

Chaos in the U.S. Financial System

by John W White
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Note: The financial data used in this commentary was sourced directly from the U.S. Treasury and the Federal Reserve databases with the following exceptions. The GAAP data (2000-2012) was sourced from the U.S. Treasury but interpreted and smoothed by **Shadowstats.com**. The GAAP data (1969-1999) and the Fiscal Gap Data (1969-2011) were interpolated with geometric progressions as I was not able to find official Government reports for these numbers. Also this data only extends thru Fiscal Year 2012 (September 30, 2012) since the reports for Fiscal Year 2013 have not yet been released.

It is my contention that much of the chaos (budget fights, Government shutdown, debt limit debates, Affordable Care Act funding, etc.) in the United States Financial system has been caused by the use of an improper accounting system, namely using Cash Accounting rather than the more appropriate methods of GAAP (Generally Accepted Accounting Principles) Accounting and Fiscal Gap Accounting. By using Cash Accounting to assess and report our financial condition we have not appropriately informed the stakeholders in the U.S. Economy and even the decision makers for fiscal and monetary policy about our true financial condition.

By dramatically understating our future financial commitments by using Cash Accounting, the Congress has grossly over committed the U.S. taxpayer to the point that we have no hope of meeting these future promises especially for social benefits and even making it difficult to pay down our national debt. In this commentary I will attempt to explain and even quantify, to the best of my ability, the degree to which we have over committed.

As a result of this distortion in our financial reporting we have set in place a massive Ponzi scheme which I explain and analyze on a website **www.usaponzi.com**. The start of this Ponzi scheme was in Fiscal Year 1969 when we adopted the Unified Budget and chose to continue using Cash Accounting. However we have also made many fiscal policy and geopolitical decisions that have made this distortion and chaos more exaggerated. I would name 5 such decisions: 1) the Prescription Drug Act, 2) the response to 9/11, 3) the Bush Tax cuts, 4) the Affordable Care Act, and 5) the response to the subprime crisis.

Some, even most, of these decisions and actions can be deemed desirable (even imperative) but I contend that all major fiscal policy decisions must be made with the financial implications well understood by all policy makers and stakeholders. By not having the proper information when these decisions are made the policymakers are continuing to overextend an already overstretched taxpayer.

As I have said many times on this website, we must gain approval in Congress of the Inform Act (www.theinformact.org) so that these policy makers can make decisions with the most accurate financial information we can provide. This paper is intended to explain why we must begin using these more appropriate accounting methods and to quantify the magnitude of the distortion and chaos that exists in our financial assessing and reporting.

Demographics, Deficit, Debt, and Devastating Distortion

Demographics: statistical data relating to the population and particular groups within it.

Deficit: the amount by which something, esp. a sum of money, is too small.

Debt: something, typically money, that is owed or due.

Devastating: highly destructive or damaging.

Distortion: the action of giving a misleading account or impression.

The first three “D”s in the title of this section are generally well known and understood.

We realize that the United States (and the world) has an aging **demographic** trend and as a result we have an increasing need for retirement support and healthcare for this older population and a smaller percentage of the population is of working age to support our overall economic activity. We can’t do much about this situation; we must just deal with it.

We realize that we have a fiscal **deficit** and **debt** that are both too big and we could do something about this but we choose not to because that would clearly slow down the overall U.S. and global economic activity.

Most of us do not know about the **distortion** that we have in our fiscal policy nor do we understand just how **devastating** this **distortion** is now and will be increasingly so in the future to our economy and potentially even to the fundamental fabric of our society. Many of the people in Washington that do know about this **distortion** and could do something about it (at least most of them) choose to ignore it because the actions required to correct (or even minimize) this distortion might be in conflict with their own personal or political objectives.

What is this **distortion** of which I speak? See the definition of “**distortion**” in the preface to this commentary.

The Government is using a misleading accounting methodology and as a result is leaving the U.S. (and world) citizenry with the wrong impression about our fiscal health. I contend that this **distortion** is so extreme that it is corrupt and fraudulent. By employing this misleading accounting (using Cash Accounting rather than the more appropriate GAAP Accounting) we have been able to spend a whole lot more taxpayer money than the Government has to admit to when reporting to the U.S. citizens. But that is not the only problem. We also choose to spend more on a “cash” basis as well. At least the Government tells the citizens about most of this cash basis over spending.

