

Available information

Our website can be found at <http://www.usafacts.org/>, where we make available free of charge a variety of information. Our goal is to maintain the website as a portal through which users can easily find or navigate to pertinent information about our Government, including:

- USAFacts Annual Report – a detailed annual score card for our Government;
- USAFacts 10-K (this report) – an annual report for our Government in the style of a corporate Form 10-K;
- Facts in Focus – brief topical analyses; and
- a database containing the data used in these reports, plus additional data and analysis.

In addition to our website, we use social media to communicate with the public. You can follow us on Twitter at @usafacts and Facebook at USAFacts.

Item 1A. Risk Factors

Our Government's operations, financial results, and satisfaction of its customers are subject to various risks and uncertainties, including those described below.

In a free society, human behavior cannot be fully regulated or controlled.

Our Government provides services, promulgates regulations, and enacts legislation intended to make progress towards our Constitutional objectives; however, citizens are responsible for making their own choices as to employment, healthcare, education, and the like. They may choose wisely or poorly, and they may or may not take advantage of the opportunities open to them. For example:

- While our Government seeks to create a stable economic climate that favors full employment and low inflation, it cannot guarantee these outcomes. Company investment, hiring decisions, and individuals' desire to work are beyond our Government's control.
- Our Government provides access to healthcare and discourages unhealthful behavior (for example, by imposing high excise taxes on tobacco and requiring warning labels); however, individuals may still choose to engage in unhealthful behavior such as smoking.
- Our Government sets emissions standards for automobiles to limit air pollution, but citizens are still free to drive as much as they wish.
- Our Government seeks to promote transportation safety by issuing drivers' licenses, imposing speed limits, requiring the use of seatbelts in cars and regulating the trucking, rail, and airline industries. Even so, accidents will occur as a result of human error or unforeseeable mechanical failures.

Government personnel security clearance processing challenges put us at risk.³¹

A high-quality and timely government-wide personnel security clearance process is essential to minimize the risks of unauthorized disclosures of classified information and to identify and assess individuals with criminal histories or other questionable behavior. As of October 1, 2015, the latest date for which data are available, approximately 4.2 million government and contractor employees, at nearly 80 executive branch agencies, were eligible to hold a personnel security clearance. Current challenges in the personnel security clearance process include:

- *Timeliness* - For fiscal year 2016, the government-wide average for the fastest 90% of initial secret clearance investigations ranged from 92 days to 135 days, while investigations for the fastest 90% of initial top-secret clearances ranged from 168 days to 208 days. In both areas, these timeframes significantly exceed established timeliness objectives. As of September 2017, there was a backlog of more than 700,000 background investigations.
- *Investigation quality* - The executive branch has not established measures for the quality of background investigations. Establishing performance measures is one element of a framework for effectively managing program performance to achieve desired outcomes.
- *Resolution of previously identified issues* - Several critical areas of previously identified areas for reform - such as the implementation of continuous evaluation, and the issuance of a reciprocity policy - remain incomplete. Over the last nine years, the GAO made 43 recommendations to executive branch agencies to improve the personnel security clearance process; however, only 12 of them had been fully implemented as of January 2018.

Increasing cyber security threats challenge our safety, prosperity, and well-being.³¹

Our Government and our nation's critical infrastructures—such as energy, transportation systems, communications, and financial services—are dependent on computerized (cyber) information systems and electronic data to carry out operations and to process, maintain, and report essential information. Ineffectively protecting cyber assets can facilitate security incidents and cyberattacks that disrupt critical operations; lead to inappropriate access to and disclosure, modification, or destruction of sensitive information; and threaten national security, economic well-being, and public health and safety. We are seeing steady advances in the sophistication of cyber-attack technology and the emergence of new and more destructive attacks. Over the last several years, the US Government Accountability Office (GAO) has made about 2,500 recommendations to agencies aimed at improving the security of federal systems and information. However, many agencies continue to be challenged in safeguarding their information systems and information, and as of October 2016, about 1,000 of the GAO's information security-related recommendations had not been implemented.

