John Williams'

Shadow Government Statistics

Analysis Behind and Beyond Government Economic Reporting

No. 500: SPECIAL COMMENTARY

U.S. Government GAAP-Based 2012 Financial Data

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GAAP-Based Federal Budget Deficit Hit Record $6.6 Trillion in 2012

Five-Year Average Annual Shortfall at $5.2 Trillion

With U.S. Facing Mortal, Long-Range Solvency Issues, Hyperinflation Remains a Virtual Certainty

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PLEASE NOTE: This Special Commentary *updates the GAAP-based federal budget deficit and total federal obligations, based on the* 2012 Financial Report of the United Stated Government *published by the U.S. Treasury on January 17, 2013.*

Best wishes to all — John Williams

U.S. Fiscal Circumstances Simply Are Not Sustainable

The 2012 fiscal condition of the United States suffered its worst annual deterioration in the history of the Republic. Based on generally accepted accounting principles (GAAP-based accounting), the actual federal deficit hit a record $6.6 trillion in the year ended September 30, 2012, a level that was fully 42% of the nation's annual GDP.

The GAAP-based annual deficit differs markedly from the headline cash-based accounting version, which showed a $1.1 trillion cash shortfall in the government's 2012 day-to-day operations. Using GAAP-based accrual accounting, though, as typically used by private corporations, the government's day-to-day operations were shown to have suffered a shortfall of $1.3 trillion, with an additional $5.3 trillion shortfall in the year-to-year increase of unfunded liabilities in social programs, such as in Medicare and Social Security. Those unfunded liabilities are reported in terms of net present value (NPV), where future liability dollar estimates have been reduced to reflect the time-value of money. Effectively, the NPV indicates the amount of cash needed in hand today in order to meet those unfunded obligations.

Total Government Obligations. Based on the same official GAAP numbers, the federal government's total obligations as of September 30, 2012, stood at $85.4 trillion, or 5.5 times the level of fiscal-2012 GDP. The GDP, though, is not that meaningful a measure here, other than it gives some perspective to the magnitude of the government's annual deficit and total obligations.

Suggestions that somehow the total GDP can cover the government's deficit, debt and obligations problems are nonsense. With decades of practice and fine-tuning, the U.S. government has reached the practical limits of the net cash it can siphon out of the income-producing private sector. The system has reached that delicate balance, where the government's raising taxes actually reduces the government's cash receipts, where higher taxes reduce economic activity enough to reduce tax revenues.

Apologists for runaway spending and obligations like to look at some measure of the NPV of unfunded liabilities as a percentage of the NPV of the next 75 years of GDP, a ratio that is estimated at somewhere around a "sustainable" several percent, depending on the measure. That approach simply is not meaningful.

Beyond the lack of GDP significance, as mentioned above, the NPV of the unfunded liabilities effectively has accounted for a measure of future GDP, already, in the related projections of revenues to be raised for the various social programs, going forward. Reiterating the NPV concept, the GAAP-based 2012 deficit of $6.6 trillion and obligations of $85.4 trillion reflect the cash needed in hand today, in order to cover those amounts; that is why the NPV is used in the accounting.

More importantly, the apologists for the unsupportable unfunded liabilities view the aggregate liabilities as static, where, in fact, the circumstance is deteriorating annually at an unsustainable pace. As can be seen in the accompanying table, the consistent GAAP-based annual deficit for the U.S. government has averaged $5.2 trillion per year for the last five years, an average annual deterioration equal to 36% of average annual GDP, during the same period.

It Gets Worse. The federal government's annual fiscal circumstances are even worse than as indicated by the headline numbers above. Noted, but not tallied in the government's financial statements are major government programs that technically are insolvent. Official liabilities do not include a full accounting for existing exposures or related funding that will be needed to support programs that either have, or have as a practical matter, the full faith and credit of the United States behind them. Those entities include the Pension Benefit Guaranty Corporation (PBGC), the U.S. Postal Service and the Federal Housing Authority (FHA), as well as the circumstances surrounding Fannie Mae and Freddie Mac.

