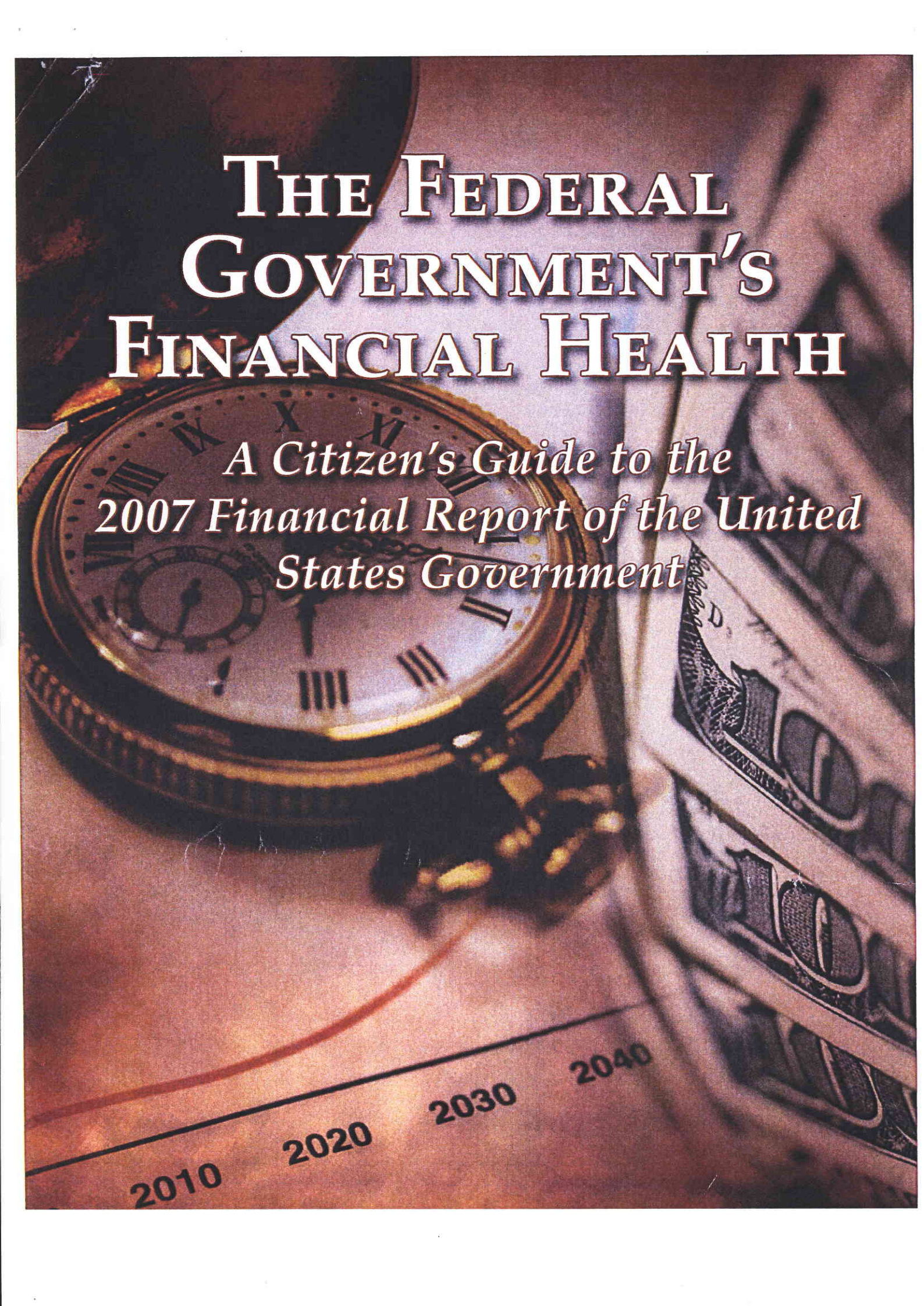


# THE FEDERAL GOVERNMENT'S FINANCIAL HEALTH

*A Citizen's Guide to the  
2007 Financial Report of the United  
States Government*

