CITIZENS GUIDE
FINANCIAL REPORT
OF THE UNITED STATES GOVERNMENT

FY 2016

Citizen's Guide to the Fiscal Year 2016 Financial Report of the United States Government

The Citizen's Guide to the Fiscal Year 2016 *Financial Report* of the U.S. Government (*Financial Report*) summarizes the U.S. Government's current financial position and condition, and discusses key financial topics, including fiscal sustainability. This Guide and the *Financial Report* are produced by the U.S. Department of the Treasury in coordination with the Office of Management and Budget (OMB) of the Executive Office of the President. The Secretary of the Treasury, Director of OMB, and Comptroller General of the United States at the Government Accountability Office believe that the information discussed in this Guide is important to all Americans.

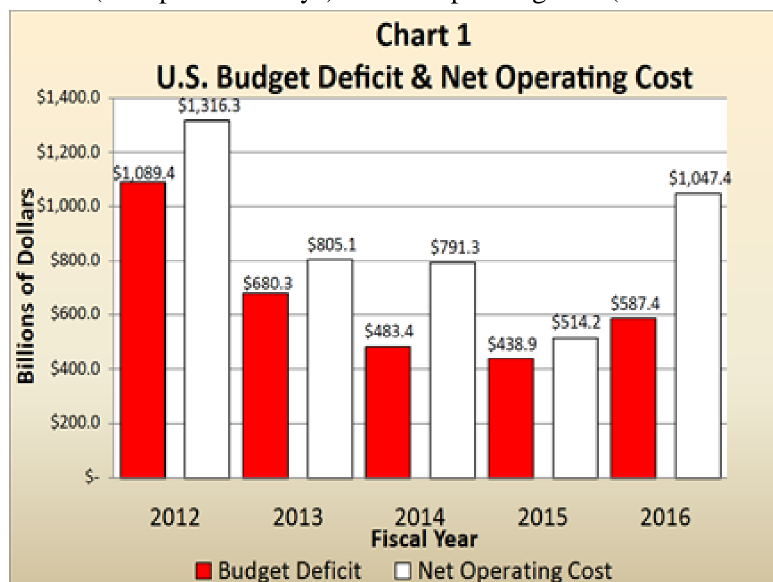
Where We Are Now

Comparing the Budget and the Financial Report

Together, the ***Budget of the United States Government*** (***Budget***) and the ***Financial Report of the U.S. Government (Financial Report)*** present complementary perspectives on the Government's financial position and condition.

- The *Budget* is the Government's primary financial planning and control tool. It accounts for past Government receipts and spending, and presents the President's proposed receipts and spending plan. The *Budget* focuses on *receipts*, or cash received by the U.S. Government (*Government*) and *outlays*, or payments made by the Government to the public. An excess of receipts over outlays is called a budget *surplus*; an excess of outlays over receipts is called a budget *deficit*.
- The *Financial Report* focuses on the Government's costs and revenues (what went out and what came in), assets and liabilities (what it owns and owes), and other important financial information. The *Financial Report* compares the Government's *revenues* (amounts earned, but not necessarily collected), with its *costs* (amounts incurred, but not necessarily paid) to derive net operating cost.

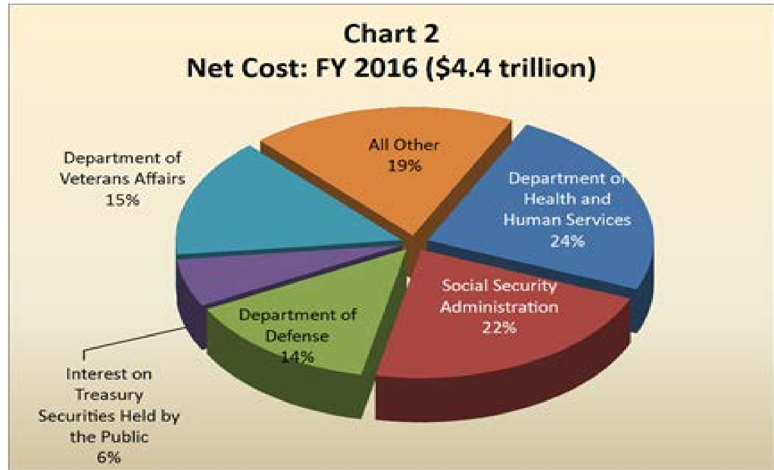
Chart 1 compares the Government's budget deficit (receipts vs. outlays) and net operating cost (revenues vs. costs) for Fiscal Years (FY) 2012 - 2016. During FY 2016:



- A $166.5 billion increase in outlays was offset slightly by an $18.0 billion increase in receipts to increase the budget deficit by $148.5 billion (about 33.8 percent) to $587.4 billion.
- Net operating cost more than doubled by $533.2 billion or 103.7 percent to $1.0 trillion, due largely to a $551.1 billion increase in net cost, offset by a slight $11.3 billion increase in tax and other revenues.
- The $460.0 billion difference between the budget deficit and net operating cost is primarily due to accrued costs (incurred but not necessarily paid) associated with increases in estimated federal employee and veteran benefits liabilities and certain other liabilities that are included in net operating cost, but not the budget deficit.

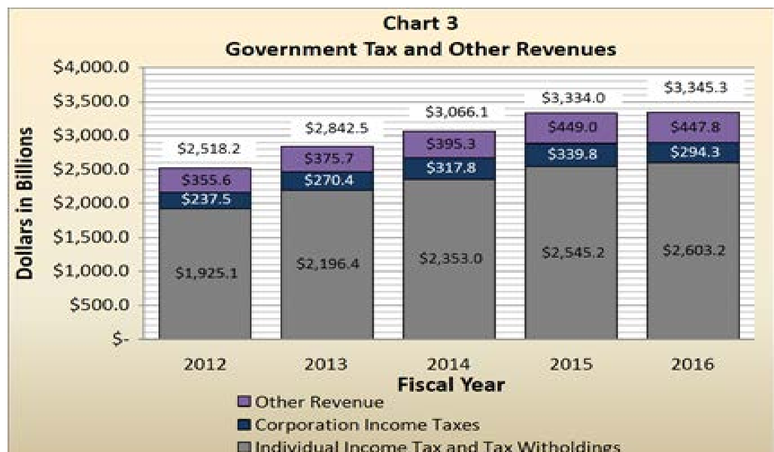
What Went Out and What Came In

The Government's "bottom line" net operating cost (Net cost of Government operations less tax and other revenues with some adjustments) more than doubled, increasing $533.2 billion (103.7 percent) during FY 2016 to $1.0 trillion. It is calculated as follows:



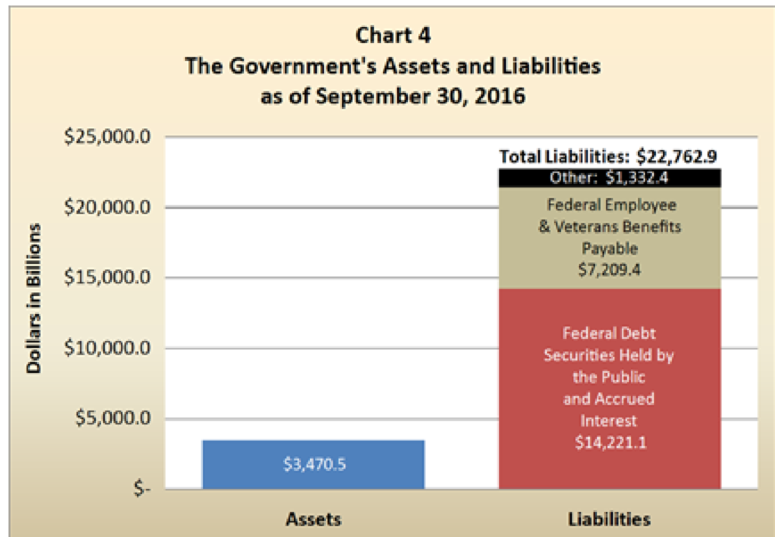
- Starting with total gross costs of $4.5 trillion, the government subtracts earned program revenues (e.g., Medicare premiums, national park entry fees, and postal service fees) and adjusts the balance for gains or losses from changes in actuarial assumptions used to estimate future liabilities for federal employee and veterans benefits to derive its net cost of $4.4 trillion, an increase of $551.1 billion (14.3 percent) from FY 2015. This net increase is the combined effect of many offsetting increases and decreases across the Government. For example:
  - Agencies administering federal employee and veterans benefits programs employ a complex series of assumptions, including but not limited to interest rates, beneficiary eligibility, life expectancy, and medical cost levels, to make actuarial projections of their long-term benefits liabilities. Across the government, the total increase in net actuarial loss (net cost increase) from assumption changes of $292.6 billion was composed largely of a $390.5 billion actuarial loss increase recorded by the Department of Veterans Affairs (VA) due largely to increases in estimates of future compensation cases. This loss was partially offset by an actuarial gains increase (net cost decrease) of $64.2 billion and $30.1 billion recorded by the Office of Personnel Management (OPM) and the Department of Defense (DOD), respectively. VA costs increased by an additional $83 billion due to actual results differing from the prior year's actuarial projections.
  - Department of Health and Human Services (HHS) and Social Security Administration (SSA) net costs increased $44.8 billion and $37.1 billion, respectively, largely due to increases in benefit expenses from the social insurance programs administered by those agencies (e.g., Medicare, Social Security). DOD net costs increased by $47.3 billion due largely to increases in costs for operations readiness and support, as well as military retirement benefits. Chart 2 shows that the largest shares of the Government's total FY 2016 net cost came from HHS, SSA, VA, and DOD.

- The Government deducts tax and other revenues from its net cost (with some adjustments) to derive its "bottom line" net operating cost of $1.0 trillion.
  - From Chart 3, total Government tax and other revenues grew by $11.3 billion (0.3 percent) to more than $3.3 trillion for FY 2016.
  - Together, individual income tax and tax withholdings, and corporation taxes accounted for about 86.6 percent of total tax and other revenues in FY 2016. Other revenues include Federal Reserve earnings, excise taxes, and customs duties.



What We Own and What We Owe

Chart 4 summarizes what the Government owns in assets and what it owes in liabilities. As of September 30, 2016:



- The Government held about $3.5 trillion in assets (mostly $1.3 trillion in net loans receivable (primarily student loans) and $979.5 billion in net property, plant, and equipment).
  - Beyond these assets, other significant Government resources not reported on the balance sheet include stewardship assets, natural resources, and the Government's power to tax and set monetary policy.
- Total liabilities ($22.8 trillion) consist mostly of: (1) $14.2 trillion in federal debt securities held by the public and accrued interest and (2) $7.2 trillion in federal employee and veteran benefits payable.
  - The "public" consists of individuals, corporations, state and local governments, Federal Reserve Banks, foreign governments, and other entities outside the federal government.
- The Government also reports about $5.5 trillion of intragovernmental debt outstanding, which arises when one part of the Government borrows from another.
  - For example, Government funds (e.g., Social Security and Medicare trust funds) typically must invest excess annual receipts in Treasury-issued federal debt securities, creating trust fund assets and Treasury liabilities. These amounts are included in the financial statements of investing agencies and Treasury, respectively, but offset each other when consolidated into the governmentwide financial statements. Thus, they are not reflected in Chart 4.

