April 20, 2007

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
441 G Street NW, suite 6184 (mailstop 6K17V)
Washington, D.C., 20548

Dear Ms. Comes:

This letter comments on your document, Accounting for Social Insurance, Revised, of Oct 23, 2006. Although I am a Senior Fellow at the Center on Budget and Policy Priorities, I write based on my experience as a member of the professional staff of the Committee on the Budget of the U.S. House of Representatives, on which I served for 21 years.

In summary, I feel that the approach advocated by the "Primary View" is misguided, while the approach advocated by the "Alternative View" is considerably less so. The two views and the comment letters received to date raise many issues; I will comment on a few of them.

1. The Alternative View correctly stresses the point that the people, through their elected representatives, are sovereign and are not compelled to pay future social insurance benefits; such laws may be amended to reduce those benefits, in the past have been, and in the future likely will be. It is therefore misleading to the public and Congress to treat the projected future costs of social insurance programs as current liabilities. Most importantly, they are not equivalent to, say, such liabilities as future interest payments on debt that has already been issued, or future disbursements to cover loan guarantee contracts or flood insurance contracts that have already been signed.[1]

2. The Alternative View also correctly points out that OASDI and HI are not "exchange transactions" in any meaningful sense, because the taxes to pay for them are compulsory and the benefits are mandated by law, not created by a voluntary, business-type transaction. Yet this is really just a different way of making the first point, which is that OASDI and HI benefits are established by law and may be amended or repealed by law, notwithstanding the payroll taxes that current or prospective beneficiaries have paid.

3. Broadly, OASDI and HI do not, as a matter of law, confer any more or any less right to a future benefit than do existing laws providing food stamps, supplemental security insurance (SSI), farm price supports, Medicaid, the earned income tax credit, or the mortgage interest deduction. In each case, some or all members of society have been provided a safety net as insurance against certain types of adverse outcomes or a subsidy to undertake certain types of activities. FASAB recognizes those outcomes — and the costs associated with them — only

[1] The same point applies (notwithstanding the view of FASAB) to future civil service and military retirement benefits or retiree health benefits, which may also be reduced or repealed. True, there is merit in considering those deferred employee benefits as though they were immutable — and therefore accruing them — when an agency attempts to compare the long-term costs of achieving a public purpose through federal employees, contract employees, private-sector contracts, or greater investment technology. This suggests that such costs should be accrued for purposes internal to an agency's marginal cost analyses, but that the accrued costs should be washed out (or ignored) when reporting the current cost of government as a whole and current deficit or surplus as a whole.

when they actually occur. OASDI and HI differ from these other programs *only* in that they are financed by earmarked taxes (and the interest any temporarily "excess" taxes earn), and so should likewise have their costs recognized only when actually occur. Indeed, as the Alternative View points out, in HI and DI there is no relation between the amount of payroll taxes an individual pays and the level of benefits he receives, and this is true to a reasonably large extent even for OASI. Food stamps and SSI work much the same way; taxpayers pay for them through general revenues and receive a benefit in the form of insurance against bad outcomes with respect to disability and poverty.

4. The fact that OASDI and HI are supported by earmarked taxes while other programs I mentioned are supported by general revenues makes no economic or legal difference. It does, however, create a greater degree of political commitment to OASDI and HI in the eyes of the public and many members of Congress. That commitment represents a *political agreement* providing, in essence, that OASDHI benefits shall be paid for over time[2] only from earmarked taxes. One consequence of this political deal is to treat OASDHI as independent of the rest of the budget; if the "trust funds" supporting OASDI and HI are solvent, the benefits should not be cut regardless of the state of the rest of the budget, and if insolvency threatens those trust funds, the solution must be obtained from increases in earmarked taxes or cuts in program benefits, not from general-revenue transfers. The annual reports by the trustees of the OASDI and HI trust funds do a good job of projecting and explaining the short-term, mid-term, and long-term status of those trust funds, and consequently the degree to which the political deal is likely to require higher dedicated taxes or lower benefits. There is no need for FASAB to try to replicate these reports.

5. Because Medicare Parts B & D are not supported by earmarked taxes, the political deal inherent in OASDI and HI does not apply to the costs of Medicare B&D. It is therefore meaningless to discuss or estimate the "unfunded liabilities" of Medicare B&D. More precisely, the concept of unfunded liability has no more meaning for Medicare B&D than it does for food stamps, the Department of Defense, elementary and secondary education, SSI, or the mortgage interest deduction. It therefore follows that treating the future net cost of Medicare B&D as an unfunded liability and adding it to the actuarial shortfall in the HI trust fund is at best misleading. In this respect, both the Primary and Alternative Views have gone off track.

6. To the extent that either the Primary or the Alternative View believes that calculating a present value is appropriate, both views express the resulting present value first of all in billions of current dollars. This is both confusing and misleading. Neither the public nor members of congress distinguish PVs from current figures such as one year's GDP or the current level of household assets, even those such comparisons are inherently wrong. Moreover, the year-to-year change in dollar PVs will increase simply because the stream of expected costs is discounted to this year rather than to last year, even if there is no change from one year to the

[2] The phrase "over time" is an important part of the political deal, and is accomplished by having the OASDI and HI trust funds earn interest on their balances. It must be recognized that the *rest of government* is in no way subsidizing those trust funds or otherwise being harmed by their existence; if the trust funds did not lend their balances to the rest of government, the rest of government would borrow from the public instead. The annual deficits and accumulated debt of the rest of government is the same, and the amount of interest payments made by the rest of government is the same, whether the OASDI and HI trust funds invest their assets in Treasury securities or in gold, private equities, or lottery tickets.

next in the projected nominal stream of costs or income that that makes up the basis for the PV calculation. As an example of the misleading results that can occur, you have only to look at the April 23 reports OASDI and HI trustees reports. They reported that the unfunded liabilities of OASDI and HI each fell from 2005 to 2006 as a percent of GDP and as a percent of payroll (notwithstanding one "bad year" added to the end of the valuation period). Yet they reported that that the unfunded liabilities of OASDIO and HI grew in dollar terms. The right answer is that the trust funds are now projected to be slightly more solvent; the wrong answer is that they are now projected to be slightly less solvent. For this reason alone, PVs should never be expressed in dollar terms, but rather relative to the PV of GDP, of program benefits, or program revenues (if such there be), or of a program's tax base such as taxable payroll. Most particularly, treating the year-to-year change in an accrued dollar value as equivalent to an annual deficit is simply wrong for any purpose of government accounting.

7. Finally, the Alternative View suggests the creation of a long-term portrayal of *all* government costs and revenues. This can be meaningful, and the Center on Budget and Policy Priorities has undertaken just such an analysis; see http://www.cbpp.org/1-29-07bud.pdf and http://www.cbpp.org/1-29-07bud-meth.pdf for our results and methodology, respectively. However, SSA Chief Actuary Steve Goss makes a good point when he says that summary numbers — PVs — for such government-wide analyses only tell part of the story and that graphs and tables showing the year-by-year results (preferably as a percent of GDP) can often be more instructive. Douglas Holtz-Eaken, former CBO Director, believes that the charts and graphs are *always* more instructive. In addition, we disagree strongly with the concept of projecting the entire federal government to the infinite horizon. Given the vast uncertainty surrounding future health care costs — which totally drive long-term results — even a 75-year projection is a stretch. We would recommend instead a 50-year time frame with a considerable amount of caveats concerning uncertainty.

Sincerely,

Richard Kogan
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Center on Budget and Policy Priorities