

United States Government Supplemental Information (Unaudited) for the Years Ended September 30, 2006, and September 30, 2005

Social Insurance

The social insurance programs were developed to provide income security and health care coverage to citizens under specific circumstances as a responsibility of the Government. Because taxpayers rely on these programs in their long-term planning, social insurance program information should indicate whether they are sustainable under current law, as well as what their effect will be on the Government's financial condition. The resources needed to run these programs are raised through taxes and fees. Eligibility for benefits rests in part on earnings and time worked by the individuals. Social Security benefits are generally redistributed intentionally toward lower-wage workers (i.e., benefits are progressive). In addition, each social insurance program has a uniform set of entitling events and schedules that apply to all participants.

Social Security and Medicare

Social Security

The Federal Old-Age and Survivors Insurance (OASI) Trust Fund was established on January 1, 1940, as a separate account in the Treasury. The Federal Disability Insurance (DI) Trust Fund, another separate account in the Treasury, was established on August 1, 1956. OASI pays cash retirement benefits to eligible retirees and their eligible dependents and survivors, and the much smaller DI fund pays cash benefits to eligible individuals who are unable to work due to medical conditions. At the end of calendar year 2005, OASDI benefits were paid to approximately 48 million beneficiaries. Though the events that trigger benefit payments are quite different, both trust funds have the same earmarked financing structure: primarily payroll taxes and income taxes on benefits. All financial operations of the OASI and DI Programs are handled through these respective funds. The two funds are often referred to as simply the combined OASDI Trust Funds.

The primary financing of these two funds are taxes paid by workers, their employers, and individuals with self-employment income, based on work covered by the OASDI Program. Since 1990, employers and employees have each paid 6.2 percent of covered earnings. The self-employed pay 12.4 percent of covered earnings. Payroll taxes are computed on wages and net earnings from self-employment up to a specified maximum annual amount (\$94,200 in 2006) that increases each year with economy-wide wages.

Since 1984, up to one-half of OASDI benefits have been subject to Federal income taxation. Effective for taxable years beginning after 1993, the maximum percentage of benefits subject to taxation was increased from 50 percent to 85 percent. The revenue from income taxes on up to 50 percent of benefits is allocated to the OASDI Trust Funds and the rest is allocated to the Hospital Insurance (HI) Trust Fund.

Medicare

The Medicare Program, created in 1965, also has two separate trust funds: the Hospital Insurance (HI, Medicare Part A) and Supplementary Medical Insurance (SMI, Medicare Parts B and D) Trust Funds.¹ HI pays for inpatient acute hospital services and major alternatives to hospitals (skilled nursing services, for example) and SMI

¹ Medicare legislation in 2003 created the new Part D account in the SMI Trust Fund to track the finances of a new prescription drug benefit that began in 2006. As in the case of Medicare Part B, approximately three-quarters of revenues to the Part D account will come from future transfers from the General Fund of the Treasury. Consequently, the nature of the relationship between the SMI Trust Fund and the Federal budget described below is largely unaffected by the presence of the Part D account though the magnitude will be greater.

pays for hospital outpatient services, physician services, and assorted other services and products through the Part B account and pays for prescription drugs through the Part D account. Though the events that trigger benefit payments are similar, HI and SMI have different earmarked financing structures. Similarly to OASDI, HI is financed primarily by payroll contributions. Employers and employees each pay 1.45 percent of earnings, while self-employed workers pay 2.9 percent of their net earnings. Other income to the HI fund includes a small amount of premium income from voluntary enrollees, a portion of the Federal income taxes that beneficiaries pay on Social Security benefits (as explained above), and interest credited on Treasury securities held in the HI Trust Fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level.

For SMI, transfers from the General Fund of the Treasury represent the largest source of income covering about 75 percent of program costs for both Parts B and D. Beneficiaries pay monthly premiums that finance approximately 25 percent of costs. With Part D drug coverage, Medicaid will no longer be the primary payer for beneficiaries dually eligible for Medicare and Medicaid. For those beneficiaries, States must pay the Part D account a portion of their estimated foregone drug costs for this population (referred to as State transfers). As with HI, interest received on Treasury securities held in the SMI Trust Fund is credited to the fund. These Treasury securities and related interest are excluded upon consolidation at the Governmentwide level. Refer to Note 23—Social Insurance, for additional information on Medicare program financing.

Social Security, Medicare, and Governmentwide Finances

The current and future financial status of the separate Social Security and Medicare Trust Funds is the focus of the trustees' reports, a focus that may appropriately be referred to as the "trust fund perspective." In contrast, the Federal Government primarily uses the *unified budget* concept as the framework for budgetary analysis and presentation. It represents a comprehensive display of all Federal activities, regardless of fund type or on- and off-budget status, a broader focus than the trust fund perspective that may appropriately be referred to as the "budget perspective" or the "Governmentwide perspective." Social Security and Medicare are among the largest expenditure categories of the U.S. Federal budget. Together, they now account for more than a third of all Federal spending and the percentage is projected to rise dramatically for the reasons discussed below. This section describes in detail the important relationship between the trust fund perspective and the Governmentwide perspective.

Figure 1 is a simplified graphical depiction of the interaction of the Social Security and Medicare Trust Funds with the rest of the Federal budget.² The boxes on the left show sources of funding, those in the middle represent the trust funds and other Government accounts (of which the General Fund is a part) into which that funding flows, and the boxes on the right show simplified expenditure categories. The figure is intended to illustrate how the various sources of program revenue flow through the budget to beneficiaries. The general approach is to group revenues and expenditures that are linked specifically to Social Security and/or Medicare separately from those for other Federal programs. (For ease of understanding, these other Federal programs are referred to here as *other Government programs*.)

Each of the trust funds has its own sources and types of revenue. With the exception of General Fund transfers to SMI, each of these revenue sources is earmarked specifically for the respective trust fund, and cannot be used for other purposes. In contrast, personal and corporate income taxes and other revenue go into the General Fund of the Treasury and are drawn down for any Government program for which Congress has approved spending.³ The arrows from the boxes on the left represent the flow of these revenues into the trust funds and other Government accounts.

The heavy line between the top two boxes in the middle of Figure 1 represents intragovernmental transfers between the SMI Trust Fund and other Government accounts. The Medicare SMI Trust Fund is shown separately from the two Social Security trust funds (OASI and DI) and the Medicare HI Trust Fund to highlight the unique financing of SMI. SMI is currently the only one of the four programs that receives large transfers from the General Fund of the Treasury, which is part of the other Government accounts (the Part D account will receive transfers from the States). The transfers finance roughly three-fourths of SMI Program expenses. While the transfers currently support the Part B account, in 2006 additional transfers were made to the Part D account and are expected to finance about three-fourths of expenses in that account. The transfers are automatic; their size depends on how much the program spends, not on how much revenue comes into the Treasury. If General Fund revenues become insufficient

² The Federal unified budget encompasses all Federal Government financing and is synonymous with a Governmentwide perspective.

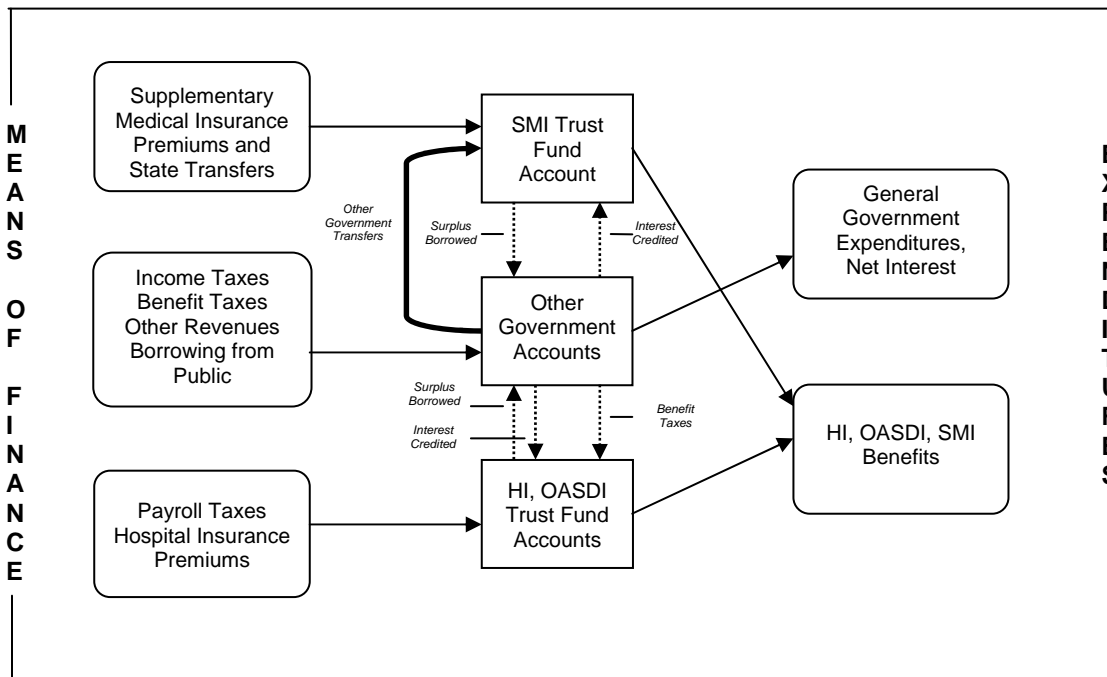
³ Other programs also have dedicated revenues in the form of taxes and fees (and other forms of receipt) and there are a large number of earmarked trust funds in the Federal budget. Total trust fund receipts account for about 40 percent of total Government receipts with the Social Security and Medicare Trust Funds accounting for about two-thirds of trust fund receipts. For further discussion see *Federal Trust and Other Earmarked Funds*, GAO-01-199SP, January 2001. In the figure and the discussion that follows, we group all other programs, including these other earmarked trust fund programs, under "Other Government Accounts" to simplify the description and maintain the focus on Social Security and Medicare.

to cover both the mandated transfer to SMI and expenditures on other general Government programs, Treasury would have to borrow to make up the difference. In the longer run, if transfers to SMI are increasing—as shown below, they are projected to increase significantly in coming years—then Congress must either raise taxes, cut other Government spending, or reduce SMI benefits.

The dotted lines between the middle boxes of Figure 1 also represent intragovernmental transfers but those transfers arise in the form of “borrowing/lending” between the Government accounts. Interest credited to the trust funds arises when the excess of program income over expenses is loaned to the General Fund. The vertical lines labeled *Surplus Borrowed* represent these flows from the trust funds to the other Government accounts. These loans reduce the amount the General Fund has to borrow from the public to finance a deficit (or likewise increase the amount of debt paid off if there is a surplus). But the General Fund has to credit interest on the loans from the trust fund programs, just as if it borrowed the money from the public. The credits lead to future obligations for the General Fund (which is part of the other Government accounts). These transactions are indicated in Figure 1 by the vertical arrows labeled *Interest Credited*. The credits increase trust fund income exactly as much as they increase credits (future obligations) in the General Fund. So from the standpoint of the Government as a whole, at least in an accounting sense, these interest credits are a wash.

It is important to understand the additional implications of these loans from the trust funds to the other Government accounts. When the trust funds get the receipts that they loan to the General Fund, these receipts provide additional authority to spend on benefits and other program expenses. The General Fund, in turn, has taken on the obligation of paying interest on these loans every year and repaying the principal when trust fund income from other sources falls below expenditures—the loans will be called in and the General Fund will have to reduce other spending, raise taxes, or borrow more from the public to finance the benefits paid by the trust funds.

Figure 1
Social Security, Medicare, and Governmentwide Finances



Actual dollar amounts roughly corresponding to the flows presented in Figure 1 are shown in Table 1 for fiscal year 2006. The first three columns show revenues and expenditures for HI, SMI, and OASDI, respectively, and the fourth column is the sum of these three columns. The fifth column has total revenues and expenditures for all other Government programs, which includes the General Fund account, and the last column is the sum of the “combined” and “other Government” columns. In Table 1, revenues from the public (left side of Figure 1) and expenditures to the public (right side of Figure 1) are shown separately from transfers between Government accounts (middle of Figure 1). Note that the transfers (\$162.8 billion) and interest credits (\$114.5 billion) received by the trust funds appear as negative entries under other Government and are thus offsetting when summed for the total budget column. These two intragovernmental transfers are key to the differences between the trust fund and budget perspectives.

From the Governmentwide perspective, only revenues received from the public (and States in the case of Medicare, Part D) and expenditures made to the public are important for the final balance. Trust fund revenue from the public consists of payroll taxes, benefit taxes, and premiums. For HI, the difference between total expenditures made to the public (\$184.9 billion) and revenues (\$194.4 billion) was \$9.5 billion in 2006, indicating that HI had a relatively small positive effect on the overall budget outcome *in that year*. For the SMI account, revenues from the public (premiums) were relatively small, representing about a quarter of total expenditures made to the public in 2006. The difference, \$147.7 billion, resulted in a net draw on the overall budget balance in that year. For OASDI, the difference between total expenditures made to the public (\$548.5 billion) and revenues from the public (\$636.4 billion) was -\$87.9 billion in 2006, indicating that OASDI had a positive effect on the overall budget outcome *in that year*.

The trust fund perspective is captured in the bottom section of each of the three trust fund columns. For HI, total revenues exceeded total expenditures by \$25.4 billion in 2006, as shown at the bottom of the first column. This surplus would be added to the beginning trust fund (not shown) that leads to budget obligations in future years. For SMI, total revenues of \$210.2 billion (\$46.1 + \$164.1), including \$162.6 billion transferred from other Government accounts (the General Fund), exceeded total expenditures by \$16.4 billion. Transfers to the SMI Program from other Government accounts (the General Fund), amounting to about 75 percent of program costs, are obligated under current law and therefore appropriately viewed as revenue from the trust fund perspective. For OASDI, total revenues of \$733.8 billion (\$636.4 + \$97.4), including interest and a small amount of other Government transfers, exceeded total expenditures of \$548.5 billion by \$185.2 billion.

Table 1
Annual Revenues and Expenditures for Medicare and Social Security Trust Funds and the Total Federal Budget, Fiscal Year 2006

(In billions of dollars)

Revenue and Expenditure Categories	Trust Funds				Other Government	Total ¹
	HI	SMI	OASDI	Com-bined		
Revenues from the Public:						
Payroll and benefit taxes	190.7	-	636.4	827.1	-	827.1
Premiums	3.7	46.1	-	49.8	-	49.8
Other taxes and fees	-	-	-	-	1,529.8	1,529.8
Total	194.4	46.1	636.4	876.9	1,529.8	2,406.7
Total expenditures to the public ²	184.9	193.8	548.5	927.1	1,727.2	2,654.4
Net results for budget perspective³	9.5	(147.7)	87.9	(50.3)	(197.4)	(247.7)
Revenues from Other Government Accounts:						
Transfers	0.5	162.6	(0.3)	162.8	(162.8)	-
Interest credits	15.4	1.5	97.7	114.5	(114.5)	-
Total	15.9	164.1	97.4	277.3	(277.3)	-
Net results for trust fund perspective^{3,4}	25.4	16.4	185.2	227.0	N/A	N/A

¹ This column is the sum of the preceding two columns and shows data for the total Federal budget. The figure \$247.7 was the total Federal deficit in fiscal year 2006.