The following table shows a brief summary of how the three accounting methodologies (Cash Accounting, GAAP Accounting, and Fiscal Gap Accounting) assess and report the financial considerations for social benefit commitments since these financial commitments are the dominant budget items that cause this financial distortion.

| Methodology | Liability | As of Dec 2013 | Liability recognized when | Horizon |
|-------------|------------|-----------------|------------------------------|-------------|
| Cash | Debt | \$17.2 Trillion | Insufficient Funds | Budget Year |
| GAAP | Obligation | \$93 Trillion | Participant becomes eligible | 75 Years |
| Fiscal Gap | Fiscal Gap | \$205 Trillion | Benefit program approved | Infinite |

Over the 44 Fiscal Years (1969-2012) the Government has reported a cumulative cash deficit of \$10.1 Trillion BUT has increased our debt by \$14.5 Trillion. But that discrepancy is only a small part of the distortion. We have also accumulated \$69.3 Trillion of GAAP basis Unfunded Liabilities during that same 44 years by agreeing in Congress that we will not collect and put in trust funds the money required to fully finance the social benefit commitments that Congress has approved!

Chart 1 below shows the magnitude of the deficit spending by the Government over this 44 year period as a percent of GDP. As the Cash surplus/deficit line shows, we have been consistently spending more cash than we receive in tax revenues. The GAAP surplus/deficit line shows that we have been spending or increasing our promises to spend by 30-40% of GDP since 1997. In Fiscal Year 2012 our GAAP deficit was 42.6% of GDP!!!

As far as I can determine, the U.S. Treasury did not prepare a formal “GAAP Accounting” financial statement prior to Fiscal year 2000 but I found a source (**Shadowstats.com**) that has compared the Cash and GAAP accounting reports from the U.S. Treasury for Fiscal Years 2000-2012 and have used this data for my analysis in **www.usaponzi.com** and the related White Papers. To fill in the GAAP basis holes in the data from Fiscal Year 1969 up to Fiscal Year 2000 I have used a geometric progression (CAGR of 15.5%) of the GAAP deficit from the \$47 Billion initial “borrowing” from the trust funds in Fiscal Year 1969 to provide continuity to both the GAAP deficit and the Federal Obligation in Fiscal Year 2000 where my GAAP Accounting data source began.

Also the U.S. Treasury does not yet prepare a formal “Fiscal Gap Accounting” statement but the CBO (Congressional Budget Office) does prepare what is called an **Alternative Fiscal Scenario** which calculated our Fiscal Gap as of the end of Fiscal Year 2013 according to this article by Dr. Larry Kotlikoff (<http://finance.yahoo.com/blogs/the-exchange/oh-way-government-totally-broke-222918359.html>). This gives a single data point (\$205 Trillion) for the “current” Fiscal Gap” and to generate a proxy curve of Fiscal Gap from 1969 to 2012 I used a starting value of \$1 Trillion in 1969 and a geometric progression to the current \$205 Trillion. Since Fiscal Gap Accounting recognizes liabilities for social benefits as soon as they are approved and for all expected beneficiaries, there would of course be many step function changes in this curve over time as new benefit programs are approved or as benefit rates are adjusted or as other budget changes are approved by Congress. I have made no attempt to recreate history for these types of adjustments but have chosen to display this simple geometric curve that has a CBO provided determination of our current Fiscal Gap.

