BABY-BOOM RETIREMENT CRISIS

1) USEFUL BACKGROUND INFORMATION SOURCES:

FiscalSolvency.com

fullhousetrader.com/cornerstone_annual_market_outlook_jan2007.htm

2) THE THREE CORE PROBLEMS:

i) The U.S.A. has many tens of trillions of unfunded promises to the nation's retirement system (S.S., and especially Medicare & Medicaid). The figure for fiscal year 2008 is approximately $59.3 trillion. $65.5 Tril.

ii) This fact is well hidden because the Federal Government keeps 3 sets of books (cash, "audited", and full accrual). The "headline" numbers are always the most favorable and meaningless "cash basis" books.

iii) Without public outcry, elected officials won't address this problem until it's an obvious crisis. The solution must start with voters not politicians. Reason: it's a very difficult issue that "takes away" rather than "gives". This is not a winning platform for a candidate.

3) NECESSARY INSTITUTIONAL SOLUTIONS:

A) Adopt accrual based, actuarially sound federal accounting

B) Establish a "VBO" Voters Budget Office, independent of Congress, that reports to the people on the financial condition of our government and vital government programs. This isn't so far fetched. We had a very conscientious Comprotroller General in David Walker for 12 years!

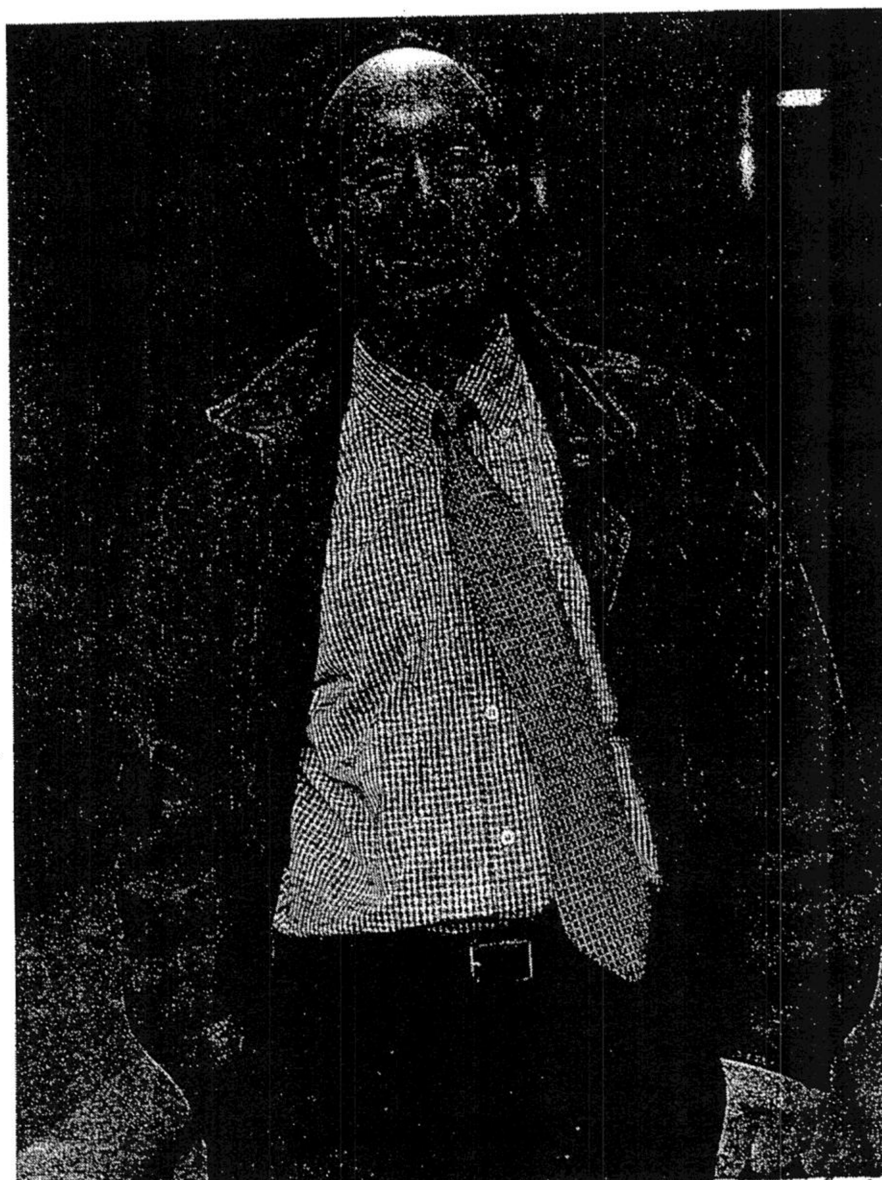
C) All government insurance programs must be fully funded and fiscally sound as is required for all private insurance company policies.

Baby-Boom Retirement Debacle Starts 2008

The $44 Trillion ABYSS

The baby-boomers are about to retire, and it's going to cost us—*big*. Here's what the government doesn't want you to know.

BY ANNA BERNASEK



Last fall Paul O'Neill, then Secretary of the Treasury, wanted a simple answer to a thorny question: How prepared was the nation today to pay all its future bills? Two government experts worked for months to calculate the answer. Their findings, which shocked even them, were never published—the Bush administration made sure of that. The reason for the silence was that by the time the two researchers had completed their study, O'Neill had been thrown out of the Treasury and replaced by the more politically astute John Snow. No savvy administration power player would dare point out, right in the middle of tax-cut season, that there was a huge hole in the country's finances—a *$44 trillion* hole.

MAN WITH A MISSION Boston University's Kotlikoff is a one-man fiscal warning system.

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"There are tens of trillions of dollars in discounted net present value of commitments and obligations that aren't adequately addressed... We would have to have tens of trillions of dollars invested at Treasury rates today to make good on those promises and we just don't have it..."

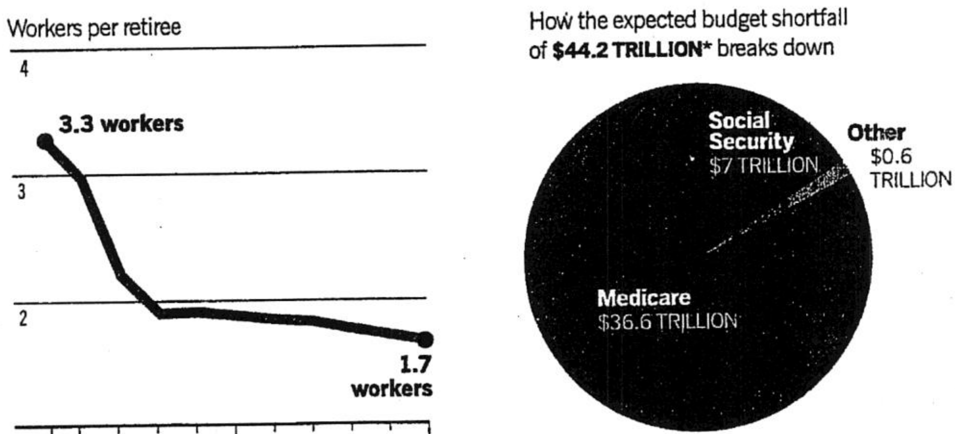
"... We face a demographic tidal wave that is unprecedented in the history of this country..."