Our Government's revenue and spending are significantly affected by economic conditions.

Our Government's ability to deliver services to citizens is influenced by the state of the economy. Indeed, maintaining economic growth, full employment, and low and stable inflation are among its top priorities, at least in part because these conditions both foster the prosperity and well-being of its citizens and provide tax revenue that funds Government services.

An economic downturn could result in business failures and job losses, with a resulting decline in corporate and personal income-tax revenue. At the same time, spending would rise as government increases outlays for services such as unemployment insurance, Temporary Assistance to Needy Families, and the Supplemental Nutrition Assistance Program.

On the federal level, the combination of lower revenue and higher spending would widen the budget deficit, which would have to be financed either by raising taxes, selling government assets, or issuing debt. The increase of our national debt raises interest costs and constrains our Government's ability to provide services in the future.

An economic downturn could be caused by policy errors, the vagaries of the business cycle, and exogenous factors. In the longer term, the economy could succumb to a slowing pace of growth as an aging society reduces the size of the labor force as a proportion of the total population.

Policy errors

- Keeping interest rates low for too long could stoke inflation, which may then need to be curbed by a sudden, sharp increase in interest rates. Too-low rates also raise the risk of unsustainable asset valuations, or "bubbles."
- Keeping interest rates higher than necessary, which could slow the pace of economic growth by increasing the cost of doing business, as an example, and thereby raise unemployment.
- Excessive government spending with borrowed funds, which could drive inflation higher, eroding citizens' standard of living, creating an uncertain business environment, and discouraging investment.
- Insufficient government spending on services such as policing, health, defense, and education could reduce the effectiveness of key government functions and adversely affect the safety and well-being of the population.
- Raising personal and/or corporate income taxes excessively, thus possibly reducing incentives for certain individuals to work, invest, and innovate.
- Reducing personal and/or corporate income taxes too much and not decreasing government spending accordingly, thereby increasing the budget deficit.

Other potential causes

The state of the economy also depends on factors beyond our Government's control, including:

- *External shocks* – economic downturns or crises in overseas markets could reduce demand for US exports of goods and services, potentially slowing domestic economic growth.
- *Energy shocks* – a sudden, sharp jump in the price of oil and/or natural gas could result in higher prices for products such as gasoline and heating fuel, curbing consumer spending for other goods and services and slowing the overall pace of growth. More expensive energy could also spur broader consumer-price inflation by pushing up prices companies pay for electricity, fuel, and raw materials for the production of chemicals, plastics, and other goods.

- *Financial shocks* – a sharp drop in financial asset prices (e.g. common stocks) would reduce household wealth, potentially limiting consumer spending and driving companies into bankruptcy.
- *Housing bubble* – a steep increase in home prices, followed by a sharp decline, could push the economy into a recession by causing a drop in household balance sheets, consumer confidence, and spending.

Our Government's revenue and its ability to provide needed services in the long run may also be limited by failure to control budget deficits and the national debt.

Without a change in current laws and policies, federal spending, especially for Social Security and Medicare, is forecast to outstrip revenue over the next decade, widening the national debt to 89% of GDP in 2027 from 77% in 2017, according to the Congressional Budget Office. In 30 years, the Congressional Budget Office projects the debt will rise to 150% of GDP. As a result, there is a risk that interest payments on the debt could consume a growing portion of the budget, possibly limiting the federal government's ability to provide other services unless taxes are raised or revenue is otherwise increased. A rising debt also risks pushing up interest rates, reducing savings and investment, and increasing the chances of a fiscal crisis.

Newly enacted legislation and tax avoidance put downward pressure on tax revenues, reducing Government resources.

