked for you. Instead, it is merely *supposed* to be there to pay your future benefits. In the 2000 budget, the Clinton Administration stated that the Social Security Trust Funds "do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures."[2] So like a statement from Madoff Securities, the statement you receive from the Social Security Administration does not have enough assets to back its commitments.

The major flaw of our social security system involves the number of workers paying taxes relative to the number of beneficiaries. As previously stated, for a Ponzi scheme to work you must find the next sucker, but you also need them to grow exponentially. Factors that contributed to the decline in this ratio include the declining birth rate after the baby boomer generation, the increase in life expectancy, and the increased number of people receiving disability benefits.

Year	Tax Payers to Beneficiaries
1945	41.9/1
1960	5.1/1
1980	3.2/1
2000	3.4/1
2007	3.3/1
2030	2.1/1

As shown in the table,[3] for every person receiving Social Security benefits in 1945, there were 41.9 workers. You would think that during this time we would have built a substantial balance, but in 1945 the Social Security tax rate was 3%. They increased it to 6% in 1950, 8.4% in 1970, 10.2% in 1980, and 12.4% in 1990. In addition to increasing the tax rate, they also increased the income threshold. The original amount was capped at $3,000. As you know, the income threshold is now much more than this, which is natural

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[2] Report: Analytical Perspectives: Budget of the United States Government, fiscal year 2000. Executive Office of the President of the United States, U.S. Government Printing Office, 1999.

[3] http://www.ssa.gov/OACTTR/TR08/tr08.pdf

considering inflation. The disturbing part is that in 1951 the wage threshold was 129% of the national average wage and in 2007 it was 241%.[4] **In other words, the original Social Security plan has been failing since the 1950s.** Increasing taxes and the amount of income to be taxed has prolonged this scheme.

Baby Boomers

As everyone knows, the first baby boomers have started receiving Social Security benefits. Unfortunately for baby boomers, they are the Madoff clients of this scheme. The boomers have seen Social Security prolonged with their hard earned money and will also see it come to its ultimate demise during their collection period.

As stated earlier, for a Ponzi scheme (our Social Security system) to work as it was fundamentally created, we need for the suckers (population) to grow exponentially. The birth rate per woman was 3.6 in 1960. It dropped to 1.77 in 1975 and in 2004 was at 2.05.[5] So instead of growing exponentially, we actually contracted.

Did you know?
Between 2010 and 2030, the number of people receiving Social Security will increase by 66%, while the number of people paying Social Security taxes will increase by only 10%.

Life expectancy[6]

As our life expectancy has increased, we have not increased the retirement age of social security benefits at the same rate. The life expectancy of a 65-year-old man has increased 40% since 1940. In 1940, a 65-year-old man was expected to live for another 11.9 years. Today, he is expected to live another 16.7 years.

Women have seen a 45% increase in life expectancy. They are now expected to live to be approximately 85 years old, where in 1941 they were expected to live to be 78. That is great except when you are providing actuarial work on a system that is already fundamentally flawed. We have only increased the full retirement age by 3% during this time.

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[4] http://www.ssa.gov/OACTTR/TR08/tr08.pdf The 2008 Annual Report of the Board of Trustees of the OASDI Trust Fund. March 28, 2008.

[5] http://www.ssa.gov/OACTTR/TR08/tr08.pdf The 2008 Annual Report of the Board of Trustees of the OASDI Trust Fund. March 28, 2008.

[6] Publication No 21-059: "Social Security: A Brief History" and http://www.ssa.gov/OACTTR/TR08/tr08.pdf The 2008 Annual Report of the Board of Trustees of the OASDI Trust Fund. March 28, 2008.

Did you know?
The first person to receive a monthly Social Security check was Ida May Fuller on January 31, 1940. Ida contributed $22 over her working years and received over $22,000 in benefits.

Disability

In 2007, 17%, or $99 billion, of all Social Security benefits were paid out for disabilities. From 1960 to 2005, the U.S. population grew 55%, while the number of people receiving disability has increased 1,109%.[7]

Year	U.S. Population	Number of People receiving Disability	Percentage
1960	190,172,000	687,000	0.36%
2000	288,284,000	6,667,000	2.31%
2005	302,863,000	8,309,000	2.74%

Who is to blame?

It is a long list, but for starters, it is every President, Senator, and Representative since the Baby Boom. They have been confronted with the problem, but chose not to make a change. They only enabled the problem to intensify. None of them want to confront the difficult nature of this broken system because we have become so dependent on it.