> Donald Walker, Comptroller General of the United States
> Fortune, Sept. 10, 2003

"This particular insurance company [the Federal Government] has made promises to it's policyholders that have a current value $20 trillion or so in excess of the revenues that it expects to receive..."

> Peter Fisher, Treasury Undersecretary for Domestic Finance
> Wall Street Journal, Jan. 2003

GULP The first massive wave of baby-boomer retirees will hit five years from now. That will leave fewer workers to pay for ballooning Social Security and Medicare bills.



*Based on current government revenue and spending.

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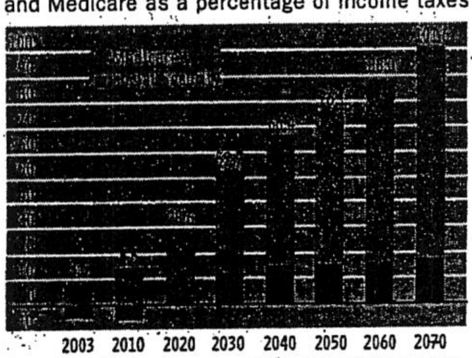
Pity the Kids

General Revenue Transfers to Social Security and Medicare as a percentage of income taxes

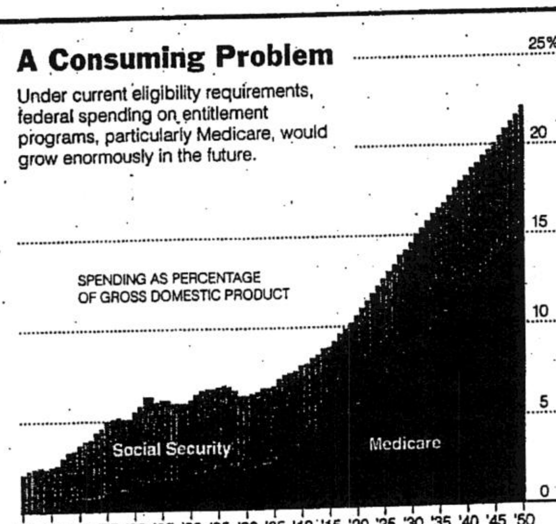


Notes: Federal Income Taxes are estimated to be 10.89% of GDP, which is the 50-year average.

Source: 2004 Social Security and Medicare Trustees Reports and author's estimates.

A Consuming Problem

Under current eligibility requirements, federal spending on entitlement programs, particularly Medicare, would grow enormously in the future.



Source: Congressional Budget Office

The New York Times

Backgrounder

Published by The Heritage Foundation

No. 2253
March 24, 2009

A First Big Step Toward Medicare Sustainability

J. D. Foster, Ph.D.

Medicare is the third largest program in the federal government after defense spending and Social Security. It will soon become the largest program, absorbing an ever-increasing share of the budget and national income. While the basic facts about Medicare are not new, what is new and encouraging is the growing recognition that Medicare is unaffordable in its current form and must be fundamentally reformed.

The Medicare trustees report that Medicare presents the nation with an $85.6 trillion financial hole.[1] This is the present value of Medicare's projected excess costs,[2] which reflect current and future subsidies provided under current law to Medicare beneficiaries for health insurance. For example, in 2007, the average Medicare enrollee received a benefit valued at $10,460, which included a subsidy of $4,053.

Medicare is a vital part of a federal social safety net, and it should be preserved, kept affordable for lower-income seniors, and be available to all seniors. However, this does not justify taxing workers and families to subsidize the health insurance premiums of higher-income seniors.

This observation suggests a policy of phasing out Medicare subsidies for upper-income beneficiaries. Such a phaseout would be good policy even if Medicare were fiscally sound, but it is even more important given Medicare's fiscal plight. On fiscal grounds and on fairness grounds, phasing out the subsidy for upper-income seniors should be among the first steps toward comprehensive Medicare reform.

Talking Points

- Medicare is a vital program for seniors, but is fundamentally unaffordable as it is currently structured because it faces an unfunded obligation of $85.6 trillion.
- Successful Medicare reform will need an achievable goal consistent with sustainability. Maintaining general revenue support for Medicare at today's levels as a share of the economy provides such a goal and would reduce the reform target to $67.8 trillion.
- In 2007, the average Medicare beneficiary received a general revenue subsidy of $4,053.
- Subsidizing low-income seniors' health insurance is and always will be an integral part of the nation's social safety net; however, subsidizing middle-income seniors becomes questionable at some point, and using tax dollars to subsidize the health insurance of upper-income seniors has never been appropriate.
- Phasing out the subsidy for upper-income seniors is an obvious first step toward Medicare sustainability. Such a policy would reduce Medicare's long-run excess costs by over $41 trillion.

This paper, in its entirety, can be found at: *www.heritage.org/Research/HealthCare/bg2253.cfm*

Produced by the Thomas A. Roe Institute for Economic Policy Studies

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ANTIQUATED PAY-AS-YOU-GO ACCOUNTING:
Key to the Baby-Boom Retirement Crisis

"3 SETS OF BOOKS"

Sound like Don King or Enron??

–$318 billion
Official deficit

–$760 billion
Audited version

What's the *real* federal deficit?

How many billions (or trillions) of dollars depends on how you do the accounting

The official deficit tally for the 2005 fiscal year comes from Congress and the White House.

The audited version is from the Treasury Department and follows standard accounting principles.

The third figure is based on accounting rules like those used by corporations and includes the costs of Social Security and Medicare.

By Dennis Cauchon
USA TODAY

Cover story

The federal government keeps two sets of books. The set the government promotes to the public has a healthier bottom line: a $318 billion deficit in 2005.

The set the government doesn't talk about is the audited financial statement produced by the government's accountants following standard accounting rules. It reports a more ominous financial picture: a $760 billion deficit for 2005. If Social Security and Medicare were included — as the board that sets accounting rules is considering — the federal deficit would have been $3.5 trillion.

Congress has written its own accounting rules — which would be illegal for a corporation to use because they ignore important costs such as the growing expense of retirement benefits for civil servants and military personnel.

Last year, the audited statement produced by the accountants said the government ran a deficit equal to $6,700 for every American household. The number given to the public put the deficit at $2,800 per household.

Please see COVER STORY next page ▸

–$3.5 trillion
Corporate-style

(8)

CBO

**Director's Conference on
Budgeting and Accounting for
Long-Term Obligations**

The ABCs of Long-Term Budget Challenges

**Opening Remarks
by
Donald B. Marron
Acting Director**

December 8, 2006

CONGRESSIONAL BUDGET OFFICE
SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

Good morning. Welcome to the Congressional Budget Office's (CBO's) annual Director's Conference.