² The OASDI figure includes \$3.8 billion transferred to the Railroad Retirement Board for benefit payments and is therefore an expenditure to the public.

³ Net results are computed as revenues less expenditures.

⁴ Details may not add to totals due to rounding.

Note: "N/A" indicates not applicable.

Cashflow Projections

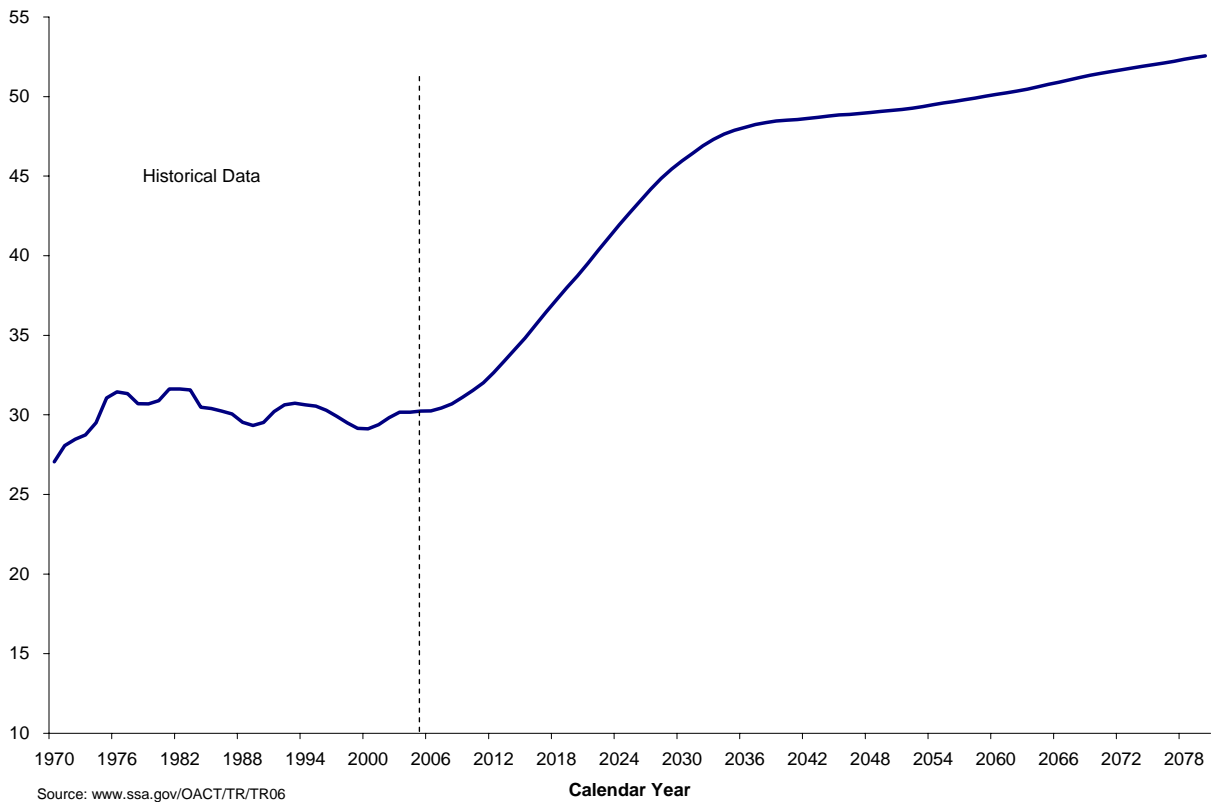
Background

Economic and Demographic Assumptions. The Boards of Trustees⁴ of the OASDI and Medicare Trust Funds provide in their annual reports to Congress short-range (10-year) and long-range (75-year) actuarial estimates of each trust fund. Because of the inherent uncertainty in estimates for 75 years into the future, the Boards use three alternative sets of economic and demographic assumptions to show a range of possibilities. The economic and demographic assumptions used for the most recent set of intermediate projections for Social Security and Medicare are shown in the "Social Security" and "Medicare" sections of Note 23—Social Insurance.

⁴ There are six trustees: the Secretaries of Treasury (managing trustee), Health and Human Services, and Labor; the Commissioner of the Social Security Administration; and two public trustees who are appointed by the President and confirmed by the Senate for a 4-year term. By law, the public trustees are members of two different political parties.

Beneficiary-to-Worker Ratio. Underlying the pattern of expenditure projections for both the OASDI and Medicare Programs is the impending demographic change that will occur as the large baby-boom generation, born in the years 1946 to 1964, retires or reaches eligibility age. The consequence is that the number of beneficiaries will increase much faster than the number of workers who pay taxes that are used to pay benefits. The pattern is illustrated in Chart 1 which shows the ratio of OASDI beneficiaries to workers for the historical period and estimated for the next 75 years. In 2006, there were about 30 beneficiaries for every 100 workers. By 2030, there will be about 46 beneficiaries for every 100 workers. A similar demographic pattern confronts the Medicare Program. For example, for the HI Program, there were about 26 beneficiaries for every 100 workers in 2006; by 2030 there are expected to be about 42 beneficiaries for every 100 workers. This ratio for both programs will continue to increase to about 50 beneficiaries for every 100 workers by the end of the projection period, after the baby-boom generation has moved through the Social Security system due to declining birth rates and increasing longevity.

**Chart 1—OASDI Beneficiaries per 100 Covered Workers
1970-2080**

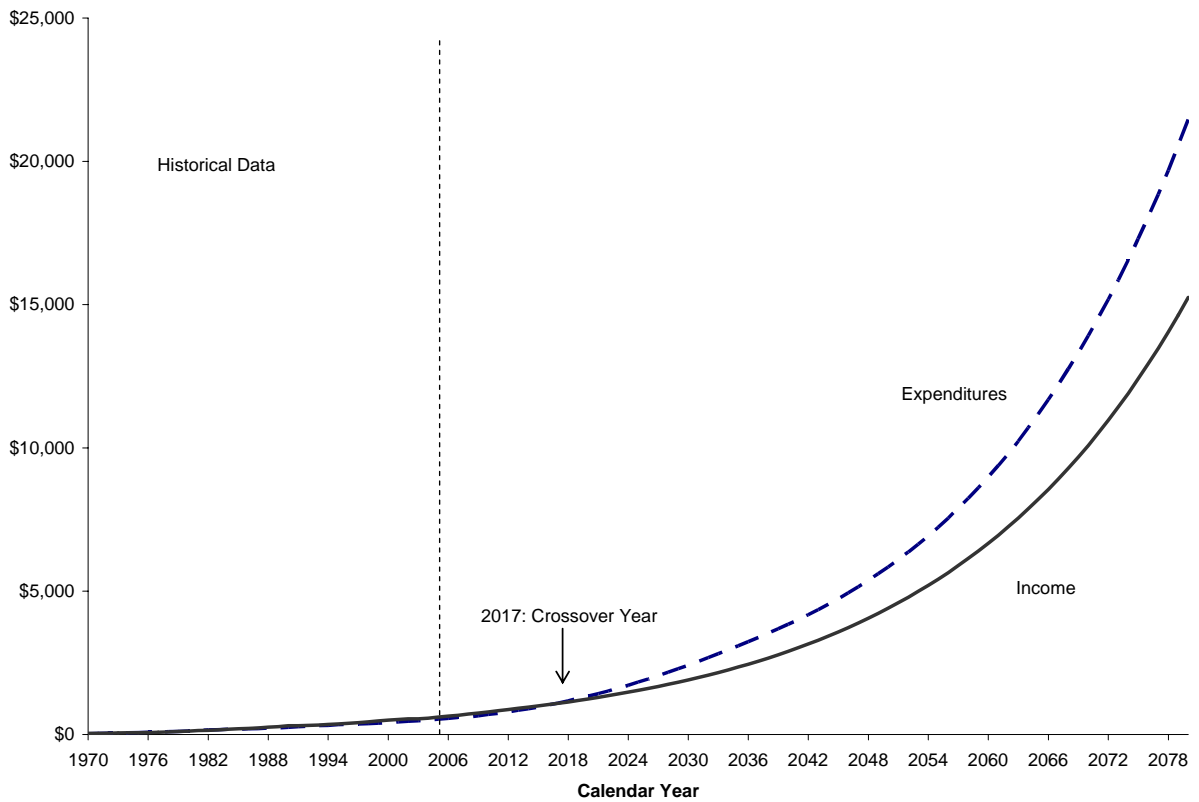


Social Security Projections

Nominal Income and Expenditures. Chart 2 shows historical values and actuarial estimates of combined OASDI annual income (excluding interest) and expenditures for 1970-2080 in nominal dollars. The estimates are for the open-group population. That is, the estimates include taxes paid from, and on behalf of, workers who will enter covered employment during the period, as well as those already in covered employment at the beginning of that period. These estimates also include scheduled benefit payments made to, and on behalf of, such workers during that period. Note that expenditure projections in Chart 2 and subsequent charts are based on current-law benefit formulas regardless of whether the income and assets are available to finance them.

**Chart 2—OASDI Income (Excluding Interest) and Expenditures
1970-2080**

(In billions of nominal dollars)



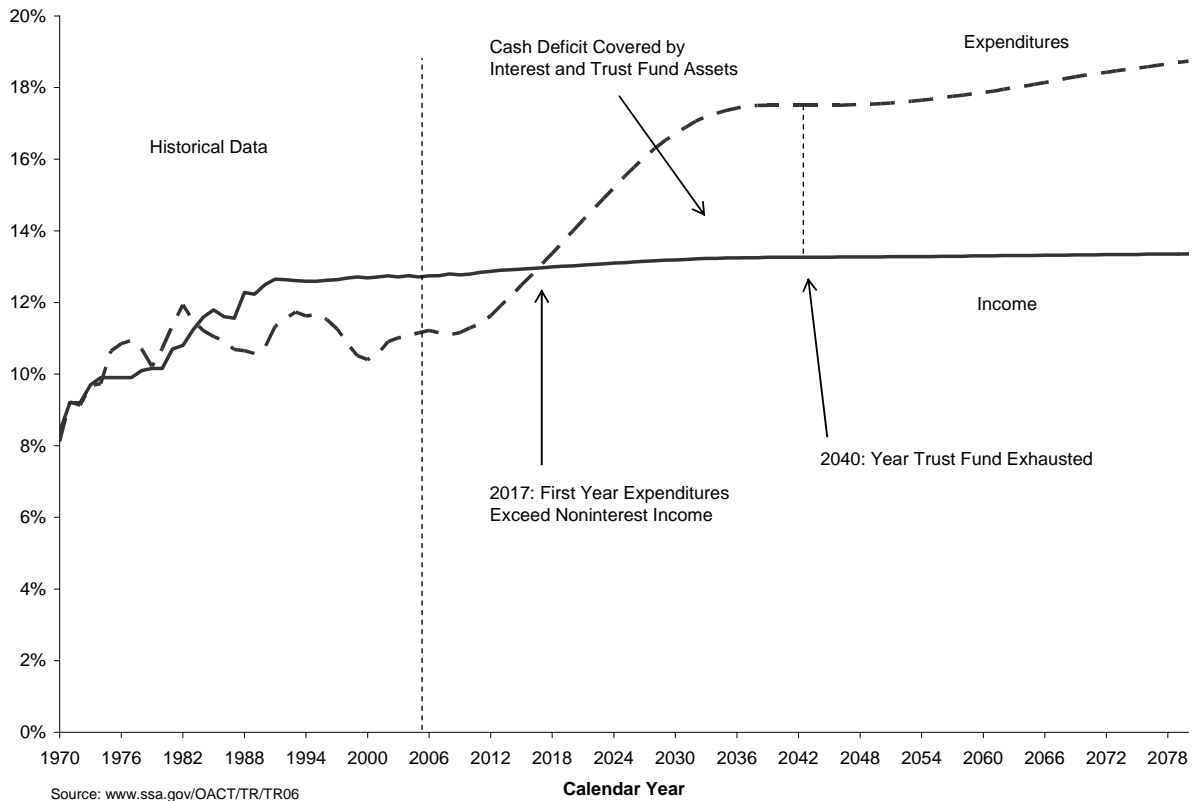
Source: www.ssa.gov/OACT/TR/TR06

Currently, Social Security tax revenues exceed benefit payments and will continue to do so until 2017, when revenues are projected to fall below benefit payments, after which the gap between expenditures and revenues continues to widen.

Income and Expenditures as a Percent of Taxable Payroll. Chart 3 shows annual income (excluding interest but including both payroll and benefit taxes) and expenditures expressed as percentages of taxable payroll, commonly referred to as the income rate and cost rate, respectively.

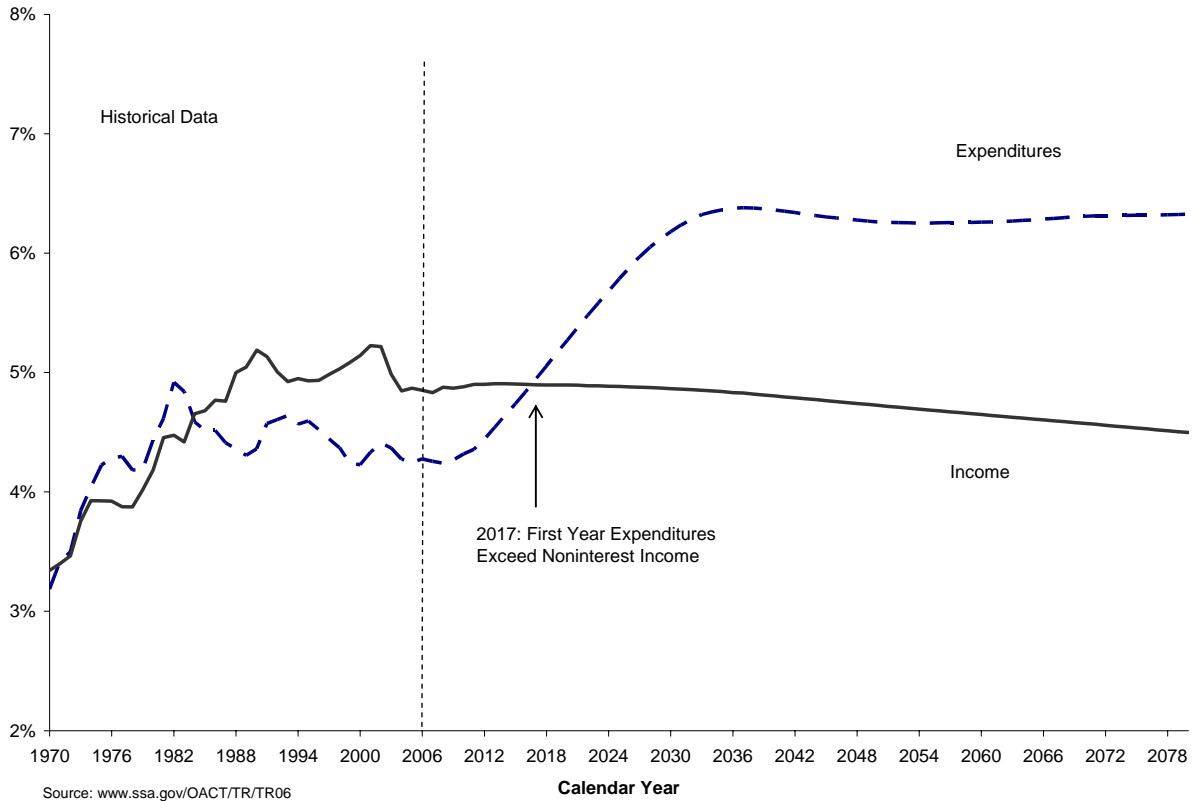
The OASDI cost rate is projected to decline slightly until about 2008. It then begins to increase rapidly and first exceeds the income rate in 2017, producing cashflow deficits thereafter. As described above, surpluses that occur prior to 2017 are “loaned” to the General Fund and accumulate, with interest, reserve spending authority for the trust fund. The reserve spending authority represents an obligation for the General Fund. Beginning in 2017, Social Security will start using interest credits to meet full benefit obligations. The Government will need to raise taxes, reduce benefits, increase borrowing from the public, and/or cut spending for other programs to meet its obligations to the trust fund. By 2040, the trust fund reserves (and thus reserve spending authority) are projected to be exhausted. Even if a trust fund's assets are exhausted, however, tax income will continue to flow into the fund. Present tax rates would be sufficient to pay 74 percent of scheduled benefits after trust fund exhaustion in 2040 and 70 percent of scheduled benefits in 2080.