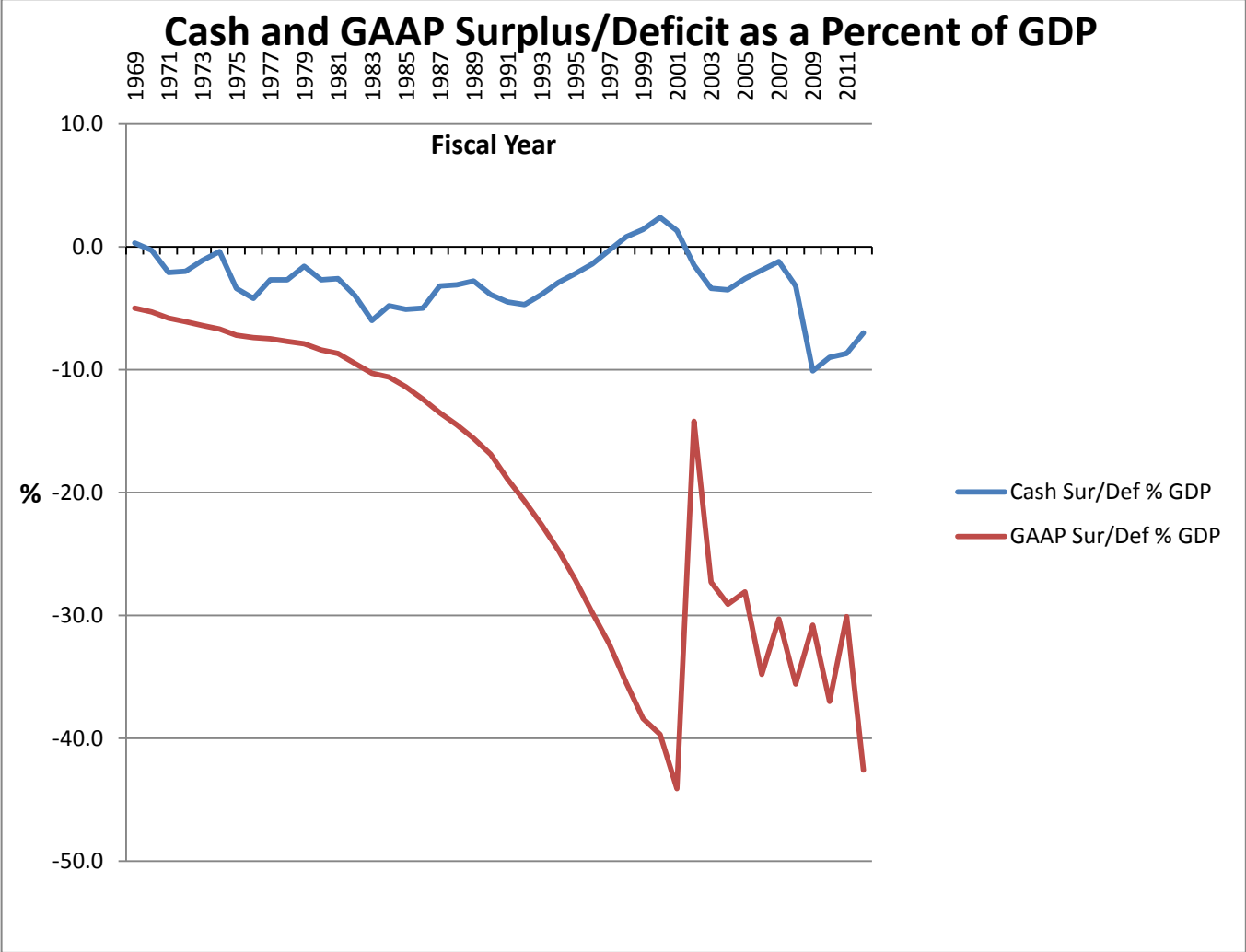


Chart 1: Cash Accounting vs. GAAP Accounting

As is evident by **Chart 1**, there is a lot of chaos that occurs in this GAAP deficit beginning at the Fiscal Year 2000 when my fitted curve meets up with the ShadowStats.com data. This can be explained, to some degree by the budget decisions that were made just after the turn of the millennium: response to the dot.com bust, response to 9/11, and the enactment of the Prescription Drug Act. **Shadowstats.com** actually made some well documented adjustments to the Government provided GAAP data to smooth out some of the dramatic distortion in the Government provided results but the cumulative impact over the period 2000-2012 matches precisely with the Government report.

Wealth Transfer

By continuing to use Cash Accounting to report our financial condition the Federal Government has been able to conceal much of this GAAP basis deficit spending and as a result has been able to effect the largest transfer of wealth in the history of the planet. This is a transfer from the “virtual” public sector to the private sector. Another way to say it is that we have transferred wealth from future generations of taxpayers to the current population and current business entities.