In previous years, these conferences have addressed issues such as improving revenue estimation and strengthening the budget process. Today's conference focuses on the largest fiscal challenge facing the nation: the aging of the population and the growing cost of federal health and retirement programs.

The basic challenge is well-known. If current trends continue and current policies remain in place, federal spending will outstrip revenues in coming decades, even if tax reductions enacted over the past few years expire, as scheduled, at the end of 2010. Deficits will increase sharply, debt held by the public will grow faster than the economy, and interest payments will soar, undermining the government's finances and weakening the economy.

In short, the nation's fiscal policy is on an unsustainable path, posing a long-term threat to the well-being of the American people and the country's status in the world.

The reasons for that dire outlook are familiar but warrant repeating. Over coming decades, the aging of the U.S. population will slow the pace of economic growth —and the growth of tax revenues—at the same time that a combination of the aging population and rising health care costs will cause spending growth to accelerate.

Economic growth will slow because as workers age, they become less likely to participate in the labor market. Over the next decade alone, CBO estimates, that demographic effect will trim about 0.5 percentage points off of the annual growth of the labor force, and, as a result, decrease the potential real growth rate of the economy from the 3 percent that it has been, on average, since 1990 to 2.6 percent over the next 10 years.[1]

At the same time, the aging population will place increased demands on Social Security. Spending for that program today amounts to about 4 percent of gross domestic product (GDP). If current trends continue, however, that spending will reach roughly 6 percent of GDP in 2030—and will continue to increase thereafter.[2]

Medicare and Medicaid pose an even greater challenge. Those programs face the same demographic pressures as does Social Security. However, Medicare and

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1. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2006).

2. Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005).

Medicaid also face the pressures of rapidly rising health care costs. Over recent decades, health care costs per beneficiary in those programs have grown an average of 2 percentage points to 3 percentage points faster than per capita GDP each year. Even if that extra growth slows to just 1 percentage point, spending on those programs will grow from roughly 4.6 percent of GDP today to more than 9 percent of GDP in 2030—and will continue to rise thereafter.[3]

To put those figures in context, keep in mind that federal spending today is slightly more than 20 percent of GDP. Social Security, Medicare, and Medicaid together amount to about 9 percent of GDP, slightly more than two-fifths of federal spending. By 2030, however, spending on those programs is projected to reach roughly 15 percent of GDP, equivalent to about three-quarters of current federal spending levels. If that increase happened and total spending was held at about today's level as a percentage of GDP, the rest of the budget would have to be cut by more than half.

Spending on Social Security, Medicare, and Medicaid will thus exert pressures on the federal budget that economic growth alone is unlikely to alleviate. Substantial reductions in the projected growth of spending and perhaps a sizable increase in taxes as a share of the economy will therefore be necessary to maintain fiscal stability in coming decades.

The challenges themselves are well-known, yet there is little evidence that they have yet had much influence on policy decisions. The goal of today's conference, therefore, is not only to document the challenges but, more importantly, to discuss how they might become more prominent in the policy process. That discussion has three components—the ABCs, if you will, of long-term budget challenges: how to account for long-term federal obligations, how to budget for them, and how to communicate about them.

Let me begin with the A, accounting.

The budget has long held the spotlight in discussions of fiscal policy. However, the federal government also keeps another set of books. That second set of books —the *Financial Report of the United States Government*—reports fiscal performance using financial accounting principles rather than budget accounting principles.

In this case, there is nothing sinister in keeping two sets of books. The budget and the financial report serve different purposes and therefore have different ways of reporting the government's fiscal condition. Neither provides all relevant information about federal finances.

3. Ibid.

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The key difference between the two reports is the method of accounting used in each.[4] With a few exceptions, the budget uses cash accounting; it measures cash flows in and out of the U.S. Treasury and reports them in the year they occur. The financial report, in contrast, uses accrual accounting; it recognizes expenses and revenues when economic events occur, rather than when the resulting cash flows take place.

The difference between cash and accrual accounting is particularly important when outlays and underlying economic events happen at different points in time. Retirement benefits for federal workers are a prime example. The budget reports outlays when benefit payments are made to retired workers. The financial statements, in contrast, record an operating expense for the estimated cost of those benefits as workers earn them.

The Federal Accounting Standards Advisory Board (FASAB)—the organization that establishes accounting standards for the federal government—is now grappling with the question of how to apply accrual accounting principles to programs like Social Security and Medicare.[5] As one of our speakers will discuss, a majority of the board members favor an approach that would treat a large portion of future Social Security and Medicare benefits as current liabilities and that would recognize a large expense each year (measured in the hundreds of billions or perhaps trillions of dollars) to reflect increases in those obligations over time.

Thus, FASAB's efforts raise important questions about the appropriate accounting treatment for social insurance programs. The increasing attention being paid to FASAB and, more generally, to the financial report also raise a broader question of whether and to what extent budget policy should be informed by the accounting statements. (I should emphasize that FASAB standards apply only to the financial statements and, contrary to some media coverage, have no direct effect on the budget.)

That brings us to the B, budgeting.

As I noted, the budget is generally prepared on a cash basis. As a result, the impacts of long-term obligations appear in the budget in the years in which outlays eventually occur. That approach can create problems if significant effects occur beyond the standard five- or 10-year budget window.

Today, a 10-year window does include the beginning of the approaching fiscal 8
challenges. As the leading edge of the baby-boom generation begins to retire and

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4. For a detailed discussion of the similarities and differences between the budget and the financial reports, see Congressional Budget Office, *Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition* (December 2006).

5. The Congressional Budget Office has one of the 10 seats on the board.

Federal Deficit Reality

September 7th, 2004

Updates to the Primer below, with more recent numbers are available at the following links:

2008 Federal Deficit

2007 Federal Deficit

2006 Federal Deficit

"GOVERNMENT ECONOMIC REPORTS: THINGS YOU'VE SUSPECTED BUT WERE AFRAID TO ASK!"

A Series Authored by Walter J. "John" Williams

"Federal Deficit Reality"
(Part Three in a Series of Five)

September 7, 2004

U.S. Treasury Shows Actual 2003 Federal Deficit at $3.7 Trillion

Deficit Moves Beyond Any Possible Tax Remedy

Could U.S. Treasuries Face a Rating Downgrade?

The U.S. government's fiscal ills have spun wildly out of control and no longer are containable within the existing system. As detailed in this article, the actual annual shortfall in U.S. government operations for fiscal year 2003 (September 30) was $3.7 trillion. Put in perspective, that means if the U.S. Treasury had seized all wages and salaries in 2003 with a 100% income tax, there still would have been a deficit! The outlook for fiscal 2004 numbers is even worse.

Considering that the popularly reported 2003 budget deficit was $374 billion, one-tenth the number cited above, this installment on government reporting concentrates on where the incredulous $3.7 trillion number comes from, how and why the Treasury is reporting it, and why the financial press and federal politicians are ignoring it.

Nonetheless, some implications of the current circumstance are touched upon briefly, here, conditioned by the promise of a full and separate analysis at a future date.