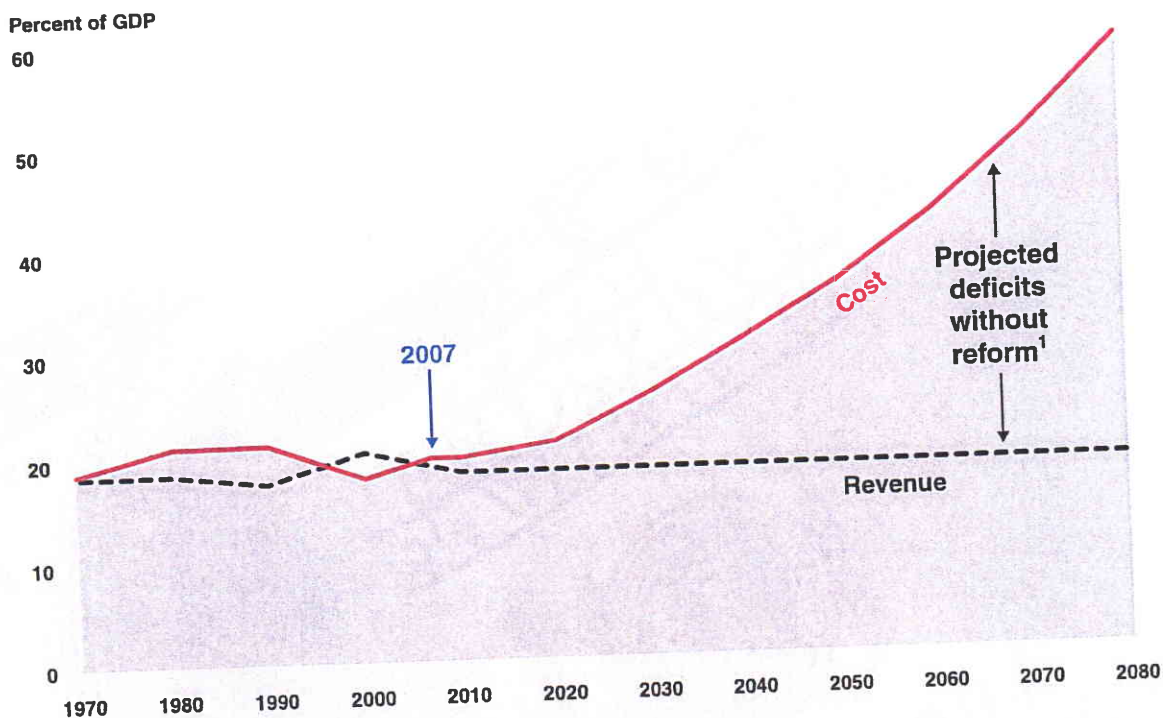
The background of the cover is a composite image. On the left, a large, detailed pocket watch with a white face and Roman numerals is shown. To the right, several US dollar bills are fanned out, showing the number '10'. At the bottom, a curved timeline with the years 2010, 2020, 2030, and 2040 is visible.

2010 2020 2030 2040



# The Government Is On An Unsustainable Fiscal Path

Chart 1: The Government Is On An Unsustainable Fiscal Path



## Key dates

- 2007** Medicare Part A benefit payments began to exceed the program's tax revenue.
- 2017** Social Security benefit payments will begin to exceed the program's tax revenue.
- 2019** Medicare Part A Trust Fund assets will not be enough to pay full benefits. Under current law, benefits would be reduced to 79 percent of scheduled benefits in 2019, declining to 29 percent by 2081.
- 2040** Federal debt held by the public will exceed the historical high of 109 percent of GDP.
- 2041** Social Security Trust Funds' assets will not be enough to pay full benefits. Under current law, benefits for all retirees would be reduced to 75 percent of scheduled benefits in 2041, declining to 70 percent by 2081.
- 2080** Total government cost will be more than three times revenue.

