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Lessons that Citizens Should Learn from Shareholders

The United States Government's Financial Statements for the Fiscal Year Ending September 30, 2020

In many ways, citizens in the United States play an analogous role to corporate shareholders when it comes to our government. Citizens and shareholders are both "investors." As citizens, we invest through tax payments and fees, whereas shareholders invest through stock purchases. Citizens and shareholders both expect "returns" on their investments. For citizens, the United States Government delivers services and infrastructure, while corporations deliver expected dividends and share value appreciation to its shareholders. Citizens and shareholders both have elected representatives. Citizens elect politicians, while shareholders elect members of the board of directors.

However, there are differences as well. Most notably, shareholders pay close attention to the financial results of the companies they invest in, whereas most citizens generally pay little attention to the financial statements of the United States. For example, this past month, the United States Government issued its financial statements for the fiscal year ended September 30, 2020 ("Financial Report"), without receiving much attention in the media or interest from citizens. Yet, there are numerous facts that citizens, if they acted like shareholders, would want to know, and scrutinize.

Below we highlight several of the most significant observations from this year's Financial Report.

Record High Deficit in Fiscal Year 2020

Per the Financial Report, the United States Government reported an annual deficit of $3.1 trillion during the fiscal year ended September 30, 2020, setting a record high deficit.

Of significance, the deficit is calculated using the cash basis of accounting and would be higher under the accrual basis of accounting, the method required by Generally Accepted Accounting Principles. Spending programs enacted in fiscal year 2021, while important to maintaining the national economy as it emerges from the pandemic, will again put pressure on near term deficits.

Solvency Key Metric; the Debt-to-Gross Domestic Product ("GDP") Ratio

Per the United States Treasury, a key metric to measure the United States Government's solvency is the ratio of its outstanding debt to the GDP, a common measure for the size of the total economy.

Based on the national debt as reported on the United States Government's balance sheet of approximately $26.8 trillion as of September 30, 2020, the debt-to-GDP ratio equaled approximately 1.00.[1] This debt amount is before consideration of "off balance sheet" debt such as Social Security, Medicare, and other programs set up in unconsolidated entities. Similarly, the revenue sources supporting the payments for these liabilities are reported separately as well.

Of significance, the debt-to-GDP ratio increased by approximately 25% from FY 2019 to FY 2020.[2] This rise in the debt-to-GDP ratio, as well as the level of the ratio, is similar to that of the World War II period, which peaked in 1946 at approximately 1.06.[3] Economic growth in the years following the war helped lower this ratio and managing the United States Government's finances in the next several years is at a critical point as well, as described below.