As brief background, the $3.7 trillion number is from government financial statements prepared using generally accepted accounting principles (GAAP), and a large portion of the expanded deficit is from the annual increase in the net present value of unfunded Social Security and Medicare obligations.

The impossibility of this circumstance working out happily is why lame-duck Federal Reserve Chairman Alan Greenspan suddenly has urged politicians in Washington to come clean on not being able to deliver promised Social Security and Medicare benefits already under obligation. He suggests, correctly, that there is no chance of economic or productivity growth resolving the matter. The funding shortfall projections already encompass optimistic economic assumptions.

Even if the Administration and Congress heeded Greenspan's advice, the unfolding fiscal disaster faces one of only two very unpleasant general solutions:

- The first solution is draconian spending cuts, particularly in Social Security and Medicare, even if accompanied by massive tax increases. This appears to be a political impossibility, at present.

- In the absence of political action, the second solution is the U.S. government facing some form of insolvency within the next decade or so. Shy of Uncle Sam defaulting on debt, the most likely outcome is the Fed eventually having to monetize U.S. debt heavily, triggering a hyperinflation. U.S. obligations eventually would be paid off in a significantly debased and devalued dollar.

Implications for the United States' sovereign credit rating is discussed more fully in a later section, but the unfolding fiscal crisis also opens the possibility of a credit downgrade for U.S. Treasury securities. This could happen before either of the two broad solutions discussed above comes into play.

Accounting Gimmicks Mask Underlying Reality for Decades

Misleading accounting used by the U.S. government, both in financial and economic reporting, far exceeds the scope of corporate accounting wrongdoing that has received partial credit for recent stock market turbulence. The bad boys of Corporate America, though, still were subject to significant regulatory oversights and the application of GAAP accounting to their books. In contrast, the government's operations and economic reporting have been subject to oversight solely by Congress, America's only "distinctly native criminal class."[1]

Nearly four decades ago, President Lyndon Johnson's political sensitivities led him and the Congress to slough off some of the costs of an escalating Vietnam War through the use of accounting gimmicks. To mask the rapid growth in the federal government's budget deficit, revenues from the surplus being generated by Social Security taxes were added into the general cash fund, without making any accounting allowance for the accompanying and increasing Social Security liabilities. This accounting-gimmicked reporting was dubbed "unified" budget accounting.

The government's accounting then, as it is now, was on a cash basis, reflecting cash revenues versus cash expenditures. There were no accruals made for monies owed by or due to the government at some time in the future.

The bogus accounting understated the actual deficit for decades and even allowed for claims of budget surpluses in the years 1998 to 2001. While there were extensive self-congratulatory comments between the President, Congress and the Fed Chairman, at the time, all involved knew there never were any actual budget surpluses. There hasn't been an actual balanced budget, let alone a surplus, since before Johnson and his cronies cooked the bookkeeping.

The doctored fiscal reporting complemented the short-term political interests of both major political parties. Additionally, the ignorance and/or complicity of Pollyannaish analysts on Wall Street and in the financial media-eager to discourage negative market activity-helped to keep the fiscal crisis from arousing significant concern among a dumbed-down U.S. populace.

U.S. Treasury Owns Up to a Financial Nightmare

In the mid-1970s, the then "Big Ten" accounting firms proposed setting up for the federal government an accrual accounting and reporting system similar to that used in the business community. Purchases of capital equipment, weapons and buildings would be booked as assets and depreciated, taxes receivable and accounts payable would better reflect near term cash needs. Accrued liabilities, such as Social Security payments due in the future, would reflect longer-term cash-flow needs.

As the project progressed, GAAP accounting was applied to the government's operations and prototype annual statements were published beginning in 1974. The appropriate accounting for Social Security liabilities, however, was discarded during the Reagan administration as being politically untenable.

Under the eventual mandate of Congress, the accounting project culminated in the U.S. Treasury publishing its first formal *Financial Report of the United States Government* for fiscal year 2000, consistent with GAAP, except for Social Security and similar accounts such as Medicare, Medicaid and the Railroad Retirement Fund.

To the credit of the Bush administration, later reports, published in April 2003 and April 2004 for fiscal years 2002 and 2003, indicated for the first time since the 1980s what the Social Security and related numbers would look like if they were included in the accounting, just as corporations need to account for pension and retiree health benefit liabilities.

The gimmicked accounting standards, as established during the Johnson era, and as used today for official, unified budget reporting, show a 2003 deficit of $374.3 billion. Using GAAP reporting (without Social Security reporting), the official GAAP deficit for 2003 expands to $665.0 billion. Including accounting for Social Security and related areas, the 2003 deficit balloons to $3,702 billion, or $3.7 trillion.[2] The accounting reflects no adjustment for the new, more expensive Medicare program.

As an aside, if you download[3] a copy of the financial statements, the GAO's auditor's letter as to why they won't certify the statements is an exposé of significant financial mismanagement within the federal government.

Beyond the $3.7 trillion deficit in 2003, however, the numbers get even worse, because the shadow deficit has been taking its toll ever since the Johnson era. According to the Treasury's 2003 financial statement, the U.S. government has a negative net worth of $34.8

trillion. That $34.8 trillion reflects $36.2 trillion in financial liabilities offset by $1.4 trillion in assets, of which only $0.4 trillion are liquid.

Part of the underlying reality-the actual operating cash shortfall-is reflected in the growth of the federal debt. During fiscal 2003, for example, gross federal debt increased from $6.2 trillion to $6.8 trillion, or by $600 billion, against the unified $374 billion deficit. As of the end of August 2004, the debt had increased to $7.3 trillion.

While gross federal debt is at a record, relentlessly pushing against borrowing ceilings, the markets, press and politicians generally ignore that portion of the debt borrowed from Social Security and similar programs. So, the September 30, 2003 debt level commonly is reported as only the $3.9 trillion owed to the public, instead of the total $6.8 billion. Again, the more accurate GAAP estimate of total government liabilities is $36.2 trillion.

2004 Results

Results for the official 2004 deficit will be published in the next several months, and the numbers are projected by the Bush administration to be significantly worse than in 2003, $445 billion versus $374 billion, with the actual deficit likely to near $4.3 trillion (my estimate). The 2004 GAAP financial statements on the government will not be published until March/April 2005.

Fiscal Year	"Official" Deficit	GAAP-Based Deficit Without Soc. Sec., Etc.	2004 GAAP-Based Deficit With Soc. Sec., Etc
2004 est.	$445 Billion	$800 Billion	$4.3 Trillion
2003	$374 Billion	$665 Billion	$3.7 Trillion
2002	$158 Billion	$365 Billion	$1.5 Trillion

The credit markets were rattled slightly by the early official projections of an increasing shortfall in government finances, but only the surface problems have gained any market recognition. The

U.S. government operations for fiscal 2005 (year-ended September 30), based on generally accepted accounting principles (GAAP) as usually applied in the business world, but excluding ongoing liabilities to Social Security, **Medicare** and similar programs. The $760.0 billion was up 23.2% from 2004's $615.6 billion GAAP-based **deficit**, while the official, accounting-gimmicked 2005 **deficit** of $318.5 declined by 22.8% from $412.3 billion in 2004.