The GAAP-Based Federal Deficit Remains Unsustainable, Uncontainable and Unstable. As shown in the accompanying table *U.S. Government Annual Fiscal Deficits and Total Obligations* (GAAP versus

Cash Accounting), U.S. government fiscal conditions continued to deteriorate sharply in 2012. They likely will continue to do so again in 2013.

Often, before a large company goes bankrupt, creditors can see the financial collapse coming and tighten up on credit, freeze credit, or move to collect a debt while there still may be time. The same thing happens at the level of sovereign states, and the global financial markets increasingly have indicated waning patience for the United States to address its longer-range solvency issues.

As discussed in *Hyperinflation 2012*, even with the government seizing all salaries and wages, taxes simply could not be raised enough to bring the system into balance for one year, let alone for future years. That also ignores the question—raised earlier—of whether raising taxes has reached a tipping point, where further tax increases would slow the economy and reduce—instead of increase—tax revenues. Separately, every penny of government spending—except for Social Security and Medicare—could be cut, but the system still would be in annual deficit.

With limited tax-raising options, massive spending cuts have to be put in place and the social programs recast so as to be solvent, 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 United States will be doomed to an eventual hyperinflation, as the government prints money to meet its obligations, a process that already has started. There is little time to restore balance to the system, as discussed in *No. 485: Special Commentary*.

Comparative Detail in the Cash-Based and GAAP-Based Government Accounting. For more than a decade, the U.S. Treasury has been publishing audited financial statements of the U.S. government, using generally accepted accounting principles (GAAP). The statements have been audited by the Government Accountability Office (GAO, at one time the General Accounting Office), but—due to "material" problems with the government's bookkeeping, the GAO has yet to offer an unqualified opinion on any of the annual statements.

The following table of *U.S. Government Annual Fiscal Deficits and Total Obligations* (GAAP versus Cash Accounting) and related graphs summarize various measures of the U.S. government's fiscal circumstance. The subsequent *Sources* and *Footnotes* explain how the numbers are put together. The shaded columns reflect the data used in plotting the graphs that follow the *Footnotes*. The latest numbers are based on the *2012 Financial Report of the United States Government.*

U.S. Government Annual Fiscal Deficits and Total Obligations
GAAP versus Cash Accounting. Sources: ShadowStats.com, U.S. Treasury

I	II	III	IV	V	VI	VII
Fiscal Year Ended Sep 30	Formal Cash-Based Deficit [Surplus] ($Billions)	GAAP Ex-SS Etc. Deficit [Surplus] ($Billions)	GAAP With SS Etc., Raw Deficit [Surplus] ($Trillions)	GAAP With SS Etc., Consistent-Basis Deficit ($Trillions)	Gross Federal Debt ($Trillions)	Total Federal Obligations (GAAP) ($Trillions)
2012	$1,089.4	$1,316.3	$6.6	$6.6	$16.2	$85.4 [1]
2011	1,298.6	1,312.6	4.5	4.5	14.9	80.9 [1]
2010	1,294.1	2,080.3	[7.0] [1]	5.3 [1]	13.6	76.3 [1]
2009 [2]	1,417.1	1,253.7	4.3 [2]	4.3 [2]	11.9	70.5 [2]
2008	454.8	1,009.1	5.1	5.1	10.0	65.6
2007	162.8	275.5	1.2	4.2	9.0	59.8
2006	248.2	449.5	4.6	4.6	8.5	58.2
2005	318.5	760.2	3.5	3.5	7.9	53.3
2004	412.3	615.6	11.0 [3]	3.4 [3]	7.4	49.5
2003	374.8	667.6	3.0	3.0	6.8	39.1
2002	157.8	364.5	1.5	1.5	6.2	35.4
2001 [4]	[127.0]	514.8	4.5	4.5	5.8	30.3
2000 [4]	[236.9]	[39.6]	3.9	3.9	5.7	25.9

Last updated: February 4, 2013.

