

COMMENTARY NUMBER 410
Special Commentary, GAAP-Based 2011 U.S. Financial Data

December 28, 2011

Actual 2011 Federal Deficit Topped \$5.0 Trillion
U.S. Government Debt and Obligations Top \$80 Trillion
Long-Term U.S. Insolvency/Hyperinflation Remain Virtual Certainty

PLEASE NOTE: The next regular Commentary is scheduled for Friday, January 6th, covering the estimates of December 2011 employment and unemployment. See [Schedule](#) for month ahead.

Best wishes to all for happy, healthy and prosperous New Year! — John Williams

SPECIAL COMMENTARY— 2011 BUDGET DEFICIT REALITY

Continuing \$5 Trillion GAAP-Based Federal Deficit Remains Unsustainable, Uncontainable and Unstable. Against a headline, official quasi-cash-basis and gimmicked reporting of a \$1.3 trillion federal budget deficit in 2011, GAAP-based accounting (using generally accepted accounting principles) indicates that the actual 2011 deficit ran somewhat in excess of \$5 trillion for the year. The largest

difference between these estimates is that the GAAP-based number includes the widening shortfall of unfunded liabilities for social insurance programs, such as Social Security and Medicare.

As shown in the accompanying table of “U.S. Government – Alternative Fiscal Deficit and Debt Numbers” (SGS Table), the various 2011 deficit estimates remained close to the same horrendous levels as estimated for 2010. Based on the [2011 Financial Report of the United States Government](#) the 2011 cash-based federal deficit at \$1.299 trillion was little changed against the \$1.294 trillion estimate for 2010. The limited GAAP-based deficit (before consideration of changes in social insurance unfunded liabilities), narrowed to \$1.313 trillion in 2011, from \$2.080 trillion in 2010, but that was due almost entirely to one-time reporting/assumption changes in Veterans’ Benefits and U.S. government liabilities on Fannie Mae and Freddie Mac. Accordingly, the operating deficits effectively were about the same level in both 2010 and 2011.

In like manner, the indicated full GAAP-based deficits (including annual change in the net present value of social insurance programs) of \$4.6 trillion in 2011 and \$5.3 trillion in 2010, effectively were about \$5 trillion in each of 2010 and 2011, adjusted for one-time reporting changes.

Total Federal Debts and Obligations Exceed \$80 Trillion. The numbers discussed in the text here are those from the GAO-Based Alternative version of the 2011 numbers as shown in the SGS Table. Unfortunately, the government’s financial reporting has become as heavily politicized as some of its economic reporting. Unlike the economic numbers, though, the financial data are audited (where possible) by the GAO (Government Accountability Office, formerly the General Accounting Office).

In the 2010 statement, consistent year-to-year accounting was not shown, with a large, one-time reduction in reported Medicare liabilities being based on overly optimistic assumptions of the impact from the then recently enacted healthcare legislation. Referred to in the government’s statements as the Affordable Care Act (ACA), the full GAAP-based results from the ACA accounting showed an annual surplus of \$7.0 trillion in 2010, but again, that was not in terms of consistent reporting, which would have been along the lines of a \$5 trillion annual deficit.

The new health-care enhanced Medicare results used in the government’s statements were prepared under the auspices of the Obama Administration, but the GAO did not fully buy into the happy numbers in 2010 or again in 2011, with disclaimers of opinion. The GAO went so far as to run an “Illustrative Alternative Scenario” (pages 130 and 134, respectively of the 2010 and 2011 statements) to the government’s happy Medicare adjustments. The “Alternative” versions appear to have more realistic assumptions than the politicized data used in official ACA-based data. Unfortunately, under present accounting conditions there simply is no way of coming up with truly meaningful hard number, in terms of total government obligations.

Where the “Alternative” data used here show \$80.9 trillion of U.S. government debt, obligations and the net present value of the unfunded social security liabilities, as of September 30, 2011, that likely is shy of reality. Adding estimates of government liabilities in, and exposures to Fannie Mae, Freddie Mac, the PBGC and FDIC easily could take that total into the \$100 trillion range. Publicized estimates of U.S. government exposure beyond the \$100 trillion mark usually included gross unfunded liabilities, which are not adjusted for net present value (NPV). NPV reflects the amount of cash needed in hand today to be able to cover a future obligation. *(Text continues following the SGS Table.)*

U.S. Government - Alternative Fiscal Deficit and Debt Numbers Reported by U.S. Treasury

Sources: U.S. Treasury, Shadow Government Statistics.