Including Social Security, **Medicare** and similar liabilities, the total GAAP-based 2005 **deficit** was $3.5 trillion, down from 2004's $11.1 trillion, which was spiked by a one-time setup charge for recent **Medicare** enhancements. Net of the one-time charge, which we have re-estimated based on the 2005 data (the government has not published an estimate), the GAAP-based **deficit** in 2004 was about $3.4 trillion.

CUMULATIVE ACCRUAL SHORTFALL 2005

DEFICIT

US Government - Alternate Fiscal **Deficit** and Debt (Source: US Treasury; $s Are Either Billions or Trillions, as Indicated)

Fiscal Year	Formal Cash-Based **Deficit**	GAAP Ex-SS Etc. **Deficit**	GAAP With SS Etc. **Deficit**	GAAP Federal Negative Net Worth	Gross Federal Debt	Tot. Fec eral Ok ligatior (GAAP)
	(Bil)	(Bil)	(Tril)	(Tril)	(Tril)	(Tril)
2005	$318.5	$760.0	$ 3.5	$49.4	$7.9	$50.9
2004	412.3	615.6	11.1*	45.9	7.4	47.3
2003	374.8	667.6	3.7	34.8	6.8	36.2
2002	157.8	364.5	1.5	32.1	6.2	32.7

*$3.4 trillion (updated from an initial approximation of $4.7 trillion), excluding one-time setup costs of the **Medicare** Prescription Drug, Improvement, and Modernization Act of 2003 (enacted December 8, 2003).

As shown in the accompanying table, a debilitating pattern has started to surface in U.S. government operations, with annual GAAP-based deficits, net of gimmicked accounting and one-time charges, running at $3.7 trillion in 2003, $3.4 trillion in 2004 and $3.5 trillion in 2005.

From Clarity to Obfuscation in One Year

Administration comments in last year's financial statements were refreshingly honest about the severity of the United States' fiscal travails. Such was not the case in the more heavily politicized 2005 statements.

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From the second page of "Management's Discussion and Analysis" (page 4) of the 2004 statements[2]:

*"In a table on page 11 of this section, the **net present value** for all of the*

John Williams'
Shadow Government Statistics
Analysis Behind and Beyond Government Economic Reporting

Number 48

January 3, 2009

Section Four of Four

Reporting/Market Focus

GAAP-Based 2008 Federal Deficit Hits $5.1 Trillion

Government Bankruptcy/Hyperinflation Just a Matter of Time

As discussed in the December 15th *Alert*, the U.S. Treasury published its *2008 Financial Report of the United States Government* on December 15th: http://fms.treas.gov/fr/08frusg/08frusg.pdf. A summary of the generally accepted account principles (GAAP)-based detail is shown in the table on the following page. Against what had been the recently publicized, cash-based "official" fiscal 2008 (year-ended September 30th) federal deficit of $454.8 billion, and parallel $161.8 billion deficit in 2007, the U.S. Treasury reported that the 2008 deficit [change in net position] was $1,009.1 billion, versus $275.5 billion in 2007, using GAAP. Since 2002, the Treasury has been reporting the government's finances using annual statements prepared using accounting standards similar to those used in corporate America.

Those numbers, however, did not account for the annual change in the net present value of unfunded Social Security and Medicare liabilities, except in discussions and footnotes. Counting those changes, as a corporation would for its pension and healthcare liabilities for retirees, the 2008 annual deficit was $5.1 trillion, versus $1.2 trillion in 2007. Such showed total U.S. obligations -- gross federal debt outstanding plus the net present value of unfunded liabilities -- at $66 trillion, roughly 4.6 times the level of reported U.S. GDP, and greater than total estimated global GDP. These numbers are unsustainable, as suggested in the accompanying graphs, and already are deteriorating severely for fiscal 2009. They also doom the U.S. dollar to hyperinflation, as discussed in the *Hyperinflation Special Report* of April 8, 2008.

FISCAL
2008

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

Dollars are in either billions or trillions, as indicated.
Sources: U.S. Treasury, Shadow Government Statistics.

Fiscal Year (1)	Formal Cash-Based Deficit ($Bil)	GAAP Ex-SS Etc. Deficit ($Bil)	GAAP With SS Etc. Deficit ($Tril)	GAAP Federal Negative Net Worth ($Tril)	Gross Federal Debt ($Tril)	Total(2) Federal Obligations (GAAP) ($Tril)
2008	$454.8	$1,009.1	$5.1	$59.3	$10.0	$65.5
2007	162.8	275.5	1.2(3)	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(4)	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. (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) On a consistent reporting basis, net of one-time changes in actuarial assumptions and accounting, SGS still 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 in the table for 2007. (4) SGS estimates $3.4 trillion, 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. Link to the 2008 statements: http://www.fms.treas.gov/fr/08frusg/08frusg.pdf

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Lieberman Demands Explanation From Treasury For Suppressing Long-term Budget Analysis

Calls for immediate release of report cut out of 2004 Budget; Study found true cost of federal obligations to be $44 trillion

WASHINGTON - Senate Governmental Affairs Committee Ranking Member Joe Lieberman, D-Conn., Thursday asked the Treasury Department for a formal explanation of why an eye-opening analysis of the Federal Government's long-term budget obligations was suppressed by the Bush Administration.

The *Financial Times* and other news media last week reported that an analysis commissioned by the Treasury Department - which showed that the shortfall in funding to pay Medicare and Social Security entitlement benefits over the next 75 years would be $26 trillion higher than previously projected - was stripped out of the Fiscal Year 2004 Budget at the last minute and has been kept from public view since then.

In a letter sent to Treasury Secretary John Snow, Lieberman said he wanted answers to a number of questions surrounding the decision to bury the long-term obligations report, and called on Snow to immediately release the full analysis and the budget document based on it to the general public.

"These accounts -- which have been confirmed independently by my staff - are deeply troubling, suggesting that this Administration is trying to hide the true nature of our financial obligations from the American people in order to advance its agenda of cutting taxes indiscriminately," Lieberman wrote.

"I believe the public we serve is owed a full accounting - both of the facts surrounding the suppression of this study, and of what it says about our fiscal stability and the Administration's fiscal policy."

Lieberman said the need for the report to be made public could not be "more plain or more urgent." He cited the more than $2 trillion in revenue the government will lose from the two major Bush tax cuts -- which will grow exponentially if those cuts are made permanent -- and the record-breaking deficits the government is projecting, largely as a result of those tax cuts.

May 25, 2004

SEN. LIEBERMAN'S "PRESENT VALUE" BUDGETING PROPOSAL

Last fall, Sen. Joe Lieberman introduced a bill (S. 1915) to require that the government use "present value" accounting estimates of proposals that would expand unfunded entitlements or tax cuts that are not "paid for" by offsetting reductions in federal spending.

