

Contribution to the Task Force on Pension Schemes

Towards a compromise for the new SNA.

François Lequiller (OECD). August 2005.

The present paper is a compromise between the conflicting proposals made, on one side, by the moderators of the EDG and, on the other side, by a large majority of European national accountants through their FAWP and CMFB committees (paper by R. Mink and R. Walton¹). It should therefore be read after having read the two other papers.

The main objective of the paper is to avoid that they are two standards in the future SNA that would continue to hamper international comparisons of global pension obligations in the national accounts. However, if the task force reaches a consensus on one of the two proposals and thus this danger is avoided, the present paper can be discarded.

1. Introduction

The moderators of the EDG (IMF, US BEA) have presented in December 2004 an issue paper which makes the following 5 proposals:

1/ Treat all unfunded employers' pension schemes (including general government for its employees) identically to funded employers' pension schemes in the core national accounts. This amounts to replace the current criterion "funded/unfunded" to recognise a liability or to not recognise a liability² by the criterion "employer/social security". Liabilities of all employer schemes would be recognised (i.e. they would be treated as saving schemes), even if they are unfunded PAYG defined benefits schemes, but not pension obligations of social security schemes.

2/ For all defined benefit employers' pension schemes, use actuarial valuations to measure employers' social contributions and property income attributed to insurance policy holders.

3/ Allocate the net assets of defined benefit employers' schemes to the sponsoring employer.

4/ Do not change anything about "social security" in the SNA. Thus do not change the definition of social security, and do not record a liability for a contributory social security scheme.

¹ This paper is posted on the IMF EDG. In the present paper, this paper will be referred to as the "European paper".

² When, in this paper, the words "recognise a liability" are formulated, this means treating completely these schemes as if they were pure "saving schemes". This implies that contributions is saving, benefits dissaving (i.e. contributions and savings are treated as financial transactions), that cost of labour is calculated using actuarial values, and that a property income is imputed to contributors, equal approximately to the stock of pension liability multiplied by the discount rate. The paper uses also the terms "defined contribution schemes". These schemes are treated as pure savings schemes in the SNA.

5/ Do not change anything about defined contribution schemes.

In parallel, the European Financial Accounts Working Party (FAWP) and the European Committee for Monetary, Financial and Balance of Payment Statistics (CMFB) widely endorsed a paper posted on the EDG containing the following proposals:

1/ Do not change the current criterion of “funded” for recognition of the pension liability in the core accounts.

2/ Do not change the recording of unfunded schemes (including social security schemes) in the core accounts.

3/ But create a full set of supplementary accounts where both employer unfunded schemes and social security would be recorded “as if” they were saving schemes. The use of a supplementary account means that the key balances in the SNA would not be impacted by these items but there would be full disclosure of the balances and flows relating to them in a separate account, outside the core accounts.

Both proposals have merits and demerits. The present paper discusses them and proposes a compromise. It focuses on government employer pension schemes and some aspects of social security. It does not tackle other issues that should not however be forgotten by the task force (see box).

Other issues on pension obligations that the new SNA should clarify.

-What to do with mixed systems (Poland, Sweden, Hungary) whereby “social security” covers both unfunded and funded systems? Eurostat has taken a decision which should be reflected in the new SNA.

-What is to do with funded social security systems? The SNA currently discards treating them as a saving scheme while if they are funded they should be treated as saving schemes, exactly as private defined contributions schemes. The task force should therefore envisage modifying the sentences of paragraph 13 of Annex IV: “Social security schemes may be either funded or unfunded. Even when separate funds are identified, they remain the property of the government and not of the beneficiaries of the schemes”.

-Is it necessary to pursue the existence of the “dual” recording system for funded schemes in the new SNA, leading to the current transaction D8³? Several countries already do not apply this recommendation (Australia, USA, Canada)?

³ “Dual recording” refers to the current recommendation of the SNA to record contributions and benefits of funded schemes *also* in the non financial accounts. This means they are recorded twice: once as financial transactions in accordance with the recognition of liabilities of funded schemes, and then, one more time, as if they were non financial transactions (contributions = decrease of income of households, benefits = increase of income of households). The objective of this additional recording was to facilitate international comparisons of households’ income. Because of this dual recording, a transaction D8 is recorded just before the balancing item “B8 saving” in order to correct for this “dual” recording.