Chart 2 below shows how the **assets (net worth) of the private sectors** of our economy have increased by **\$91.8 Trillion**, from \$5.5 Trillion in Fiscal Year 1969 to \$97.3 Trillion in Fiscal Year 2012. Over this same time period, our GAAP basis **public liabilities (Obligation)** increased by **\$85.0 Trillion**.

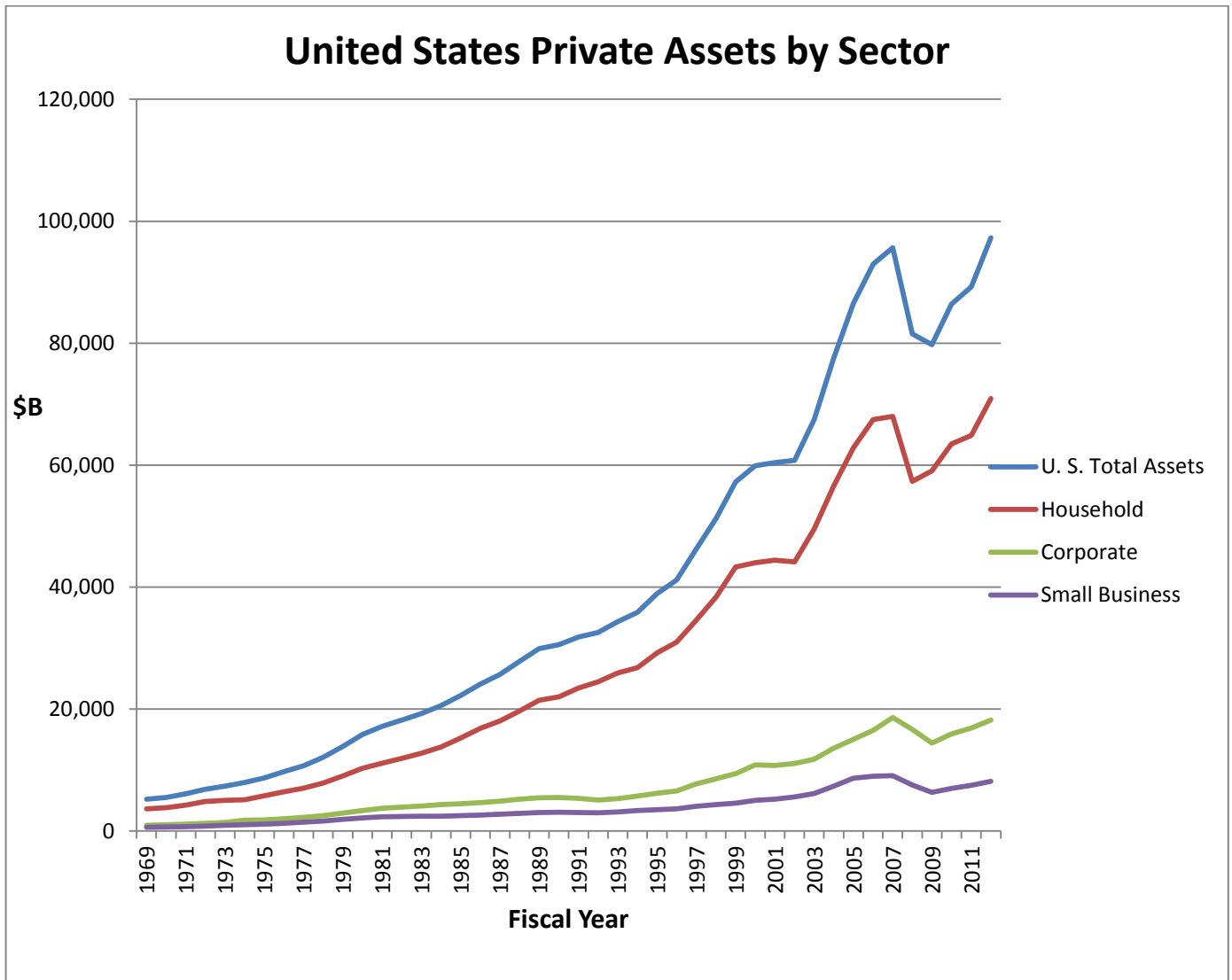


Chart 2: United State Private Assets (Private Net Worth)