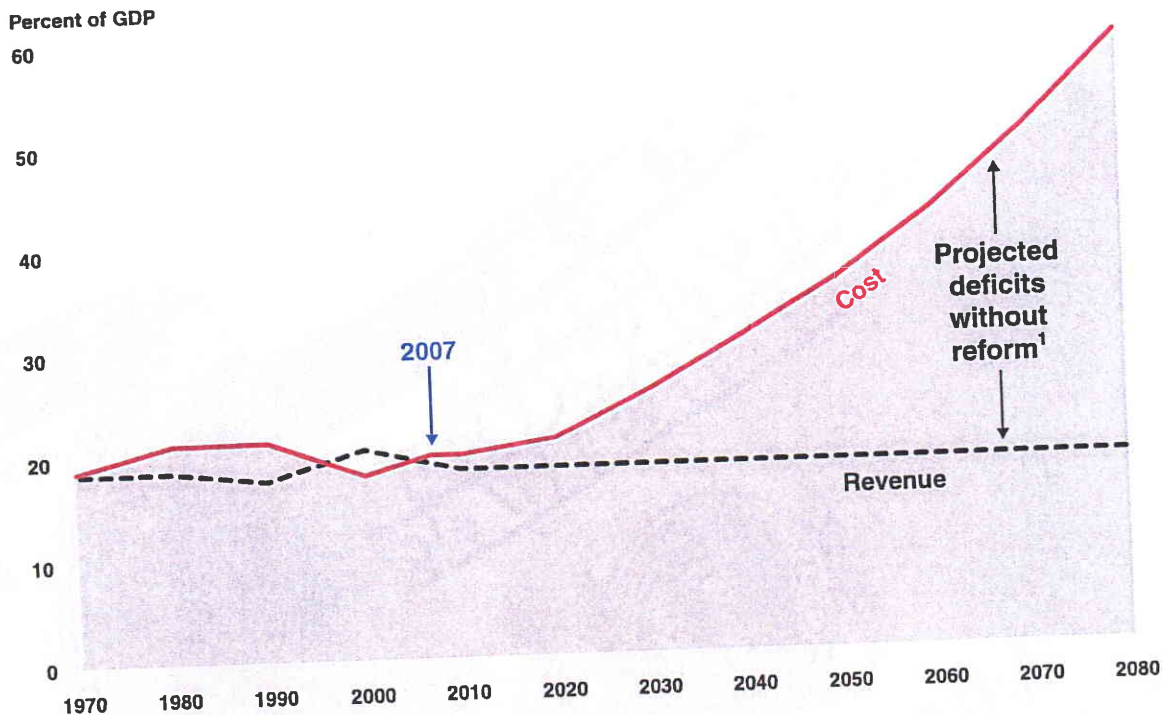
## Notes:

1. Projected deficits represent projected cost in excess of revenue, where revenue as a percent of gross domestic product (GDP) is set equal to its historical average and projected cost is based on scheduled Social Security and Medicare benefits and current cost trends. While the precise amounts of the government's financial responsibilities are far from certain—they are based on many complex calculations and assumptions, including life expectancies and health care cost—their magnitude and the need to control them are evident.

2. The dates and events presented above are taken from the 2007 Annual Reports of the Social Security and Medicare Boards of Trustees and the 2007 Financial Report of the United States Government.

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## Overview

This Citizens' Guide (guide) highlights important information in the *2007 Financial Report of the United States Government*.<sup>1</sup> The Secretary of the Treasury, Director of the Office of Management and Budget (OMB), and Comptroller General of the United States believe that the information discussed in this guide is important to all Americans.

While attention has been recently focused on addressing emerging challenges in today's economy, the last 3 years show economic growth and improvement. Revenue went up, deficits went down, and cost stayed fairly constant. But as you can see in chart 1, the government faces a huge fiscal challenge in the years ahead. This year, 2008, is the year in which the first of the approximately 80 million baby boomers—those born between 1946 and 1964—become eligible to draw Social Security benefits. Scheduled Social Security and Medicare benefits together with other federal programs' projected long-term cost are much greater than the resources (revenue and borrowings) available to pay for them.<sup>2</sup> Unless action is taken to bring program cost in line with available resources, the coming surge of entitlement spending will end in a fiscal train wreck that will have an adverse effect on the U.S. economy and on virtually every American.