<u>Sources for the ShadowStats.com Table Data:</u>

The *2012 Financial Report of the United States Government* (2012 report), the annual GAAP-based financial statements published by the U.S. Treasury on January 17, 2013, are found here: http://fms.treas.gov/fr/index.html. Earlier GAAP-based statements are found here: http://fms.treas.gov/fr/backissues.html.

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

***Formal Cash-Based Deficit (Column II)* –** The headline cash-based deficit numbers for 2012 and 2011 are from the last section of Table 1, as *Unified Budget Deficit*, on page 3 of the *2012 Report*, "Management's Discussion and Analysis" (hereinafter referred to as MDA). Earlier years are from the respective financial statements or as otherwise reported by the U.S. Treasury. The 2012 cash-based deficit was $1,089.4 billion.

***GAAP ex-SS Etc., Deficit (Column III)* –** The simple GAAP-based deficit, before accounting for unfunded liabilities, is referred to as "Net Operating Cost" in the first section of Table 1, on page 3 of MDA in the *2012 Report*. It excludes annual change in social-insurance unfunded liabilities. For 2012, the simple GAAP-based deficit was $1,316.3 billion,

***GAAP with SS Etc., Raw Deficit (Column IV)* –** The numbers here are calculated as the simple GAAP-number in *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 19) 5th row of data, *Total Social Insurance Expenditures, Net (Closed Group)*, 2012 minus 2011 for the 2012 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 unfunded liabilities for fiscal 2012 and 2011, respectively, were $51,604 and $46,272 billion, an annual increase of $5,332 billion. That, plus the $1,316.3 billion from *Column III* totals the $6.6 trillion shown in *Column IV* for 2012.

***GAAP with SS Etc., Consistent-Data Deficit (Column V)* –** The year-to-year changes reflected in the raw-deficit GAAP numbers of *Column III* can be skewed terribly by significant one-time events, accounting and otherwise, and those variations are adjusted for in this *Column V*, so as to reflect the comparative annual deficits on as close to a consistent year-to-year basis as possible. Massive changes were seen in the accounting for the 2004 overhaul of Medicare, which added nearly $8 trillion to the net present value of 2004 unfunded liabilities, and for the 2010 introduction of the Affordable Care Act (ACA), which purportedly reduced 2010 unfunded liabilities by more than $12 trillion. The affected years have been 2004, 2007, and 2010. Detail is discussed in the related footnotes.

***Gross Federal Debt (Column VI)* –** The gross federal debt is as indicated in "Note 14. Federal Debt Securities ..." pages 91 to 93 of the *2012 Report*: total held by public (page 91) plus total intragovernmental (page 93). These numbers may differ from other Treasury tallies, as the totals include accrued interest payable. For 2012, gross federal debt totaled $16,185 billion, composed of $11,332 billion public, $4,853 billion intragovernmental.

***Total Federal Obligations (Column VII)* –** From the *2012 Report*, total Federal Obligations include balance-sheet liabilities ($18,849 billion), from the *Total Liabilities* line in the second section of MDA, Table 1, page 3; plus total intragovernmental debt of $4,853 billion on page 93; plus the 2012 *Closed Group* net present value unfunded liabilities of $51,604 billion (official) plus the alternative differential of $10,071 billion (see *Column V* and page 135 of the *2012 Report*); which total $85.4 trillion.

The *Total Liabilities* account in the consolidated financial statements formally excludes intragovernmental debt, where the non-public debt is debt the government owes to itself for Social Security, etc. Those obligations are counted as "funded," however, and, as such, are part of total government obligations and are added back in here.

See the general accompanying text and footnote (1) for a discussion on the inclusion of the GAO's alternative scenario of unfunded liabilities for the ACA in the total obligations number shown in *Column VII*.