Debt held by the public plus intragovernmental debt equals gross federal debt, which, with some adjustments, is subject to a statutory debt ceiling ("debt limit"). Increasing or suspending the debt limit does not increase spending or authorize new spending; rather, it permits the Government to continue to honor pre-existing commitments. Congress suspended the debt limit during FY 2015 and FY 2016: Public Law (P.L.) 113-83 suspended the debt limit from February 15, 2014 through March 15, 2015; and P.L. 114-74 suspended it again from November 2, 2015 through March 15, 2017. The debt limit was last raised to $18.1 trillion in March 2015. When delays in raising the debt limit occur, as they did during both fiscal years 2015 and 2016, Treasury implements "extraordinary measures," on a temporary basis, to enable the Government to protect the full faith and credit of the United States by continuing to pay the Nation's bills.

As budget deficits continue to occur, the Government will have to continue to borrow from the public. Instances where the debt held by the public increases faster than the economy for extended periods can pose challenges to the sustainability of current fiscal policy.

Considering key macroeconomic indicators can help place the discussion of the Government's financial results in a broader context. During FY 2016 the economy continued to grow, job growth accelerated, and the unemployment rate declined. These and other economic and financial developments are discussed in greater detail in the *Financial Report*.

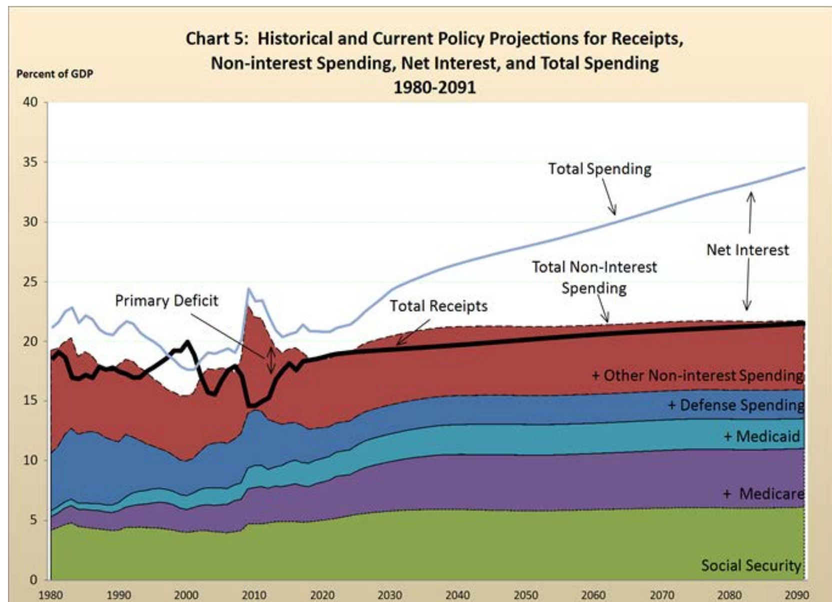
Where We Are Headed

An important purpose of this Guide and the *Financial Report* is to help citizens understand current fiscal policy and the importance and magnitude of policy reforms necessary to make it sustainable. A sustainable policy is one where the ratio of debt held by the public to Gross Domestic Product (GDP) (the debt-to-GDP ratio) is stable or declining over the long term. GDP measures the size of the Nation's economy in terms of the total value of all final goods and services that are produced in a year. Considering financial results relative to GDP is a useful indicator of the economy's capacity to sustain the Government's many programs.

To determine if current fiscal policy is sustainable, the projections discussed in this Guide assume current policy will continue indefinitely and draw out the implications for the growth of the debt-to-GDP ratio.[1] The projections are therefore neither forecasts nor predictions. As policy changes are enacted, actual financial outcomes will be different than those projected.

Receipts, Spending, and the Debt

Chart 5 shows historical and current policy projections for receipts, non-interest spending by major category, and total spending expressed as a percent of GDP.