I contend that most of this appreciation in net worth by the private sector is a direct result of the GAAP basis deficit spending by the Federal Government. This has left us, as a country, with a massive public liability which I refer to as our GAAP basis “Federal Obligation”. This Obligation (\$85.4 Trillion as of September 30, 2012) is the sum of our Federal Debt and the present value of the Unfunded Liabilities created by not collecting (and putting in trust funds) sufficient tax revenues to finance our social benefit commitments. In fact today we have **NO** real money in trust funds for this purpose. All tax revenues collected for these social benefits have either been spent for current period social benefit commitments or have been borrowed and spent for other general operating expenses. The record of this borrowing is maintained on our balance sheet as Intragovernmental Holdings.

Chart 3 below shows how U. S. private assets (private net worth) have increased as compared to how our public liabilities increased over this 44 year period as measured by Cash, GAAP, and Fiscal Gap Accounting.

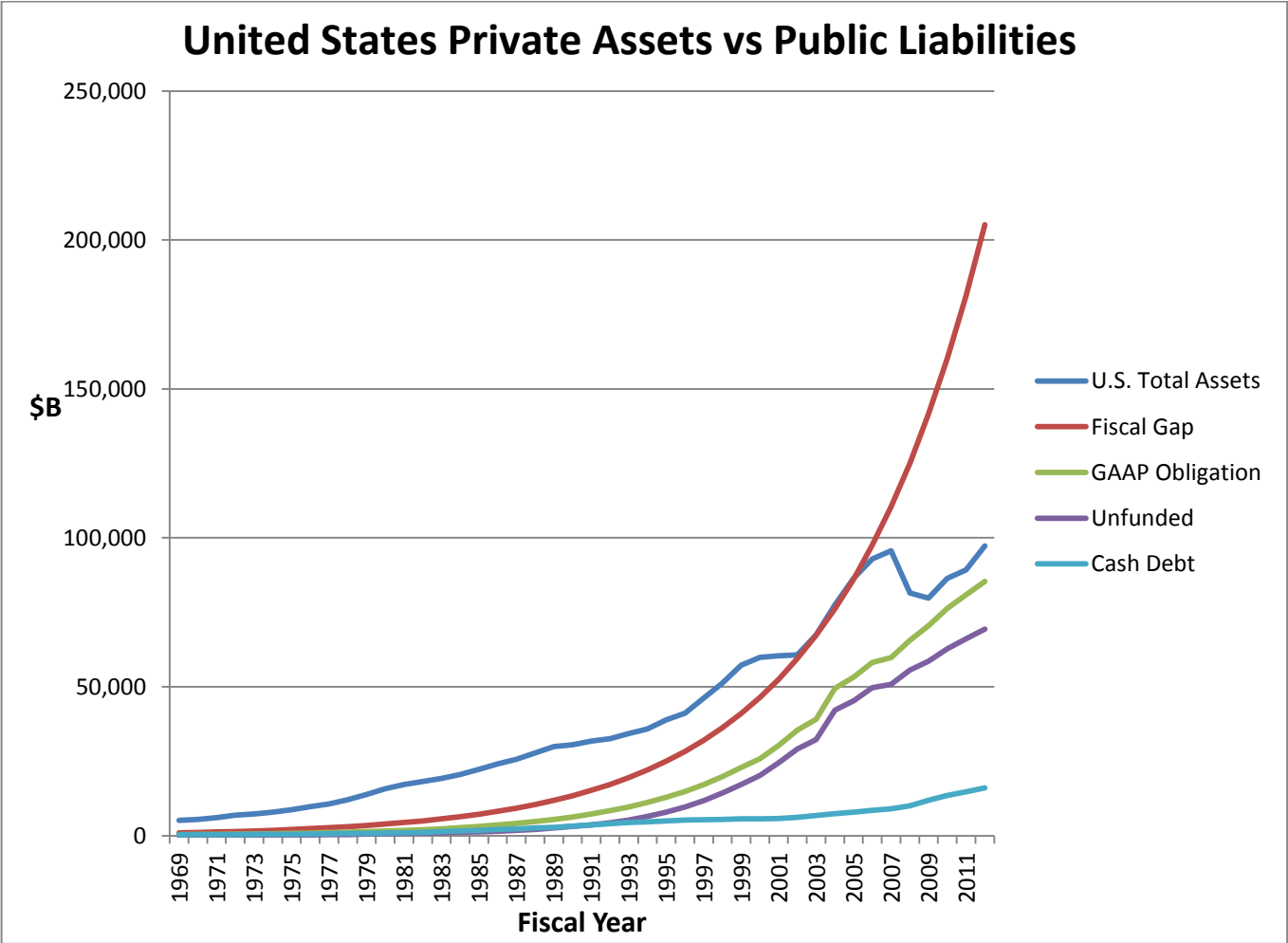


Chart 3: United States Private Assets vs. Public Liabilities (Obligation = Debt + Unfunded)

Chart 4 below shows what I am calling our United States “Net Worth” by netting our private assets (U.S. Total Assets) with our public liabilities as measured by Cash Accounting (Debt), GAAP Accounting (Obligation), and Fiscal Gap Accounting (Fiscal Gap).

