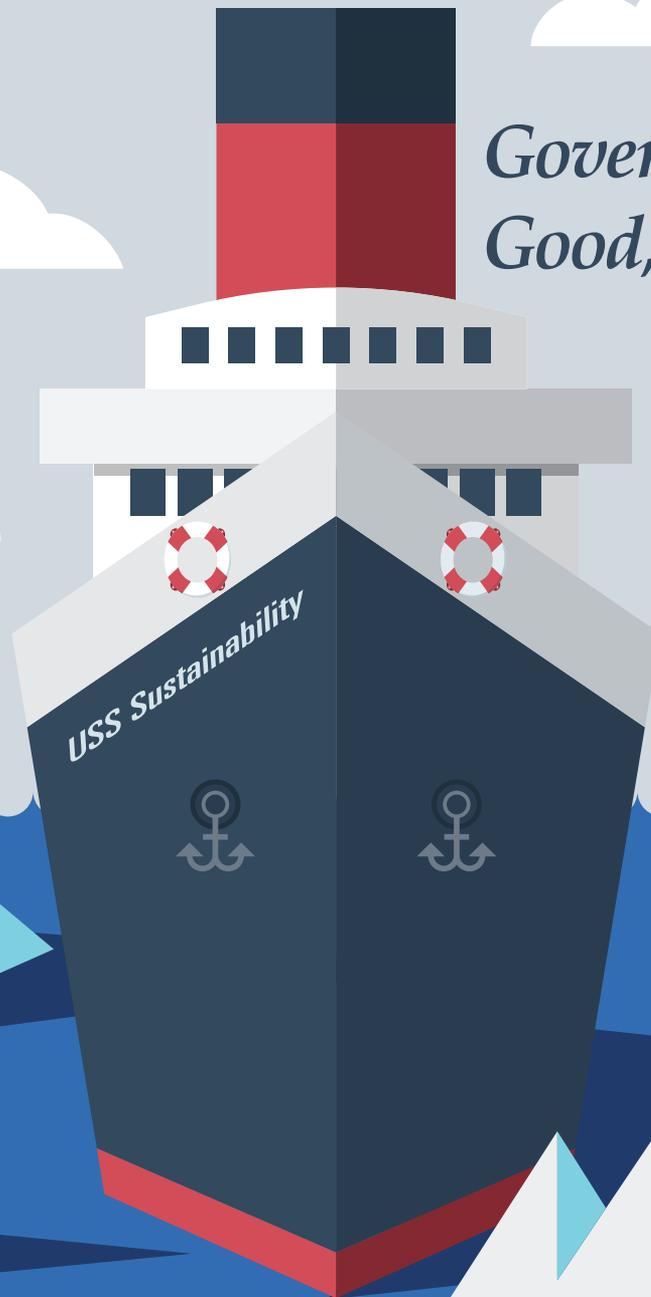


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*Government Debt:
Good, Bad or Ugly?*





The National Debt: a Ticking Time Bomb with Rising Interest Rates

By: Joseph J. DioGuardi, CPA

In 1816, Thomas Jefferson wrote, “[T]o preserve [the people’s] independence, we must not let our rulers load us with perpetual debt. We must make our election between *economy and liberty, or profusion and servitude.*”¹ Today, make no mistake, the American people are heading toward a national debt overload, and many experts agree our federal government is on an unsustainable fiscal and economic path with no end in sight. As one of the very few Certified Public Accountants ever elected to the U.S. Congress, I made this very clear in *Unaccountable Congress: It Doesn’t Add Up* by putting a “congressional credit card” on the cover.² In Chapter 1, I said Washington has a “credit card mentality,” perennially running up bills by spending money we do not have and borrowing from countries we neither respect nor trust.