-The term “defined contribution” should enter in the new SNA. Also a clarification should be made on “notional” defined contribution schemes.

2. Merits and demerits of the moderators.

The main merit of the moderators’ proposal is to correspond to the movement which is engaged in business and public finance accounting standards. Indeed, international accounting rules move in the direction of recognizing the liabilities of unfunded employer defined benefits schemes (IAS 19). While it is true that, today, not all OECD governments include a debt figure for their pension obligations regarding their own employees, the movement is also clearly going in this direction, alongside the movement in business sector accounting. The International Public Sector Accounting Standard Board (IASB) has not prohibited recognition by governments of their pension liabilities vis-à-vis their employees (in *exchange* for their services as employees) even if the pension scheme is unfunded. Already, even a country such as France, which was at first reluctant, publishes an estimate of the pension liability for the civil servant scheme in its official public finance account, albeit as a memorandum item. By implementing this extension to employer schemes in the national accounts, the SNA will converge with these other accounting systems at the right time. It will come after the recognition of these liabilities in some countries, but before this recognition in other countries. This seems a balanced timing considering the importance of international comparability in the dynamics of the SNA. Also, by using a criterion that is easy to implement and to verify, the SNA will gain in international comparability.

However, there are drawbacks in the position of the moderators. First, there is no understanding that being in an employer/employee relationship does not have in all countries, in particular for *government* as an employer, a mechanical implication on the “strength” of the liability. Second their proposals avoid exploring why there would be such a strong difference in treatment between government employee schemes and social security schemes, when these systems are similar. In Sweden, for example, civil servants are in the general social security scheme and do not have a specific government scheme⁴.

First, regarding the “strength” of the liability. In the countries that generally support the moderators’ position, it seems that the contract between the employer and employee is a solid (legal?) ground to consider that the employer (the government) guarantees a pension to the employee, in the nature of a “deferred compensation”. For example, it seems that the government cannot revise the amount of pension benefit already “gained” by an employee. Thus the employee may fully “enforce its ownership rights on the pension” (which is the SNA definition of an asset). Thus the use of the criterion of the employment contract as the basis to recognise a pension liability has a very solid ground. Moreover, in these countries, governments have, in the recent years, recognised these unfunded pension liabilities in their own accounts, in a move to apply to themselves the progress made by business accounts. Thus national accountants have also the data at their disposal

⁴ On the Swedish case, see F. Lequiller’s paper on the EDG:
<http://www.imf.org/external/np/sta/ueps/2004/123004.pdf>

to include them into their own accounts. It would even be strange for them not to include in the national accounts a liability which is recognized by the employer (here the government) itself.

On the contrary, in some other OECD countries the government does not give this sort of strong guarantee to its employees. As evidence of such situations, some governments (France, Belgium) recently changed the law and reduced substantially the amount of the pension “promises” for their own government employees. Hence the argument used in the European paper to discard the introduction of these pension obligations as liabilities in the core SNA accounts: “*because they can be altered at any time*”⁵. Moreover (or as a result), in these countries, governments have yet not fully recognized these liabilities in their own accounts. Also, in some of these countries, the relationship between the employer (government) and the contributor (employee) is sometimes assimilated to the relationship existing between the social security system and any employee (private or public). Thus some national accountants in these countries do not understand why they should be obliged by the new SNA to recognise a liability that their own government does not recognise, and why government employees would have a pension asset but not employees of the private sector who are in the social security system which is not very different from the system for the government employees.

Thus, by completely assimilating all employer schemes, even unfunded, to saving schemes the proposal of the moderators appears extreme to some users. It does not allow for the recognition that there is probably a liability but somewhat different than the full liability of a “real” saving scheme.