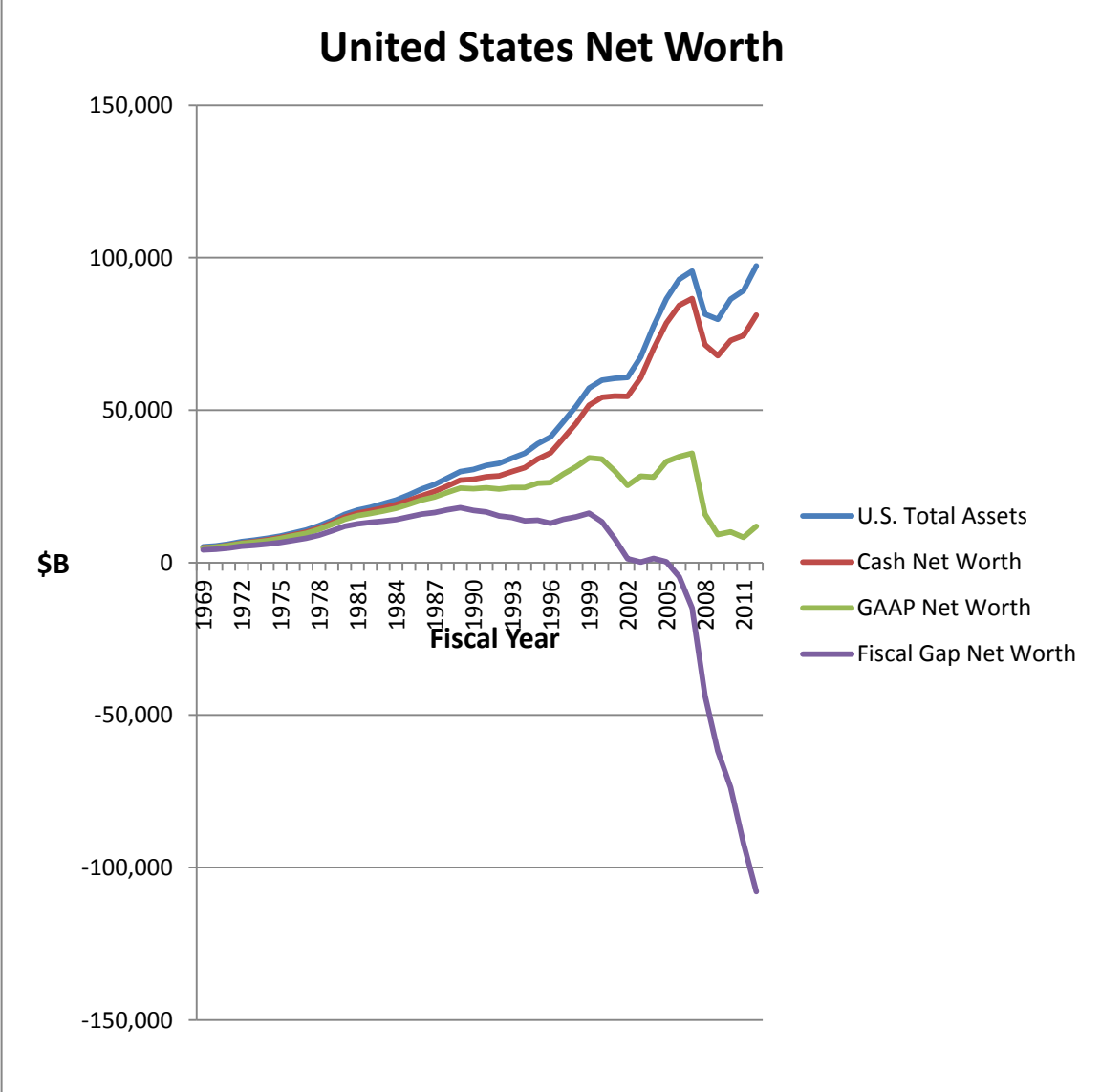


Chart 4: United States Net Worth
 (Cash Net Worth = U.S. Total Assets – Debt)
 (GAAP Net Worth = U.S. Total Assets – Obligation)
 (Fiscal Gap Net Worth = U.S. Total Assets – Fiscal Gap)

Chart 4 demonstrates that we currently have sufficient private assets to pay down our national debt. Yes it would be traumatic for the private sector but the assets are available to cover this level of liabilities. **Chart 4** also shows that in theory we could meet the liabilities represented by our GAAP basis Obligation but I contend that in reality we could not. I contend that there is not enough liquid capital in the world to purchase the equity and debt that make up these private assets, plus any such liquidation would destroy much of the value represented by these assets. Further, where would the U.S. Treasury invest these funds to get the returns required for these Trust Funds to finance future social benefit commitments and still be in compliance with the conservative investment guidelines? This level of public liability creates a paradox that reflects the devastating distortion and chaos that exists in our U.S. financial system.

The Fiscal Gap net worth is self-evident. We are bankrupt.

One of the conclusions that I draw from this analysis is that a large portion of the gains in household and business net worth in the private sector is due to the fact that our taxing policy does not collect nearly enough revenue to meet our social benefit commitments.

Another conclusion that I infer from this analysis is that our economic activity is significantly enhanced by this same under taxing of individuals and businesses since these entities then have more disposable income and profits which they can spend or invest back into the economy.

Inflation-A Byproduct of USAPonzi

On the www.usaponzi.com website page “Inflation-A Byproduct of USAPonzi” I make the assertion that **USAPONZI** is introducing systemic inflation into the U.S. economy of nominally 5% per year as a result of this massive GAAP basis deficit spending. **Chart 5** below shows this GAAP deficit as a percentage of U.S. Total Assets which is the basis for my assertion that USAPonzi is creating asset inflation.

By the way the CAGR (compound annual growth rate) of U.S. Total Assets is 6.75% from 1969 to 2012.