To put things in perspective, by the end of 1984, the year I was elected to represent the people of Westchester County, N.Y., in the U.S. House of Representatives, our national debt was only \$1.3 trillion, or just more than \$3 trillion in 2015 dollars. This number was calculated on the grossly inadequate cash basis of accounting used in federal budgeting and financial reporting. In reality, it was already \$3.8 trillion (about \$9 trillion in today’s dollars) using accrual accounting principles applicable to every business in America. By the end of fiscal year 2016, the national debt on the modified accrual basis is expected to reach \$19 trillion (see **Figure 3**).³

national government has available for discretionary spending on important government programs. The big point to make here is discretionary spending is already squeezed to less than one-third of the budget by spending on mandatory entitlement programs (see **Figure 2**).⁵ And, it is defense spending that accounts for more than half of discretionary spending. Since interest also acts as a mandatory expense and must be paid currently, unless we begin to reform entitlement spending or increase taxes over the next 10 years, discretionary spending will increasingly become a hostage to rising interest costs on the national debt, including defense spending and the funds we need for homeland security.

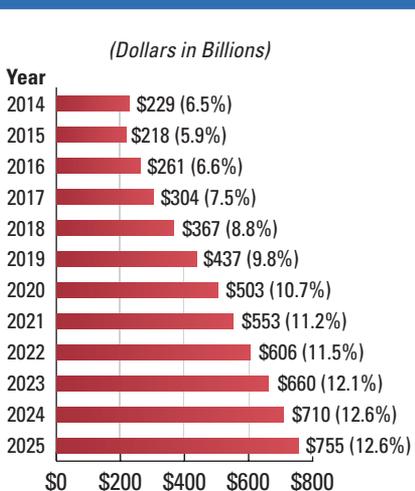
Projected Interest Rates Increase Our Economic and Financial Vulnerability

Like with any credit card, there is a cost to paying later — interest to the lenders. Since the Federal Reserve Bank commenced its program of “quantitative easing” (QE), interest rates dropped dramatically in 2008 to keep the economy from sinking and remains at historically low rates, today. As a result, the annual cost of borrowing for the U.S. government has been very low for the last seven years. But, this is about to change since unemployment has now dropped to approximately 5 percent and the economy, while not yet at the growth levels needed for long-term sustainability, has resuscitated moderately. In any case, the Congressional Budget Office (CBO) is projecting, ominously, a rapid increase in the annual cost of interest on the national debt from \$218 billion in 2015 to \$755 billion in 2025 (see **Figure 1**).⁴

The Need to Use Professional Accounting Principles to Fully Disclose the National Debt

Let me emphasize that full accrual accounting is essential for genuine financial accountability. It recognizes obligations incurred even though not yet paid, like long-term unfunded entitlements for Social Security and Medicare, and it spreads capital costs for long-term assets over the useful lives of those assets. It rules out clever smoke-and-mirror tricks that can mask economic reality in a given year and, above all, makes fiscal responsibility and financial accountability possible. The International Monetary Fund (IMF) published a working paper in November 2015, “Defining the government’s debt and deficit,” in which the author, Timothy Irwin, concluded “debt and deficit measures need protection from manipulation, such as independent measurement, independent auditing, the use of standards set by independent bodies, and the publication of the assumptions underlying the measure-

Figure 1. Interest Costs on Debt

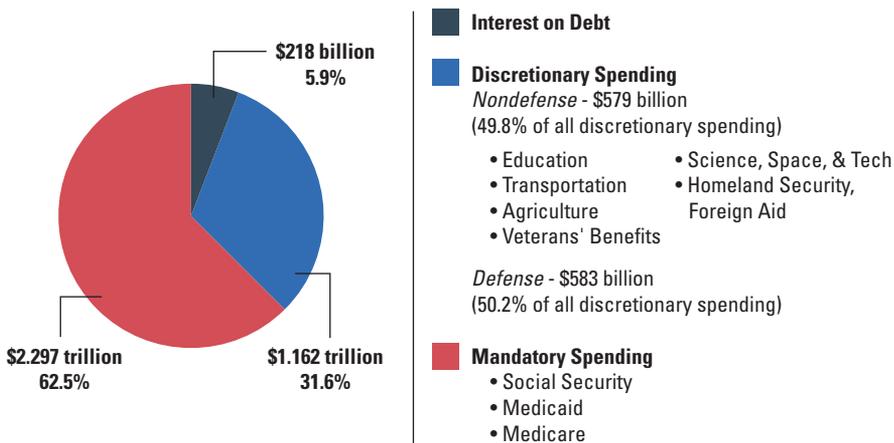


Note. percentages are based on the costs of interest as a percent of federal spending in respective years