On December 22, 2017, H.R.1, also known as the Tax Cuts and Jobs Act, became law. Effective January 1, 2018, H.R. 1 reduces the top individual income tax rate from 39.6% to 37%, changes the income tax brackets associated with each tax rate, increases the child tax credit, and provides for a 20% deduction of qualified business income and certain dividends for individuals, among other provisions. The Joint Committee on Taxation, a nonpartisan committee of the US Congress, estimates that H.R.1 will reduce federal income tax revenue by \$1.5 trillion between 2018 and 2027, including \$1.1 trillion between 2018 and 2022. The estimated impacts on annual tax revenues range from a gain of \$33 billion in 2027 to a loss of \$280 billion of revenue in 2019. This works out to an average estimated annual revenue loss of \$146 billion, or about 3% of our Government's annual revenue.

Enforcement of tax laws helps fund our Government. Internal Revenue Service (IRS) enforcement collects revenue from noncompliant taxpayers and, perhaps more importantly, promotes voluntary compliance by giving taxpayers confidence that others are paying their fair share. The IRS's capacity to implement new initiatives, carry out ongoing enforcement and taxpayer service programs, and combat identity theft (IDT) refund fraud under an uncertain budgetary environment remains a challenge. In 2016, the IRS estimated that the average annual gross tax gap—the difference between taxes owed and taxes paid on time—was \$458 billion for tax years 2008-2010, of which it estimates it may collect only \$52 billion (11%). In addition, the IRS estimates that at least \$14.5 billion in IDT tax refund fraud was attempted in tax year 2015, of which it prevented at least \$12.3 billion (85%).

Failure to raise the debt limit could create operational and economic risk.

Gross federal debt, or the sum of the debt held by the public and debt held by government entities (such as the Social Security trust fund) is subject to a statutory ceiling set by Congress. The ceiling, known as the debt limit, has been suspended (there is no limit) until March 1, 2019. Once the limit is reached, the Treasury may not issue new debt to pay bills already incurred by Congress. Since 1960, Congress has raised, extended, or altered the definition of the debt ceiling or suspended it numerous times, most recently effective February 9, 2018. Failure to raise the ceiling when needed could prompt an unprecedented default on Treasury securities, which are generally considered the world's safest government debt and form a foundation for the global financial system. A US default, in turn, could trigger a financial crisis and throw the nation into a recession.

Ongoing efforts to modernize the financial regulatory system and the federal role in housing finance also pose risks to the budget outlook and economic stability.³¹

Following massive bailouts of financial firms during the 2007-2008 crisis, the federal government in 2010 enacted the Dodd-Frank Act, which was intended to strengthen oversight of the financial system and reduce the risk of another crisis. The act has not been tested, however, and it's unclear whether it is adequate to prevent future financial crises that would involve the use of government funds to rescue financial institutions. Our Government also took over two housing-finance agencies, Fannie Mae and Freddie Mac, which guarantee about half of the new mortgages in the US and have combined assets of about \$5 trillion. Our Government's role in housing finance could require the use of significant government funds.

Our Government has significant fiscal exposure to risks associated with a changing environment.³¹

Changes in our environment may pose risk to agriculture, infrastructure, and the health of citizens. Possible effects include coastal flooding as a result of rising sea levels, changes to the productivity of farms, and more intense and frequent weather events, according to our Government Accountability Office. Drought and diminishing water supplies are also risks. Our Government is the owner and operator of infrastructure that is vulnerable to changes in our environment, insures crops that could be damaged, and provides disaster aid in emergencies.

The federal government is also financially liable for cleaning up areas where federal activities have contaminated the environment. Various federal laws, agreements with states, and court decisions require the federal government to clean up environmental hazards at federal sites and facilities—such as nuclear weapons production facilities and military installations. Such sites are contaminated by many types of waste. The GAO reports that the federal government's environmental liability has been growing for the past 20 years and is likely to continue to increase. For fiscal year 2016, the federal government's estimated environmental liability was \$447 billion—up from \$212 billion for fiscal year 1997. However, this estimate does not reflect all of the future cleanup responsibilities federal agencies may face. The GAO has found that federal agencies cannot always address their environmental liabilities in ways that maximize the reduction of health and safety risks to the public and the environment in a cost-effective manner, and that some agencies do not take a holistic, risk-informed approach to environmental cleanup that aligns limited funds with the greatest risks to human health and the environment.