Footnotes:

[1] As reported in *Column VII* of the table, fiscal years 2010 through 2012 reflect alternative-scenario measures on the size of the government's unfunded liabilities, as put forth by the Government Accountability Office (GAO) in its notes to the financial statements of those years. Also, just for 2010, the GAO alternative is used in *Column V*, which results in an annual $12.4 trillion swing in the raw 2010 GAAP-based surplus of $7.0 trillion, shown in *Column IV*, to a $5.3 trillion deficit (there is a rounding difference). In order to maintain consistency with the official estimates, the raw-deficit data are published in *Column III*.

In fiscal 2010, the Administration estimated a one-time $12.4 trillion reduction in the 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, ShadowStats estimated that the GAAP aggregate GAAP-based shortfall would have been roughly $5 trillion, instead of the proffered aggregate $7 trillion surplus.

The GAO-Alternative numbers were used here to adjust for those issues, reflecting results using the "Illustrative Alternative Scenario" on Medicare costs shown on page 130 of the *2010 Report*, page 134 of the *2011 Report* and on page 135 of the *2012 Report*. The alternative calculations post-2010 were not particularly dynamic, but those numbers are being used as placeholders for the *Total Obligations* numbers, until such time as better accounting estimates are available.

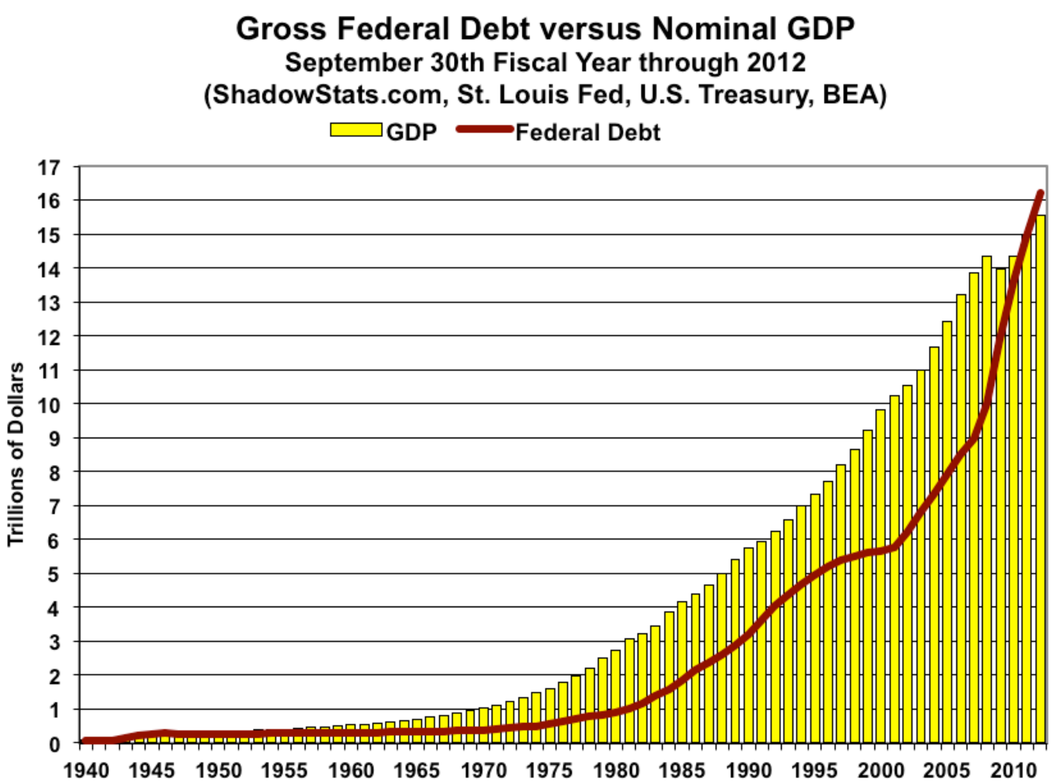
[2] The 2009 data predate December 2009 guarantees of Fannie Mae and Freddie Mac (GSEs) and do not reflect Pension Benefit Guaranty Corporation or FDIC liabilities. Even so, the accounting for 2009 to 2012 reflected nothing of what might be considered direct, full faith and credit guarantees of the U.S. 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.