## Where We Are Now

- Strong growth in individual incomes and corporate profits contributed to 4 consecutive years of tax revenue growth—revenue was up by 46 percent since 2003 to \$2.6 trillion in 2007.<sup>3</sup> Social Security and Medicare tax withholdings accounted for almost a third of total revenue in 2007.
- Social Security Trust Funds' revenue exceeded what the government paid out in benefits by \$186 billion in 2007. This surplus was credited to the Trust Funds.
- The government's total operating cost remained relatively constant—\$2.9 trillion in 2006 and in 2007.
- Revenue increases and relative cost stability resulted in a drop in the government's net operating cost—to \$276 billion—and a decline in the unified budget deficit (budget deficit)—to \$163 billion in 2007.
- To fund cumulative budget deficits, the government has borrowed a total of \$5 trillion from the public as of the end of fiscal year 2007. The government has also borrowed excess annual cash flows from the Social Security and Medicare Trust Funds and similar funds to finance other government cost. Including interest, the government owes \$4 trillion to these funds, which is backed by the full faith and credit of the government, resulting in total federal debt of \$9 trillion.

## Where We Are Headed

- As baby boomers retire and health care cost continue to rapidly rise, the cost of the Social Security, Medicare, and Medicaid programs will account for a growing portion of government cost.

<sup>1</sup>The administration annually issues two complementary reports on the government's finances. *The Financial Report of the United States Government* (Financial Report), issued by the Department of the Treasury, analyzes how revenue was spent in the fiscal year on programs and services and discusses the government's resulting financial position. Cost is reported at the time an obligation to pay arises rather than when payments are made. The *President's Budget* is the government's primary tool for financial planning and control. It focuses on taxpayers' dollars the government collects, how it uses them to support programs and services, and whether this use results in a surplus or deficit.

<sup>2</sup>This calculation assumes future government revenue as a percent of GDP is at its average historical rate of about 18 percent, and uses current spending trends to project the cost of federal programs other than Social Security and Medicare.

<sup>3</sup>The government's fiscal year begins October 1 and ends September 30.

- Absent reforms, the Social Security Trust Funds will be exhausted in 2041 and the Medicare Part A Trust Fund will be exhausted in 2019. Revenue dedicated to these entitlement programs under current law will not be enough to pay for scheduled Social Security and Medicare Part A benefits.
- The projected cost of all federal programs will exceed available resources. Unless the government brings program cost in line with available resources, resulting budget deficits will be so large that the government will not be able to borrow enough to fund them.
- Our children and grandchildren will bear a greater burden of the cost if we delay in implementing fundamental reforms.