Chart 3—OASDI Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2080



Income and Expenditures as a Percent of GDP. Chart 4 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the OASDI Program in relation to the capacity of the national economy to sustain it. The gap between expenditures and income widens continuously with expenditures generally growing as a share of GDP and income declining slightly relative to GDP. Social Security’s expenditures are projected to grow from 4.3 percent of GDP in 2006 to 6.3 percent in 2080. In 2080, expenditures are projected to exceed income by 1.8 percent of GDP.

Chart 4—OASDI Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2080



Sensitivity Analysis. Actual future income from OASDI payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors: the size and composition of the population that is receiving benefits, the level of monthly benefit amounts, the size and characteristics of the work force covered under OASDI, and the level of workers’ earnings. These factors will depend, in turn, upon future marriage and divorce rates, birth rates, death rates, migration rates, labor force participation and unemployment rates, disability incidence and termination rates, retirement age patterns, productivity gains, wage increases, cost-of-living increases, and many other economic and demographic factors.

This section presents estimates that illustrate the sensitivity of long-range expenditures and income for the OASDI Program to changes in *selected individual assumptions*. In this analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost (Alternative I) and high cost (Alternative III) projections. For example, when analyzing sensitivity with respect to variation in real wages, income and expenditure projections using the intermediate assumptions are compared to the outcome when projections are done by changing only the real wage assumption to either low cost or high cost alternatives.

The low cost alternative is characterized by assumptions that generally improve the financial status of the program (relative to the intermediate assumption) such as slower improvement in mortality (beneficiaries die younger). In contrast, assumptions under the high cost alternative generally worsen the financial outlook. One exception occurs with the CPI assumption (see below).

Table 2 shows the effects of changing individual assumptions on the present value of estimated OASDI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. For example, the intermediate assumption for the annual rate of *reduction in age-sex-adjusted death rates* is 0.72 percent. For the low cost alternative, a slower reduction rate (0.30 percent) is assumed as it means that beneficiaries die at a younger age relative to the intermediate assumption, resulting in lower expenditures. Under the low cost assumption, the shortfall drops from \$6,449 billion to \$5,000 billion, a 22 percent smaller shortfall. The high cost death rate assumption (1.26 percent) results in an increase in the shortfall, from \$6,449 billion to \$8,195 billion, a 27 percent increase in the shortfall. Clearly, alternative death rate assumptions have a substantial impact on estimated future cashflows in the OASDI Program.

A higher fertility rate means more workers relative to beneficiaries over the projection period, thereby lowering the shortfall relative to the intermediate assumption. An increase in the rate from 2.0 to 2.3 results in an 12 percent smaller shortfall (i.e., expenditures less income), from \$6,449 billion to \$5,699 billion.

Higher real wage growth results in faster income growth relative to expenditure growth. Table 2 shows that a real wage differential that is 0.5 greater than the intermediate assumption of 1.1 results in a drop in the shortfall from \$6,449 billion to \$5,542 billion, a 14 percent decline.

The CPI change assumption operates in a somewhat counterintuitive manner, as seen in Table 2. A lower rate of change results in a higher shortfall. This arises as a consequence of holding the real wage assumption constant while varying the CPI so that wages (the income base) are affected sooner than benefits. If the rate is assumed to be 1.8 percent rather than 2.8 percent, the shortfall rises about 7 percent, from \$6,449 billion to \$6,876 billion.

The effect of net immigration is similar to fertility in that, over the 75-year projection period, higher immigration results in proportionately more workers (taxpayers) than beneficiaries. The low-cost assumption for net immigration results in a 7 percent drop in the shortfall, from \$6,449 billion to \$5,982 billion, relative to the intermediate case; and the high-cost assumption results in a 5 percent higher shortfall.

Finally, Table 2 shows the sensitivity of the shortfall to variations in the real interest rate or, in present value terminology, the sensitivity to alternative discount rates. Assuming a higher discount rate results in a lower present value. The shortfall of \$4,850 billion is 25 percent lower when the real interest rate is 3.6 percent rather than 2.9 percent, and 40 percent higher when the real interest rate is 2.1 percent rather than 2.9 percent.

Table 2
Present Values of Estimated OASDI Expenditures in Excess of Income
Under Various Assumptions, 2006-2080

(In billions of dollars)

Assumption	Shortfall		
	Low	Intermediate	High
Average annual reduction in death rates ..	5,000 (0.30)	6,449 (0.72)	8,195 (1.26)
Total fertility rate	5,699 (2.3)	6,449 (2.0)	7,189 (1.7)
Real wage differential	5,542 (1.6)	6,449 (1.1)	7,091 (0.6)
CPI change	6,015 (3.8)	6,449 (2.8)	6,876 (1.8)
Net immigration	5,982 (1,300,000)	6,449 (900,000)	6,782 (672,500)
Real interest rate	4,850 (3.6)	6,449 (2.9)	9,034 (2.1)

Numbers in parentheses are the values of the assumptions used in the respective scenario.

Source: 2006 OASDI Trustees Report and SSA.

Medicare Projections

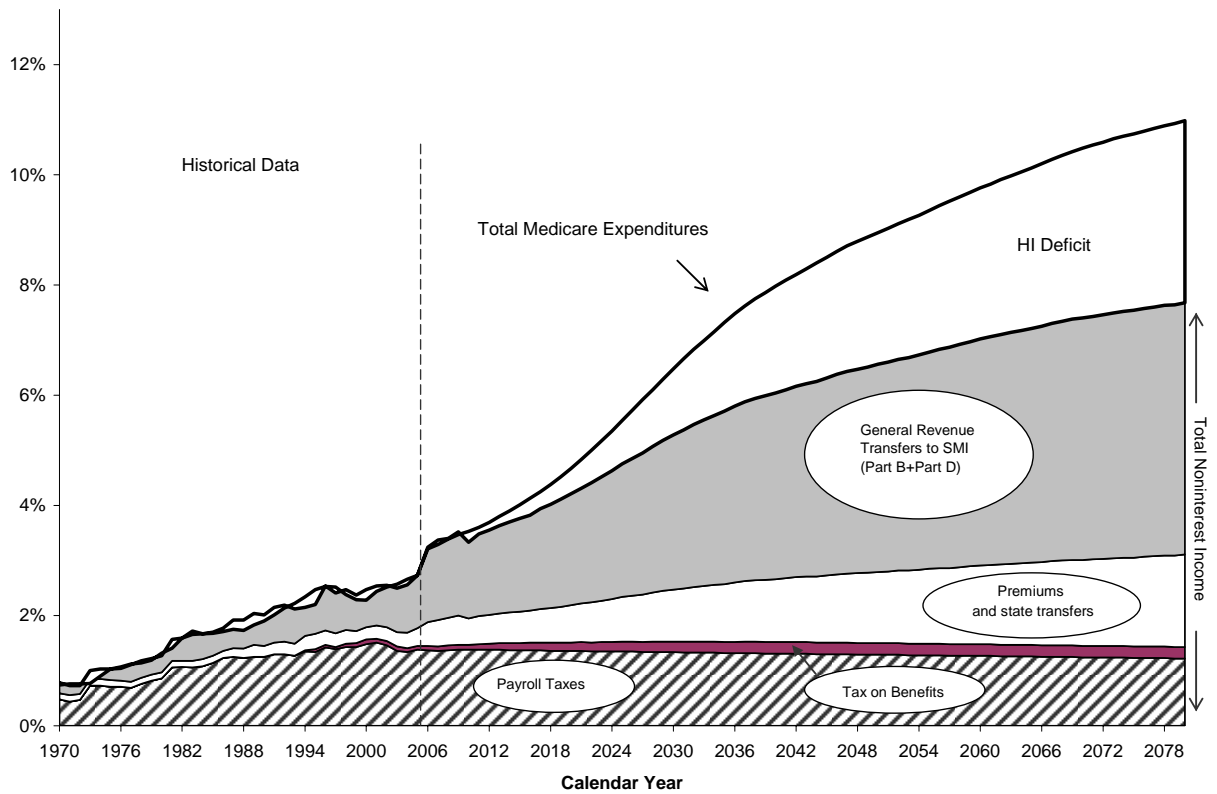
Recent Medicare Legislation. On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. The 2003 law will have a major impact on the operations and finances of Medicare. The law added a prescription drug benefit to Medicare beginning in 2006 and a new prescription drug account in the SMI Trust Fund. The benefit could be obtained through a private drug-only plan, a private preferred-provider organization or health maintenance organization, or through an employer-sponsored retiree health plan. The preferred-provider organizations are new to the Medicare Program and will operate on a regional basis. The Federal Government will assume some of the costs of providing prescription drug coverage to people eligible for both Medicare and Medicaid.

The legislation also includes provisions not related to the prescription drug benefit. It includes increases in Medicare provider reimbursements, higher Medicare Part B premiums for people at higher income levels, and an expansion of tax-deductible health savings accounts. The 2003 legislation is expected to have a significant effect on future Medicare finances as seen below and earlier in the Statement of Social Insurance.

Health Care Cost Growth. In addition to the growth in the number of beneficiaries per worker, the Medicare Program has the added pressure of expected growth in the use and cost of health care per person. Continuing development and use of new technology is expected to cause health care expenditures to grow faster than GDP in the long run. For the intermediate assumption, health care expenditures per beneficiary are assumed to grow, on average, about one percentage point faster than per capita GDP over the long range.

Total Medicare. It is important to recognize the rapidly increasing long-range cost of Medicare and the large role of general revenues and beneficiary premiums in financing the SMI Program. Chart 5 shows expenditures and current-law noninterest revenue sources for HI and SMI combined as a percentage of GDP. The total expenditure line shows Medicare costs rising to 11 percent of GDP by 2080. Revenues from taxes and premiums (including State transfers under Part D) are expected to increase from 1.8 percent of GDP in 2005 to 3.1 percent of GDP in 2080. Payroll tax income declines gradually as a percent of GDP as growth in the number of workers paying such taxes slows and wages as a portion of compensation declines, offset by higher premiums combined for Parts B and D of SMI as a percent of GDP. General revenue contributions for SMI, as determined by current law, are projected to rise as a percent of GDP from 1.0 percent to 5.0 percent over the same period. Thus, revenues from taxes and premiums (including State transfers) will fall substantially as a share of total noninterest Medicare income (from 65 percent in 2005 to 40 percent in 2080) while general revenues will rise (from 35 percent to 60 percent). The gap between total noninterest Medicare income (including general revenue contributions) and expenditures begins around 2010 and then steadily continues to widen, reaching 3.3 percent of GDP by 2080.

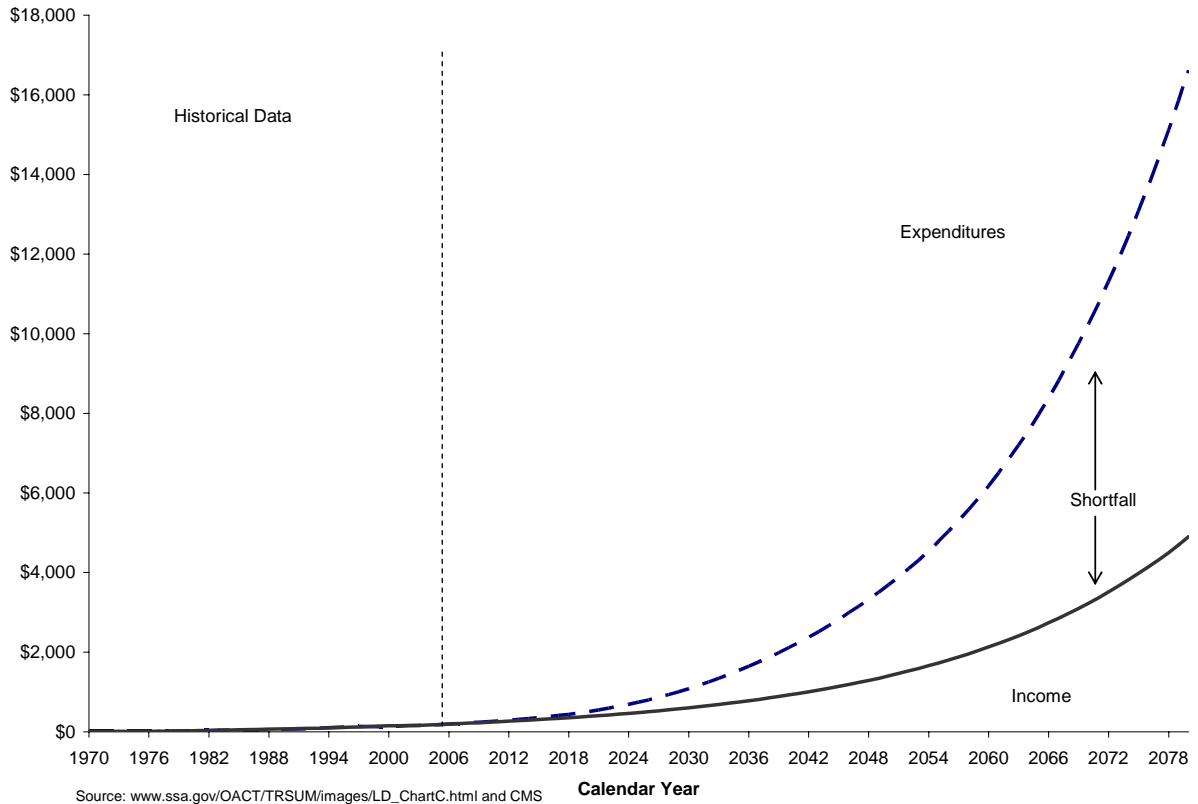
Chart 5—Total Medicare (HI and SMI) Expenditures and Noninterest Income as a Percent of GDP 1970-2080



Medicare, Part A (Hospital Insurance)—Nominal Income and Expenditures. Chart 6 shows historical and actuarial estimates of HI annual income (excluding interest) and expenditures for 1970-2080 in nominal dollars. The estimates are for the open-group population. The figure reveals a widening gap between projected income and expenditures.