Last but not least, the exclusion of social security from the scope of the moderators proposals leave unresolved the issue of what happens when the general government employees are themselves part of a social security system. Under the moderators’ proposals, no liability would be recorded. Thus for those countries where government pension schemes for their own employees are similar to the general social security system, the recording of a liability would depend on what can be seen as a minor institutional arrangement. A government could therefore easily wipe out its “liability” in the national accounts by changing the organization of the scheme, without, in fact, changing none of its obligations.

3. Merits and demerits of the European paper.

The main merit of the European paper is to offer to users the potential of a very large amount of information on pension obligations in the framework of the new SNA. This is an important move forward.

⁵ The full quote (paragraph 3) of the Bank of England/ECB paper is “[The SNA does not recognise] unfunded pension obligations as a liability in a strict sense, *because they can be altered at any time*. In fact, I did not find this reason stated in the SNA, but I may have missed it. Nevertheless, what is important here is the use of the argument that these obligations are not as strong as liabilities *because they can be changed*.”

Indeed, the paper proposes a full supplementary (and compulsory) account that would give not only the information given by the moderators' proposal but also the same information for social security systems⁶. The second merit is that, by separating the different categories of liabilities (funded/employer unfunded/unfunded social security), it takes into account the difference in the degree of commitment between different pension schemes. It takes also into account the different degrees of difficulty in estimating these obligations, including in the core accounts the ones that are easy to estimate and leaving the ones that are more difficult to estimate in supplementary accounts, outside of the core accounts. Economists who participated into the OECD workshop on "implicit"⁷ liabilities (June 2004⁸) welcomed such a clear separation of these various components of the pension obligations.

There are however two disadvantages to this proposal. The first one is that the treatment of explicit exchanges of liabilities between systems is not resolved. The second is that it is not clear what is the proposal regarding the recording of the cost of labour of employer unfunded schemes.

Privatisations or reforms of the pension systems have, in several occurrences (such as the France-Télécom, Belgacom or Daiko Henjo cases, in, respectively, France, Belgium and Japan), led to situations where different pension schemes exchange cash for unrecognised pension liabilities. A typical case is the one of a public enterprise in the process of being privatized which wants to alleviate part of its pension liabilities by paying a lump sum to the government in exchange of the latter taking the responsibility of this part of future pension benefits. In terms of accrual accounting, such a transaction should be neutral to the net worth of the government in the period of the transaction. Indeed, the lump sum received is compensated by an increase in pension liabilities. Unfortunately, the present SNA does not allow implementing such a simple treatment because the pension scheme is not funded, and thus no liability can be recorded. Thus these countries have treated the lump sum as a capital transfer to the government, improving the government net lending/borrowing in the period of the transaction. The European paper, by continuing to exclude from the core accounts the unfunded pension schemes, does not spontaneously resolve this problem. Unless additional specific rules are introduced in addition to their proposal, this type of "non accrual" accounting could continue in the revised SNA.

The second drawback of the European proposal is that it is not clear what they would record as the cost of labour for employer unfunded schemes. The recognition of the liabilities of unfunded employer pension schemes should come, in the flow accounts, with the recognition that the current cost of labour includes the discounted value of the future benefits gained by the employee *during the period*. By excluding the unfunded employer schemes from the core accounts, the European proposal does not seem to allow

⁶ One could even imagine delivering to users not only the data on the liability but the data which is used to compile the liability, in occurrence the set of expected future benefits. Users may be more interested by this set than by the amount of the liability itself.

⁷ Also called "unrecognized liabilities", meaning not recorded in the accounts.

⁸ "Accounting for implicit liabilities (4/6/2005)":

http://www.oecd.org/document/16/0,2340,en_2649_34245_2494416_1_1_1_1,00.html#23_pension_funds

for this recording. This would undermine the accuracy of the measured rate of profit for private employer unfunded defined benefits schemes which would be overestimated or underestimated depending on the circumstances and, similarly, the value-added of government (and thus GDP) because compensation of employees is included in its estimation.

4. Toward a better compromise

From the start, the OECD's stance in this debate is delicate, as its member countries are split on this issue and our main concern is to improve international comparability⁹. On the other hand we feel that the two positions are not so far and that a compromise is at hand which would be better than obtaining at the end two different standards of national accounting for OECD countries, one in the SNA and another in the ESA (the ESA is the European version of the SNA).