It is Franklin Delano Roosevelt, who had good intentions, but did not consider the future consequences. Social Security was never meant to be the primary retirement system of America. It promised benefits that could only be delivered on the backs of the next generation.

It is me. It is you. It is our parents, grandparents, relatives, neighbors, friends, and co-workers. We are all to blame for passing it on to our next generation. In order to fix our system today, we would need $4.3 trillion over the next 75 years. This represents an additional $26,000 from every person who paid Social Security tax in 2007.[8] If we chose to do it the American way and finance it for the next 75 years, our total debt would be $35 trillion, or an additional $135,000 for every person expected to be paying Social Security in 2082. I am sure they are going to love us when they get this bill.

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[7] http://www.ssa.gov/OACTTR/TR08/tr08.pdf The 2008 Annual Report of the Board of Trustees of the OASDI Trust Fund. March 28, 2008.

[8] www.justfacts.com/socialsecurity.asp Page 6.

Fixes

Current Proposal: President Obama has mentioned taxing individuals 2 to 4% over any income over $250,000. Currently, there are approximately 1.7 million households in America with earnings of over $250,000; households, however, are not individuals. You could have two individuals earning $125,000 and not be subject to the tax. You will also have business owners whose business income passes through to their individual tax return. These individuals do not pay Social Security tax on this income. The cash from this income does not necessarily enter the owner's pockets, but is normally used to expand the business, or for future operating expenditures.

In my opinion, this proposal is like every other proposal in that it will only prolong the inevitable. **All Ponzi schemes have a bad ending.**

A realistic long-term solution needs a combination of the following:

- ✓ Pay back the Trust Fund and repeal the mandate that forces the Trust Fund to lend the money to the government. Our politicians have become addicted to this money to the point where they spend it without even having it. We cannot wait any longer to break this habit. Our time is nearly up. *Note: 2017 was the date the CBO had forecasted when we would begin distributing more in benefits than we receive in tax dollar*s. *Because of the recession, that date has been moved up to as early as 2010.*

- ✓ No early retirement for anyone currently under 60. I know they decrease benefits, but assuming a normal rate of return, you would need to live into your late 70s for early retirement not to be a benefit.

- ✓ No spousal benefit for anyone currently under 55. Currently, a spouse is allowed to receive the higher of their Social Security or half of their spouse's even if they did not pay into the plan. (I am not suggesting cutting survivor benefits.) I am sorry, but if you paid for one benefit, then that is all you should receive.

- ✓ Move full retirement age to 70 for anyone under 55. With the increasing life expectancy, we must move the full retirement age back.

- ✓ For anyone 55 and under, cut projected benefits by 5% for each 5 year period you have under until the full retirement age. A 35 year old would have his retirement benefit cut by 35%, assuming you move full retirement to 70.

- ✓ Offer current tax credits for individuals to forfeit their Social Security benefits. Call it the Warren Buffett or the Bill Gates rule.

- ✓ Privatize the disability portion of Social Security. Insurance companies can better manage the risk and reduce costs through pooling. They will also handle claims more efficiently and effectively.

- ✓ After you have computed the liability for each individual to cover the indebtedness of Social Security by implementing steps 1-7, you create individual accounts that actually have real assets for the individual. I am not suggesting we privatize it, but we at least have real assets. (At a later time I will be providing an analysis of an individual making minimum wage and retiring this year with a portfolio invested in 60% S&P 500 and 40% U.S. Treasury Bonds. Even with last year's dismal market, he would be ahead of his Social Security benefit.)

- ✓ Any net interest accumulated or profits from the Capital Purchase Plan would be split between the Social Security Fund and Medicare Fund. For goodness sake, do not put these in the general fund. (This appears to be a long shot for the profitability and receiving all of our interest)

- ✓ Make it easier for companies to offer retirement plans. Currently, only 58% of Americans work for a company that sponsors a plan. This industry needs regulation, but it needs to be overhauled first.

The goal for the plan would be covering future promises while eventually releasing the burden on future generations. I envision a plan that allows us to take care of current retirees, but also allows individuals to have an asset with their name on it and not an empty promise.

The words hope and change have been used a lot lately. With Social Security, there is no HOPE without real CHANGE. We have already increased taxes, delayed benefits, and raised the taxable threshold and the system is still on the brink.

These potential solutions are one man's idea. You will have people complain no matter what we do, but it is in the best interest of our country to have an in-depth discussion that lays everything on the table.

This plan would require sacrifice from everyone, but a total overhaul must happen. If not, look at your kids, your grandkids, your nieces and nephews and just tell them it's their problem.

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For these and other facts on Social Security, you can visit www.justfacts.com/socialsecurity.asp.