- The difference between the receipts and non-interest spending shares of GDP (the primary deficit-to-GDP ratio) grew rapidly in 2009 due to the financial crisis, the recession, and the policies pursued to combat both. The ratio remained high from 2010 to 2012, despite shrinking in each successive year, and fell significantly in 2013 and 2014.
- The primary deficit is projected to shrink further in the next few years as spending limits called for in the *Budget Control Act* (BCA) continue and the economy continues to recover, becoming a surplus starting in 2020 that peaks at 0.3 percent of GDP in 2021.
- After 2021, however, increased spending for Social Security and health programs[2] due to the continued retirement of the baby boom generation and increases in the price of health care services is expected to cause primary surpluses to steadily deteriorate and become a primary deficit starting in 2025 that reaches 1.0 percent of GDP by 2029 and peaks at 1.6 percent of GDP in 2038. After 2038, the aging of the population continues at a slower pace, causing the primary deficit to gradually decrease to 0.2 percent of GDP in 2091.

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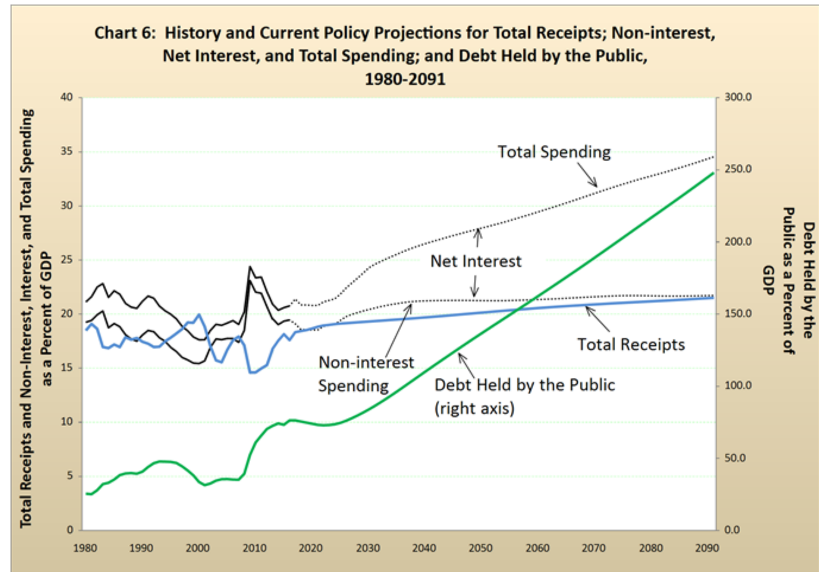
[1] Current policy in the projections is based on current law, but includes extension of certain policies that expire under current law but are routinely extended or otherwise expected to continue.

[2] The 2016 Medicare Trustees Report projects that the Hospital Insurance (HI) Trust Fund will remain solvent until 2028 (two years earlier than noted in last year's report), at which point, HI revenues are projected to cover 87 percent of program costs. This percentage is projected to decrease to 79 percent in 2040, and then increase to about 86 percent by the end of the projection period. As for Social Security, under current law, the Old-Age, Survivors, and Disability Insurance (OASDI) Trust Fund reserves, considered on a theoretical combined basis, are projected to be depleted in 2034 (unchanged from last year's Financial Report), at which time the projected share of scheduled benefits payable from trust fund income is 79 percent, decreasing to about 74 percent by 2090. The Disability Insurance (DI) Trust Fund alone is projected to become depleted by the end of 2023, at which time 89 percent of scheduled benefits would be payable, rising to a somewhat higher level through 2040, then declining to 82 percent by 2090. The projections assume full Social Security and Medicare benefits are paid after the corresponding trust funds are exhausted. See the 2016 Trustees Report for Medicare (pp 5, 29) and Social Security (pp 3, 6, 13, 24).

- In these projections, the *Affordable Care Act* (ACA)[3] provision of health insurance subsidies and expanded Medicaid coverage boosts federal spending, and other ACA provisions significantly reduce per-beneficiary Medicare cost growth.
- Overall, the ACA is projected to substantially reduce the growth rate of federal expenditures for Medicare over the next 75 years. However, as noted in the *Financial Report*, there is uncertainty about the extent to which the ACA's provisions will result in reduced health care cost growth. Even if those provisions work as intended and as assumed in these projections, Chart 5 still shows a persistent gap between projected receipts and total spending.