The compromise proposal that we propose has the merit of separating clearly the different types of pension obligations, but, at the same time, allowing to better record exchanges of liabilities between systems and also the actuarial cost of labour. It can be summarised in a few principles and illustrated by a simple example.

First, it would consist in incorporating unfunded employer pension schemes in the core accounts, but *as a separate category from the funded schemes, with a separate set of transactions, leading to alternative balancing items*. This would allow satisfying both views.

Second, regarding social security, because both camps agree in excluding their liabilities from the core accounts, we would propose to accept this and thus exclude them for the core accounts. However, we would certainly retain the proposal of the European paper for recording the liability of, at least, *contributory* social security schemes in a separate supplementary set of accounts (see box below). This move of recognizing contributory social security liabilities is also currently discussed by the IPSASB, more or less in the same terms as in national accounts. It would be an excellent result if the national accounts and IPSASB could make the same type of recommendations in this case.

Third, we propose to have a special treatment when government employees are directly attached to a social security system. In both the moderators and the European proposal, these liabilities would not be recognised in the core accounts because they are labeled "social security". As the borderline between social security systems and pension systems set up by government for their own employees may be considered as arbitrary, we recommend recording government pension obligations vis-à-vis their employees

⁹ The current situation is already not good as regards international comparability. Some OECD countries (Australia, Canada, and perhaps USA) do not apply the current SNA as regards unfunded government employee schemes, and treat them as if they were funded, in the core accounts. The OECD is therefore currently obliged (pushed by some of the national governments concerned) to adjust the official public debt of these countries to make it more comparable to other countries'. We were hoping to avoid having to do that in the future SNA.

systematically in the core accounts even if they are officially labeled as “social security”¹⁰. The rationale to record those liabilities for government employees but not for private sector employees is that, in the case of its own employees, the government acts as the sponsor whatever the system.

Recognizing *contributory* social security liabilities in supplementary accounts

In most countries, there are large, state sponsored, (mainly unfunded) PAYG social security systems. In some countries, the corresponding pension benefits are obtained whatever the status of the person, without any specific contribution and correspond to a basic “social assistance” schemes. It is difficult to envisage recording a liability for these schemes as there is no special moment, except when the age limit is reached, to record the creation of the pension obligation. Thus these systems are generally excluded from the scope of recognition of liability.

On the contrary, in some other countries, there are very large *contributory* social security schemes (i.e. based on contributions generally proportional to salary) for which it is possible to make such a calculation. In some OECD countries, these systems completely replace employer schemes, which hardly exist. In this case, everything functions as if the government was organizing a vast unfunded defined benefit *multi-employer* scheme, with salary-based contributions. It is therefore possible to compile a liability for these schemes exactly as for a pure employer scheme, except that the sponsorship is delegated to the government (the employers have no liability: they discharge their responsibility when they have paid their contribution).

We propose to record a liability for these schemes in the new SNA, but not in the core accounts. The amounts are at the same time difficult to measure and enormous (sometimes reaching 400% of GDP). Also, one may contend that it is unbalanced to record a liability of the government for these schemes and not an asset on the other side. Indeed, if the government is responsible for the pension liability, one could also consider that it has also an “asset” consisting of the future (compulsory) contributions. But accountants have a difficulty to recognise this special asset because it relates to future events and not past events¹¹. However, if one would record a liability but not an asset in the core accounts, the system would appear *structurally* in deficit in the core national accounts even if it could be that the system is structurally in equilibrium (benefits are met by contributions in the current period as well as in future periods). This would send a wrong and useless message. Thus the recommendation is to record these liabilities in a supplementary set of accounts and not in the core accounts.

The technicalities of this proposal are not new. It had already been made to the EDG under the name of “option 5”, which was one of the six options referred to in the mandate of the task force¹². The best way to illustrate the proposal is to take an example.

¹⁰ This additional recommendation applies also to the moderators’ proposal.

