Selected Analysis and Commentary on The Financial Report of The United States Government

As Published by the Department Of The Treasury

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Forward

This exposition is written with the intention of informing the reader about selected financial facts disclosed in the most recent Financial Report of The United States Government (Fiscal year ended September 30, 2011) and other sources as noted. I realize that much of the information in the financial report as published by the Treasury Department is unclear and hard to understand to those who have no specific training concerning how to read and interpret financial statements and the data contained in the notes. I have attempted, as much as possible, to deliver selected facts in plain language and in a way for everyone to understand.

Most citizens are not aware that the United States Government publishes a complete set of Financial Statements each year, much like the Financial Reports published by companies you know, such as IBM, GE, Ford Motor Company, Intel, Microsoft, etc. The fact that this detailed information is available is not disclosed to the public by the government or by major media outlets. You can find this report by going to any internet search engine and using this term – "Financial Report of the United States."

I believe that every citizen should understand the dire financial condition of our Federal Government. To that end, I hope you take this information to heart and begin to demand that our elected officials treat our public finances the way we treat our own individual finances, and that by doing so, embark on a path to bring long-term financial stability to our nation.

For your convenience, a copy of the full Financial Report of the United States Government for the fiscal year ended 09/30/11 has been posted at www.dwaynedillscpa.com

Definitions and Information to Assist Understanding the Report

A. How to interpret a Trillion Dollars. Numerically it is $1,000,000,000,000.00. Most of us have trouble understanding the magnitude of the number. Here's a way to understand. If you started a business on January 1 in the year 1 A.D., and in that business you lost One Million ($1,000,000.00) Dollars per day, seven days per week (including Leap Days when applicable), every year, year in and year out until now, you have yet to reach One Trillion Dollars. You have only reached approximately 735 Billion as of 10/15/12. As an interesting note, since President Obama took office, we have added $4,029,304,320.00 on average to the national debt EACH DAY (yes, you read correct – over 4 BillionPer Day).

B. Negative Net Worth. This is a measure of the excess of liabilities and debts owed versus assets owned. As a note – if you request a loan from a bank with a large negative net worth, it indicates that you owe much more than you own. Thus, you are unlikely to get a loan.

C. Time Value of Money. The concept is that money gains value over time. This is the reason you earn interest on funds deposited at a bank. In the Financial Report, future obligations that must be paid have been reduced to the value of Today's Dollar. For example, if I must pay out $100,000.00 in 3 years, and I anticipate a growth rate of 3 Percent, then in Today's Dollar Value, I owe $91,403.38. This is how the Financial Report values the obligations to be paid in the future. Please note that the actual dollars to be paid are MUCH MORE than the figures reported in the Financial Report.

D. Cash Basis Report. When you hear on the nightly news that the United States Government has incurred a deficit of One Trillion Dollars, this is a measure of actual funds received versus the actual funds expended for the current year. This figure is reported by major media outlets. However, this deficit number does not disclose the additional liabilities and debts that the United States Government has promised to pay at some point in the future. This is disclosed in the Financial Report.

E. The information used in this document was taken direct from The Financial Report of the United States Government and the related footnotes thereto (along with other selected sources as noted). This information is compiled each year by the Department of the Treasury and provided to the President, Congress and the American People (Have you honestly ever heard of this report? – thus proving my point in #D above). The Department of the Treasury along with the Office of Management and Budget (OMB) prepared the Report, and are generally required to be prepared in conformity with U.S. Generally Accepted Accounting Principles. Pursuant to 31 U.S.C. Section 331(e)(1), the Department of the Treasury must submit the Report to the President and to the Congress no later than 6 months after the September 30 Fiscal Year End. The report is signed by the Secretary of the Treasury (currently Timothy F. Geithner).

Analysis and Data Discussion

To be blunt at the beginning, the finances of the United States Government are, in my opinion, in a dire position. In summary, our Federal Government is borrowing money at an unprecedented pace. Further, our Federal Reserve Bank is literally printing money out of thin air via Quantitative Easing and other methods (some call this monetizing the debt). The Federal Reserve is purchasing US Government Bonds, Mortgage Backed Securities and other US Government Securities from the Treasury Department. Wikipedia has a good discussion on the issue and I suggest you research this topic to gain a better understanding. Unfortunately, I cannot find a solid figure on the amount of purchased debt by the Federal Reserve system but it is estimated to be near 2.5 to 2.8 Trillion Dollars before another round of Quantitative Easing was announced to begin in September, 2012. This round will have a plan to purchase 40 Billion of mortgage backed securities per month, and it was recently published that Ben Bernanke and Company are willing to continue down this road as long as deemed necessary.