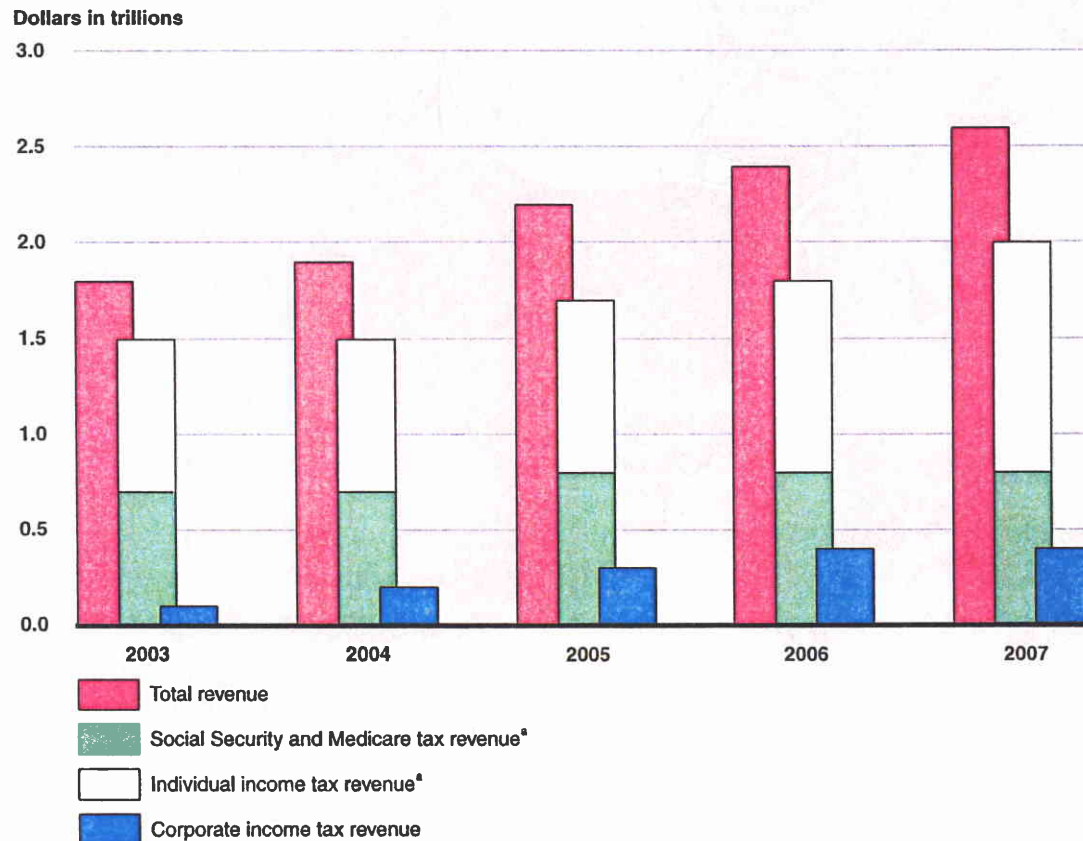
## Where We Are Now

### What Came In and What Went Out

What came in? In 2007, government revenue totaled \$2.6 trillion. What went out? The government's operating cost totaled \$2.9 trillion. The "bottom line" net operating cost—the difference between revenue and cost—was \$276 billion—a \$174 billion decrease from 2006. It is also more than \$100 billion greater than the unified budget deficit, as it includes approximately \$90 billion in accrued, but as of yet unpaid, post-employment benefits to the millions of people who are part of the government's current and retired civilian and military workforce. The budget deficit is the amount by which the government's spending exceeds its revenue, and thus, is a measure of how much the government has to borrow from the public. The budget deficit decreased \$85 billion to \$163 billion in 2007.

In 2007, a growing U.S. economy led to record revenue of \$2.6 trillion. Chart 2 shows that government revenue increased steadily from 2003 through 2007, largely because of taxes on increasing individual incomes and corporate profits. Social Security tax revenue of \$648 billion and Medicare tax revenue of \$200 billion accounted for almost a third of total revenue. The recent slowing of U.S. economic growth will have an effect on 2008 revenue.

Chart 2: Government Revenue 2003-2007

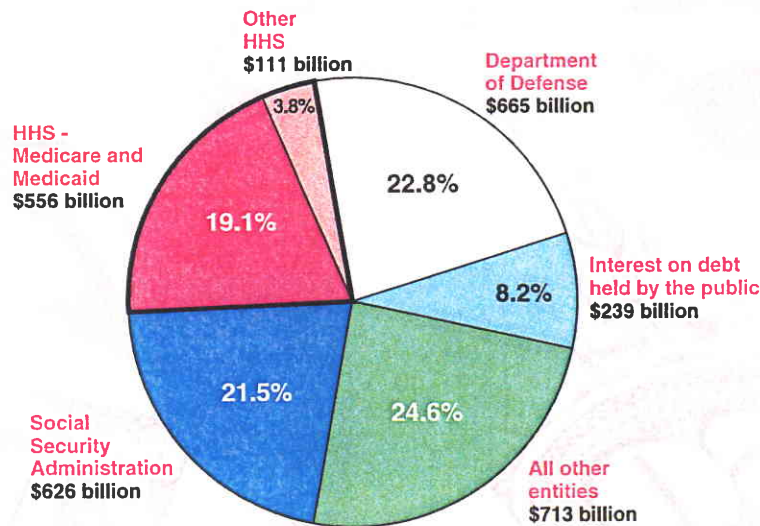


<sup>a</sup>In the *Financial Report*, Social Security and Medicare tax revenue are combined with individual income tax revenue.



The government's net cost in 2007 was relatively constant compared to 2006. Chart 3 shows that in 2007, the Department of Health and Human Services (HHS), Department of Defense, and Social Security Administration, plus interest on debt held by the public, accounted for approximately three-fourths of the government's total net cost. Medicare cost of \$368 billion and Medicaid cost of \$188 billion accounted for more than 80 percent of HHS' total net cost in 2007.<sup>4</sup>

**Chart 3: Government Net Cost 2007**



## The Debt

The government incurs debt when it borrows from the public to fund its budget deficits. The government also incurs debt when government funds invest their excess receipts in government securities. Of the government's total debt of about \$9 trillion at the end of 2007, approximately \$5 trillion was debt held by the public in the form of Treasury securities, such as bills, notes, and bonds. The public includes individuals, corporations, state and local governments, Federal Reserve Banks, and foreign governments.

