

National Statistician and Registrar General

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Dear Paul

Thank you for your letter of 10 November 2006, in which you invite the opinion of National Statistical Offices on the proposal for the treatment of government unfunded pensions schemes in the national accounts.

The proposed compromise

The proposal with regard to the update of the system of national accounts is to record a liability for government where this can be done with sufficient confidence as to scope, event and value. This is in line with the recommendations of the IMF - BEA Task Force, and is supported by the InterSecretariat Working Group on National Accounts (ISWGNA).

The difficulty for some European member states is characterised in your letter as that of disentangling unfunded pension schemes for government employees, from schemes for social security in general (the Old Age Pension in the UK). We think this is a simplification of the reasons for concerns over recognising a liability in the accounts. It is a fact that some European countries will have difficulty in determining the scope of unfunded schemes vis a vis social security schemes. But there is also at least one major European country that believes there is insufficient commitment by the government to pay future pensions under unfunded schemes to justify recognition of a liability. Other countries have concerns on the confidence with which the value can be estimated. This is largely due to the critical dependence on assumptions with regard to the appropriate discount rate to be used in calculating the estimate.

The proposed compromise is for those countries that can make confident estimates of liabilities arising from government unfunded pension schemes, to enter these in the core accounts. But where countries cannot make confident estimates for reasons of scope, commitment and confidence of estimation, these countries will not show the liabilities in the core accounts. All countries will complete a supplementary table setting out best estimates of these liabilities, and where they are not taken into the core accounts, set out the reasons why it is not judged appropriate. The existence of this table will allow alternative sets of accounts to be drawn up according to user need.

So if it is felt that analytical policy needs are best served by including liabilities for unfunded schemes, even when some country estimates are not so confidently made as would be



desirable for the core accounts, then the supplementary table will contain sufficient information to enable the derivation of a set of accounts with the liabilities included. Similarly, if it is felt that for reasons of reliability and comparability the liabilities should be excluded from the core accounts, the supplementary table will allow the liabilities to be abstracted from the core accounts where countries have included them. This latter approach is felt to be more appropriate for the comparability of accounts where derived measures are used in fiscal policy areas, as in Europe. In these areas, considerations of reliability and comparability outweigh the need for useful but unavoidably less reliable measures that are needed to assist policy analysis.

As part of the compromise, it is suggested that the criteria which determine whether liabilities should be recognised are unclear, and clarification should be remitted to the long-term research agenda. The acceptance of alternative treatments is justified by this lack of clarity.

I have taken some care in setting out the issue as I see it, and would be grateful if you could let me know if I have misrepresented the situation in any material manner.

UK View

The proposed compromise will enshrine in the international standard, two different sets of national accounts. The first (the wide view) will include liabilities for government unfunded pension schemes. The second (the narrow view) will exclude these liabilities. If the difference between the estimates in the two different ways of representing the economy was small, then the issue wouldn't be so serious. But the differences in this case are huge. The government debt to GDP ratio for the UK would change from below 40% to about 100%, The household saving ratio would rise from 5% to about 6.5%. Comparisons between economies with this kind of difference would be seriously undermined. The proposal that users could calculate the figures needed for their own purpose is to avoid the responsibility the statistical international community has for the creation and defence of a single standard for national accounts estimates. When times are difficult, and policy advocates have a choice of figures, we can hardly be surprised that they choose the one most supportive of their case. This is where statisticians and the international institutions that represent their interest, earn their money by creating and working to common international standards which take the argument over alternative concepts and measurement methods out of the political arena.

So it is the UK view that the current proposal should be developed further. The international community should weigh the pros and cons of the alternative approaches, and take a decision which allows only one set of accounts to be the international standard. Then the supplementary table can enable users to derive an alternative estimate which they may find more appropriate for their fiscal target or economic analysis needs. The UK would rather sign up to a single international standard about which we have reservations, than see our own preferred treatment presented in the accounts in conflict with that of other countries.