Here are selected figures from the Financial Report of the United States Government and other sources as indicated:

14.784 Trillion Dollars – The negative Net Worth of the United States Government as of 09/30/11 on the Cash Basis of Accounting. Measured as 2.71 Trillion Dollars in Assets versus 17.49 Trillion Dollars in Liabilities. Note that these numbers DO NOT take into account the information to follow later and the obligations promised.

1.32 Trillion Dollars – The net Cash Basis Deficit For Fiscal Year Ended 09/30/11.

2.08 Trillion Dollars – The net Cash Basis Deficit For Fiscal Year Ended 09/30/10.

98.229 Trillion Dollars -- The present value (See Definition C) of all Social Insurance Program payments to be made in the next 75 years per actuarial projections (including Social Security, Medicare, Railroad Retirement, Black Lung, etc).

64.399 Trillion Dollars -- The present value of all Social Insurance Program Revenues to be collected from taxes and other sources over the next 75 years.

33.830 Trillion Dollars -- NET SHORTFALL – Excess Present Value of Expenses versus Revenue for these programs over the next 75 years.

102.9 Percent – The amount of cumulative Federal Debt versus our national Gross Domestic Product. This number is projected to be 200 Percent of Gross Domestic Product in 25 years. Source – Congressional Budget Office.

"In 2011 the Fed (Federal Reserve Bank) purchased a stunning 61% of the total net Treasury issuance (Net Treasury Debt issued in the form of Treasury Bills, Treasury Bonds, etc), up from negligible amounts prior to the 2008 financial crisis. This not only creates the false appearance of limitless demand for US debt but also blunts any sense of urgency to reduce supersized budget deficit." Quote – Lawrence Goodman of the Wall Street Journal.

If you were to raise the tax rates to 100% on everyone making $500,000.00 per year or more, it would still not be enough to balance the Federal budget. Let's get some statistics on this. In 2009, the total income earned by those making $500,000.00 or more was $1,029,256,075,000.00. This group paid $256,699,499,000.00 in Federal Income Tax. This left them with $772,556,576,000.00 after Federal Income Taxes were paid. The 2009 National Debt increased by 1.61 Trillion Dollars ($1,611,544,812,899.90). Thus, we would still have a 2009 budget shortfall of 839 Billion Dollars (Source – CNSNews.com). I have researched this topic at the Congressional Budget Office website. Unfortunately, 2009 is the latest year that we have concrete information on this topic. Years 2010 and 2011 are listed as estimated.

Additional Data from the Financial Report

Again, for your convenience, the full Financial Statement of the United States Government is located at www.dwaynedillscpa.com

Near the front of the Financial Report, there is a section entitled, “A citizen’s guide to the Fiscal Year 2011 Financial Report of the United States Government.” This is an overview of the entire Financial Report. There are some charts that do justice to our situation.

Please see page iii of this Citizen’s Guide. Here you get a graph of expected total spending versus total receipts out to year 2080. Notice the ever growing gap of spending versus revenue.

Please see page x through page xiii. Please notice that, on page xii, the projection of the public debt outstanding will reach about 280% of our Nation’s GDP (Gross Domestic Product – a measure of what our nation produces in goods and services in a year) by year 2080. Please take note that no nation has been able to thrive under a Debt versus GDP load of this magnitude. Greece is virtually bankrupt with a Debt versus GDP load of 165.3%. Japan has had a stagnant economy for years with a Debt versus GDP load of 208.2%. The United States now has a Debt versus GDP Load of roughly 103%.

The problem with a swelling debt is that the interest payments on that debt consume an ever-growing amount of the public money available for budgeting. This is compounded as we face a large projected deficit in funds already promised to be paid for Social Insurance Programs in the next 75 years.

Let me be very clear about what Treasury Secretary Timothy F. Geithner said on Page xiii. Under the “Conclusion” section, he points out that projections of 75 years of data can be uncertain. However, he points out, “there is little question that current policies cannot be sustained indefinitely.” Let me say it another way. Very simply – the government cannot pay for everything that has been promised.

Implications of What The Government is Doing

There are implications to actions of government – some positive, some negative. It is difficult to determine the timing and extent of the impacts of things they have done. Below is a discussion of some of these:

A. Quantitative Easing and the Printing of Money. The Federal Reserve Bank has injected a huge amount of cash (over 2 Trillion dollars) into the system through the purchase of Treasury Bonds, Treasury Notes, Mortgage Backed Securities and the like. The short-term impact of this action is the artificial lowering of interest rates for lending in the hope of spurring economic development and activity. However, there are negative impacts that can occur if too much money is injected into the system for too long a period of time. I liken this to winding a clock. Eventually, it must unwind or else the spring will be damaged or break.

   The first negative impact, which is already being experienced, is that interest rates paid on savings is artificially low.

