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Comments on exposure draft, *Comprehensive Long-Term Projections for the U.S. Government*

Q1. This exposure draft proposes reporting that would support FASAB Objective 3, Stewardship, and in particular, Sub-Objective 3B:

> Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.[1]
>
> Sub-Objective 3B: Federal financial reporting should provide information that helps the reader to determine whether future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due.[2]

More detailed discussion of the reporting objective and the objectives of fiscal sustainability reporting can be found in ….

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[1] SFFAC 1, par. 134.

[2] SFFAC 1, par. 139.

Do you believe that the proposed reporting adequately supports the above objectives? Are there different reporting requirements that might better support the above objectives or that you believe should be added to the proposed requirements in this exposure draft? If so, please explain.

The proposed reporting fails to meet Objective 3, primarily for two reasons. First, statements of “financial condition” are, generally, balance sheets. These are constructed with two columns: one for liabilities, and the other for assets. The proposed “federal financial reporting” contains no mention of the assets that correspond to the liabilities. For example, it would treat the obligations of the Social Security system as a liability. But the same liability is, of course, an asset to the public. Nowhere is this Social Security wealth reported or even remarked on. The *nation’s* financial condition is a combination of the financial condition of the government and that of its citizens. Hence the Social Security wealth of the current population is just as real as the liabilities that support it. Put another way, a transfer program, from one group of citizens to another, merely transfers resources. It does not increase or diminish them.

Second, it is impossible to assess “the impact on the country of the government's operations and investments” without assessing the *economic effects* of such operations and investments. If a government program produces a higher rate of growth and lower rate of unemployment, then that is surely an “impact on the country of the government’s operations and investments.” But the procedures explicitly propose to ignore those impacts. That is, irrespective of the government action, the economic projections used to assess that action will not be changed. The assumption will be made that there is *no* effect of that action on the rate of economic growth, the rate of employment and unemployment, the mix between consumption and investment, or any other pertinent economic variable. The inference will therefore be drawn that the program necessarily involves costs – associated with the debt -- without benefits, associated with higher growth or lower unemployment. This procedure is *prima facie* absurd.

The proposed reporting fails to meet Sub-Objective 3B, in part because there is no clear definition of what is meant by “budgetary resources.” If what is meant is “tax revenue,” the definition is totally inappropriate. The government does not need tax revenue sufficient to match spending in order to “sustain public services and meet obligations as they come due.” This is obvious: the government almost never has sufficient tax revenue for that purpose. This is why we have a national debt to begin with. Yet the US federal government has never, in 230 years of operation, lacked for “budgetary resources” sufficient to “sustain public services and meet obligations as they come due.” This is also obvious, insofar as the government has never defaulted on its obligations.

If, on the other hand, the term “budgetary resources” means “tax revenues and public borrowings” sufficient to “sustain public services and meet obligations as they come due,” the standard would be intended to inform the public about the borrowing capacity of the government of the United States. Yet the procedures contain no information about and no guidance as to how to assess this question.

Can we imagine that the US domestic sector will reach a point that it will refuse to accumulate dollar claims on our government, in the form of currency and interest-bearing government bonds. Would we reach the point where American businesses would ever sell something and refuse US currency? If households had more currency than desired would they refuse to substitute it for Treasuries? Would private banks refuse reserve credits? Looking overseas, it might be interesting, for example, to know whether there is a point at which, despite continuing surpluses in China's trade with the United States, the People's Bank might become unwilling to add to its stock of US Treasury bonds (and whether, if that were to happen, it would matter). There is no mention, let alone analysis, of the policies of the People's Bank of China in this document.

Finally, again on the assumption that "budgetary resources" includes public borrowing, the proposed procedure betrays a false supposition that there is some finite limit to the nominal value of the bonds that can be issued by the U.S. Treasury. No such limit exists. Nor does the government have to issue securities in order to spend. As an operating matter, it spends first and issues securities later, transferring funds from interest-bearing reserve accounts at the Federal Reserve to interest-bearing Treasury securities.

The consequence of excess issue is not a refusal (on the part of foreign creditors or anyone else) to hold the bonds; it is rather a possible devaluation of the dollar and a possible decline of the real terms of trade of the country. But this possibility – an appropriate concern up to a point and under certain conditions – is also ruled out by the assumption of unchanged economic conditions. So again, the standard fails to meet Objective 3, of promoting understanding of the Nation's financial condition.

Q2. In this proposed Statement, projections are prepared not to predict the future, but rather to depict results that may occur under various conditions. Accordingly, projections require assumptions to be made about the future. This exposure draft proposes broad and general guidance for selecting policy, economic, and demographic assumptions for long-term projections with a primary focus on the future implications of the continuation of current policy without change for federal government public services and taxation. The guidance … explains that although current law is a reasonable starting point in selecting policy assumptions, a simple projection of "current law" would not always reflect current policy without change. Examples are provided.