Specifically, the bill would

(1) create a supermajority budget hurdle or "point of order" for bills that would increase the present value of our unfunded liabilities or debts by more than $1 trillion (in today's dollars), regardless of any "sunset" provisions designed to hide the intended long-term cost,

(2) disallow the use of expedited budget procedures (such as budget reconciliation) to increase the deficit or reduce the surplus,

(3) reestablish a strict "pay-as-you-go" regimen for spending and tax bills, requiring a supermajority vote for bills that aren't "paid for,"

(4) require Congress and the executive branch to estimate the overall present value of the nation's unfunded liabilities or debts in official budgets,

(5) compel the President to submit plans to reduce debts if their present value exceeds a threshold, and

(6) set up a bipartisan commission to consider the President's plan and prod Congress on the issue.

In the absence of these sorts of measures, the Bush Administration and Congress seem intent on buying the loyalty of voters (and political donors) using our children's money.

Ultimately, every additional dollar of national debt must be paid back by future generations, either through higher taxes, lower government spending, or higher interest payments coupled with slower economic growth.

The Lieberman bill would help bring that reality into focus.

Links:
One Page Summary of S. 1915 from Sen. Lieberman's office (5/24/2004)
Section by Section Explanation
Bill Text

Centrists.Org It's the Sunsets, Stupid! CBO and JCT Should Show the Extended Cost of Expiring Provisions (May 3, 2004)

Centrists.Org The Fourth Entitlement: Interest (December 1, 2003)

Posted by Jeff Lemieux at May 25, 2004 12:10 PM

AMERICAN ENTERPRISE INSTITUTE
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ARTICLES & COMMENTARY

Boring, Yes, but Fixing Accounting Rules Is Vital for Budget Sanity

By Norman J. Ornstein
Roll Call
Wednesday, July 7, 2004

ABSTRACT

Honest fiscal accounting is a necessary first step to begin to implement policy change.

At a recent seminar about the economy, I heard an economist close to the Bush administration scoff at the notion that budget deficits are a big problem, then tout the administration's record. He noted, "If you take out entitlements, the budget is basically in balance." Very impressive. It is akin to saying, "If you take out the fact that your heart has stopped, your health is excellent." Or to pick a more familiar analogy, "Other than that, Mrs. Lincoln, how was the play?"

Finding an appropriate international role for America in the age of terrorism is the biggest challenge facing the country. But looming structural budget deficits, driven by the coming explosion in entitlement spending, is close behind. In just three years, the first wave of baby boomers becomes eligible for early retirement benefits. That is the first wave of a population of 77 million, including 8 million immigrants who are in the baby boom age group. It is by far the largest generation of soon-to-be retirees in our history.

But the baby boomers represent only one end of the squeeze. Meet the "geezer boomers." The fastest-growing age group in America is the over-85 generation--and within that is the similarly expanding over-100 category. It is a good thing Willard Scott no longer works full-time on the *Today* show: He would not be able to keep up with the announcements of 100th birthdays.

As people live longer, they make increasing demands on the health care system--including not just Medicare but also the long-term care system that is by far the single largest component of the Medicaid program. And, of course, Americans will also collect Social Security benefits for ever-longer periods of time.

Put these inexorable demographic realities together with prudent projections of health care costs and inflation, and we get a bottom line as expressed by the trustees to these entitlement programs. We have $72 billion in unfunded obligations to future retirees--$10.4 trillion in Social Security and $61.6 trillion in the various parts of Medicare--plus an additional large sum (uncalculated, so far as I can tell) for Medicaid. That assumes no further expansion of the programs. And every year that we fail to act to set aside assets to fund these obligations, the numbers grow.

Today's budget deficit is 4.2 percent of our GDP. That's a large but not alarming number--a figure that, by itself, could be sustainable indefinitely without deeply damaging the economy. But any realistic projection of the revenue base that we can use to cover these future obligations shows a dismal future--one in which the deficit balloons to almost 16 percent of GDP by 2030, and nearly 29 percent of GDP by 2040. That is not merely unsustainable. It's downright catastrophic--the equivalent of a suitcase nuclear bomb set off in the middle of our economy.

All of this is occurring while we blithely go about cutting the tax base and adding funding for a host of other problems, including homeland security, defense, the environment, education and highways--just to name a few that get overwhelming support from Congress and the American people. Our debate about "fiscal discipline" focuses overwhelmingly on the tiny share of the budget that is in discretionary domestic spending. Cut it all out and we still have staggering obligations and huge future deficits.

Whoever holds the reins of power next year, two things are virtually certain: We will cut taxes even more to deal with the looming problem of the alternative minimum tax, and we will expand the entitlement obligation by revising the Medicare prescription drug benefit to eliminate or reduce the "doughnut hole" that creates disparities in the benefit at different income levels.

Given the nasty nature of our politics and the intensity of partisan feeling these days, it may be equally certain that any move to restrain the growth of these entitlement programs will go nowhere. But if we do not confront this problem soon, and head-on, we will be handing our children and grandchildren an intolerable burden.

What to do? First, we need to be honest about it. And here Sen. Joe Lieberman (D-Conn.) has stepped in with a simple and straightforward way to compel honesty in the policymaking process. He wants to force the government to change its basic method of accounting from cash accounting to net present value accounting.

I know, I know, it sounds boring and meaningless--and some are apt to wonder what possible difference a change in accounting rules could make. The answer, though, is that it could make a major difference simply by changing the terms of debate.

The current standards focus the debate on the current year's budget, with a nod to the coming 10 years (even as some politicians try to change that standard to five years). This process encourages turning a blind eye to problems that emerge or expand down the road, while simultaneously encouraging deceit in projecting future burdens.

Consider the sham approaches used to justify the tax cuts of 2001--which, among other things, shrunk the estate tax to zero by 2010, only to be reinstated fully in 2011. There is no way that policy will stand--but it enabled the drafters of the tax cut to look fiscally prudent enough to elude budget rules in the Senate that would have imposed some fiscal discipline.

If we switch to net present value accounting, the debate would shift focus, toward comparing the real liabilities the government has (that is, the debt held by the public, along with the commitments to future generations in entitlement programs) plus ongoing and new programs such as defense and education, against the funding that will be available.

This would force a debate on priorities: What will the size of government be compared to our gross domestic product in 10 years or 20 years, given the net present value of our future revenues? As was the case with the pay-as-you-go provisions that successfully brought short-term fiscal discipline from 1990 until they expired a couple of years ago, the simple process of forcing every policy proposal, program expansion or tax cut to be gauged within a larger context will alter the voting context and also begin the process of educating voters, including older voters, about the consequences of our current policies.

To be sure, an accounting change will not bring miracles. The numbers are already out there and can be injected into the debate. The tough choices are going to remain tough, and the ability to create broad bipartisan consensus or cover for any change that cuts the growth of Social Security or Medicare will remain limited or nonexistent. But honest fiscal accounting is a necessary first step to begin to implement policy change. The embarrassing failure of the House last month to enact any real change in the budget process underscores the problems we face. Let's hope Lieberman, and his allies in championing fiscal honesty such as Sen. John McCain (R-Ariz.), can prevail.