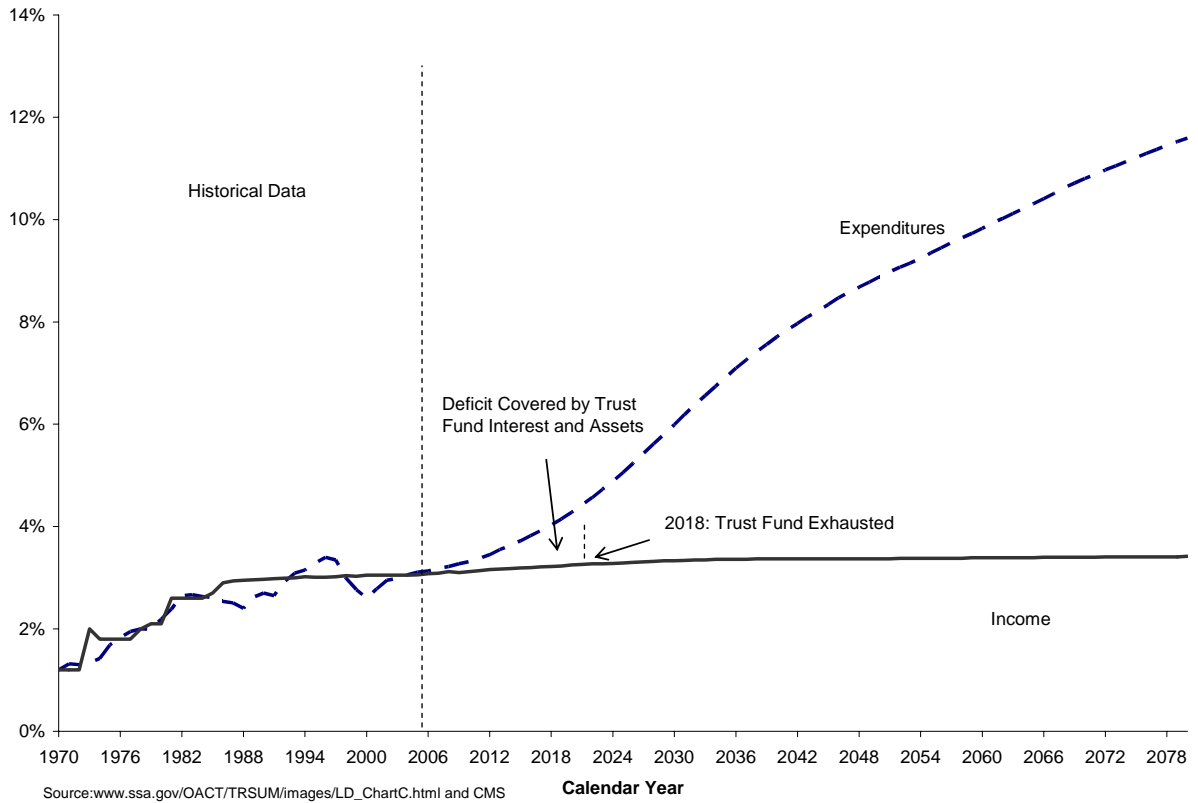
**Chart 6—Medicare Part A Income (Excluding Interest) and Expenditures
1970-2080**

(In billions of nominal dollars)



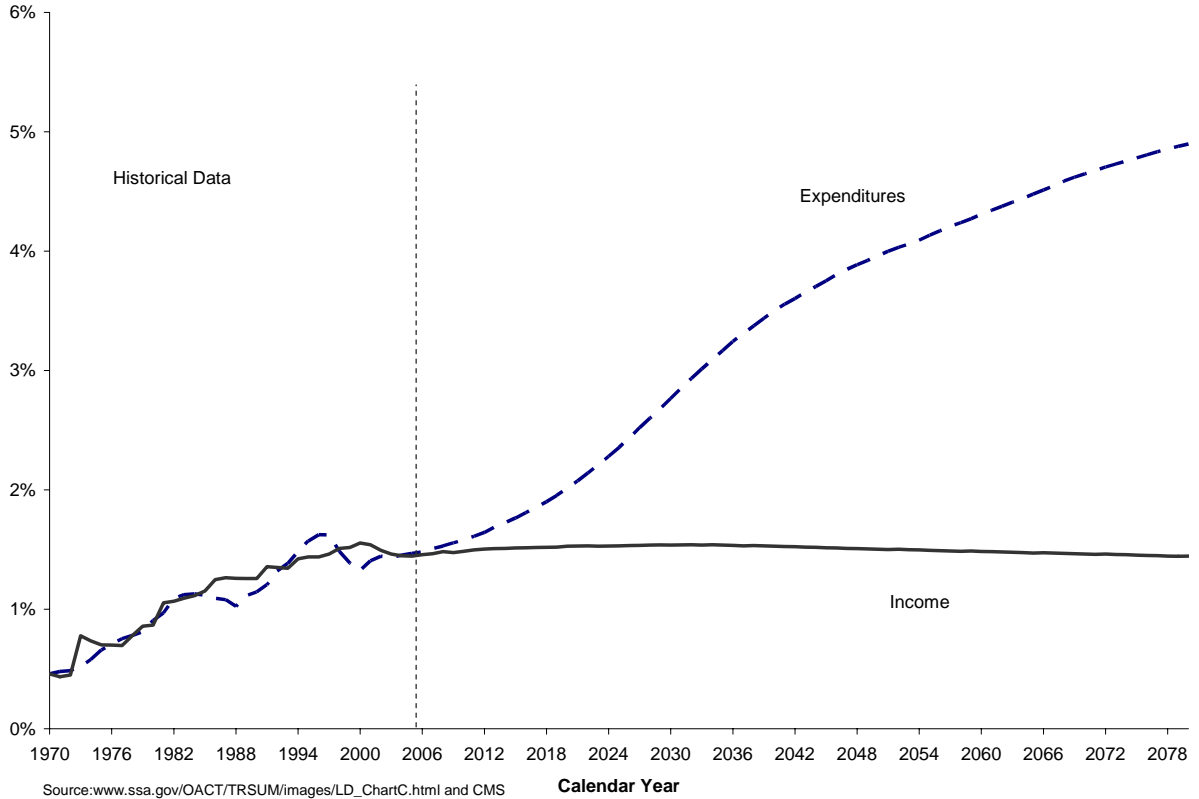
Medicare, Part A Income and Expenditures as a Percent of Taxable Payroll. Chart 7 illustrates income (excluding interest) and expenditures as a percentage of taxable payroll over the next 75 years. The chart shows that the expenditure rate exceeds the income rate beginning in 2004, and cash deficits continue thereafter. Trust fund interest earnings and assets provide enough resources to pay full benefit payments until 2018 with general revenues used to finance interest and loan repayments to make up the difference between cash income and expenditures during that period. Pressures on the Federal budget will thus emerge well before 2018. Present tax rates would be sufficient to pay 80 percent of scheduled benefits after trust fund exhaustion in 2018 and 29 percent of scheduled benefits in 2080.

Chart 7—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of Taxable Payroll 1970-2080



Medicare Part A Income and Expenditures as a Percent of GDP. Chart 8 shows estimated annual income (excluding interest) and expenditures, expressed as percentages of GDP, the total value of goods and services produced in the United States. This alternative perspective shows the size of the HI Program in relation to the capacity of the national economy to sustain it. Medicare Part A’s expenditures are projected to grow from 1.5 percent of GDP in 2005, to 2.8 percent in 2030, and to 4.9 percent by 2080. The gap between expenditures and income widens continuously with expenditures growing as a share of GDP and income declining slightly relative to GDP. By 2080, expenditures are projected to exceed income by 3.5 percent of GDP.

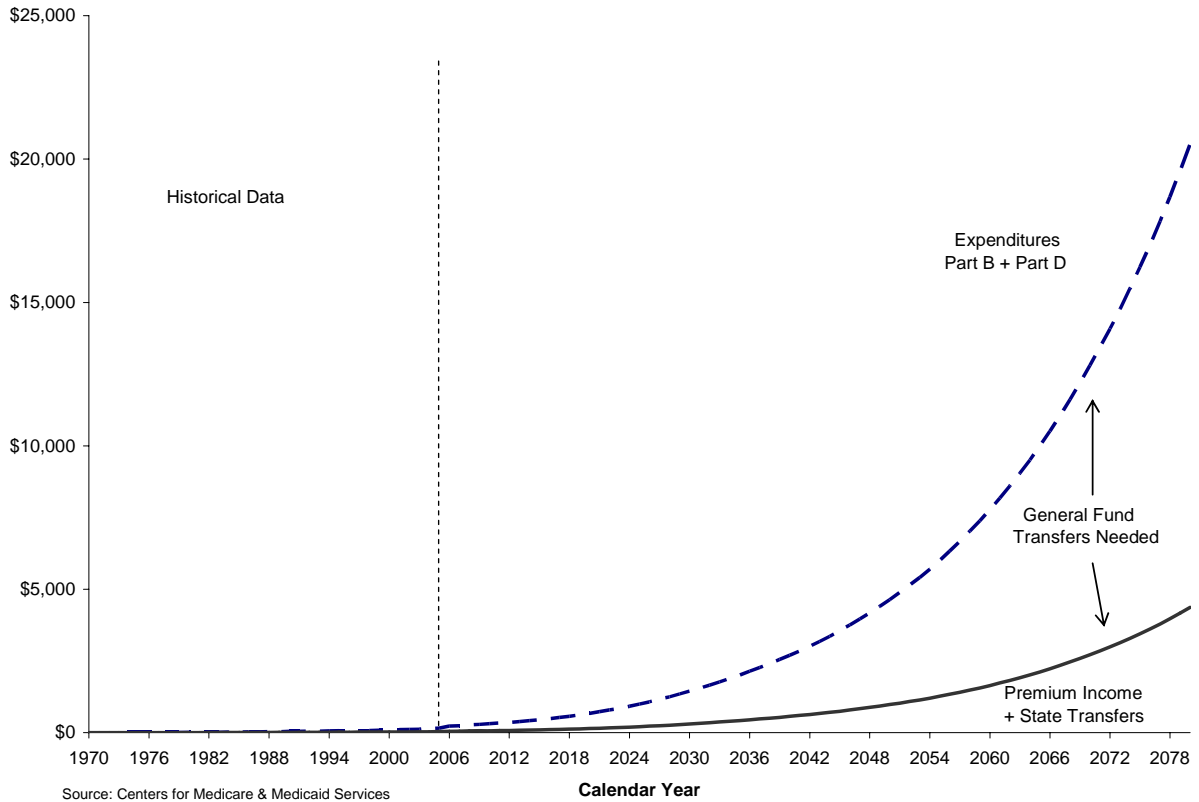
Chart 8—Medicare Part A Income (Excluding Interest) and Expenditures as a Percent of GDP 1970-2080



Medicare, Parts B and D (Supplementary Medical Insurance). Chart 9 shows historical and actuarial estimates of Medicare Part B and Part D premiums (and Part D State transfers) and expenditures for each of the next 75 years, in nominal dollars. The gap between premiums and State transfer revenues and program expenditures, a gap that will need to be filled with transfers from general revenues, grows throughout the projection period.

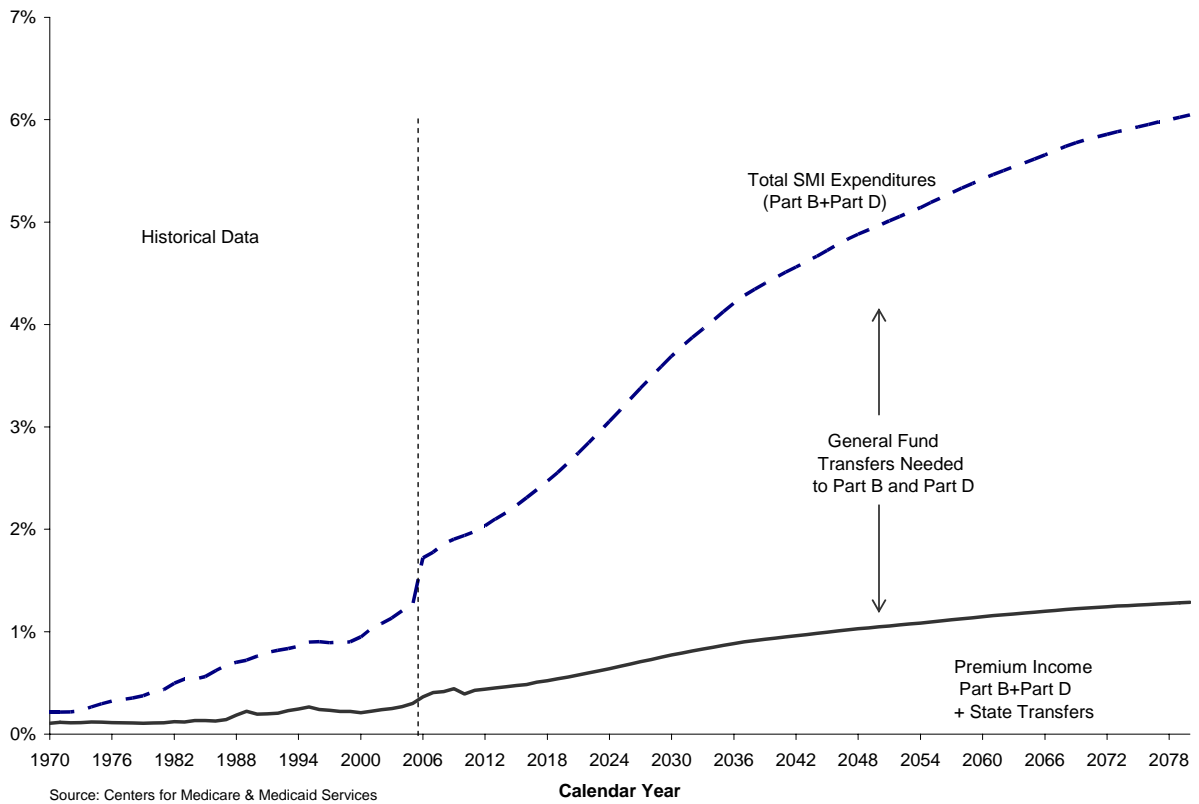
**Chart 9—Medicare Part B and Part D Premium and State Transfer Income and Expenditures
1970-2080**

(In billions of nominal dollars)



Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP. Chart 10 shows expenditures for the Supplementary Medical Insurance Program over the next 75 years expressed as a percentage of GDP, providing a perspective on the size of the SMI Program in relation to the capacity of the national economy to sustain it. In 2005, SMI expenditures were \$157 billion, which was 1.26 percent of GDP. After 2005, this percentage is projected to increase steadily reaching 6.1 percent in 2080. This reflects growth in the volume and intensity of Medicare services provided per beneficiary throughout the projection period, including the prescription drug benefits, together with the effects of the baby boom retirement. Premium and State transfer income grows from about 0.3 percent in 2005 to nearly 1.5 percent of GDP in 2080, so the portion financed by General Fund transfers to SMI is projected to be about 75 percent throughout the projection period.