(I) Fiscal Year ⁽¹⁾	(II) Formal Cash-Based Deficit (\$Billions)	(III) GAAP Ex-SS Etc. Deficit (\$Billions)	(IV) GAAP With SS Etc. Deficit (\$Trillions)	(V) GAAP Federal Negative Net Worth (\$Trillions)	(VI) Gross Federal Debt (\$Trillions)	(VII) Total ⁽²⁾ Federal Obligations (GAAP) (\$Trillions)
GAO- Alternative Based⁽³⁾						
2011	\$1,298.6	\$1,312.6	\$4.6 ⁽⁵⁾	\$73.5	\$14.9	\$80.9
2010	1,294.1	2,080.3	5.3 ⁽³⁾	68.9 ⁽³⁾	13.6	\$76.3 ⁽³⁾
Official ACA- Assumption Based⁽³⁾						
2011	\$1,298.6	\$1,312.6	\$4.5 ⁽⁵⁾	\$61.1	\$14.9	\$68.5
2010	1,294.1	2,080.3	(7.0) ⁽³⁾	56.5 ⁽³⁾	13.6	64.0 ⁽³⁾
Pre-ACA Distortions⁽³⁾						
2009 ⁽⁴⁾	1,417.1	1,253.7	4.3	63.6	11.9	70.5
2008	454.8	1,009.1	5.1	59.3	10.0	65.6
2007	162.8	275.5	1.2 ⁽⁵⁾	54.3	9.0	59.8
2006	248.2	449.5	4.6	53.1	8.5	58.2
2005	318.5	760.2	3.5	48.5	7.9	53.3
2004	412.3	615.6	11.0 ⁽⁶⁾	45.0	7.4	49.5
2003	374.8	667.6	3.0	34.0	6.8	39.1
2002	157.8	364.5	1.5	31.0	6.2	35.4

(1) Fiscal year ended September 30th; the numbers are subject to rounding differences. (2) Includes gross federal debt, not just "public" debt. While the non-public debt is debt the government owes to itself for Social Security, etc., the obligations there are counted as "funded" and as such are part of total government obligations. (3) Fiscal years 2011 and 2010 are broken out into "Alternative" and "Official" measures necessitated by "Official" 2010 reporting including a large, one-time reduction in the estimated net present value of unfunded Medicare liabilities, due to unrealistically favorable assumptions tied to the passage of the Affordable Care Act (ACA) healthcare legislation. With consistent accounting, SGS estimates the GAAP shortfall with Social Security and Medicare for 2010 to be roughly \$5 trillion. The "GAO-Alternative" numbers here are being used as a placeholder until such time as better accounting estimates are available, and reflect results using the "Illustrative Alternative Scenario" on Medicare costs shown on page 130 of the 2010 report and on page 134 of the 2011 report. (4) The 2009 data predate December 2009 guarantees of Fannie Mae and Freddie Mac (GSEs) and do not reflect PBGC or FDIC liabilities. Even so, accounting for

neither 2010 nor 2011 reflected what might be considered direct, full faith and credit guarantees of the U.S. government in those areas. Please note that mid-year 2009 accounting redefinitions for TARP knocked off roughly \$500 billion from the reported formal cash-based estimate and contributed to a TARP “profit” in the GAAP numbers. Accordingly, post-2008 reporting may understate annual operating shortfalls and federal debt obligations by significant amounts. (5) On a consistent reporting basis, net of one-time changes in assumptions (actuarial and otherwise) and accounting, SGS estimates that the GAAP-based deficit for 2011 topped \$5 trillion. In like manner, SGS estimates that the GAAP-based deficit for 2007 topped \$4 trillion, with negative net worth of \$57.1 trillion and total obligations of \$59.8. So as to maintain consistency with the official GAAP statements, the “official” numbers are shown. (6) SGS estimates a \$3.4 trillion 2004 deficit, excluding one-time unfunded setup costs of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (enacted December 2003). Again, in order to maintain consistency with the official GAAP statements, the “official” numbers are shown in the table for 2004. The 2011 GAAP statements were released on December 26, 2011: <http://fms.treas.gov/fr/index.html>.

Sources for the SGS Table Data

Fiscal Year (Column I) – All numbers are for the indicated fiscal-year (ended September 30th), in either billions or trillions of dollars as shown.

Formal Cash-Based Deficit (Column II) – headline deficit number from Table 3 on page 7 of the [2011 report](#), “Management’s Discussion and Analysis” (hereinafter referred to as MDA). Please note that the latest (November 2011) monthly statements from the U.S. Treasury show a 2011 deficit of \$1,296.8 billion and a 2010 deficit of \$1,294.2 billion.

GAAP ex-SS Etc. Deficit (Column III) – euphemistically referred to as “Net Operating Cost” in MDA (Table 3 on page 7). It excludes annual change social insurance unfunded liabilities.