Norman J. Ornstein is a resident scholar at the American Enterprise Institute.

PREDICTABLY, OUR "LEADERS" COMPLETELY AVOID DISCUSSION OF THE TICKING BABY BOOM FINANCING CRISIS, "PAINFUL ACTION" NEEDED."

Presidential Candidates Shrink From Budget

Worsening Fiscal Picture Looms, But Hopefuls Prefer Not to Look

By Jackie Calmes
Washington

ONE THING UNITES ALL the presidential candidates, of both parties: None are honestly facing up to the huge budget challenges that will confront the next White House resident.

In fairness, if any of them did, voters probably wouldn't give them the keys.

The next president will be inaugurated just as the first of 78 million post-World War II baby boomers begin to retire, and in his or her first term they will be making their claims on Medicare, Medicaid and Social Security. Annual deficits will start climbing, even without any of the new spending that the candidates promise for defense and domestic programs.

War costs will continue to pile up. Net interest on the national debt, to creditors in China and elsewhere, already is one of the single-largest spending items, and growing fast.

Meanwhile, revenue will be many billions less than projected. That is because all the candidates have promised to fix or even repeal the alternative minimum tax—which was intended for rich tax-evaders but not indexed for inflation—so that the AMT won't hit the increasing millions of middle-class voters due to be ensnared otherwise.

Even as Democrats and Republicans on the campaign trail are vaguely promising "change"—and making it sound easy—back in Washington the director of the nonpartisan Congressional Budget Office, Peter Orszag, testified on Capitol Hill in mid-December about the nation's long-term budget outlook, and he wasn't optimistic. "Under any plausible scenario, the federal budget is on an unsustainable path—that is, federal debt will grow much faster than the economy over the long run," he said. And that, he added, means more borrowing from abroad, and less investment and income growth at home.

The main culprit, according to the budget office's latest report, is the projected explosion in costs of health care, exacerbated by the rising claims of aging baby boomers. "Therefore," Mr. Orszag said, "efforts to reduce overall government spending will require potentially painful actions to slow the rise of health-care costs." An economist, Mr. Orszag is a Democrat, but his message echoes that of his Republican predecessor as CBO director, Douglas Holtz-Eakin, who is now the chief economic adviser to presidential candidate and Arizona senator, John McCain. Yet pain isn't something candidates talk about.

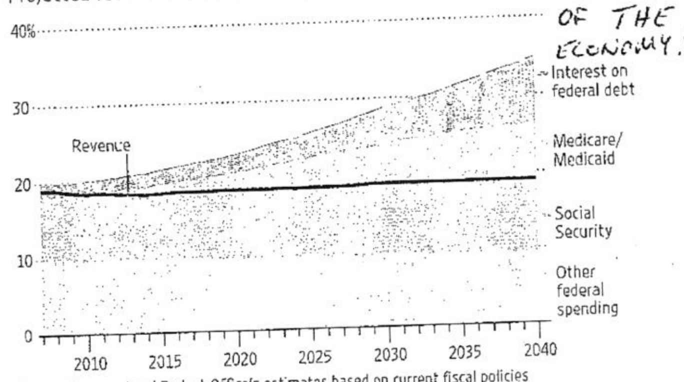
Mr. McCain does stand out among Republicans, and some Democrats, for having a detailed proposal to constrain health-care costs. And he and former Republican Sen. Fred Thompson emphasize more than others in both parties the need for cost-saving changes to Medicare and Social Security, if not the specifics. On Social Security, Mr. McCain—like most Democrats—would consider raising revenue by lifting the cap on wages subject to Social Security payroll taxes (the 2008 cap is $102,000). Mr. Thompson's more politically risky plan would reduce the initial level of benefits to future retirees, using a formula similar to one Mr. Bush floated in 2005—unsuccessfully.

All the Republicans favor extending the Bush tax cuts, which otherwise would expire in the next presi-

Please turn to page R11

Racking Up Debt - FED. GOVT. "GROWS" FROM 20% to 35% OF THE ECONOMY!!

Projected federal revenue and spending as a percentage of GDP



Source: Congressional Budget Office's estimates based on current fiscal policies

Candidates Shy From Budget

Continued from page R1

dent's first term, and rule out any income-tax rises. When quizzed about Social Security's looming instability, all of the Republicans say they support letting workers divert payroll taxes to personal accounts. But that would add to the program's financial woes for decades, requiring additional taxes, benefit reductions or borrowing—which is why Mr. Bush's own proposal never went anywhere even in a Republican-led Congress.

Despite the country's worsening fiscal picture, the Republicans' platforms don't sound all that different from Mr. Bush's back in 2000, when the country was at peace, running a surplus and paying down the debt. Besides echoing his call for overhauling Social Security, they favor more tax cuts, look to market-based remedies for health-care savings and promise deep cuts in other federal spending, without specifics.

But even slashing the overall federal budget—which ranges from agriculture subsidies and parks to research and weaponry—wouldn't avert the crisis that Mr. Orszag and others forecast: As CBO data consistently show, the ballooning costs are mostly in Medicare and Medicaid, and to a lesser extent Social Security and interest on the federal debt—not in the annual appropriations that include much-criticized "earmarks" for lawmakers' special projects.

The Democratic candidates are even less inclined to detail how they would curb the growth of Medicare and Social Security. Their party considers both programs its legacy. Neither they nor

that Mr. Bush added to Medicare, though its long-term costs dwarf the government's entire tab for Social Security's unfunded obligations. Democrats, in fact, would expand the drug benefit to do away with the so-called doughnut hole, where a beneficiary's coverage lapses before kicking in again when costs reach catastrophic levels.

Unlike Republicans, Democrats also aim for universal health care, to cover the 47 million uninsured, and propose new spending and tax incentives for energy and technology innovations, arresting global warming, and for education and college aid. They also promise to restore pay-as-you-go budgeting to the federal government. The biggest offset they offer to "pay" for their proposals is ending Mr. Bush's tax cuts for the richest Americans, typically those making more than $200,000 a year.

But what sounds like an all-purpose source of revenue is anything but. Eugene Steuerle, a senior fellow at the nonpartisan and centrist Urban Institute think tank, and a former Reagan Treasury official, says that returning income-tax rates for the wealthy to pre-Bush levels would mean about $50 billion a year. While no small amount, that is less than a third of the fiscal 2007 deficit. It would cover no more than half the revenue cost of overhauling the AMT, and a few months of Medicare's cost increase.