Do you believe that the guidance for assumptions is appropriate? If not, please suggest alternative guidance. Please provide the rationale for your response.

Comments under Q1 above relate to the issues as stated in paragraph 19. Guidance for "policy assumptions" is otherwise generally reasonable.

But there is no guidance whatever on the choice of economic assumptions. This is a serious shortcoming, particularly insofar as it has become a habit for the Social Security actuaries to violate generally accepted accounting practices when making economic projections relevant to the financial flows of the Social Security System. Specifically, past performance is characteristically ignored, and future projections are systematically pessimistic with respect to past performance. Guidance should specifically address two issues: the proper relationship of economic projections to generally-accepted accounting principles, and the appropriate ways in which to factor into projections the effect of policy changes on economic performance. As the comments under Q1 make clear, it is inappropriate merely to assume that economic policies cannot affect economic outcomes.

Further, paragraph 20 refers to “surpluses, deficits and debt.” This should be expanded to include that other accounting category: “assets.” Suitable guidance should be developed to permit appropriate measurement of and accounting for assets, in both the public and the private sectors. Assets in the private sector are no less important for federal fiscal sustainability, since they provide the tax base.

Q3. This exposure draft proposes a basic financial statement[3] and disclosures. (Description begins at paragraph XX and an illustrative example of the basic financial statement is provided in Appendix B.) The Board has indicated that the primary audiences for the consolidated financial report of the U.S. Government (CFR) are citizens and citizen intermediaries such as journalists and public policy analysts.

Do you believe that the basic financial statement and disclosures would be understandable and meaningful for the primary audiences of the CFR? Please note any changes that you believe should be made to the proposed requirements for the basic financial statement and/or the disclosures.

Again, as noted under Q1 and Q2, a balance sheet is not a balance sheet unless it accounts for assets as well as liabilities. It is therefore inappropriate to refer to the proposed document as a “financial statement.” In general, disclosures under the format suggested will be meaningless, and therefore “understandable” only to those who do not understand very much.

The proposed time horizons are also problematic. They are so long that they will involve making assumptions that are, in the nature of things, impossible. An example is the assumption of current Medicare forecasts that health care costs will continue to rise indefinitely more rapidly than nominal GDP, so that the share of health care in GDP rises without limit. This cannot happen. No understanding of the issues is gained by a procedure that necessarily incorporates unrealistic assumptions of this type.

[3] The basic financial statement will be presented as RSI for a period of three years and subsequently as a basic financial statement.

Further, the choice of time horizon is arbitrary, so that the present value of future "liabilities" can be blown up to any size, simply by changing time horizons and discount rates. But most readers of the proposed document are unlikely to be aware that the exercise is purely arithmetic in this sense.

Q4. The Board is proposing that the basic financial statement display the difference between projected revenue and projected spending, and that the fiscal gap (the change in non-interest spending and/or revenue that would be necessary to maintain public debt at or below a target percentage of gross domestic product (GDP)) must be reported either on the face of the basic financial statement or in a disclosure. Also, the fiscal gap may be reported for a specific debt level or over a range of debt levels …). Both options for reporting fiscal gap are illustrated in Appendix B … (narrative on the face of the financial statement) and … (disclosure)). See paragraphs … in the Basis for Conclusions for an explanation of the pros and cons of the options.

a. Do you agree with the flexible requirements for reporting fiscal gap?

b. Do you believe that the illustrative disclosure (Illustration 8 in Appendix B) is clear and understandable?

The concept of a "fiscal gap" implies as a policy norm that it would be desirable to "maintain public debt at or below a target percentage of gross domestic product." No such policy objective exists in any statute of the United States Government. Nor can such an objective be justified by reference to any known economic theory. There are times when the level of debt in relation to GDP should rise. There are times when it should fall. There are times when it *will* fall or rise irrespective of policy. To repeat, there is no justification in law or theory for attempting to legislate in an accounting standard a debt-to-gdp ratio as a target for economic policy.

Further, the guidance fails to distinguish between total public debt, public debt held by the public, guaranteed agency debt, and implicit liabilities in the form of guarantees. The guidance at FAQ 3 refers to these concepts as "alternatives" but fails to take a position as to which alternative is meaningful and which is not. As such, the measure of the so-called "fiscal gap" is essentially meaningless.

