CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

February 13, 2009

Ms. Wendy M. Payne
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Payne:

Attached please find the Congressional Budget Office's comments on the *Accounting for Social Insurance, Revised* exposure draft.

Please feel free to contact David Torregrosa on my staff at (202) 225-6926 with any questions or for further discussion.

Sincerely,

Douglas W. Elmendorf

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Director

Attachment

CBO Comments on FASAB Statement of Social Insurance Exposure Draft
Draft: February 13, 2009

CBO believes that on net, the proposal would improve the Statement of Social Insurance. However, there are two shortcomings in the current proposal that would considerably limit its use to policymakers and might even present a misleading message about the state of federal finances. Moderately expanding the presentation in two ways would make the SOSI substantially more useful to readers and relevant to the policymaking process.

First, the draft requires that Social Security and Medicare cash flows be presented as a share of GDP and taxable payroll. However, all present value figures are shown in dollars only. The standard should require that present value measures be shown as a share of the present value of GDP and taxable payroll over the same period.

The current SFFAS 17 requires that cash-flow measures be shown in both nominal dollars and relative to GDP and, if applicable, taxable payroll. The proposed amendment would no longer require the values to be shown in nominal dollars, a great improvement.[1] (For example, the Social Insurance Supplemental Information in the 2008 Financial Report presents the confusing and misleading fact that in nominal dollars, OASDI outlays will grow to over $20 trillion by 2080 (Chart 2, p.123).)

Similarly, in the discussion of Fiscal Sustainability Reporting, the board notes that presenting present values "in a meaningful base such as GDP is required to assist readers in understanding large dollar amounts." (A49a)

In the SOSI currently, that requirement applies only to the cash flow measures. But nothing in the current or proposed standard *prohibits* other values from being presented relative to a meaningful base. Yet in the current SOSI and in the appendices of the draft, *every* value other than the cash flows is given in dollars only. As a result, readers will have great difficultly interpreting the policy implications of the report.

CBO strongly recommends that the Board require all values in the SOSI to be presented as a share of a relevant base, such as GDP, taxable payroll or both. Preferably, that presentation would come before the tables that show dollar values.

> <u>Current values (e.g., the Table of Key Measures and the Balance Sheet)</u>: Even for expert readers who know the current value of GDP (about $14 trillion in 2008), not presenting current values as a share of GDP makes interpreting the data difficult. Simply showing these values as a share of GDP would make the policy implications of the data much clearer for all readers.

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[1] Instead, the draft says: "For the OASDI and HI programs, the actuarial projections should be expressed as a percentage of taxable payroll and gross domestic product (GDP). For the SMI program, the actuarial projections should be expressed as a percentage of GDP. For the RRB program, the actuarial projections should be expressed as a percentage of taxable payroll. For the Black Lung and UI programs, the actuarial projections should be expressed in constant (or inflation-adjusted) dollars."

Present values (e.g., Statement of Social Insurance and Statement of Changes in Social Insurance Amounts): Presenting present value measures in dollar values places an even greater burden on the reader. Virtually no one knows the present value of GDP or taxable payroll over the next 75 years. The Social Security trustees project the present value of GDP over the next 75 years to be $768.4 trillion.[2] As a result, the economic meaning of the numbers is obscure. Most readers are likely to react to "$1 trillion" differently than to "0.13 percent of GDP," though the values are equal.

Second, the current structure of the Statement of Changes in Social Insurance Amounts (SCSIA) only analyzes changes to the closed group measure and does not distinguish between the portion of the increase that is due to the addition of new participants and the growth that occurs simply because the reference date has shifted forward by a year.

An explanation of changes in the financial statement from the previous year is essential for readers to understand the government's financial position, and the additional Statement of Changes in Social Insurance Amounts (SCSIA) is an important step in that direction. However, it has several shortcomings.

First, the proposed SCSIA would apply only to the closed group measure. It should instead focus on changes in the open group measure. It is inconsistent to include the open group measure in the SOSI balance sheet and the closed group measure as a supplement, and then address only the closed group measure in the SCSIA. (CBO does not object to explaining changes in the closed group measure or other values as supplementary information in the SCSIA.)