The balance of the debt—nearly \$4 trillion—was intragovernmental debt. This represents debt held by government funds, including the Social Security (\$2.2 trillion) and Medicare (\$359 billion) Trust Funds. These government funds are typically required to invest any excess annual receipts in federal securities. When the government borrows these excess receipts, it still has an obligation to repay them to the government funds with interest. If expected budget deficits continue, as the government funds redeem the federal securities to pay for benefits or other program cost, then additional borrowing from the public will likely be required.

<sup>4</sup>Medicare cost is net of related premium revenue.

## Where We Are Headed

### An Unsustainable Fiscal Path

The projected growth in spending for Social Security and Medicare benefits affects every citizen in the nation.<sup>5</sup> Scheduled benefits under these programs are expected to exceed dedicated revenue (e.g., payroll taxes and premiums) by more than \$40 trillion (present value) over the next 75 years, under current laws and policy.<sup>6</sup> The fiscal imbalance is even larger looking beyond 75 years.<sup>7</sup> Moreover, without reform

- In **2007**, Medicare Part A benefit payments began to exceed the program's tax revenue.
- In **2011**, the Medicare Part A Trust Fund begins to decline as benefits exceed payroll taxes and trust fund interest.
- In **2017**, Social Security benefit payments will begin to exceed the program's tax revenue.
- In **2019**, Medicare Part A Trust Fund assets will not be enough to pay full benefits. Under current law, benefits would be reduced to 79 percent of scheduled benefits in 2019, declining to 29 percent by 2081.
- In **2027**, Social Security Trust Funds begin to decline as benefits exceed tax revenue and trust fund interest.
- In **2040**, federal debt held by the public will exceed the historical high of 109 percent of GDP.
- In **2041**, Social Security Trust Funds' assets will not be enough to pay full benefits. Under current law, benefits for all retirees would be reduced to 75 percent of scheduled benefits in 2041, declining to 70 percent by 2081.
- In **2080**, total government cost will be more than three times revenue.

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<sup>5</sup>The dates and events described in this section are taken from the 2007 Annual Reports of the Social Security and Medicare Boards of Trustees and the 2007 *Financial Report*.

<sup>6</sup>This estimate, included in the fiscal year 2007 Statement of Social Insurance, may be found in the 2007 *Financial Report*.