[3] ShadowStats estimates a $3.4 trillion consistent-basis total 2004 GAAP-deficit, excluding the one-time and initial unfunded liabilities for the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (enacted December 2003), which

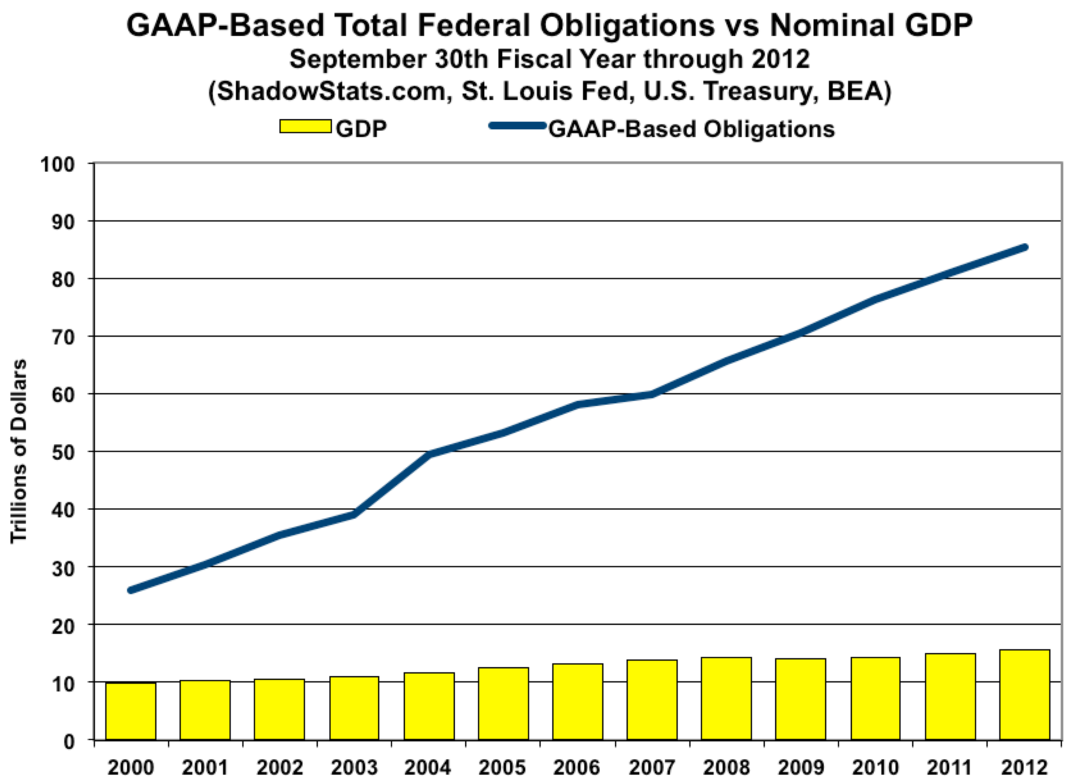
pushed the annual GAAP-based deficit to $11.0 trillion. In order to allow consistency with the official GAAP statements, the raw "official" numbers are shown in *Column IV*; the "consistent" accounting is shown in *Column V* of the table.