The UK view on lack of clarity over the criteria is that this is not the reality. The criteria can be simply described as follows:

a) is there sufficient definition of scope (unfunded employee schemes or general social security schemes)

b) is there sufficient strength of commitment (is there a constructive obligation for government to pay future pensions)

c) is there sufficient confidence of estimation. (agreement on actuarial methods and choice of key value determinants such as discount rates)

Which one?

The UK finds itself in a difficult position. Actuarial estimates of liabilities for unfunded pension schemes for government employees do exist in the UK, and are included in the resource accounts of government drawn up according to the appropriate financial reporting standards (UK Generally Accepted Accounting Practice - GAAP). So the UK can estimate the liabilities of unfunded government pension schemes, and recognise them in the accounts. But this would be quite inappropriate for comparison across Europe where many member states do not have such estimates from a respected external source and feel there is an insufficient basis to recognise the liability in the accounts. In this situation, where the majority of European member states cannot estimate the liabilities, it will be necessary for the UK to also suppress these entries from the accounts until there is a sufficient consensus on implementation to make inclusion useful - and this applies to both fiscal policy use and economic policy comparisons.

The same arguments can be advanced for international standards beyond Europe. If the majority of countries across the world are not yet in a position to estimate liabilities for unfunded pension schemes, and the effect on key aggregates is significant, then the case for introducing is weak. If it is felt that the position is temporary, and that further work such as that being taken forward by the European Task Force on pensions holds the prospect of increasing the likelihood that countries will be able to make confident estimates of unfunded pension scheme liabilities, then the case for including the liabilities in international guidance is that much stronger.

At present despite the existence of actuarial estimates deemed sufficient to include estimates for government unfunded schemes in the resource accounts of government for the UK, the Office for National Statistics is taking an active part in the European Task Force in order to assist in an assessment of what estimates can be made across Europe, how confident we can be in them with respect to scope, event and value, and what the implications are for the inclusion or exclusion of the liabilities in the core accounts. We are doing this because of the paramount need for one standard and one implementation across all member states.

UK proposal

A world-wide inquiry should take place to determine country views on whether they are currently able to implement the recognition of liabilities for government unfunded pension schemes in the accounts. This inquiry should establish the reasons for those that cannot - unclear scope, lack of strength of commitment and lack of confidence in the value estimation. The inquiry could also ask whether countries felt that there was a realistic prospect of their concerns being addressed through further work - either through the European Task Force or another international initiative. The relative numbers of

a) those who can do it,

- b) those who can't at present but think they will be able to do it, and
- c) those who see no prospect of including the liabilities,

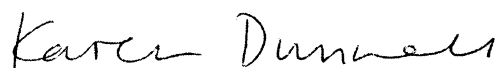
should provide the basis for a decision on inclusion.

The international statistical community must recognise that if only a very few countries can make sufficiently confident estimates to justify recognition in the accounts, then the absolute requirement for an authoritative implementable international guidance on national accounts implies the following. Those that can, must meet their analytical needs through satellite accounts and supplementary tables, and wait for the rest of the world to catch up. If most countries are able to make estimates, or believe they can in time for implementation, then those that feel they can't, must examine ways to meet the international standard as best as they can and seek ways to further develop and improve their estimates, consistent with the experience of other countries.

So we reject the proposed compromise of alternative sets of accounts being endorsed by the international standards.

We propose that an international survey on the current state and future prospects of recognition of the liabilities should be held, and a decision on which alternative is chosen as the single international standard be taken in the light of the response. The United Nations Statistics Commission may wish to request a special inquiry group to help with the conduct of the inquiry and help prepare supporting material for the inquiry. The ongoing European Task Force into pensions can contribute to this initiative, with help in preparing the questionnaire and supporting papers. It is hoped that members of the Task Force sponsored by the IMF and BEA would similarly be able to contribute.

Yours sincerely



Karen Dunnell