Q5. Finite and infinite time horizons for fiscal projections are discussed in the Basis for Conclusions… This exposure draft proposes the following requirements regarding time horizons for projections: (a) the projections presented in the basic financial statement should be "sufficient to illustrate long-term sustainability" (for example, traditionally the Social Security program has used a projection period of 75 years for long-term projections); (b) projections for both a finite and an infinite horizon should be provided, one in the basic financial statement and the other in the disclosures; and (c) either the basic financial statement or the disclosures should include projections for Social Security and Medicare based on the time horizon used for long-term projections for Social Security and Medicare in the Statement of Social Insurance (SOSI).

a. Do you believe that the above requirements for time horizons are appropriate to meet the reporting objectives of Fiscal Sustainability Reporting? Specifically, do you believe that data for both finite and infinite horizon projection periods should be reported? If not, please explain.

b. Do you believe that there should be a specific time horizon requirement (for example, 75 years) for the basic financial statement for Fiscal Sustainability Reporting and/or the SOSI? If so, what time horizon do you believe should be required?

The proposed compromise between 75-year and infinite horizons is to show them both. We favor this compromise, as it will help to remind readers that the exercise should not be taken seriously. To make the problem even clearer, the report should include estimates at intermediate intervals: 25 years, 50 years, 100 years, 200 years, 500 years, and a millennium. Each should be reported with a range of discount rates: zero, the rate of growth, and twice the rate of growth. All of these projections should be in the basic financial statement, of course, since they are all equally reasonable and relevant, and the document should not try to discriminate between them.

[To make this point another way, consider: who could have foreseen in 1900 events such as the Great Depression, the New Deal, and the war in Iraq? In any event, for Social Security and other very long range programs, what matters much more are demographics, and perhaps technology and economic growth, about the latter of which very little can be known. "Financing" is by comparison irrelevant. If by 2083 everyone is over age 67, no financing scheme will allow us to meet our commitment to let people retire at a decent living standard. This, however, is most unlikely.]

Further, the concept of "receipts" in the calculation of the fiscal gap must be clarified. It should, of course, include receipts from borrowing as well as tax receipts. Again, there should be guidance on how the report seeks to evaluate sustainability of borrowing, as discussed under Q1 above. An explicit examination of this question will almost surely reveal that the Board has no understanding of it.

The Board's mission is to issue reporting requirements for the federal government's general purpose financial statements, and not to recommend budget policy. This exposure draft proposes a title for the basic financial statement: "Long-Term Fiscal Projections for the U.S. Government." An alternative title, "Statement of Fiscal Sustainability," might imply to some that the Board has established or plans to establish specific rules that define "fiscal sustainability" and/or budget rules that would result in fiscal sustainability. However, others have indicated that the "plain English" meaning of the words "fiscal" and "sustainability" should be adequate, and that the title "Statement of Fiscal Sustainability" might be more appropriate.

The Board's working definition of "fiscal sustainability" is explained in the Basis for Conclusions, paragraph A3. The concept of "Financial Condition" is explained in the Basis for Conclusions, paragraphs...

Do you believe that the basic financial statement should be titled
a. "Long-Term Fiscal Projections for the U.S. Government,"
b. "Statement of Fiscal Sustainability,"
c. "Statement of Financial Condition," or
d. A title not listed above (please specify).
Please explain the reasons for your choice.

"Fiscal sustainability" is defined in A3 as a condition of policy under certain arbitrary economic assumptions such that "public debt does not rise continuously as a share of GDP." The difficulty here is that the assumption of a stable inflation rate under hypothetical conditions of excessive fiscal expansion is untenable. Under those conditions, the dollar would fall, inflation and therefore nominal GDP would rise, and the public debt will eventually cease to rise as a share of GDP. This effect is known to economists as the "inflation tax." The inflation tax is an automatic stabilizer, which prevents excessive growth of real demand. It therefore vitiates the problem of "fiscal sustainability" as defined in A3.

An appropriate title might therefore be "Projections of federal revenues, expenditures and borrowings under arbitrary economic and policy assumptions."

Q6. This exposure draft proposes a minimum level of disaggregation for the basic financial statement. For projected receipts, major programs such as Medicare and Social Security would be shown separately from the rest of government. For projected spending, major programs such as Medicare, Social Security, and Medicaid would be shown separately from the rest of government. (See paragraphs ….)

a. Do you believe that the above general guidance provides for an appropriate level of disaggregation in the basic financial statement? Please explain the basis for your views.

b. Do you believe that specific line items (instead of or in addition to the "major programs" required by paragraph … of the ED) should be disaggregated in the basic financial statement? If so, please identify the line items and explain your reasoning.

The purpose of program budgets is to discipline the program. It is certainly appropriate to hold programs accountable to ensure that they do what they are supposed to do. There is little public interest in reporting after the fact the fiscal balance of particular portions of the budget.

This exposure draft proposes that disclosures should explain and illustrate the major factors impacting projected receipts and spending (such as the rising cost of health care) (see paragraph …). Illustrative examples in Appendix B begin on page …).

a. Do you believe that an explanation and illustration of the major factors impacting projected receipts and spending will be helpful to readers? Please explain the basis for your view and note any recommended changes in the requirements.

b. Do you believe that the display of a range for major cost drivers and/or major programs, as shown in Illustrations 1a and 1b in Appendix B should be optional or mandatory? Please explain the basis for your view.