¹¹ But this is possible: the Swedish social security system “Inkomstpension” has recognised a liability and, as well, such an asset. This is not purely formal, the ratio between the liability and the asset is used in practice to really adjust the amount of future benefits.

¹² Even if the original option 5 has been modified in the present paper.

5. Numerical example.

The table in page 11 illustrates the compromise proposal in a small quantified example applied to an unfunded government-employer scheme for civil servants (the most contentious case). In the example, the employer contribution is 9.5 though the actuarially calculated cost of labour is 12. The employee contribution is 1.5. Pensions paid are 11. The actuarial valuation of stocks of pension obligations is 80 in the opening balance sheet. The property income on those is 4 (5% discount rate). Liabilities other than pensions are at 50. No other changes in pension obligations arises other than due to contributions, property income and pension payments.

Here are, line by line starting from the top, the explanations of the system of recording under this proposed compromise:

D122: government pays imputed contributions to households of 12 (actuarial value of contribution) as part of cost of labour of government employees. *One can here verify that our proposal allows for the compilation of labour costs on an actuarial value.*

D44: an imputed property income flow of 4 from government to households is recorded, corresponding to the imputed interest cost of the unfunded liabilities of the government (it is equal to 80, the stock of liabilities, multiplied by 5%, the discount rate). It captures the increase of pension debt over time due to the sole effect of time passing.

D6112: this flow correspond to the actuarial contributions paid by households to the organizer of the schemes. It includes cash payments (1.5 for the GG employer scheme) *plus* property income (4, counterpart of D44).

D62: this flow corresponds to the (cash) flows of benefits to retirees.

At this stage, the reader should have understood that, under this proposal, all flows linked to the unfunded employer scheme are recorded, *to this point*, as they would appear in a funded scheme in the present SNA, and thus, as they would appear in the proposals of the moderators.

However, as shown in the next line, “B8 Saving” begins to differ and is equal to the net *cash* flows of the employer system and not to the accrual flows. Indeed, cash flows for the government are: +1.5 (D6112) – 11 (pensions GG employees) = -9.5¹³. Similarly in this proposed system, “B9A net lending/net borrowing” (i.e. the balancing item of the capital account) remains equal to the net *cash flows* of this unfunded scheme. These first core balancing items therefore *satisfy those who prefer to use the cash approach* for this unfunded scheme in the core accounts.

¹³ This is because all imputed flows above B8 have counterparts: D44 property income is recorded in the use column of general government but also in the resource column as part of imputed contributions, etc...

However an “accrual” approach is immediately also afterwards in the core accounts, with the creation of a new account and an additional balancing item, B9X, thus also satisfying those who want to show *accrual* balancing items. The special account is devoted to unfunded schemes and called “Accumulation Account for Unfunded Employer Pension Schemes” (shaded in grey). This account simply contains one line: “D8X Adjustment for the change in net equity of households in unfunded employer schemes”, which corresponds mechanically to the adjustment which is necessary to introduce to obtain a new “adjusted” net lending borrowing (B9.X) corresponding to a situation where unfunded pension schemes are treated *as if they were funded*. It is equal, to actuarial contributions (12+4+1.5) minus benefits (11).

At this point the reader should have understood that the proposal is not a revolution in the SNA. This adjustment D8X already exists in the current SNA 93 under the name D8. In fact, the proposal could be summarized as consisting simply in changing the location of the D8 adjustment¹⁴.

The new balancing item, “B9X Net lending borrowing adjusted” corresponds to the net lending/borrowing where all employer pension schemes are treated as if they were saving schemes. *This should satisfy the moderators and users that prefer this approach.*

Regarding the financial accounts, we propose to extend them to include the changes in unfunded pension liabilities, with the creation of a new financial instrument: F6X (unfunded employer pension liabilities). This inclusion (shaded in grey) allows users to dispose of all employer pension liabilities, whether funded or unfunded, in the same account, thus a situation which should fully satisfy the moderators.

One consequence of this integrated presentation is that the traditional identity between B9A (net lending borrowing of the capital account--9.5 in the numerical example) and B9X.B (net lending borrowing of the financial accounts, --16 in the numerical example) is broken. However it is immediately to be replaced by a similar identity, but extended to unfunded pension liabilities: under this new accounting system, the identity becomes: $B9X = B9X.B$ (both are equal to 16 in the numerical example).