Source: CBO, August 2015

The increase in interest costs for federal spending over the next 10 years could dramatically squeeze the funds our

Figure 2. Federal Spending for Fiscal Year 2015



Source: CBO, August 2015

ments so that calculations can be checked.”⁶ In discussing cash versus accrual accounting for public-sector entities, Irwin argues against cash accounting because of the desirability of recording transactions not when cash changes hands, but when value is “created, transformed, exchanged, transferred, or extinguished” in order to reduce window-dressing and leading to a balance sheet that includes all assets and all liabilities.⁷

On Feb. 25, 2009, I testified before the Federal Accounting Standards Advisory Board (FASAB) on the need for full accrual accounting for U.S. budgeting and financial reporting.⁸ While not endorsed by FASAB, a compromise was reached to at least show the largest components of unfunded liabilities for entitlements as “sustainability” numbers just below the U.S. Balance Sheet, in order to show the direction that the perennial U.S. fiscal policy of deficit

spending was taking the country. Now, in the spring of 2016, it is clearer than ever before that Congress is not heeding the dangerous trend of financial unsustainability, and the time for full and comprehensive accrual accounting may have finally arrived.

Jacob Soll, a professor of accounting and sociology at the University of Southern California, published *The Reckoning*, wherein he talks about the roots of our chronically imbalanced U.S. federal budget.⁹ According to Soll, successful societies, while they last, properly account for all economic and financial activity. He explains they openly confront and disclose their liabilities as well as their assets, achieving accountability until one misfortune or another, or mismanagement, “gets the red ink flowing unchecked” as we clearly see in Washington today. But Soll makes the point that while in the past nations went

broke through ignorance, there is no excusing leaders today since accountants are everywhere.

So, then, what could be the problem we face today? I dare say that while accountants may be everywhere, the political will is lacking to use accounting principles that record all unfunded long-term obligations and political promises to pay. And since the accounting rules cannot be changed without legislation and the enforcement thereof, requiring the implementation of professional accounting standards, the political establishment in Washington is not inclined to tell the truth about its profligate deficit spending and about the real size of our seemingly uncontrollable national debt. In their calculative thinking, politicians must assume this could put their hold on incumbency in jeopardy, which could sound like a classic conflict of interest to many of us.

And this public perception of a political “conflict of interest” was made painfully clear by my old accounting firm, Arthur Andersen & Co., in its 1986 publication “Sound Financial Reporting in the US Government: A Prerequisite to Fiscal Responsibility,” as follows:

“Given the existing practice of cash-basis budgeting and reporting, programs can be adapted, and promises made, without knowledge of their full cost. This lack of accountability creates an incentive for elected officials to curry favor with today’s voters at the expense of tomorrow’s taxpayers. This lack of accountability has been a root cause of fiscal mismanagement within the U.S. Government.”¹⁰