Chart 10—Medicare Part B and Part D Premium and State Transfer Income and Expenditures as a Percent of GDP 1970-2080



Medicare Sensitivity Analysis. This section illustrates the sensitivity of long-range cost and income estimates for the Medicare Program to changes in *selected individual assumptions*. As with the OASDI analysis, the intermediate assumption is used as the reference point, and one assumption at a time is varied. The variation used for each individual assumption reflects the levels used for that assumption in the low cost and high cost projections (see description of sensitivity analysis for OASDI).

Table 3 shows the effects of changing various assumptions on the present value of estimated HI expenditures in excess of income (the *shortfall* of income relative to expenditures in present value terms). The assumptions are shown in parentheses. Clearly, net HI expenditures are extremely sensitive to alternative assumptions about the growth in health care cost. For the low cost alternative, the slower growth in health costs causes the shortfall to drop from \$11,290 billion to \$4,459 billion, a 61 percent smaller shortfall. The high cost assumption results in a near doubling of the shortfall, from \$11,290 billion to \$22,387 billion.

Variations in the next four assumptions in Table 3 result in relatively minor changes in net HI expenditures. The higher or lower fertility assumptions cause a less than 2 percent change in the shortfall relative to the intermediate case. The higher real wage growth rate results in about a 7 percent greater shortfall while a lower growth rate reduces the shortfall by about 9 percent. Wages are a key cost factor in the provision of health care. Higher wages also result in greater payroll tax income. HI expenditures exceed HI income by a wide and increasing margin in the future (Charts 6 to 8). As a result, an assumed higher real wage differential has a larger impact on HI expenditures than HI income, thereby increasing the shortfall of income relative to expenditures. CPI and net immigration changes have very little effect on net HI expenditures. Higher immigration increases the net shortfall modestly as higher payroll tax revenue is more than offset by higher medical care expenditures.

Table 3 also shows that the present value of net HI expenditures is 25 percent lower if the real interest rate is 3.6 percent rather than 2.9 percent and 40 percent higher if the real interest rate is 2.1 percent rather than 2.9 percent.

Table 3
Present Values of Estimated Medicare Part A Expenditures in Excess of
Income Under Various Assumptions, 2006-2080

(In billions of dollars)

Assumption ¹	Shortfall		
	Low	Intermediate	High
Average annual growth in health costs ²	4,459 (3.1)	11,290 (4.1)	22,387 (5.1)
Total fertility rate ³	11,078 (2.3)	11,290 (2.0)	11,510 (1.7)
Real wage differential	10,521 (0.6)	11,290 (1.1)	12,286 (1.6)
CPI change	11,234 (1.8)	11,290 (2.8)	11,337 (2.8)
Net immigration.....	11,157 (672,500)	11,290 (900,000)	11,498 (1,300,000)
Real interest rate.....	8,464 (3.6)	11,290 (2.9)	15,847 (2.1)

¹ The sensitivity of the projected HI net cashflow to variations in future mortality rates is also of interest. At this time, however, relatively little is known about the relationship between improvements in life expectancy and the associated changes in health status and per beneficiary health expenditures. As a result, it is not possible at present to prepare meaningful estimates of the Part A mortality sensitivity.

² Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low cost and high cost alternatives assume that costs increase 1 percent slower or faster, respectively, than the intermediate assumption, *relative to growth in taxable payroll*.

³ The total fertility rate for any year is the average number of children who would be born to a woman in her lifetime if she were to experience the birth rates by age observed in, or assumed for, the selected year and if she were to survive the entire childbearing period.

Table 4 shows the effects of various assumptions about the growth in health care costs on the present value of estimated SMI (Medicare Parts B and D) expenditures in excess of income. As with HI, net SMI expenditures are very sensitive to changes in the health care cost growth assumption. For the low cost alternative, the slower assumed growth in health costs reduces the Governmentwide resources needed for Part B from \$13,132 billion to \$9,236 billion and in Part D from \$7,884 billion to \$5,559 billion, about a 30 percent difference in each case. The high-cost assumption increases Governmentwide resources needed to \$19,316 billion for Part B and to \$11,539 billion for Part D, just over a 45 percent increase in each case.

Table 4
Present Values of Estimated Medicare Parts B and D Future Expenditures
Less Premium Income and State Transfers Under Three Health Care Cost
Growth Assumptions, 2006-2080

(In billions of dollars)

Medicare Program ¹	Governmentwide Resources Needed		
	Low (4.1)	Intermediate (5.1)	High (6.1)
Part B	9,236	13,132	19,316
Part D	5,559	7,884	11,539

¹ Annual growth rate is the aggregate cost of providing covered health care services to beneficiaries. The low and high scenarios assume that costs increase one percent slower or faster, respectively, than the intermediate assumption.

Source: Centers for Medicare & Medicaid Services.

Sustainability of Social Security and Medicare

75-Year Horizon

According to the 2006 Medicare Trustees Report, the HI Trust Fund is projected to remain solvent until 2018 and, according to the 2006 Social Security Trustees Report, the OASDI Trust Funds are projected to remain solvent until 2040. In each case, some general revenues must be used to satisfy the authorization of full benefit payments until the year of exhaustion. This occurs when the trust fund balances accumulated during prior years are needed to pay benefits, which leads to a transfer from general revenues to the trust funds. Moreover, under current law, General Fund transfers to the SMI Trust Fund will occur into the indefinite future and will continue to grow with the growth in health care expenditures.

The potential magnitude of future financial obligations under these three social insurance programs is therefore important from a unified budget perspective as well as for understanding generally the growing resource demands of the programs on the economy. A common way to present future cashflows is in terms of their *present value*. This approach recognizes that a dollar paid or collected next year is worth less than a dollar today, because a dollar today could be saved and earn a year’s-worth of interest (see footnote 1).

Table 5 shows the magnitudes of the primary expenditures and sources of financing for the three trust funds computed on an open-group basis for the next 75 years and expressed in present values. The data are consistent with the Statements of Social Insurance included in the principal financial statements. For HI, revenues from the public are projected to fall short of total expenditures by \$11,290 billion in present value terms which is the additional amount needed in order to pay scheduled benefits over the next 75 years.⁵ From the trust fund perspective, the amount needed is \$11,005 billion in present value after subtracting the value of the existing trust fund balances (an asset to the trust fund account but an intragovernmental transfer to the overall budget). For SMI, revenues from the public for Parts B and D combined are estimated to be \$21,016 billion less than total expenditures for the two accounts, an amount that, from a budget perspective, will be needed to keep the SMI program solvent for the next 75 years. From the trust fund perspective, however, the present values of total revenues and total expenditures for the

⁵ Interest income is not a factor in this table as dollar amounts are in present value terms.

SMI Program are equal due to the annual adjustment of revenue from other Government accounts to meet program costs.⁶ For OASDI, projected revenues from the public fall short of total expenditures by \$6,449 billion in present value dollars and, from the trust fund perspective, by \$4,591 billion.

From the Governmentwide perspective, the present value of the total resources needed for the Social Security and Medicare Programs equals \$38,754 billion, in addition to payroll taxes, benefit taxes, and premium payments from the public. From the trust fund perspective, which counts the trust funds and the general revenue transfers to the SMI Program as dedicated funding sources additional resources in the amount of \$15,572 billion in present value terms are needed, beyond the \$21,015 billion in present value of required general revenue transfers already scheduled for the SMI Program and the \$2,167 billion to honor the trust fund investments in Treasury securities.

Table 5
Present Values of Costs Less Revenues of 75-Year Open Group Obligations
HI, SMI, and OASDI

(In billions of dollars, as of January 1, 2006)

	HI	SMI		OASDI	Total
		Part B	Part D		
Revenues from the Public:					
Taxes.....	10,644	-	-	32,107	42,751
Premiums, State transfers.....	-	4,481	2,366	-	6,847
Total.....	10,644	4,481	2,366	32,107	49,598
Total costs to the public.....	21,934	17,613	10,250	38,557	88,354
Net results for Government-wide (budget) perspective^{1,2} ..	11,290	13,131	7,884	6,449	38,754
Revenues from other					
Government accounts	-	13,131	7,884	-	21,015
Trust fund in 1/1/2006.....	285	23	-	1,859	2,167
Net results for trust fund perspective¹	11,005	23	-	4,590	15,572

¹ Net results are computed as costs less revenues.

² Details may not add to totals due to rounding.

Source: 2006 OASDI and Medicare Trustees' Reports.

Infinite Horizon

The 75-year horizon represented in Table 5 is consistent with the primary focus of the Social Security and Medicare Trustees' Reports. For the OASDI Program, for example, an additional \$6.5 trillion in present value will be needed above currently scheduled taxes to pay for scheduled benefits (\$4.6 trillion from the trust fund perspective). Yet, a 75-year projection is not a complete representation of all future financial flows through the infinite horizon. For example, when calculating unfunded obligations, a 75-year horizon includes revenue from some future workers but only a fraction of their future benefits. In order to provide a more complete estimate of the long-run unfunded obligations of the programs, estimates can be extended to the infinite horizon. The open-group infinite horizon net obligation is the present value of all expected future program outlays less the present value of all expected future program tax and premium revenues. Such a measure is provided in Table 6 for the three trust funds represented in Table 5.

From the budget or Governmentwide perspective, the values in line 1 plus the values in line 4 of Table 6 represent the value of resources needed to finance each of the programs into the infinite future. The sums are shown in the last line of the table (also equivalent to adding the values in the second and fifth lines). The total resources

⁶ The SMI Trust Fund also has a very small amount of existing assets.

needed for all the programs sums to almost than \$86 trillion in present value terms. This need can be satisfied only through increased borrowing, higher taxes, reduced program spending, or some combination.

The second line shows the value of the trust fund at the beginning of 2006. For the HI and OASDI Programs this represents, from the trust fund perspective, the extent to which the programs are funded. From that perspective, when the trust fund is subtracted, an additional \$28.1 trillion and \$13.3 trillion, respectively, are needed to sustain the programs into the infinite future. As described above, from the trust fund perspective, the SMI Program is fully funded. The substantial gap that exists between premiums and State transfer revenue and program expenditures in the SMI Program (\$26.2 trillion + \$16.0 trillion) represents future general revenue obligations of the Federal budget.

In comparison to the analogous 75-year number in Table 5, extending the calculations beyond 2080 captures the full lifetime benefits and taxes and premiums of all current and future participants. The shorter horizon understates financial needs by capturing relatively more of the revenues from current and future workers and not capturing all of the benefits that are scheduled to be paid to them.

Table 6
Present Values of Costs Less Tax, Premium and State Transfer Revenue
through the Infinite Horizon, HI, SMI, OASDI

(In trillions of dollars as of January 1, 2006)

(In trillions of dollars)	HI	SMI		OASDI	Total
		Part B	Part D		
Present value of future costs less future taxes and premiums and State transfers for current participants	12.2	10.6	6.2	15.1	44.1
Less current trust fund	0.3	-	-	1.9	2.2
Equals net obligations for past and current participants	11.9	10.6	6.2	13.2	41.9
Plus net obligations for future participants	16.2	15.6	9.8	0.1	41.7
Equals net obligations through the infinite future for all participants	28.1	26.2	16.0	13.3	83.6
Present value of future costs less the present values of future income over the infinite horizon	28.4	26.2	16.0	15.2	85.8

Source: 2006 OASDI and Medicare Trustees' Reports.

Railroad Retirement, Black Lung, and Unemployment Insurance

Railroad Retirement

The RRB was created in the 1930s to establish a retirement benefit program for the nation's railroad workers. As the social security program legislated in 1935 would not give railroad workers credit for service performed prior to 1937, legislation was enacted in 1934, 1935, and 1937 (collectively the Railroad Retirement Acts of the 1930s) to establish a railroad retirement program separate from the social security program.

Railroad retirement pays full retirement annuities at age 60 to railroad workers with 30 years of service. The program pays disability annuities based on total or occupational disability. It also pays annuities to spouses, divorced spouses, widow(er)s, remarried widow(er)s, surviving divorced spouses, children, and parents of deceased railroad workers. Medicare covers qualified railroad retirement beneficiaries in the same way as it does Social Security beneficiaries.

Payroll taxes paid by railroad employers and their employees provide a primary source of income for the Railroad Retirement and Survivors' Benefit Program. By law, railroad retirement taxes are coordinated with Social

Security taxes. Employees and employers pay tier I taxes at the same rate as Social Security taxes. Tier II taxes finance railroad retirement benefit payments that are higher than Social Security levels.

Other sources of program income include: financial interchanges with the Social Security and Medicare trust funds, earnings on investments, Federal income taxes on railroad retirement benefits, and appropriations (provided after 1974 as part of a phase out of certain vested dual benefits). Refer to Note 23—Social Insurance, for additional information on railroad retirement program financing.

The Railroad Retirement and Survivors Improvement Act of 2001 (RRSIA), liberalized benefits for 30-year service employees and their spouses, eliminated a cap on monthly benefits for retirement and disability benefits, lowered minimum service requirements from 10 to 5 years, and provided for increased benefits for widow(er)s. Per the RRSIA, amounts in the Railroad Retirement Account and the SSEB Account that are not needed to pay current benefits and administrative expenses are transferred to the National Railroad Retirement Investment Trust (NRRIT) whose sole purpose is to manage and invest railroad retirement assets. NRRIT's Board of Trustees is empowered to invest trust assets in nongovernmental assets, such as equities and debt, as well as, in Government securities. Prior to RRSIA, all investments were limited to Government securities.

Since its inception, NRRIT has received \$21.3 billion from RRB (including \$19.2 billion in fiscal year 2003, pursuant to RRSIA) and returned \$3.6 billion. During fiscal year 2006, the NRRIT made net transfers of \$947 million to the RRB to pay retirement benefits. Administrative expenses of the trust are paid out of trust assets. The balance as of September 30, 2006, and 2005, of non-federal securities and investments of the NRRIT are disclosed in Note 7—Securities and Investments.