Whoever is elected, Mr. Steuerle says, "still must either retract many of the promises made to the middle class, increase its taxes, or both. Right now, the leaders of both political parties consider it political suicide to lead

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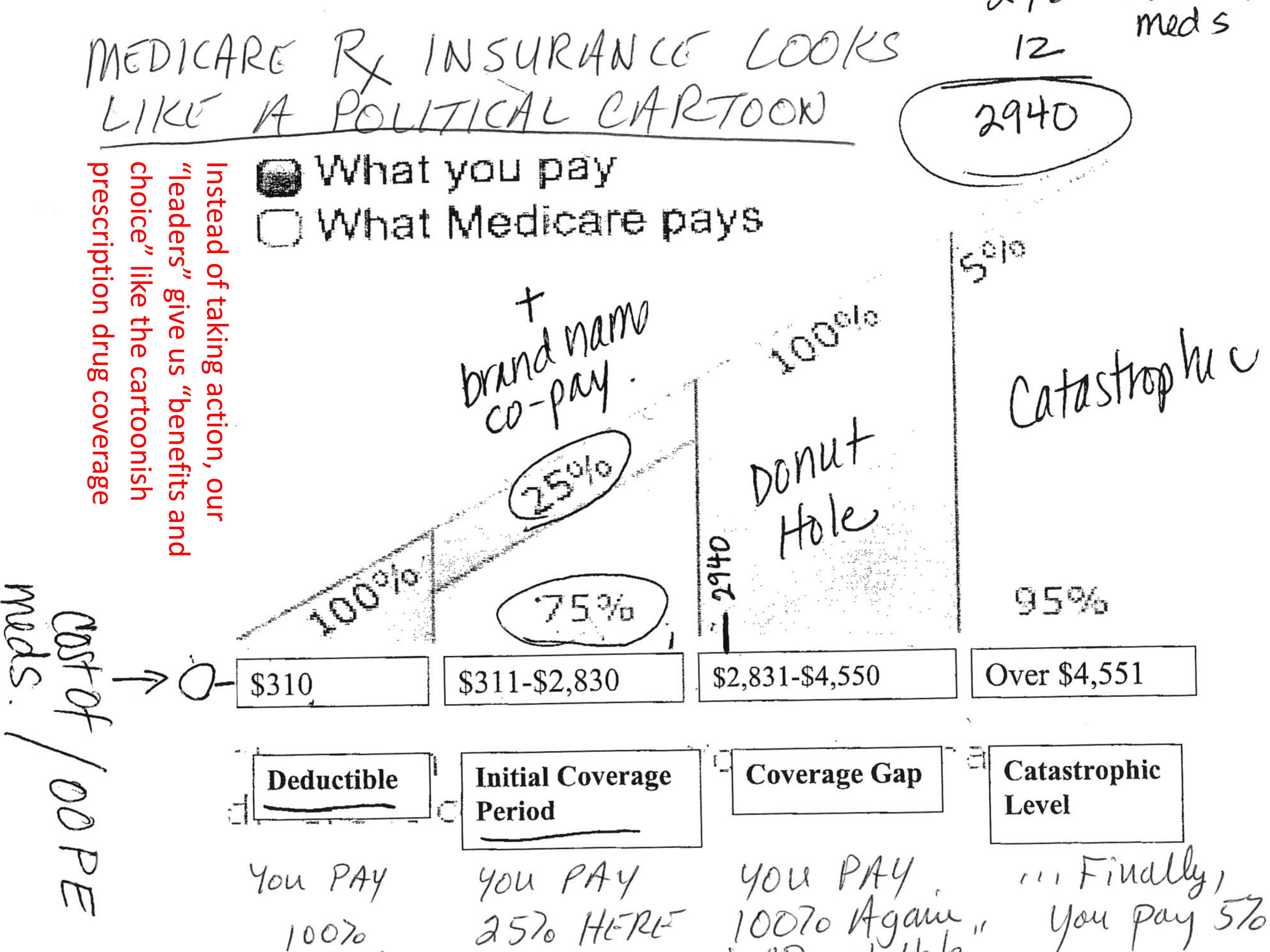

Instead of taking action, our "leaders" give us "benefits and choice" like the cartoonish prescription drug coverage

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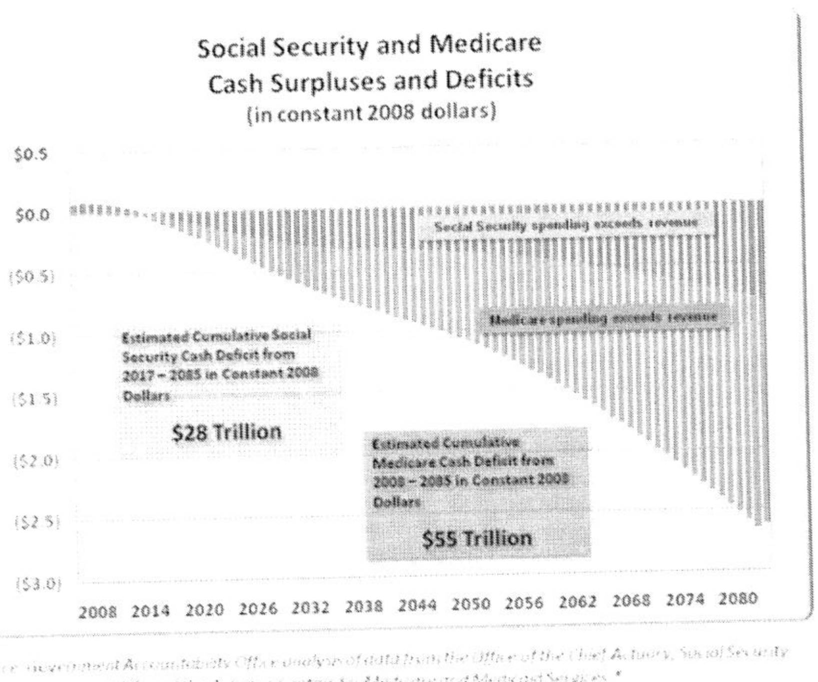

OUR LIABILITIES: $55 TRILLION & RISING

It seems unbelievable to hard-working American taxpayers that our nation could have over fifty five trillion dollars in debt and unfunded liabilities ($55,000,000,000,000), and yet it does. Deriving this figure requires just a minimal understanding of three important financial calculations: 1) the actuarial statistics behind an insurance plan (such as Social Security & Medicare); 2) the concept of adequately funding such a plan using a calculation tool called "net present value"; and 3) the "accrual" accounting method that accounts for the net present value of liabilities. These financial tools inform an insurance manager as to how much money he needs to have parked in an account earning a return today in order to fund a stream estimated future liabilities. This is the way any solvent insurance plan works, but unfortunately it's not the method used by our national retirement system (SS, Medicare, & Medicaid).

Instead of funding our retirement system we have relied on current taxpayers to pay for current retirees. Most Americans have no idea that their FICA taxes (a form of insurance premium) are not fully saved and invested for their future retirement but instead pay for CURRENT retirees and general Federal expenses. Because the ratio of workers to retirees is falling, this method has been actuarially unwise for over a generation. However, because this crisis has been "a long way in the future" and requires tough decisions, it's simply been ignored. It is conveniently hidden out of sight in Federal accounting that does not use the same "accrual" method of accounting for liabilities that is required of every publicly-listed American corporation. Time has now run out. Decades of neglect have brought the U.S.A. to the brink of financial insolvency and without public initiative our elected officials

One good reference site, with links to many other