Second, it does not allow readers to distinguish between the portion of the change in the measures that are due to ongoing real transactions with economic significance and those that are simply due to the change in the reference date.

As the Board notes, "A present obligation requires a past transaction or some other event." (A102). Readers may believe that an increase in the closed group balance results from an actual economic transaction. In fact, the balance can change for four general reasons, only the first two of which result from a real transaction or event:

1. Legislative change
2. Implementation of existing law (e.g., a group of participants enters the program)
3. Change in data, assumptions, or methods
4. Change of the reference date. (Present value projections are discounted to a different year. Therefore, even absent any real economic change, the value increases by the *nominal* value of the discount rate. Part of that growth is due to inflation, which has no economic or policy meaning. The other part of the

[2] Table IV.B6, Note 2 (p.62) of the OASDI Trustees Report.

growth is equal to the real interest rate. Note that this change does not include any real information, since it could have been computed the previous year.)

The proposed statement (Appendix E) has three lines with the effect of new data and assumptions (on demographics, economics, and health costs) and a line on the effect of methodological changes. It also has a line that shows the effect of legislative changes. However, the effects of implementing existing law and changing the reference date are not separated.

Finally, it is particularly important that the analyses of changes be shown as a share of GDP and/or taxable payroll. Some of the same factors that change the closed group measure (or other value of interest) can change GDP. For example, an increase in the assumed rate of inflation would increase the dollar value of a measure but would have little to no effect on that measure as a share of GDP. Similarly, a higher real interest rate would lower the present value of outlays but would also lower the present value of GDP. When only dollar values are presented, readers cannot tell how much of the difference between projected outlays under different assumptions is due directly to changes in the size of the economy and how much reflects a change in outlays as a share of the economy.

Responses to specific questions:

Q1. Do you believe that key measures should be presented in the MD&A as described in this exposure draft?

Yes.

Q2. Do you believe that the balance sheet should present a line item for the closed group measure as described in this exposure draft?

The closed group measure should not be a central part of the SOSI. As the members of the board who oppose including the closed group measure accurately observe, "the closed group measure … contradicts the pay-as-you-go financing principle on which the social security program was designed." (A145). However, as long as that point is made clearly and conspicuously, we see no reason to exclude the closed group measure from being shown as a supplementary measure.

Q3. Do you believe that the SOSI should have a summary section as described in this exposure draft?

Yes; a summary will be useful to many readers.

Q4. Do you believe there should be a new basic financial statement explaining changes to the present value amount included in SOSI?

Yes, but it should be greatly expanded. See discussion above.

Q5. Do you believe that an accrued benefit obligation should be disclosed as described in this exposure draft?

As for the closed group measure, we do not believe that the accrued benefit obligation should be part of the balance sheet, but we do not object to including it as supplementary information. However, if it is included, its meaning should be clearly described so readers understand that like the closed group measure, the accrued benefit obligation is not consistent with the pay-as-you-go design of social insurance programs.

Q6. Do you believe that the Statement of Net Cost (SNC) should not include a line item for the change during the period in the closed group measure, which would be presented below exchange revenue and expenses and not included in the totals for these classifications?

We agree with the proposal to continue to exclude the change in the closed group measure. This is consistent with the presentation of the closed group measure only as a supplement to the SOSI, not in the balance sheet

Q7. Do you agree with the Board's decision to feature the closed group measure?

As explained above, we do not oppose inclusion of the closed group measure, but we believe it should be only a supplemental measure and should not be featured. Rather, the SOSI should focus on the open group measure. The SOSI should also explain that the open group measure is consistent with the pay-as-you-go design of social insurance programs, while the closed group measure is not consistent with that principle.

Q8. Do you believe that a general requirement that allows flexibility in the sensitivity analysis presented will produce better information regarding the sensitivity of social insurance programs?

Yes.