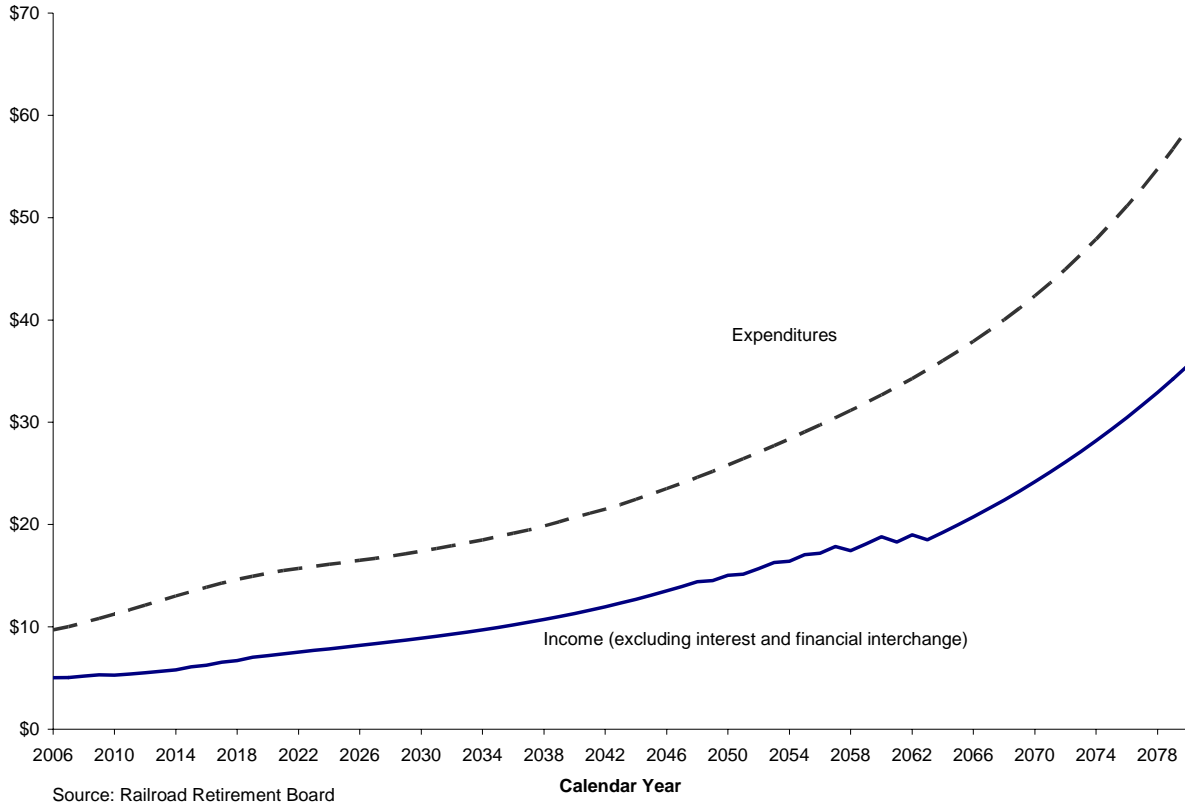
Cashflow Projections

Economic and Demographic Assumptions. The economic and demographic assumptions used for the most recent set of projections are shown in the "Railroad Retirement" section of Note 23—Social Insurance.

Nominal Income and Expenditures. Chart 11 shows, in nominal dollars, estimated railroad retirement income (excluding interest and financial interchange income) and expenditures for the period 2006-2080 based on the intermediate set of assumptions used in the RRB's actuarial evaluation of the program. The estimates are for the open-group population, which includes all persons projected to participate in the Railroad Retirement Program as railroad workers or beneficiaries during the period. Thus, the estimates include payments from, and on behalf of, those who are projected to be employed by the railroads during the period as well as those already employed at the beginning of the period. They also include expenditures made to, and on behalf of, such workers during that period.

**Chart 11—Estimated Railroad Retirement Income
(Excluding Interest and Financial Interchange Income) and Expenditures
2006-2080**

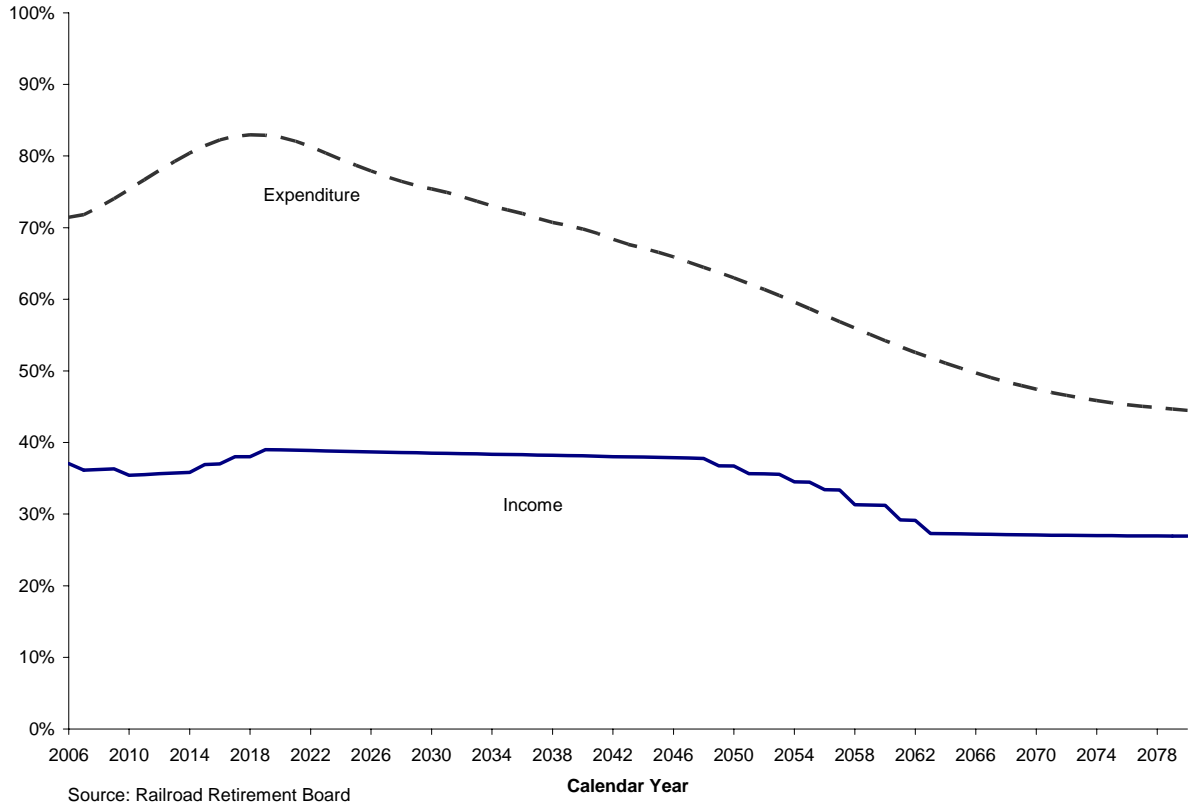
(In billions of nominal dollars)



As Chart 11 shows, expenditures are expected to exceed tax income for the entire projection period. The imbalances continue to widen until about 2020, after which their growth slows for the next 45 years (until 2050). After 2060, the imbalances widen due in part to reductions in tax rates between 2061 to 2068.

Income and Expenditures as a Percent of Taxable Payroll. Chart 12 shows estimated expenditures and income as a percent of tier II taxable payroll. The imbalances grow until 2016 but then begin to decrease steadily as expenditures fall. Tax rates begin to decline after 2048, stabilizing after 2063. Compared to last year, projected tax rates are lower. The tier II tax rate is determined from a tax rate table based on the average account benefit ratio.

**Chart 12—Estimated Railroad Retirement Income
(Excluding Interest and Financial Interchange Income) and Expenditures
as a Percent of Tier II Taxable Payroll
2006-2080**



Sensitivity Analysis. Actual future income from railroad payroll taxes and other sources and actual future expenditures for scheduled benefits and administrative expenses will depend upon a large number of factors as mentioned above. Two crucial assumptions are employment growth and the interest rate. Table 7 shows the sensitivity of the shortfall in the Railroad Retirement Program to variations in these two assumptions. The low-cost employment scenario has a 4.5 percent smaller shortfall of income to expenditures, and the high-cost scenario has a 3.8 percent higher shortfall. A higher discount rate reduces future values relative to a lower rate. As seen in the table, the shortfall is 29.5 percent lower if the interest rate is 11 percent rather than 7.5 percent and 72 percent higher when the interest rate is 4 percent rather than 7.5 percent.

Table 7
Present Values of Railroad Retirement Expenditures in Excess of Income
Under Various Employment and Interest Rate Assumptions

(In millions of dollars)

Assumption	Low	Middle	High
Employment ¹	96,480 (1.0%)	101,050 (2.5%)	104,876 (4.0%)
Interest rate.....	71,242 (11%)	101,050 (7.5%)	173,819 (4%)

¹ The low and middle employment scenarios have passenger service employment remaining at 43,000 and the remaining employment base declining at 1.0 percent and 2.5 percent, respectively, for the next 25 years. The high cost scenario has passenger service employment declining by 500 per year until a level of 35,000 is reached with the remaining employment base declining by 4.0 percent per year for 25 years, at a reducing rate over the next 25 years, and remaining level thereafter.

Source: Railroad Retirement Board.

Sustainability of Railroad Retirement

Table 8 shows the magnitudes of the primary expenditures and sources of financing for the Railroad Retirement Program computed on an open-group basis for the next 75 years and expressed in present values as of January 1, 2006. The data are consistent with the statements of social insurance.

From a Governmentwide perspective, revenues are expected to fall short of expenditures by approximately \$101.1 billion, which represents the present value of resources needed to sustain the Railroad Retirement Program. From a trust fund perspective, when the trust fund balance and the financial interchange and transfers are included, the combined balance of the NRRIT, the Railroad Retirement Account, and the SSEB Account show a slight surplus.

Table 8
Present Values of 75-Year Projections of Revenues and Expenditures for the Railroad Retirement Program^{1,2}

(In billions of present-value dollars as of January 1, 2006)

Estimated Future Income (Excluding Interest)³ Received from or on Behalf of:	
Current participants who have attained retirement age.....	4.5
Current participants not yet having attained retirement age.....	39.7
Those expected to become participants.....	55.5
All participants.....	<u>99.7</u>
Estimated Future Expenditures:⁴	
Current participants who have attained retirement age.....	91.7
Current participants not yet having attained retirement age.....	84.1
Those expected to become participants.....	25.0
All participants.....	<u>200.8</u>
Net obligations from budget perspective (expenditures less income).....	101.1
Railroad Retirement Program assets (mostly investments stated at market) ⁵	30.0
Financial Interchange from Social Security Trust.....	72.1
Net Obligations from Trust Fund Perspective.....	<u>(1.0)</u>

¹ Represents combined values for the Railroad Retirement Account, SSEB Account, and NRRIT, based on middle employment assumption.

² The data used reflect the provisions of RRSIA of 2001.

³ Future income (excluding interest) includes tier I taxes, tier II taxes, and income taxes on benefits.

⁴ Future expenditures include benefits and administrative expenditures.

⁵ The value of the fund reflects the 7.5 percent interest rate assumption. The RRB uses the relatively high rate due to investments in private securities.

Note: Detail may not add to totals due to rounding. Employee and beneficiary status are determined as of 1/1/2005 whereas present values are as of 1/1/2006.

Black Lung

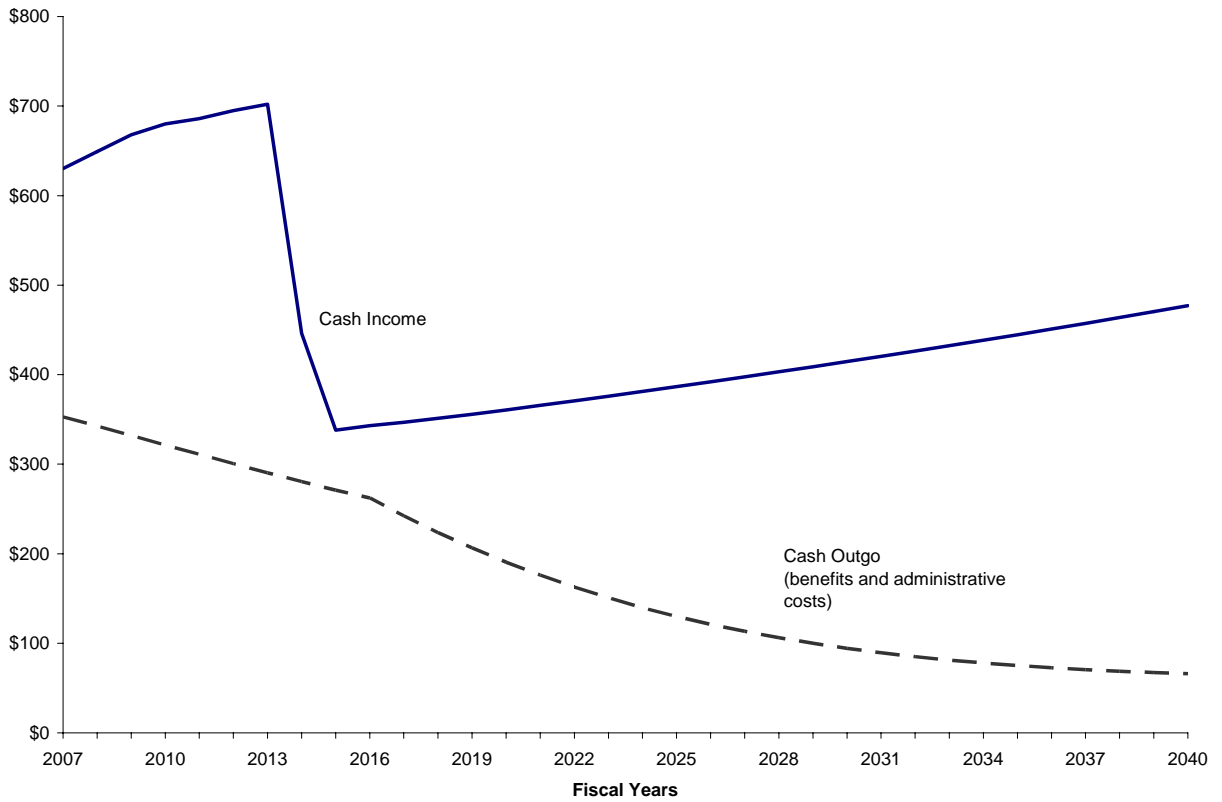
The Federal Coal Mine Health and Safety Act of 1969 created the Black Lung Disability Benefit Program to provide compensation for medical and survivor benefits for eligible coal miners who are disabled due to pneumoconiosis (black lung disease) arising out of their coal mine employment. The DOL operates the Black Lung Disability Benefit Program. The 1977 Black Lung Amendments established a Black Lung Disability Trust Fund (BLDTF) to provide benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned the liability. The beneficiary population has been declining as the incidence of black lung disease has fallen, and the group of miners affected by the disease (and their widows) has been dying at a more rapid rate than new awards have been made.