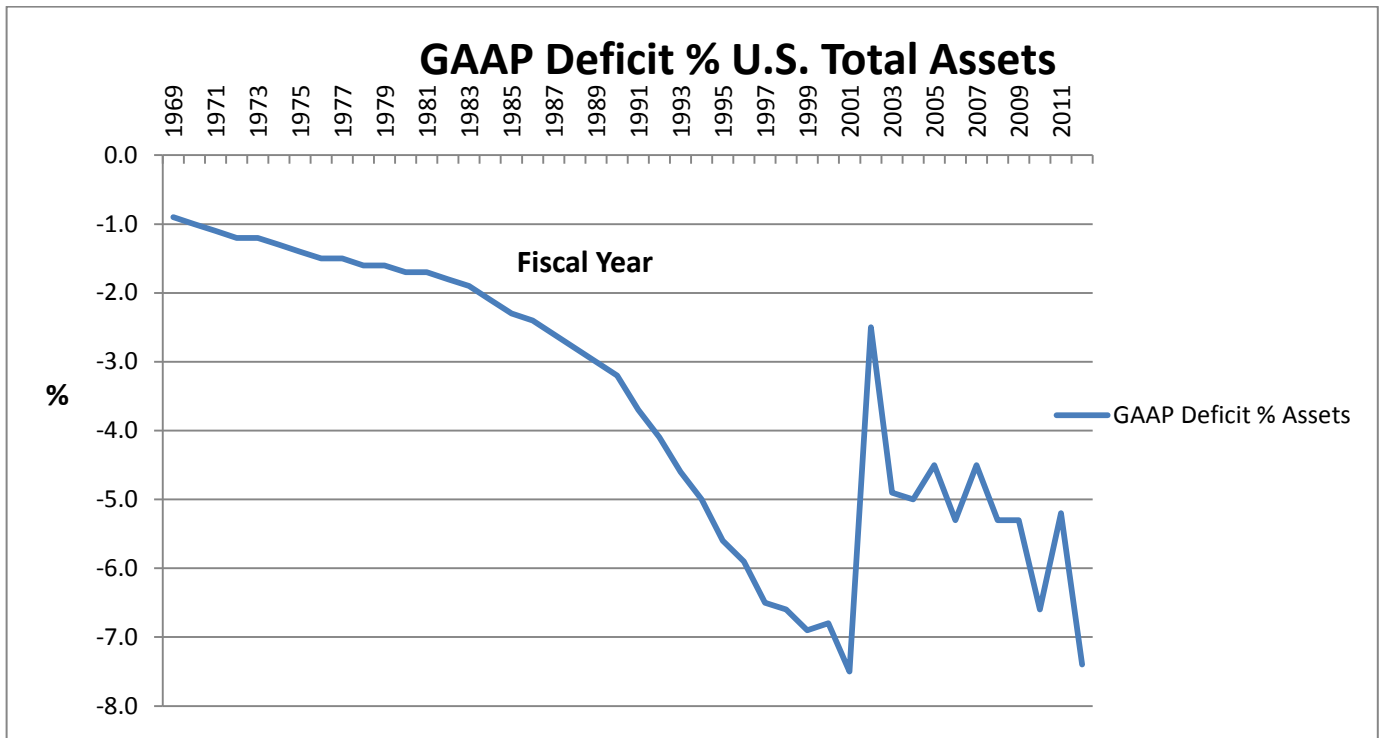


Chart 5: GAAP Deficit % U.S. Total Assets

Current Rate of Wealth Transfer

The GAAP basis deficit spending by the Government is effectively injecting over \$6 Trillion of “new” money into our economy each and every year. This is shown on the USA Ponzi website by the “USA Ponzi Fiscal Model”.

As the USA Ponzi Fiscal Model shows, we had \$6.6 Trillion of GAAP basis deficit spending in Fiscal Year 2012 and an estimated (financial statements for Fiscal Year 2013 have yet not been released) \$6.2 Trillion of GAAP basis deficit spending in Fiscal Year 2013. So in the most recent two fiscal years we took \$12.8 Trillion out of the pockets of future taxpayers and put it in the hands of current Households and current businesses and no one had to lift a finger. That means that every day for the last two years we have been transferring \$17.5 Billion ($\$12.8 \text{ Trillion} / (365 * 2) = \17.5 Billion) from future taxpayers to the current population and current businesses. We have taken a total of \$93 Trillion (GAAP basis) from future taxpayers over the last 45 years at an ever increasing pace with current rate being \$17.5 Billion a day.

Is it any wonder that the stock market went up dramatically over the last few years? Is it any wonder that Bill Gates, Warren Buffet, and 1,424 other people are billionaires? Is it any wonder that businesses are continuing to show increasing profits when their revenues are not increasing very much and even doing it with fewer people? The TV pundits say that business profits are increasing because of cost reduction and that cost reduction cannot continue to help the bottom line without increases in the top line. USAPonzi will, as long as Washington allows it to operate, continue to prop up the top line and the bottom line of most financial statements and enrich those people that know how to position themselves to accumulate this flow of funds. If you look at the wealthiest counties in the United States you will see that it really helps to be positioned very close to Washington D.C. That is where this money flows first but since it is virtual wealth you can actually capture it almost anywhere.

The Federal Reserve's printing of about \$1 Trillion a year with their "Quantitative Easing" is not a big deal when you compare it to Washington's "Devastating Deficit Spending" of over \$6 Trillion a year.

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