   The second impact already underway is that the Dollar loses value against other currencies. As more money is printed and injected into the system without backing (through selling bonds to investors or other nations), the value of each existing Dollar in circulation drops. This will eventually lead to inflation and the loss of purchasing power of existing savings. Let's examine some specifics:

   At January 1, 2006, the dollar purchased 0.8254 Euro and the dollar purchased 114.31 Japanese Yen.

   As of October 15, 2012, the dollar now only purchases 0.7729 Euro and the dollar only purchases 78.38 Japanese Yen.

   Our dollar has decreased in value versus most other major currencies, which leads to the third point below.

   Thirdly, other nations do become upset as the value of their investments in our Dollars and Bonds drops as the value of the Dollar decreases. This is why other nations have considered something other than the Dollar as the World Reserve Currency. More on this will follow later.

B. Continued and increased borrowing to finance an increasing deficit. As outlined in the Financial Report, it is expected that spending will continue to increase faster than collection of revenue. This leads the government to seek more borrowing to finance the ballooning list of promises. As borrowing increases, so do the interest payments that must be paid on the existing debt. The increase in the payment of interest on the debt continues to erode the funds available to pay for the growing list of promises. It can create a self-feeding cycle.

C. The credit rating of the United States continues to decline. Our nation has already suffered a debt rating decreases by Standard & Poor's and Egan-Jones. More will certainly follow (and these reductions have been threatened by some of the rating agencies) if we do not bring our finances into order. It is the job of these rating agencies to determine the financial soundness of anyone who issues debt instruments (such as US Government Bonds). As the ratings are decreased, the interest rate expected by investors for buying our bonds and debt increases. Thus, we add pain to the budget cycle by adding increased interest payments to debt issued.

I know without any question that an inflationary period will be in our future due to the money printing of the Federal Reserve Bank. It's impossible to say how severe or for how long. I now anticipate a period of at least three years of hyper-inflation at least as severe or more so than the inflation we experienced in the late 1070's and early 1980's. At the end of that period, a gallon of milk could cost $8.00. A gallon of gas could cost $10.00. I know this sounds incredible, but I feel it is possible. We are seeing some hints of the coming trouble in some major publications such as The Economist.

Our currency has already been impacted by the Federal Reserve Bank's actions. Inflation is expected unless the Federal Reserve can unwind the Quantitative Easing. But, ending the money printing machine leads to the next point.

I anticipate an environment of rising, and eventually, hyper-interest rates on debt. Home mortgages in the 12 to 20% range is quite possible. Again, it's hard to say for certain, but there are many analysts now predicting a rising interest rate environment to begin at some point and continue for an extended period. A rising interest rate environment will complicate the Federal budget by increasing the funds needed to pay interest on the ever expanding Federal Debt.

It is possible that other nations may demand an alternative to the Dollar for the World Reserve Currency. There has already been talk of this, especially by China, Russia and other Asian nations. There are multiple implications of this action. By having the World Reserve Currency, Crude Oil is priced in US Dollars. In simple terms, if you live in Germany, you must take Euros and purchase US Dollars to purchase Crude Oil. We get a benefit from this – we get crude oil at somewhat of a discount. Compare gasoline prices in other nations to the prices we pay for proof. If crude oil is priced in something other than dollars, and our currency continues to decline in value due to all of the printed dollars injected into the system by the Federal Reserve Bank, we will face much higher prices as we trade our Dollars to buy crude oil. Also, as our Dollar declines against other currencies, goods and products from other countries becomes more expensive to us. If we need to purchase a widget from Germany, and if the Dollar declines against the Euro then more and more Dollars will be required to purchase the Widget priced in Euros. Inflation is again the concern.

What Can We Do?

First and foremost – get informed about what is going on. Please understand that your President, your Congressmen and your Senators have the very same information that I have outlined. Remember, this is provided to them each year as required by law. They DO know what is going on and so does the news media, but they refuse to discuss it in detail. We have only begun to see some hint of willingness to discuss these issues with the push of Congressman Ryan on budget issues.

Also, you need to understand that the problem is too large for a single solution. If you were to raise the tax rates to 100% on everyone making $500,000.00 per year or more, it would still not be enough to balance the Federal budget. Thus, if you took all the income of this group in Federal Income Tax, you are still short on balancing the budget by 839 Billion Dollars (for Year 2009). Realize now that there is no way out of this mess by simply taxing the wealthy. This is a complete falsehood that is being promoted by the Administration. Spending cuts and changes in the social welfare programs must be enacted along with some changes in our tax structure. This will not be popular, but the Federal Government has promised more in benefits than it can possibly pay.

Also, I feel that you should become active in letting our elected leaders know that we, the voting public, will hold them accountable for this debacle they have created and that we demand that the National Finances be put on a path that will lead to stability.

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Now, here's a quote that sums up our financial demise:

The American Republic will endure until the day Congress discovers that it can bribe the public with the public's money.

Alexis de Tocqueville