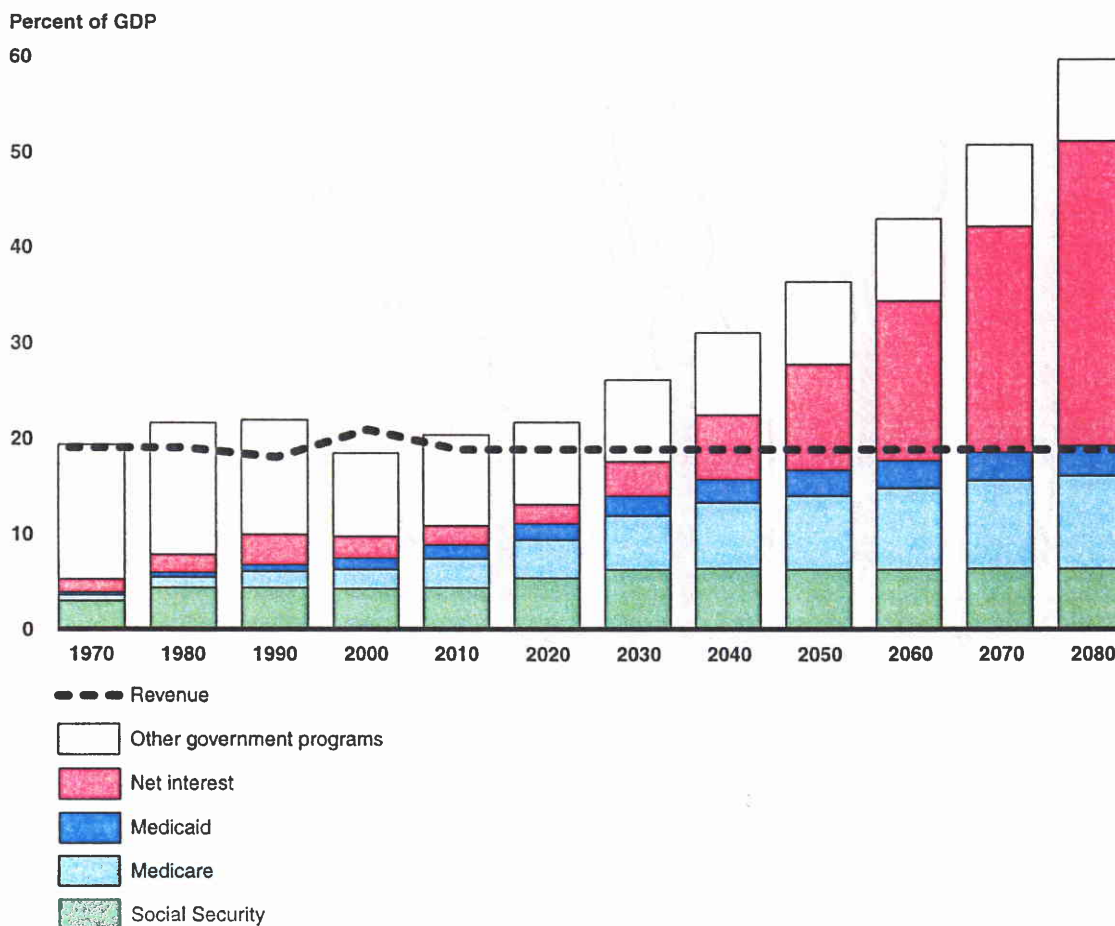
<sup>7</sup>The 75-year horizon includes the revenue from people working in the latter part of the 75-year period but not the associated benefits that will be paid when these same people retire after the end of the 75 years.



## Fundamental Reforms Are Needed Now

Chart 4 shows government revenue and spending as a percent of GDP from 1970 through 2080.<sup>8</sup> Since World War II, federal revenue as a share of GDP has been roughly constant at around 18 percent.<sup>9</sup> Whenever taxes rose, policy actions tended to pull them back.

**Chart 4: Government Revenue and Cost 1970-2080**



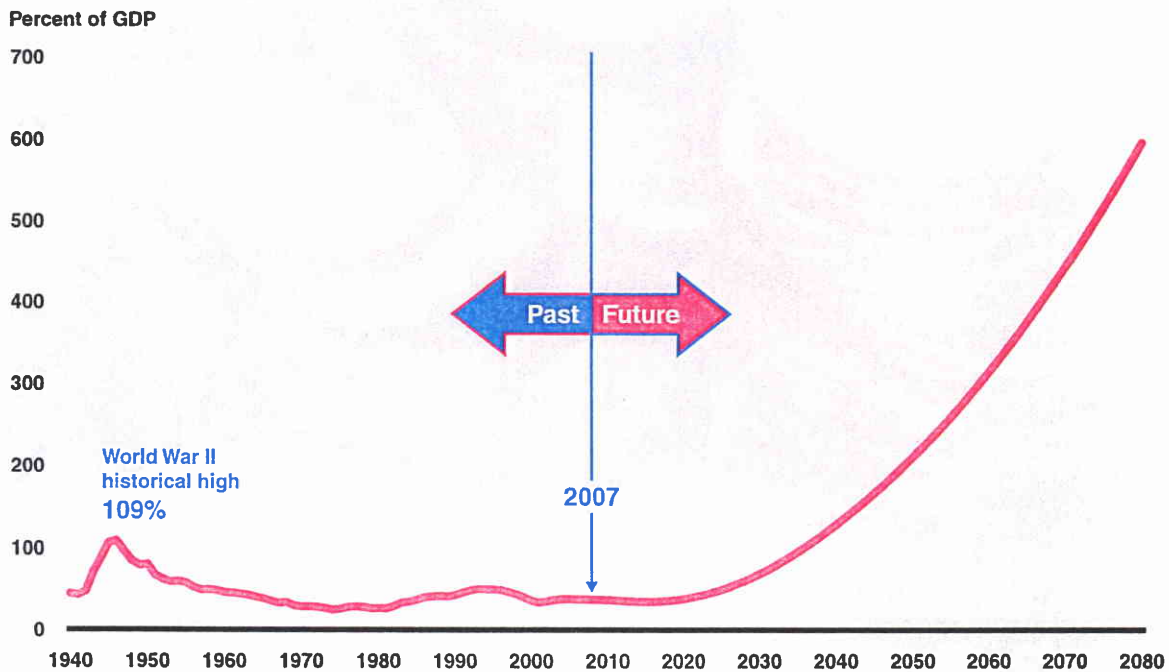
If revenue is held constant at about 18 percent of GDP (the historical average level), government spending will eventually exceed the government's ability to pay. By 2070, total government cost is projected to be 50 percent of GDP mainly because of mounting interest cost. Cost-to-GDP ratios have not been this high since World War II, when cost briefly reached 44 percent of GDP. By 2080, cost reaches nearly 60 percent of GDP, more than three times the average historical level of revenue as a percent of GDP. The dates and numbers would change with different forecasting assumptions, but under a wide range of reasonable projections, the increases in budget deficits will be dramatic.