Excise taxes on coal mine operators, based on the sale of coal, is the primary source of financing black lung disability payments and related administrative costs. The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the General Fund of the Treasury in the event that BLDTF resources are not adequate to meet program obligations. On September 30, 2006, total liabilities of the BLDTF exceed assets by \$9.6 billion. This deficit fund balance represents the accumulated shortfall of excise taxes necessary to meet benefit payment and interest expenses. This shortfall was funded by repayable advances to the BLDTF which are repayable with interest. Estimates for future interest on advances are based on the interest rates on outstanding advances ranging from 4.5 percent to 13.8 percent and new borrowings ranging from 4.9 percent to 5.8 percent.

From the budget or consolidated financial perspective, Chart 13 shows projected black lung expenditures (excluding interest) and excise tax collections for the period 2007-2040. The significant assumptions used in the most recent set of projections are shown in the "Black Lung" section of Note 23—Social Insurance. Analysts project that a scheduled reduction in taxes on coal sales will decrease cash inflows by 52 percent between the years 2013 to 2015. After 2015, cash surpluses continue to widen due to a declining beneficiary population and increasing revenues. Including projected interest payments that the program must make, however, the picture changes dramatically.

**Chart 13—Estimated Black Lung Income and Expenditures (Excluding Interest)
2007-2040**

(In millions of nominal dollars)



Source: Department of Labor

Chart 14 shows the projected financial status of the program from a trust fund perspective that includes interest outflows from the program to the general fund. Trust fund net outflows (benefits plus interest payments less cash income from excise taxes) grow without bound, as a result of projected interest payments on the large accumulated liability to the general fund. This deficit fund balance represents the accumulated shortfall between excise taxes and benefit payment plus interest expenses.

Chart 14—Estimated Black Lung Trust Fund Net Outflow and End of Year Fund Balance 2007-2040

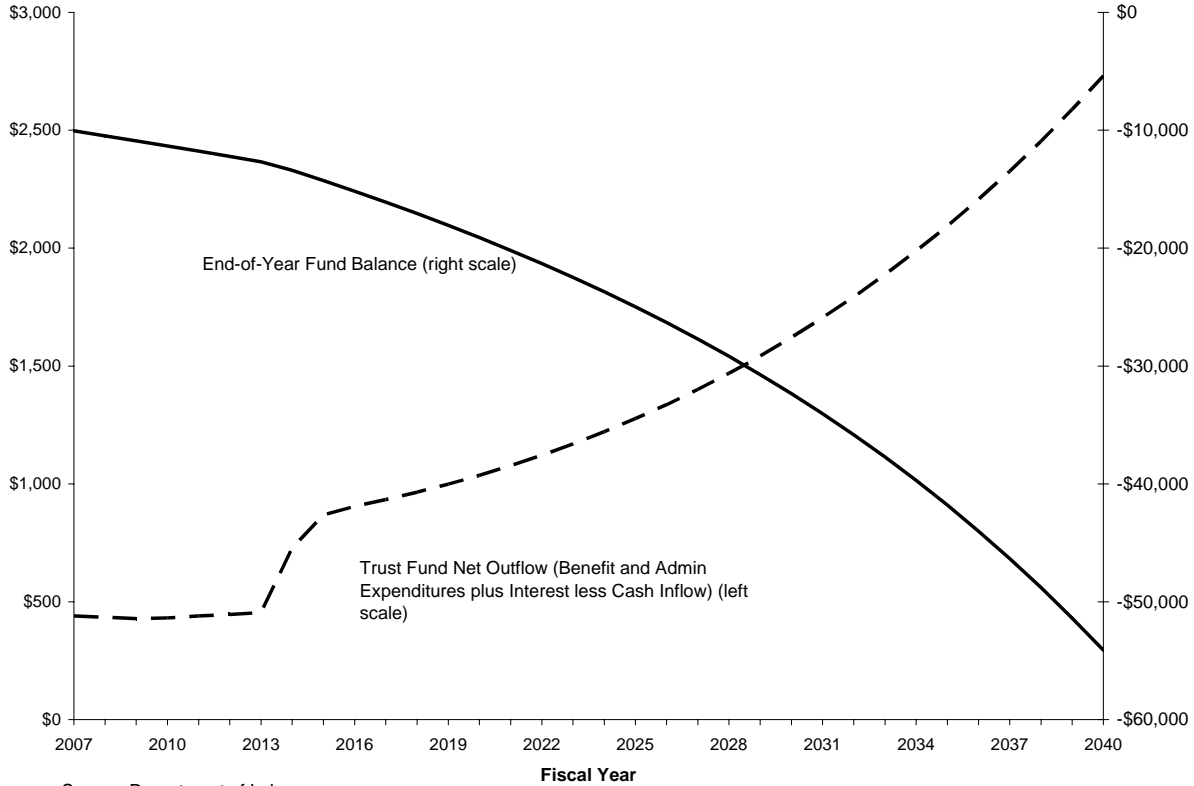


Table 9 shows present values of 35-year projections of expenditures and revenues for the Black Lung Program computed as of September 30, 2006, using a discount rate equivalent to 6.34 percent. (The discount rate is higher than the current Government borrowing rate because the program borrowed from the General Fund during periods of relatively high interest rates). From a Governmentwide (budget) perspective, the present value of expenditures is expected to be less than the present value of income by \$3.7 billion (a surplus). From a trust fund perspective, a large balance (\$9.6 billion) is owed to the General Fund. From that perspective, when that accumulated balance is combined with the cashflow surplus, the program shows a negative balance of \$5.9 billion in present value dollars.

Table 9
Present Values of 35-Year Projections of Revenues and Expenditures
for the Black Lung Program

(In billions of present value dollars, as of September 30, 2006)

Estimated future tax income	6.9
Estimated future expenditures	3.2
Net obligations from budget perspective (expenditures less income)	(3.7)
Accumulated balance due General Fund	9.6
Net obligations from trust fund perspective	5.9

Source: Department of Labor projections and Treasury Department calculations.

Unemployment Insurance

The Unemployment Insurance Program was created in 1935 to provide temporary partial wage replacement to unemployed workers who lose their jobs. The program is administered through a unique system of Federal and State partnerships established in Federal law but administered through conforming State laws by State agencies. DOL interprets and enforces Federal law requirements and provides broad policy guidance and program direction, while program details such as benefit eligibility, duration, and amount of benefits are established through individual State unemployment insurance statutes and administered through State unemployment insurance agencies.

The program is financed through the collection of Federal and State unemployment taxes that are credited to the Unemployment Trust Fund (UTF) and reported as Federal tax revenue. The fund was established to account for the receipt, investment, and disbursement of unemployment taxes. Federal unemployment taxes are used to pay for Federal and State administration of the Unemployment Insurance Program, veterans' employment services, State employment services, and the Federal share of extended unemployment insurance benefits. Federal unemployment taxes also are used to maintain a loan account within the UTF, from which insolvent State accounts may borrow funds to pay unemployment insurance benefits.

Chart 15 shows the projected cash contributions and expenditures over the next 10 years under expected economic conditions (described below). The significant assumptions used in the projections include total unemployment rates, civilian labor force levels, percent of unemployed receiving benefits, total wages, distribution of benefit payments by State, State tax rate structures, State taxable wage bases, and interest rates on UTF investments. These projections, excluding interest earnings, indicate positive net cash inflows for the next 4 years. There is a crossover back to a net outflow in fiscal year 2012, after which net inflows resume for the remainder of the projection period.

**Chart 15—Estimated Unemployment Fund Cashflow
Using Expected Economic Conditions
2007-2016**

(In billions of nominal dollars)

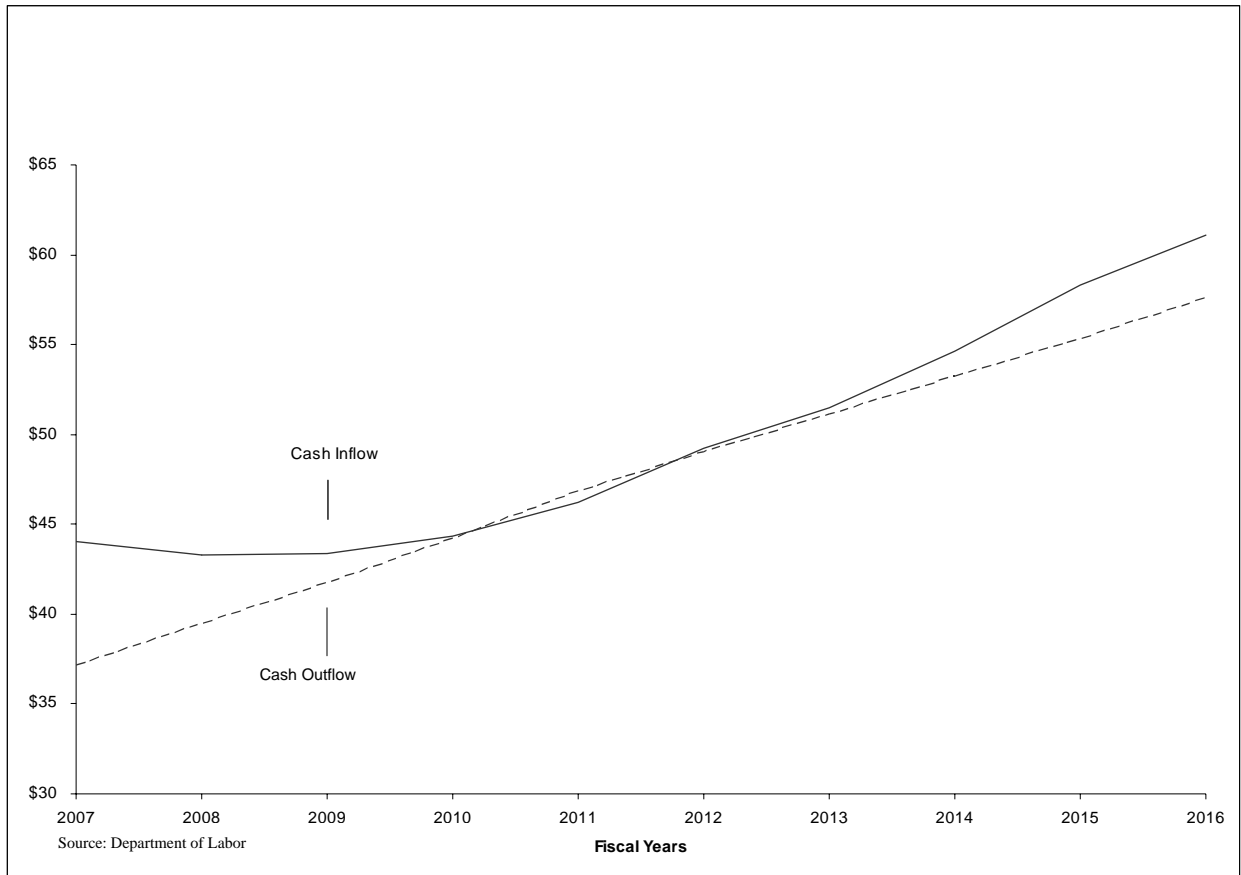


Table 10 shows present values of 10-year projections of revenues and expenditures for the Unemployment Insurance Program using a discount rate of 6.04 percent, the average of the interest rates underlying the 10-year projections. Three sets of numbers are presented in order to show the effects of varying economic conditions as reflected in different assumptions about the unemployment rate. For expected economic conditions, the estimates are based on an unemployment rate of 4.8 percent during fiscal year 2007, increasing to 4.9 percent in fiscal year 2009 and thereafter. Under the mild recessionary scenario, the unemployment rate peaks at 7.43 percent in fiscal year 2009 and declines gradually until reaching 4.9 percent in 2015. Finally, under the deep recession scenario, the unemployment rate is assumed to peak at 10.14 percent in 2010 and gradually fall to 5.25 percent by the end of the projection period.

Each scenario uses an open group that includes current and future participants of the Unemployment Insurance Program. Table 10 shows that, as economic conditions worsen, while tax income is projected to increase as higher layoffs result in higher employer taxes, benefit outlays increase much faster. From the Governmentwide (budget) perspective, under expected conditions, the present value of income exceeds the present value of expenditures by \$16 billion. From the same perspective, under a deep recession scenario, the present value of expenditures exceeds the present value of income by \$51 billion. From a trust fund perspective, the program has more than \$66 billion in assets. When combined with the present value of net cash income under expected economic conditions, the program has a surplus of \$82 billion.

Table 10
Present Values of 10-Year Projections of Revenues and Expenditures for Unemployment Insurance Under Three Alternative Scenarios for Economic Conditions

(In billions of present value dollars, as of October 1, 2006)

	Economic Conditions		
	Expected	Mild Recession	Deep Recession
Future cash income	357.3	415.6	475.1
Future expenditures.....	341.3	420.1	526.3
Net obligations from budget perspective (expenditures less income)	(16.0)	4.5	51.2
Trust fund assets	66.1	66.1	66.1
Net obligations from trust fund perspective ¹	(82.1)	(61.6)	(14.9)

¹Net obligations from the trust fund perspective=net obligations from the budget perspective-trust fund assets. The negative values in this line are indicative of surpluses.

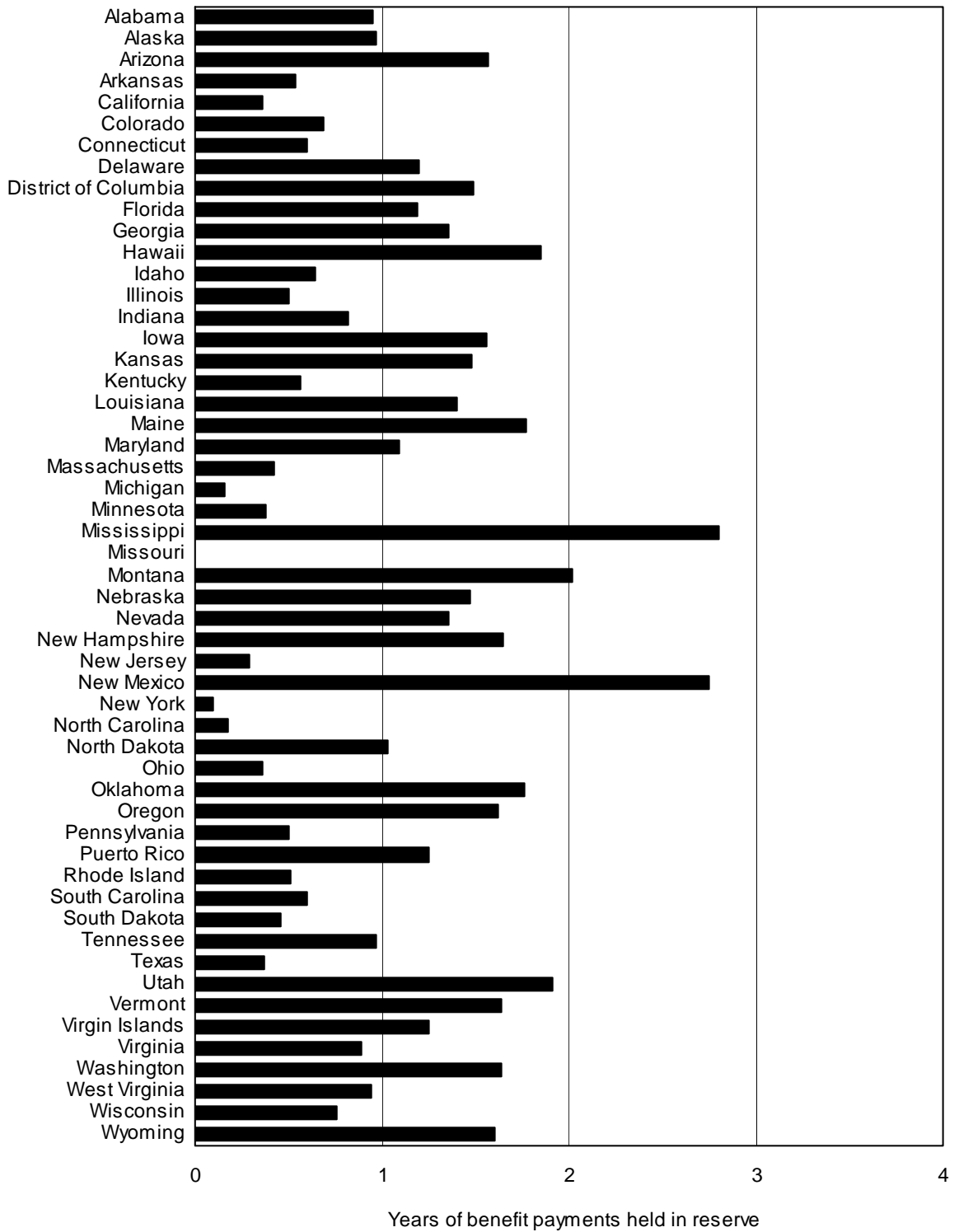
Source: Data for the present value calculations are from the Department of Labor.