Our Government's revenue and spending and our Constitutional objectives may be significantly affected by social unrest.

Establishing justice and ensuring domestic tranquility have been top priorities since the adoption of the Constitution in 1787. If there is civil unrest, most inputs and outcomes of our Government are affected.

Domestic tranquility has periodically been disrupted by localized rebellions, criminal gangs, labor actions, riots, and mass protests. In 1794, President George Washington raised a militia to suppress the "Whisky Rebellion," an uprising by farmers in western Pennsylvania resisting the imposition of an excise tax on whiskey. In 1932, President Herbert Hoover ordered the army to disperse the so-called "bonus army," a group of more than 40,000 veterans, family members and supporters who gathered in Washington to demand cash redemption for bonus certificates awarded for service in World War I. In 1968, the assassination of civil rights leader Martin Luther King, Jr. sparked a wave of riots across American cities, including Washington D.C., Chicago, Baltimore, Detroit, and Kansas City, causing dozens of deaths, more than 10,000 arrests, and widespread property damage. President Lyndon B. Johnson mobilized more than 10,000 federal troops and national guardsmen to quell the disturbances in Washington. The 1960s also saw mass demonstrations to protest the war in Vietnam, including one in 1969 that drew an estimated half a million protesters to the capital. Most significantly, a dispute between southern and northern states over the institution of slavery resulted in the secession of 11 southern states from the union, followed by a civil war to restore the union that lasted from 1861 to 1865, costing the lives of 620,000 soldiers.

Today, cities, counties, and states operate police forces and court systems responsible for enforcing local laws and maintaining public order; prisons to accommodate those who have been convicted of breaking the law and sentenced to incarceration; and fire departments to prevent and fight fires. The federal government also operates a number of law-enforcement agencies, including the Federal Bureau of Investigation and the Drug Enforcement Administration. Government also seeks to ensure the safety of consumer products, food and pharmaceuticals, and transportation systems; protect the environment; and protect the population against natural disasters.

Our Government's ability to maintain order and protect the population from a variety of threats faces a number of risks and challenges, including:

- Natural disasters such as hurricanes, earthquakes, tornadoes, and forest fires;
- Riots and civil unrest, with potential causes including racial tensions and perceptions that inequality is rising and economic mobility declining;
- Nuclear disasters, caused by an accident or sabotage;
- Terrorist attacks, either homegrown or originating abroad;
- Individuals or groups that seek to harm others, including by committing homicides, and the inability of our Government to control all individuals despite incentives and laws; and
- War with a powerful adversary.

Our Government's ability to achieve its vision is affected by foreign relations.

Cultivating friendly relations with foreign powers that share our values as well as improving relations or avoiding conflicts with actual and potential adversaries are essential to providing for the common defense. When necessary, we go to war to protect our vital national interests. Threats to our national security include:

- *Russia*, a nuclear power and principal successor to the USSR, maintains aspirations to world leadership on a par with the US and seeks to assert its influence in the Middle East, Iran, parts of Latin America, and former Soviet states, principally Belarus and Ukraine, that it considers to be essential to its security. There is a risk that Russia, under President Vladimir Putin, will seek to annex former Soviet states, including the Baltic States, which are members of NATO. An attack on one NATO member would be considered an attack on all.
- *China*, which also possesses a nuclear arsenal, is a rising economic force that's using its financial muscle to secure supplies of strategic raw materials in Latin America and Africa and expand its armed forces. China is seeking to project power beyond its shores with the purchase of four aircraft carriers and is reportedly building its own (possibly nuclear-powered) carrier. China has laid claim to the Spratly Islands, which occupy a key strategic position in the South China Sea and possess potentially significant oil and natural-gas reserves. The islands are also claimed by Vietnam, Cambodia, the Philippines, Malaysia, and Taiwan, making them a potential regional flashpoint.
- *Global terrorism* – Groups such as Islamic State have taken advantage of instability in the Middle East, including the collapse of Libya, civil war in Syria, and a weak, US-backed regime in Iraq, to extend control over territory and natural resources that can then be used to stage terrorist attacks across the globe. Such groups are difficult to counter because they usually deploy suicide attackers and their radical ideology, alien to our own values, makes it difficult if not impossible to negotiate with them.
- *Nuclear proliferation* – North Korea already possesses nuclear weapons and is working on delivery systems, potentially posing a threat to our allies in South Korea and Japan, and possibly the US. Pakistan, India, and Israel also possess nuclear weapons, and Iran has the capacity to develop them. Any of these nations could become embroiled in a regional conflict that ultimately threatens US interests and security.
- *Alliances* – Our Government has concluded alliances and partnerships with a number of nations around the world, including Turkey, Pakistan, Israel, and Saudi Arabia. The goals and interests of these nations may not be identical to our own, and they may become embroiled in local conflicts that end up involving the US.
- *Cyberwarfare* could disrupt our military capabilities and command and control; adversaries could also create economic havoc through cyber-attacks on the financial system, the power grid, our water sources, and nuclear power plants.

Our Government's ability to secure the financial future of retirees is threatened by the risk of insolvency facing Social Security trust funds and the Pension Benefit Guaranty Corporation.³¹

The cost of providing Social Security and disability benefits is rising faster than revenue generated by the payroll tax. Reserves of the DI Trust Fund may be depleted as early as 2021, and reserves of the OASI Trust Fund may be depleted as early as 2030, according to projections by the funds' trustees. See Exhibit 99.06 for more information. The Pension Benefit Guaranty Corporation (PBGC), which backs the pension benefits of nearly 40 million Americans, may not be able to meet its long-term obligations, partly because the decline in the number of defined-benefit plans is reducing premium income. According to the Government Accountability Office, the PBGC's deficit widened to a record \$76 billion as of September 30, 2017. Its projections show that the risk of insolvency in its multiemployer program could exceed 50% in 2025.

Promoting good health, especially for the elderly, faces key challenges.³¹

First, the Medicare Hospital Insurance Trust Fund is forecast to be depleted as early as 2023, reflecting rising health-care costs and a relative decline in the number of workers paying payroll taxes. See Exhibit 99.07 for more information. Second, epidemics, such as those caused by the Ebola or Zika viruses, could bring about widespread illness and loss of life.

Failure to maintain and upgrade the nation's surface transportation system could curb economic growth and adversely affect the quality of life for citizens.³¹

The nation's highways, mass transit, and rail systems are under growing strain, reflecting increasing congestion and freight demand, and traditional funding sources are eroding. For example, federal taxes on gasoline haven't been raised since 1993. Inflation-adjusted revenue from motor fuel taxes that support the Highway Trust Fund, a major source of federal surface transportation funding, is declining, according to the Government Accountability Office, and our Government has been using general revenues to maintain spending levels. This trend is forecast to continue as

consumers turn to vehicles that are more fuel efficient or that use alternative energy sources. The Congressional Budget Office estimates that \$107 billion in additional funding would be needed between 2021 and 2026 to maintain inflation adjusted spending on current levels.

Recruiting and retaining skilled Government workers is key to delivering essential, and in many cases life-saving, services to the American people.³¹

High levels of training and education are required to address complex challenges such as disaster response, national and homeland security, and rapidly evolving technology and privacy-security issues. However, current budget and long-term fiscal pressures, declining levels of federal employee satisfaction, and a potential wave of employee retirements could produce gaps in leadership and institutional knowledge.