The primary deficit projections in Charts 5 and 6 (left axis), along with those for interest rates and GDP, determine the debt-to-GDP ratio projections shown in Chart 6 (right axis).



- The debt-to-GDP ratio was 77 percent at the end of FY 2016, and under the long-term fiscal projections of current policy is projected to be 71 percent in 2026, 122 percent in 2046, and 252 percent in 2091. The debt-to-GDP ratio rises at an accelerating rate despite primary deficits that flatten out because higher levels of debt lead to higher net interest expenditures, and higher net interest expenditures lead to higher debt. The continuous rise of the debt-to-GDP ratio after 2026 indicates that current policy is unsustainable.
- These debt-to-GDP projections are generally higher than the corresponding projections in the FY 2015 *Financial Report*, but still lower than those in the FY 2014 *Financial Report*. For example, the debt-to-GDP projection for 2089 (the final projection year for the 2014 report) is 246 percent in this year's *Financial Report*, was 220 percent in the FY 2015 *Financial Report*, and was 321 percent in the FY 2014 *Financial Report*.

The Fiscal Gap and the Cost of Delaying Policy Reform

- It is estimated that preventing the debt-to-GDP ratio from rising over the next 75 years would require some combination of spending reductions and receipt increases that amount to 1.6 percent of GDP on average over the next 75 years, 0.4 percentage points greater than the 1.2 percent estimate in 2015.
- The timing of changes to non-interest spending and receipts that close this "75-year fiscal gap" has important implications for the well-being of future generations.
  - For example, relative to a policy that begins immediately, if action is delayed by 10 years, it is estimated that the magnitude of reforms necessary to close the 75-year fiscal gap will increase by about 18 percent; if action is delayed by 20 years, the magnitude of reforms necessary will increase by about 50 percent.
  - If policy changes in the near term were to go in the reverse direction, by reducing revenues and/or increasing spending, the policy changes needed to close the fiscal gap would be made all the larger.

[3] The ACA refers to P.L. 111-148, as amended by P.L. 111-152. The ACA expands health insurance coverage, provides health insurance subsidies for low-income individuals and families, includes many measures designed to reduce health care cost growth, and significantly reduces Medicare payment rates relative to the rates that would have occurred in the absence of the ACA. (See Note 22 and the Required Supplementary Information section of the Financial Report, and the 2015 Medicare Trustees Report for more information).

- Future generations are harmed by a policy delay of this sort because the higher the primary surpluses are during their lifetimes, the greater is the difference between the taxes they pay and the programmatic spending from which they benefit.

Conclusion

- The Government took significant steps towards fiscal sustainability by enacting the ACA in 2010, the BCA in 2011, and the *American Taxpayer Relief Act* (ATRA) in 2013. The ACA holds the prospect of lowering long-term per beneficiary spending growth for Medicare and Medicaid, the BCA significantly curtails discretionary spending, and ATRA increased revenues. Together, these three laws substantially reduce the estimated long-term fiscal gap.
- But even after enactment of these laws, the Government's debt-to-GDP ratio is projected to remain relatively flat over the next ten years, and then commence a continuous rise over the remaining projection period and beyond if current policy is kept in place. This trend implies that current policy is not sustainable.
- Subject to the important caveat that changes in policy are not so abrupt that they slow continued economic growth, the sooner policies are put in place to avert these trends, the smaller the revenue increases and/or spending decreases will need to be to return the Government to a sustainable fiscal path.
- If policies are put in place in the near term that increase the fiscal gap, then even more dramatic fiscal adjustments will be necessary in the future.

The Nation By The Numbers

The *Financial Report* provides the President, Congress, and the American people a comprehensive view of how the Government is managing taxpayer dollars. It discusses the Government's financial position and condition, its revenues and costs, assets and liabilities, and other responsibilities and commitments, as well as important financial issues that affect the nation and its citizens both now and in the future. The table on the following page presents several key indicators of the Government's financial position and condition, which are summarized in this Guide and discussed in greater detail in the *Financial Report*.