1 FY 2020 Financial Report at pages 1 and 10.
2 FY 2020 Financial Report at page 27.
3 *Ibid.*

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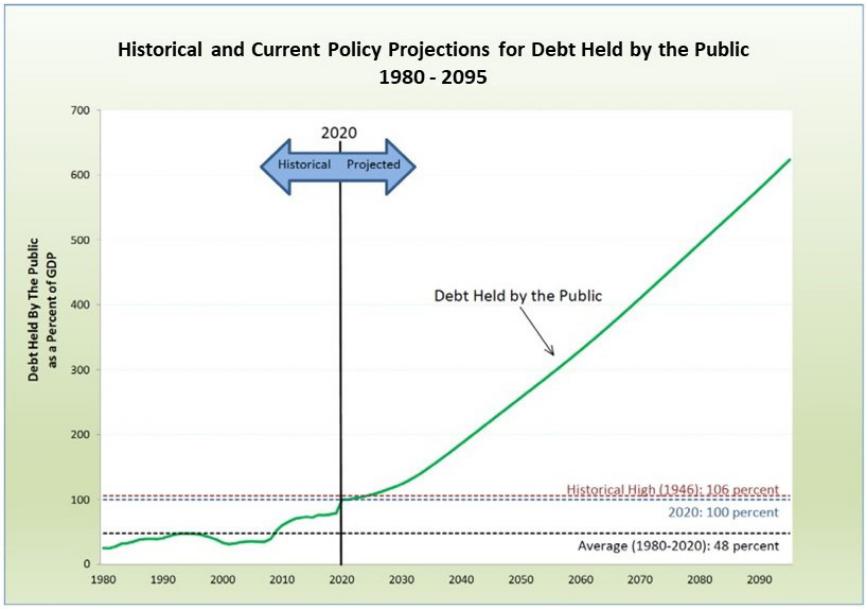
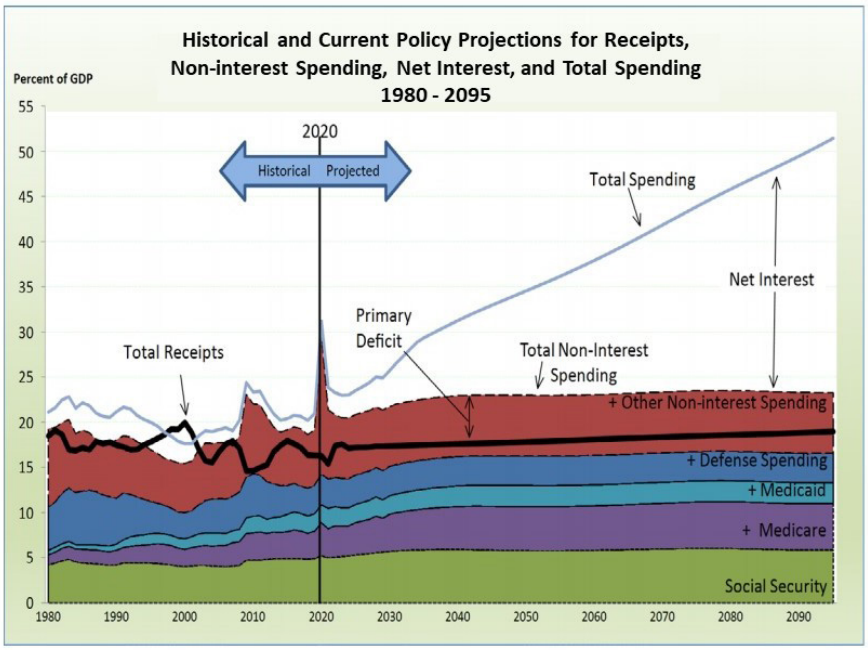
Unsustainable Long-Term Fiscal Path

Per the United States Government Accountability Office ("GAO"), "absent policy changes, the federal government *continues to face an unsustainable long-term fiscal path*."[4]

The chart below[5] reflects a projection prepared by the United States Treasury, which estimates that the government's debt-to-GDP ratio could rise to 6.23 over the 75-year period, unless changes are made to make the "fiscal policy sustainable."[6]



Also, of concern, the United States Treasury projects[7] that approximately 50 cents of every government dollar may be spent on interest costs in the future due to the accumulated debt burden unless changes are made.[8]



4 FY 2020 Financial Report at page 234.
5 FY 2020 Financial Report, *Chart 7*, at page 10.
6 FY 2020 Financial Report at page 10.
7 FY 2020 Financial Report, *Chart 6*, at page 8.
8 FY 2020 Financial Report at page 8.

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Of note, included within the Management Discussion and Analysis section of the Financial Report is the following quote which discusses the government's ability to generate revenues through taxes and to raise funds by issuing federal debt securities, as an intangible asset, of the United States Government that is not recorded on its balance sheet.

> *"Due to its sovereign power to tax and borrow, and the country's wide economic base, the government has unique access to financial resources through generating tax revenues and issuing federal debt securities. This provides the government with the ability to meet present obligations and those that are anticipated from future operations and are not reflected in net position."* [9]

While true that the ability to raise taxes and issue debt is a powerful tool, and "asset", of the United States Government, even this tool has limits as recognized by the Treasury Department when describing the current situation as "unsustainable."

Material Weaknesses in Internal Controls

Finally, the GAO identified *significant material weaknesses* in internal controls over financial reporting for the United States Government, with many arising at the Department of Defense. As a result of the material weaknesses, *the GAO issued a disclaimer of opinion*, meaning the Financial Report "*may not be reliable*."[10] Needless to say, this situation would be unacceptable for a corporation under the United States securities laws, and a fact that would cause many shareholders to sell their shares, not make new investments, or both.

To learn more, the complete Financial Report as well as an executive summary can be found at https://www.fiscal.treasury.gov/files/reports-statements/financial-report/2020/fr-03-25-2021-(final).pdf.

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9 FY 2020 Financial Report at page 56.
10 FY 2020 Financial Report at page 228.