The Concord Coalition

May 17, 2007

Ms. Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street NW
Washington, DC 20548

Dear Ms. Comes,

This letter is in response to your request for comments on the Federal Accounting Standards Advisory Board's (FASAB) *Preliminary Views, Accounting for Social Insurance, Revised.* Two views are set out in this document, the Primary View and the Alternative View. For reasons discussed below, we believe that the Alternative view is preferable.

Since its inception, The Concord Coalition has strongly supported efforts to better inform the public about the huge unfunded obligations that this generation is leaving to future generations — primarily as the result of projected cost growth in Medicare and Social Security. To help raise the alarm, we have testified at congressional hearings, written op-eds for major newspapers, devoted a regular publication called "Facing Facts Quarterly" to this issue and taken out full-page ads in the *New York Times*. Most recently, we have organized a nationwide series of public forums known as the "Fiscal Wake-Up Tour," which includes United States Comptroller General David Walker and fiscal policy experts of differing perspectives from the Brookings Institution and the Heritage Foundation.

Given the intensity of our efforts in this regard, we have a deep interest in how the nation's long-term fiscal commitments are communicated to and understood by the public. For many years we expressed frustration that estimates of the unfunded obligations of Social Security and Medicare were not generally available to the public and almost never discussed. In recent years, with FASAB's help, that has changed. Pursuant to new FASAB standards, the Treasury's Consolidated Financial Report of the United States now includes estimates of unfunded benefit obligations in a Statement of Social Insurance (SOSI). Moreover, FASAB has given these estimates more prominence by classifying them as "basic financial" rather than "supplementary stewardship" information. The President's Budget and the Social Security and Medicare Trustees' Annual Report have also begun to publish estimates of the programs' unfunded obligations.

This new openness about long-term social insurance costs is welcome. The usual measures of budgetary and trust-fund accounting say little about two key issues: sustainability and generational equity. We are thus encouraged that FASAB is considering further methods of improving the quantity and transparency of information about these issues. The differences between the Primary and the Alternative views do not appear to be about this goal but about the most appropriate method for achieving it.

In that regard, both views would retain the SOSI in the Consolidated Financial Report of the United States Government showing the present values of projected benefits and dedicated revenues of social insurance programs. Both views would also add an explanation for changes in these present values during the reporting period.

The fundamental distinction between the two views is that the Primary View would recognize as current liabilities and expenses future social insurance benefits for those who have achieved 40 quarters of covered employment. These sums would be added to the balance sheet and to the statement of net costs in the Consolidated Financial Report. The Alternative View would maintain the current practice of recognizing social insurance liabilities for benefits that are due and payable.

Another distinction is that the Alternative View would enhance reporting of the government's long-term fiscal condition by including a Statement of Fiscal Sustainability as required supplementary information in the Consolidated Financial Report. This statement would go beyond social insurance reporting to include projections for all government operations and revenues under various scenarios.

A. Social insurance as a liability

The Concord Coalition agrees with the Alternative View that social insurance benefits, beyond those due and payable, are not liabilities and should not be treated as such in the government's financial statements.

The requirement that social insurance payments must be due and payable for a liability to arise is neither an arbitrary standard nor a disingenuous attempt to conceal the "truth" about the government's finances. It simply reflects the essential nature of social insurance programs.

For example, in its landmark decision *Flemming v. Nestor*, 363 U.S. 603 (1960), the U.S. Supreme Court established that workers accrue no property rights by participating in Social Security. The program rests solely on the sovereign and distinct powers of government to tax and to spend. Social Security is a legislated entitlement, not a contract. Congress can, and on many occasions has, altered the rules by changing taxes and benefits. It can, and undoubtedly will, do so again in the future.

Congress has reserved this right because the nation's priorities and circumstances can change. During World War II, for instance, Congress allowed Social Security benefits to lag behind inflation. During the boom of the 1950s and 1960s, it legislated large real-dollar increases in benefits. In 1983 major cost cutting reforms were once again enacted in the face of impending trust fund insolvency.

A liability can only arise when there is an enforceable claim. If one party, in this case the government, can unilaterally alter or cancel its obligation no enforceable claim arises and there is no liability. This basic fact separates social insurance benefits from private sector benefits, which justifies a difference in how to account for them.