The Government Accountability Office's (GAO) audit report on the U.S. Government's consolidated financial statements can be found beginning on page 237 of the full *Financial Report*. For the reasons discussed below, GAO was prevented from expressing (disclaimed) an opinion on these consolidated financial statements. GAO disclaimed an opinion on the 2016 and 2015 Statements of Long-Term Fiscal Projections; the 2016, 2015, 2014, 2013, and 2012 Statements of Social Insurance (SOSI); and the 2016 and 2015 Statements of Changes in Social Insurance Amounts because of significant uncertainties (discussed in Note 22 in the *Financial Report*) primarily related to the achievement of projected reductions in Medicare cost growth and certain other limitations. In addition, GAO disclaimed an opinion on the remaining FY 2016 and 2015 financial statements in the *Financial Report* due to certain material financial reporting control weaknesses and other limitations on the scope of its work.

NATION BY THE NUMBERS
A Snapshot of The Government's Financial Position & Condition

	2016	2015*
Financial Measures (Dollars in Billions):		
Gross Costs	**$ (4,507.7)**	**$ (4,248.2)**
Less: Earned Revenue	$ 376.6	$ 375.6
Gain/(Loss) from Changes in Assumptions	$ (273.3)	$ 19.3
Net Cost	**$ (4,404.4)**	**$ (3,853.3)**
Less: Total Tax and Other Revenues	**$ 3,345.3**	**$ 3,334.0**
Unmatched Transactions and Balances[1]	$ 11.7	$ 5.1
Net Operating Cost	**$ (1,047.4)**	**$ (514.2)**
Assets:	**$ 3,470.5**	**$ 3,261.2**
Less: Liabilities, comprised of:		
Debt Held By the Public & Accrued Interest	$ (14,221.1)	$ (13,172.5)
Federal Employee & Veteran Benefits	$ (7,209.4)	$ (6,772.4)
Other	$ (1,332.4)	$ (1,559.9)
Total Liabilities	**$ (22,762.9)**	**$ (21,504.8)**
Net Position (Assets Less Liabilities)	**$ (19,292.4)**	**$ (18,243.6)**
Sustainability Measures (Dollars in Trillions):		
Social Insurance Net Expenditures[2]	$ (46.7)	$ (41.5)
Total Non-Interest Net Expenditures[3]	$ (10.6)	$ (4.1)
Sustainability Measures as Percent of Gross Domestic Product (GDP)[4]:		
Social Insurance Net Expenditures	(3.8%)	(3.7%)
Total Non-Interest Net Expenditures	(0.8%)	(0.3%)
Budget Results (Dollars in Billions)		
Unified Budget Deficit	**$ (587.4)**	**$ (438.9)**

*2015 amounts restated. See Financial Statement Notes 1V, 6, and 12.
1 Reflects adjustments made to bring certain accounts into balance for such items as restatements and errors in federal agency reporting and unreconciled intragovernmental transactions and balances among agencies.
2 Source: Statement of Social Insurance. Amounts equal present value of projected revenues and expenditures for scheduled benefits over the next 75 years of certain benefit programs that are referred to as Social Insurance (e.g., Social Security, Medicare). Amounts represent 'open group' population (all current and future beneficiaries). These amounts are not considered liabilities on the balance sheet.
3 Source: Statement of Long-Term Fiscal Projections. Represents the 75-year projection of the federal government's receipts less non-interest spending.
4 GDP values used represent the average of 75-year present value of nominal GDP for 2016 and 2015 based on the Social Security and Medicare Trustees Reports.

Find Out More

The *2016 Financial Report of the United States Government* and other information about the nation's finances are available at:

- U.S. Department of the Treasury, http://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/fr_index.htm;
- OMB's Office of Federal Financial Management, http://www.whitehouse.gov/omb/financial/index.html; and
- GAO, http://www.gao.gov/financial.html.