<sup>8</sup>Projected spending is based on scheduled Social Security and Medicare benefits and current spending trends. Revenue as a percent of GDP from 2010 to 2080 is assumed to equal its historical average.

<sup>9</sup>GDP is one way of measuring the size of a nation's economy and is defined as the total market value of all final goods and services the nation produces in a given period. The projection that the government's revenue as a percent of GDP will remain relatively constant is based on historical data and trends that are not expected to change.

Chart 5 shows the extreme effect on the debt of projected budget deficits indicated in chart 4. These combined trends will cause government debt levels to more than triple by 2040 and to more than double again by 2060. The nation's debt could approach 600 percent of GDP by 2080. This far exceeds the historical high of 109 percent of GDP that occurred during World War II.

**Chart 5: Federal Debt Held by the Public 1940-2080**



The nation must change course before the deficit and debt reach unprecedented heights. The government must bring program cost in line with available resources. Delays in taking this action will increase the magnitude of the reforms needed and will place more of the burden on our children and grandchildren.

While the precise amounts of the government's financial responsibilities are far from certain—they are based on many complex calculations and assumptions, including life expectancies and health care cost—their magnitude and the need to control them are evident.



## Looking Ahead

In the 2007 *Financial Report*, the Secretary of the Treasury indicates that the nation must look to the future, particularly the spending demands of Social Security and Medicare, and squarely face the need for fundamental reform if these programs are to be sustained. The government must strive to make all disclosures transparent, provide all points of view with relevant data, and expand financial and fiscal reporting in order to explain why estimates of future Social Security and Medicare costs increase year after year.

The issues discussed in this guide affect, and should be of interest to, every citizen. The *Financial Report's* comprehensive reporting is intended to inform and support the decision-making needs of lawmakers and the public and to help keep the United States on solid financial ground.

## Finding Out More

You will find more detail on these matters in the *Financial Report*. You are encouraged to explore the information it contains and to ask questions about how the government manages taxpayers' money. The 2007 *Financial Report of the United States Government* and other information about the nation's finances are available at:

- U.S. Department of the Treasury's Financial Management Service,  
<http://www.fms.treas.gov/fr/index.html>;
- OMB's Office of Federal Financial Management,  
<http://www.whitehouse.gov/omb/financial/index.html>; and
- GAO, <http://www.gao.gov/financial/fy2007financialreport.html>.

This guide can be obtained on-line at the above Web sites.

This Citizens' Guide highlights information in the 2007 *Financial Report*. The Government Accountability Office's (GAO) complete audit report on the U.S. government's consolidated financial statements can be found beginning on page 159 of the *Financial Report*. For 2007, for the first time, GAO issued an unqualified or "clean" opinion on the Statement of Social Insurance. However, certain material financial reporting control weaknesses and other limitations on the scope of its work prevented GAO from expressing an opinion on the remaining financial statements.