Rather than expose the truth about long-term fiscal challenges, the Primary View would inadvertently perpetuate a popular misconception that Social Security and Medicare represent "earned" or "guaranteed" benefits. This misconception is a big obstacle to needed reform.[1]

To be sure, adopting the Primary View would not change the legal basis of social insurance benefits since FASAB is totaling lacking in any such authority. Yet by declaring a "liability" where none exists, the Primary View might encourage the public to believe that today's projected benefits are somehow immutable commitments. By that logic, any Congressional action to reduce future benefit promises — as almost everyone believes must be done to some extent — would be seen as repudiating a liability "owed" to seniors rather than ensuring a sustainable fiscal path for future generations. And to the extent that repudiating a liability is thought to be something the government must not do, the only "reform" option would be for Congress to raise taxes by whatever it takes to satisfy these future Social Security and Medicare payments.

Another problem with recognizing a liability for future social insurance benefits is that they cannot be measured with the level of certainty that should be expected for the Consolidated Financial Report. As noted above, social insurance benefits have been changed in the past and will be again in the future. Moreover, even under current law, future Social Security and Medicare Part A benefits cannot be measured with certainty because there is no authority to pay them once the respective trust funds are exhausted. The 2007 Trustees Report estimates that this will occur in 2018 for Medicare Part A and 2040 for the combined OASDI Social Security trust funds. The Primary View would thus result in the untenable conclusion that the government has a "liability" for payments it has no authority, let alone obligation, to pay.

B. Statement of Fiscal Sustainability

All of the above *does not* mean that social insurance benefits beyond those due and payable should be ignored. It is possible, and indeed necessary, to estimate long-term social insurance costs under current law for purposes of long-term fiscal planning.

Policymakers and the public must understand the huge projected cost of these programs and their potential to overwhelm all other national priorities. As a matter of sound policy planning and generational equity, we must know if we are on a sustainable fiscal path.

The Concord Coalition thus supports the Alternative View proposal to add a governmentwide Statement of Fiscal Sustainability (SOFS) as required supplementary information to the government's financial statements. This new statement, in conjunction with the current SOSI, would highlight the nature and magnitude of the federal government's long-term fiscal condition in a more comprehensive and contextual manner than would be accomplished by the Primary View.

The most valuable contribution of a SOFS would be to show long-term year-by-year cash flow projections under various assumptions regarding spending and taxes. A close look at the unfunded obligations in the SOSI leaves no doubt that the nation faces a huge cost challenge. No single present value number, however, can give a complete and accurate picture of the magnitude of the long-term fiscal challenge or the required response. Present value numbers say nothing about annual spending levels, and hence when the cost burden will become acute. Nor do they tell

[1] In their 2007 Report, the Social Security and Medicare trustees stated, "we believe their currently projected long run growth rates are not sustainable under current financing arrangements."

us the government's annual borrowing needs, and hence its impact on U.S. savings, investment, and living standard growth.

A major drawback of long-term summarized figures is that they can conceal a roller coaster fiscal path and thus obscure the pros and cons of different reform approaches.

Consider two reform plans: one that first allows Social Security and Medicare spending to rise above today's level, then cuts it beneath today's level, and a second that keeps spending from rising in the first place. The impact on the programs' unfunded liabilities might be similar, but not the impact on the budget or the economy. It's a bit like wading out to a sand bar. The present value calculation says that you'll be safe and dry once you get there. You need annual budget projections to tell you whether you're going to drown on the way.

There is no doubt, however, that a well-designed fiscal sustainability statement — one that includes annual cash flow projections — would help wake America up to the long-term fiscal challenge. It would provide useful indicators of fiscal sustainability and generational inequity under various scenarios and act as a helpful guide to reform efforts — not by prescribing options but by showing the magnitude and timing of the challenge.

Conclusion

Although The Concord Coalition believes that current social insurance benefit programs are unsustainable and need to be reformed, we do not agree with the position taken in the Primary View that these programs' unfunded obligations should be treated as current liabilities in the Consolidated Financial Report of the United States Government. While the apparent motive is sound, the method is not. Instead of improving transparency, it would misrepresent the essential nature of these promises and needlessly complicate necessary reform efforts.

By contrast, the Alternative view would continue efforts to improve transparency of long-term obligations while allowing for the possibility of reform and better reflecting the government's overall fiscal position.

Sincerely,

Robert L. Bixby
Executive Director
The Concord Coalition