No comments.

Q7. This exposure draft proposes that the results of alternative scenarios be provided. Paragraph … provides that the present value of projected receipts, spending and the net of receipts and spending be presented for each alternative scenario. Optionally, projections for alternative scenarios may be displayed in a table format (see Illustration 7 in Appendix B).

a. Do you believe that the proposed requirement for alternative scenarios is appropriate? Please explain the basis for your view.
b. Do you believe that the requirements for additional information regarding alternative scenarios are sufficient? If not, please explain the basis for your view and what additional information you propose.

So far as transfer programs are concerned, given that both assets and liabilities should be reported, a few exercises will demonstrate that the two necessarily balance. (The government's deficit is the private sector's surplus.) Therefore it would seem unnecessary to present many alternatives, since all would show the same thing.

.This exposure draft proposes disclosures consisting of narrative and graphic displays to effectively communicate to the reader historical and projected trends and to help the reader understand the major drivers influencing projected receipts and spending. …

a. Do you believe that the disclosures would help the reader understand the basic financial statement?

b. Are there any items that you believe should be added to, or deleted from, the disclosures? If so, please explain.

c. Do you believe that the final accounting standard should include an appendix that displays illustrative disclosures (see Appendix B)? Why or why not?

The problem of “understanding” is addressed above. The “basic financial statement” is, as proposed, a document that defies understanding. Efforts to make it clear are therefore somewhat beside the point. Public purpose would be better served by efforts to make it confusing. I would therefore oppose the inclusion of “scare charts” such as those included in the draft.

Q8. The Frequently Asked Questions (FAQs) at Appendix C provide a “plain English” explanation of terms and concepts used in long-term projections.

a. Do you find the FAQs helpful?

We found the FAQs very helpful, as they helped to establish that the questions we raise above have not, in fact, been thought through in the drafting of the document.

Q9. Effective Date and Phased Implementation: This proposed Statement would be effective for periods beginning after September 30, 2009 with earlier implementation encouraged. This proposed Statement would require that the financial statement and the disclosures be included in Required Supplementary Information (RSI) for the first three years of implementation, and basic information (for example, basic financial statement and disclosures) for all subsequent years.

a. Do you believe that this implementation date is reasonable and appropriate?

b. Do you agree with the phased implementation period (3 years)?

c. Do you believe that some or all of the required information should remain as RSI after the 3-year implementation period? If so, please explain the basis for your view.

The proposed Statement should not be implemented.

Q10. A significant minority of members supported a proposal that there should be RSI regarding trends in the proportion of U.S. Treasury debt held by foreign investors. This information would remain as RSI and would not be subject to the phased-in implementation in paragraph …in the Basis for Conclusions for a discussion of this proposal and Illustration 10 in Appendix B.)

a. Do you believe that including RSI regarding the foreign holdings of U.S. Treasury debt would be relevant and useful in meeting the objectives of fiscal sustainability reporting? Please explain why or why not.

b. Do you believe that the illustrative example provided in Appendix B is clear and understandable?

If so, these trends should be described as votes of confidence in the US dollar and strength of the Treasury. Of course, the foreign holding of U.S. debt results from the willingness of foreigners to sell to us their excess output, and to accumulate dollar assets; it is an attribute of their confidence in the dollar as a reserve asset.

Q11. A minority of members supported a proposal that if the proposed Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant fiscal gap, RSI (not subject to the phased-in implementation in paragraph …) should include the identification, explanation, and fiscal impact of one or more policy alternatives that would reduce the fiscal gap. (See paragraphs … in the Basis for Conclusions for a discussion of this proposal.)

Do you believe that if the proposed Comprehensive Long-Term Fiscal Projections for the U.S. Government indicate a significant fiscal gap, the statement and disclosures be accompanied by RSI that includes identification, explanation, and fiscal impact of one or more policy alternatives that would reduce the fiscal gap? Please explain why or why not.

The board has not established its competence in a basic matter of accounting. It should certainly not embarrass itself by attempting to prescribe policy.

Q12. This exposure draft proposes that additional information that may be helpful to readers in assessing whether financial burdens without associated benefits were passed on by current-year taxpayers to future-year taxpayers (sometimes referred to as "inter-period equity" or "inter-generational equity") be included as one way to meet a disclosure requirement for providing context for the data in paragraph …n the Basis for Conclusions for a discussion of this proposal.)

Do you believe that such information should be optional (as proposed in the exposure draft) or required? Do you believe that further research and analysis should be performed by FASAB to improve the disclosure of such information? Please explain the basis for your views and note any recommended changes for the presentation of inter-period or inter-generational equity.

"Inter-generational accounting" is an experimental and unsound concept. It should not be included in any government document.