With this presentation users have a full view of the employer pension liabilities in the core accounts, whether they are funded or unfunded. At the same time, it is possible for them to separate those liabilities that are more of a nature of “imputed”, more difficult to estimate and less stringent than the funded ones. It is also possible for users to use two alternatives balancing items for net lending/borrowing, the cash one as well as the “accrual” one.

It is important to note is that, with this original accounting system, transactions occurring on unfunded pension liabilities (such as the famous France-Télécom case) will impact

¹⁴ However, this is not completely true. In the current SNA, the adjustment D8 has the objective of recording in the non financial accounts contributions and benefits of funded schemes. In the present paper, D8X has the objective of recording contributions and benefits of unfunded schemes as financial flows. Despite this difference, the essence of this “transaction” is the same.

none of the balancing items B9A, B9X and B9B, because the cash exchanged will have a counterpart (in form of AF6X) in the financial accounts. *This option therefore resolves mechanically part of the problems created by exchanges of unrecognised liabilities.* However, this feature will not apply mechanically to exchanges of transactions between funded schemes and social security, because social security is left outside of the core accounts. Thus additional recommendations should be added to treat this special case.

Finally, as mentioned earlier, government pension obligations vis-à-vis their employees would be systematically recorded as AF6X even if they are officially labeled as “social security”. This allows the recording to be neutral on the institutional arrangements made for government employees.

6. Conclusion

This compromise system functions, as shown by the example. It is only a small step apart from each of the two conflicting positions. It allows including all employer pension liabilities in the core system of national accounts, while separating the case of funded ones from unfunded ones. This difference exists in the real world; it is not a luxury that it appears in the national accounts. At the same time, transactions between funded and employer unfunded systems are taken into account and are treated correctly in terms of accrual accounting. In addition, information would be given on contributory social security liabilities in a supplementary account. As such, it seems an efficient compromise proposal.

Case of general government employer scheme

	<i>Red italics are changes to 1993 SNA</i>	General government as employer		Households		Corporations	
		Uses	Resources	Uses	Resources	Uses	Resources
D122	Imputed employer contributions	12			12		
D.44	Property income attributed to policy holders	4			4		
D6112	Employee contribution (GG employers schemes)		1.5+4=5.5	1.5+4=5.5			
D6111	Employer contribution (GG employers schemes)		12	12			
D623	Pensions (GG employers schemes)	11.0			11.0		
B8	saving	-9.5		+9.5			
B9A	Net lending/ net borrowing	-9.5		+9.5			
	<i>New accumulation account for unfunded pension liabilities</i>						
<i>D8.X</i>	<i>Adjustment for the change in net equity of households in unfunded employer schemes</i>	<i>12+5.5-11=6.5</i>			<i>12+5.5-11=6.5</i>		
B9X	Net lending/ net borrowing adjusted	-16.0		+16.0			
	Financial accounts	General government		Households		Corporations	
		Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities
F2	Cash	-9.5 (1.5-11)		+9.5 (+11-1.5)			
F6X	<i>Change in unfunded employers pension liabilities (actuarial calculation)</i>		6.5	6.5			
B9X.B	Net lending/ net borrowing adjusted	-16.0		+16.0			
	<i>Other changes in volume of assets accounts</i>	Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities
B10.2	Changes in net worth due to other changes in volume of assets	0		0			
	<i>Revaluation account</i>	Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities	Δ Assets	Δ Liabilities
B10.3	Changes in net worth due to nominal holding gains/losses	0		0			

Balance sheet

		General government		Households		Corporations	
		Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
	Opening balance sheet						
	Various financial instruments		50	50			
AF6X	<i>Unfunded employers pension liabilities</i>		80	80			
B90	Net worth	-130		130			
	<i>Closing balance sheet</i>	<i>Assets</i>					
	Various financial instruments		50	50			
AF6X	<i>Unfunded employers pension liabilities</i>		96	96			
B90	Net worth	-146		146			