Figure 3. Historical Chart on the U.S. National Debt¹²

Period	Administration	Event	Debt	
			Cumulative	In 2015 Dollars
1792	Washington	Consolidation of colonial & federal debt	\$77M	\$1.9B
1835	Jackson	Real estate boom	—	—
1865	Lincoln	Civil War	\$2.7B	\$39.4B
1893	Cleveland	Industrial Revolution	\$1.5B	\$40.7B
1919	Wilson	World War I	\$27.4B	\$380B
1930	Hoover	Roaring 20s	\$16.2B	\$231B
1945	F.D. Roosevelt	Great Depression & World War II	\$260B	\$3.5T
1969	L.B. Johnson	Vietnam War, “Unified Budget”	\$365.8B	\$2.4T
1982	Reagan	Cold War	\$1.1T	\$2.8T
1986	Reagan	Cold War	\$2.1T	\$4.6T
1992	George H.W. Bush	Gulf War	\$4T	\$6.5T
1996–2000	Clinton	NATO War	\$5.6T	\$7.9T
2001–2008	George W. Bush	9/11/2001, Iraq/Afghanistan War	\$11.9T	\$13.3T
2009–2015	Obama	Great Recession, Iraq/Afghanistan/Syria	\$19T ⁱ	\$19T
2016–2025	Projected by the Congressional Budget Office (CBO)	If no entitlement reform and/or no tax reform for economic growth or for increased tax revenue	\$26.9T ⁱⁱ	—

ⁱ According to the Fiscal Year 2014 Financial Report of the U.S. Government, using the modified accrual basis of the U.S. Treasury Department. U.S. Treasury, 2014 Fiscal Year Financial Report of the U.S. Government, Management’s Discussion and Analysis, p. 3, https://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/14frusg/FR_02252015_Final.pdf

ⁱⁱ CBO, An Update to the Budget and Economic Outlook: 2015-2025, August 2015, <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-BudEconOutlook-3.pdf>

And, in the same publication, Arthur Andersen & Co. confirmed what many experts in public-sector accounting already know but find hard to believe even today — namely, that accrual accounting has been law since the passage of Public Law 84-863 in 1956, which required U.S. government agencies to prepare GAAP-basis financial reports like those required of publicly traded companies by the Securities and Exchange Commission to protect shareholders from fraud and mismanagement.¹¹ But, succeeding administrations and Congresses have largely ignored the enforcement and implementation of the 1956 law requiring accrual accounting.

Conclusion

At its core, our problem is about more than how we account for the national debt. Citizens need to recognize the accumulated annual budget deficits of our federal government, resulting from the lack of will to balance our revenues and expenses, represent a claim on the future standard of living of the American people. Future generations of Americans face the unfair prospect of being chained to the repayment of the public debt, plus interest, racked up by their predecessors. For our children and grandchildren, that may mean the end of the “American dream” of economic opportunity, home ownership, job security and family well-being. █

Endnotes

1. Thomas Jefferson, Letter to Samuel Kercheval, July 12, 1816, http://www.constitution.org/tj/ltr/1816/ltr_18160712_kercheval.html
2. Joe DioGuardi, *Unaccountable Congress: It Doesn't Add Up*, Regnery Gateway 1992.
3. U.S. Treasury, 2014 Fiscal Year Financial Report of the U.S. Government, Management’s Discussion and Analysis, p. 3, https://www.fiscal.treasury.gov/fsreports/rpt/finrep/fr/14frusg/FR_02252015_Final.pdf; CBO, *An Update to the Budget and Economic Outlook: 2015–2025*, August 2015, <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50724-BudEconOutlook-3.pdf>
4. Ibid.
5. Ibid.
6. Timothy Irwin, “Defining the government’s debt and deficit,” IMF, November 2015, p. 25.
7. Ibid.
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9. Jacob Soll, *The Reckoning: Financial Accountability and the Making and Breaking of Nations*, Penguin: New York (2014).
10. Arthur Andersen & Co., “Sound Financial Reporting in the US Government: A Prerequisite to Fiscal Responsibility,” February 1986, p. 7.
11. Public Law 84-863 (1956).
12. Figures cited: Wayne Middlesteadt, *A Brief History of America’s National Debt*, November 11, 2015.



Joseph J. DioGuardi was first elected to represent Westchester County, N.Y., in the U.S. House of Representatives in 1984 — the first CPA in Congress.

Currently the President of Truth in Government, he previously worked for Arthur Andersen & Co.