GAAP with SS Etc. Deficit (Column IV) – previous number (Column III) plus year-to-year change in the net present value (NPV) of social insurance unfunded liabilities, which comes from MDA (Table 8 on page 21) line “Closed Group” under “Statement of Social Insurance,” 2011 minus 2010 (for the 2011 “Official” number). The “Closed Group” is used here for consistency, as it has been the preferred measure used by the U.S. government in its earlier statements. The “Official” closed group NPV for fiscal 2011 and 2010 respectively are \$46,273 and \$43,057 billion.

The “Alternative” accounting adds in the differential to the MDA line “Closed Group” and the \$12.4 trillion additional net present value of excess expenditures over income for Medicare shown in the “Illustrative Alternative Scenario,” shown in the table on page 130 of the [2010 report](#) (for the 2010 “Alternative” estimate), and the differential between the 2011 “Illustrative Alternative Scenario,” data on page 134 of the 2011 Report, and the 2010 data, to estimate the 2011 number. The resulting “Alternative” closed group NPV estimates for fiscal 2011 and 2010 respectively are \$58,707 and \$55,410 billion.

GAAP Federal Negative Net Worth (Column V) – “Net Position” from MDA Table 5 on page 11, plus the 2011 “Closed Group” “Official” and “Alternative” total net present value unfunded liabilities of social insurance as indicated and adjusted in Column IV.

Gross Federal Debt (Column VI) – from “Note 14. Federal Debt ...” pages 90 to 92 of the 2011 report. Total held by public (p. 90) plus Total intragovernmental (p. 92).

Total Federal Obligations (Column VII) – “Total Liabilities” from the MDA Table 5 on page 11, in the 2011 report, plus the 2011 “Closed Group” “Official” and “Alternative” total net present value unfunded liabilities of social insurance as indicated and adjusted in Column IV, plus total intragovernmental debt of \$4,710.9 billion from (p. 92) of the 2011 report.

Annual Deficits of \$5 Trillion Are Not Sustainable. Significant space was taken up in the government’s latest financial statements to assess the sustainability of the current system. Most of the material covered was overly misleading nonsense. A variety of sustainability issues for the system will be explored in the upcoming report *Hyperinflation 2012*. Those looking at the current \$80 trillion of government debt and obligations, who think such is stable, need to consider that the circumstance is getting worse each year by at least \$5 trillion. Taxes cannot be raised enough to bring the system into

balance for one year, let alone for the ongoing future. Every penny of government spending—except for Social Security and Medicare—could be cut and the system still would be in annual deficit. Massive cuts have to be put in place (an absolute necessity with the social insurance), if there is to be any hope of restoring long-term solvency for the United States government.

There is no political will apparent among those currently controlling the White House and Congress to do so. Accordingly, the U.S. will be doomed to an eventual hyperinflation, as the government prints money to meet its obligations. That process already has started. There is little time. The next Fed action to help the economy (a.k.a. prop-up banking system liquidity), easily could be the one that pushes the U.S. dollar into the abyss. Much greater detail, again, will follow with the new hyperinflation report.

Week Ahead. Recognition of an intensifying double-dip recession as well as an escalating inflation problem still is sporadic. The political system would like to see the issues disappear until after the 2012 election, the media does its best to avoid publicizing unhappy economic news during the holiday shopping season, and the financial markets will do their best to avoid recognition of the problems for as long as possible, problems that have horrendous implications for the markets and for systemic stability.

Until such time as financial-market expectations move to catch up fully with underlying reality, or underlying reality catches up with the markets, reporting generally will continue to show higher-than-expected inflation and weaker-than-expected economic results in the months and year ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Unemployment Rate and Payroll Employment (December 2011). Nonfarm payrolls and the unemployment rate for December 2011 are the next major economic releases due for publication, on Friday, January 6, 2012. These first major indicators of December economic activity likely will signal ongoing deterioration in broad economic conditions. A pattern of weaker-than-expected reporting remains a good bet, against a likely stronger payroll consensus expectation, and against a likely unchanged unemployment rate expectation.

Consistent with six months of contracting online help-wanted advertising, payrolls still remain at risk of showing an outright monthly contraction. Yet, as seen again with last month's change in headline payrolls, whatever is reported likely will include a payroll contraction within the 95% statistical reporting confidence interval of +/- 129,000 for payroll change.

The headline unemployment rate dropped meaningfully (by 0.4%) in November, reflecting a large number of unemployed—unable to find jobs—abandoning active job searching, leaving the headline labor force and entering the government's classification of a short-term discouraged worker.

Unusual seasonal-adjustment patterns, though, also were at work in the November unemployment detail, and some catch-up is likely in December or January reporting. Keep in mind that monthly changes in the unemployment rate that are within the 95% confidence interval of +/- 0.2% are not statistically meaningful.