Unemployment Trust Fund Solvency

Each State's accumulated UTF net assets or reserve balance should provide a defined level of benefit payments over a defined period. To be minimally solvent, a State's reserve balance should provide for 1 year's projected benefit payment needs based on the highest levels of benefit payments experienced by the State over the last 20 years. A ratio of 1.0 or greater prior to a recession indicates a State is minimally solvent. States below this level are vulnerable to exhausting their funds in a recession. States exhausting their reserve balance must borrow funds from the Federal Unemployment Account (FUA) to make benefit payments. The Missouri state account had loans payable to FUA at the end of fiscal year 2006. In addition, Texas had outstanding debts to other sources. During periods of high-sustained unemployment, balances in the FUA may be depleted. In these circumstances, FUA is authorized to borrow from the Treasury General Fund.

Chart 16 presents the State by State results of this analysis as of September 30, 2006. As the table illustrates, 27 State funds were below the minimal solvency ratio on September 30, 2006.

Chart 16—Unemployment Trust Fund Solvency as of September 30, 2006



Deferred Maintenance

Deferred maintenance is the estimated cost to bring Government-owned property to an acceptable condition, resulting from not performing maintenance on a timely basis. Deferred maintenance excludes the cost of expanding the capacity of assets or upgrading them to serve needs different from those originally intended. The consequences of not performing regular maintenance could include increased safety hazards, poor service to the public, higher costs in the future, and inefficient operations. Estimated deferred maintenance costs are not accrued in the Statements of Net Cost or recognized as a liability on the balance sheets.

The amounts disclosed for deferred maintenance are allowed to be measured using the following three methods:

- Condition assessment surveys are periodic inspections of the Government-owned property to determine the current condition and estimated cost to bring the property to an acceptable condition.
- Life-cycle cost forecast is an acquisition or procurement technique that considers operation, maintenance, and other costs in addition to the acquisition cost of assets.
- Management analysis method is founded on inflation-adjusted reductions in maintenance funding since the base year.

The amounts disclosed on the table below have all been measured using the condition assessment survey method. The standards for acceptable operating condition and the changes in these standards and changes in asset condition vary widely between the Federal entities.

Some deferred maintenance has been deemed critical. Such amounts and conditions are defined by the individual agencies with responsibility for the safekeeping of these assets. Low and high estimates are based on the materiality of the estimated cost of returning the asset to the acceptable condition versus the total value of the corresponding asset.

	Deferred Maintenance as of September 30					
	Deferred Maintenance Cost Range				Critical Maintenance	
	Low Estimate		High Estimate			
(In billions of dollars)	2006	2005	2006	2005	2006	2005
Asset Category:						
Buildings, structures, and facilities	25.3	23.2	32.1	33.7	11.7	11.4
Furniture, fixtures, and equipment	0.4	-	0.4	0.1	0.1	0.1
Other general property, plant, and equipment	1.6	1.1	1.6	1.1	0.1	-
Heritage assets.....	1.7	1.7	2.9	2.9	-	0.1
Total deferred maintenance....	<u>29.0</u>	<u>26.0</u>	<u>37.0</u>	<u>37.8</u>	<u>11.9</u>	<u>11.6</u>

Please refer to the individual financial statements of DOD, USDA, DOE, VA, DOI, and NASA for detailed significant information on deferred maintenance, including the standards used for acceptable operating condition and changes in asset condition. These agencies comprise 81 percent of the Government's total reported net property, plant, and equipment of \$688.5 billion as of September 30, 2006.

Unexpended Budget Balances

Unexpended budget balances consist of the unobligated and obligated, but unliquidated, budget balances.

Unobligated budget balances, including amounts for trust funds, are the cumulative amount of budget balances that are not obligated and that remain available for obligation. In 1-year accounts, the unobligated balance is not available for new obligations after the end of the fiscal year. In multiyear accounts, the unobligated balance may be carried forward and remains available for obligation for the period specified. In no-year accounts, the unobligated balance is carried forward until specifically rescinded by law or until the purposes for which it was provided have been accomplished. The total unobligated budget balances for fiscal years 2006 and 2005 are \$381.1 billion (estimated) and \$458.0 billion, respectively.

Obligated budget balances are the cumulative budget balances that have been obligated but not liquidated. The obligated balance can be carried forward for a maximum of 5 years after the appropriation has expired. The total obligated budget balances for fiscal years 2006 and 2005 are \$1,013.8 billion (estimated) and \$911.3 billion, respectively.

The President's Budget with fiscal year 2006 actuals is expected to be published in February 2007; thus the unobligated and obligated amounts reported for fiscal year 2006 are estimates from the President's Budget issued in February 2006. The amounts initially reported as unexpended budget balances at the end of fiscal year 2005 were different from the actual balances reflected in the President's Budget that was issued in February 2006 by approximately \$83.1 billion (net) and \$16.3 billion (net) for unobligated and obligated balances, respectively, due to compilation differences. The unobligated balance that was previously reported erroneously included about \$56.4 billion of non-budgetary financing accounts and \$27.1 billion of expired accounts and excluded \$0.4 billion amounts from certain verifying agencies. The obligated balance that was previously reported erroneously included about \$42.1 billion of non-budgetary financing accounts, and excluded \$0.8 billion from certain verifying agencies, and \$(25) billion in adjustments to agencies' reported balances.

Tax Burden

The Internal Revenue Code provides for progressive tax rates, whereby higher incomes are generally subject to higher tax rates. The tables present the latest available information on income tax and related income, deductions, and credit for individuals by income level and for corporations by size of assets.

Individual Income Tax Returns for Tax Year 2004

Adjusted Gross Income (AGI)	Number of Taxable Returns (In thousands)	AGI (In millions of dollars)	Total Income Tax (In millions of dollars)	Average AGI per Return (In whole dollars)	Average Income Tax per Return (In whole dollars)	Income Tax as a Percentage of AGI
Under \$15,000	37,315	200,248	3,306	5,366	89	1.7%
\$15,000 under \$30,000	29,581	650,044	23,749	21,975	803	3.7%
\$30,000 under \$50,000	24,536	957,783	62,190	39,036	2,535	6.5%
\$50,000 under \$100,000	28,196	1,984,569	178,486	70,385	6,330	9.0%
\$100,000 under \$200,000 ..	9,750	1,291,062	176,173	132,417	18,069	13.6%
\$200,000 or more	3,007	1,681,201	386,515	559,096	128,538	23.0%
Total	<u>132,385</u>	<u>6,764,907</u>	<u>830,419</u>			

Corporation Income Tax Returns for Tax Year 2003

Total Assets	Income Subject to Tax <small>(In millions of dollars)</small>	Total Income Tax after Credits <small>(In millions of dollars)</small>	Percentage of Income Tax after Credits to Taxable Income
Zero assets	7,476.0	1,987.0	26.6%
\$1 under \$500	8,159.0	1,435.0	17.6%
\$500 under \$1,000	3,541.0	785.0	22.2%
\$1,000 under \$5,000	10,482.0	2,994.0	28.6%
\$5,000 under \$10,000	6,240.0	2,045.0	32.8%
\$10,000 under \$25,000	9,033.0	2,941.0	32.6%
\$25,000 under \$50,000	8,208.0	2,677.0	32.6%
\$50,000 under \$100,000	10,321.0	3,297.0	31.9%
\$100,000 under \$250,000	20,870.0	6,516.0	31.2%
\$250,000 or more	615,006.0	152,840.0	24.9%
Total	<u>699,336.0</u>	<u>177,517.0</u>	25.6%

Tax Gap

The tax gap is the aggregate amount of tax (i.e., excluding interest and penalties) that is imposed by the tax laws for any given tax year but is not paid voluntarily and timely. The Internal Revenue Service (IRS) currently projects that the annual Federal gross tax gap is estimated at \$345.0 billion. This estimate is based on the results of the National Research Program (NRP). The NRP was a study conducted to measure the compliance rate of the individual filers based on examination of a statistical sample of their filed returns for tax year 2001. The tax gap arises from three types of noncompliance: not filing timely tax returns (the nonfiling gap), underreporting the correct amount of tax on timely-filed returns (the underreporting gap), and not paying on time the full amount reported on timely-filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. Each instance of noncompliance by a taxpayer contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. The tax gap does not include underpayments by corporate taxpayers or include taxes that should have been paid on income from the illegal sector of the economy.

Underreporting of income tax, employment taxes, and other taxes represents 83 percent of the tax gap. The single largest subcomponent of underreporting involves individuals understating their income, taking improper deductions, overstating business expenses, and erroneously claiming credits. Individual underreporting represents about half of the total tax gap. Individual income tax also accounts for about half of all tax liabilities.

The collection gap is the cumulative amount of assessed tax, penalties, and interest that the IRS expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the IRS's balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest) that may be paid for claims pending judicial review by the Federal courts or, internally, by appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the Federal courts is \$14.8 billion and \$12.0 billion for fiscal years 2006 and 2005, respectively. For those under appeal, the estimated payout is \$7.0 billion and \$11.1 billion for fiscal years 2006 and 2005, respectively. There are also unasserted claims for refunds of certain excise taxes. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the balance sheets or for disclosure in the Notes to the Financial Statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information. To the extent judgments against the Government for these claims prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Risk Assumed

Risk assumed information is important for all Federal insurance and guarantee programs, except those relating to social insurance, life insurance and loan guarantee programs. Risk assumed is generally measured by the present value of unpaid expected losses net of associated premiums based on the risk inherent in the insurance or guarantee coverage in force. In addition to the liability for unpaid insurance claims included in Note 14—Insurance Program Liabilities, for events that have already occurred, the Federal government is also required to report as supplementary information risk assumed amounts and the periodic changes in those amounts.

The assessments of losses expected based on the risk assumed are based on actuarial or financial methods applicable to the economic, legal and policy environment in force at the time the assessments are made. Management has estimated the loss amounts based on the risk assumed as well as the periodic changes for the following insurance programs.

Please refer to the individual financial statements of the PBGC and the National Credit Union Administration for other significant detailed information.

Risk Assumed Information as of September 30		
(In billions of dollars)	2006	2005
Present Value of unpaid expected losses, net of associated premiums:		
Pension Benefit Guaranty Corporation	73.4	108.5
All other	-	0.1
Total	<u>73.4</u>	<u>108.6</u>
Periodic changes in risk assumed amounts:		
Pension Benefit Guaranty Corporation	(35.1)	12.7
All other	-	(0.2)
Total	<u>(35.1)</u>	<u>12.5</u>

Unmatched Transactions and Balances

(In millions of dollars)	Fiscal Year 2006	Fiscal Year 2005
Change in Intra-Governmental Unmatched Balances		
Debt/Investments.....	1,231.4	(4,881.5)
Interest Payable/Receivable.....	77.7	81.6
Loans Payable/Receivable.....	(1,178.0)	(9,891.3)
Benefit Program Contributions Payable/Receivable	(128.8)	5,021.1
Accounts Payable/Receivable	10,271.5	(13,096.3)
Advances from/to Others & Deferred Credits/Prepayments ...	(855.5)	9,047.6
Transfers Payable/Receivable.....	(379.8)	1,627.4
	9,038.5	(12,091.4)
Unmatched Intra-Governmental Transactions		
Federal Securities Interest Revenue/Expense– Investment Exchange	2,206.2	1,578.9
Borrowings Interest Revenue/Expense–Exchange.....	397.0	669.6
Borrowings Gains/Losses.....	(16.5)	(10.3)
Transfers - In/Out Without Reimbursement.....	7,386.3	6,352.4
Appropriations Transfers–In/Out	(5,554.0)	(5,495.8)
Imputed Financing Source/Cost	(7.6)	87.2
Benefit Program Revenue/Cost.....	(950.3)	(1,672.8)
Unexpended Appropriations Transferred In/Out	(601.4)	3,058.3
	2,859.7	4,567.5
General Fund Transactions and Timing Adjustments.....	(13,579.9)	9,589.6
Intra-Agency Reporting Errors*	(5,357.5)	1,019.6
Top Level Journal Vouchers	(3,951.5)	(7,198.5)
Unmatched Transactions and Balances, Net.....	(10,990.7)	(4,113.2)

*Includes reporting errors for DHS (5,371.0) million in fiscal year 2006 and (2.0) million in fiscal year 2005.

The Statement of Operations and Changes in Net Position includes an amount for unmatched transactions and balances that result from the consolidation of Federal reporting entities. Transactions between Federal entities must be eliminated in consolidation to reveal the financial position of the U.S. Government. Many of the amounts included in the table represent intragovernmental activity and balances that differed between federal agency trading partners and often totaled significantly more than the net amounts shown. In addition, included in the net amount labeled “General Fund Transactions and Timing Adjustments” are certain intragovernmental accounts, primarily related to unreconciled transactions with the General Fund, totaling hundreds of billions of dollars. The table also reflects other consolidating adjustments and other adjustments that contributed to the unmatched transactions and balances amount.

Unmatched transactions and balances between Federal entities impact not only in the period in which differences originate but also in the periods where differences are reconciled. As a result, it would not be proper to conclude that increases or decreases in the unmatched amounts shown in the table above reflect improvements or deteriorations in the Government’s ability to reconcile intra-governmental transactions. The Federal community considers the identification and accurate reporting of intra-governmental activity a priority