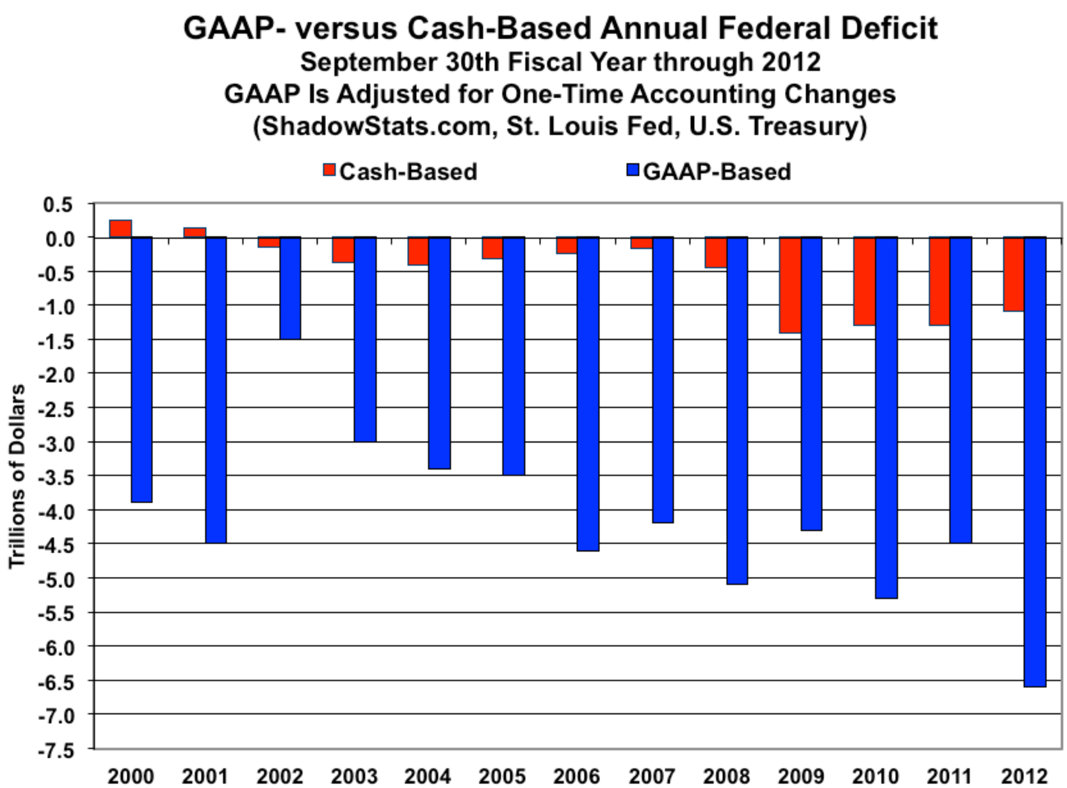
(4) The statements for 2000 and 2001 were not audited. Where the GAO has audited the government's financial statements from 2002 to 2012, the GAO has found varying "material" issues with the government's reporting and regularly does not offer an opinion on the statements.

The following graph of *Gross Federal Debt versus GDP* plots the level of the government's fiscal-year-end debt level (see *Column VI* in the table), versus the average nominal (not adjusted for inflation) GDP level for the same fiscal-year ended September 30th. In 2012, the actual debt level overtook the nominal GDP.



In the next graph, similar information is shown, but the government number reflects total federal debt and obligations, as shown in *Column VII* of the table. As of fiscal 2012, total obligations, which include gross federal debt, the net-present-value of the unfunded liabilities for the government's social programs and other liabilities was at a ratio of 5.5-to-1 versus the GDP level.


GAAP-Based Total Federal Obligations vs Nominal GDP
September 30th Fiscal Year through 2012
(ShadowStats.com, St. Louis Fed, U.S. Treasury, BEA)
GDP
GAAP-Based Obligations
Trillions of Dollars
100
90
80
70
60
50
40
30
20
10
0
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012


GAAP- versus Cash-Based Annual Federal Deficit
September 30th Fiscal Year through 2012
GAAP Is Adjusted for One-Time Accounting Changes
(ShadowStats.com, St. Louis Fed, U.S. Treasury)
Cash-Based
GAAP-Based
Trillions of Dollars
0.5
0.0
-0.5
-1.0
-1.5
-2.0
-2.5
-3.0
-3.5
-4.0
-4.5
-5.0
-5.5
-6.0
-6.5
-7.0
-7.5
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012

The preceding final graph is *GAAP- versus Cash-Based Annual Federal Deficit*. The annual GAAP numbers have been adjusted for one-time accounting changes that otherwise would distort consistent year-to-year GAAP-based numbers, as detailed in *Column II and in Column V,* and as discussed in the footnotes to the table.

