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AFTER THE FEBRUARY 2006 AEG, WHAT ABOUT RECORDING PENSION LIABILITIES IN THE NEW SNA?[1]

Submitted by the Organization for Economic Co-operation and Development

The meeting is organised jointly with Eurostat and the Organization for Economic Co-operation and Development

1. The February meeting of the AEG has made significant progress towards an improvement of the SNA regarding the recording of pension liabilities. However the AEG recognised that there remains work to be done to fully clarify the treatment of government pension schemes.

2. The present paper's objective is only to explain the background of the minutes of the February 2006 AEG[2] and set some directions of work for a final decision fully usable in the text of the new SNA. In particular, it proposes, as requested by the AEG, some first additional criteria to base the decision of recording a pension liability in the SNA.[3]

[1] This paper has been prepared by François Lequiller at the invitation of the secretariat.

3. This issue was discussed during the recent March 2006 UN Statistical Commission which consensually concluded that a good solution to the remaining issue would be hopefully found in the coming months. The present paper is therefore to be considered only as a small contribution in this debate.

4. *Warning*: the paper does not discuss issues linked to the measure of the output of pension schemes, which was part of the recommendations of the AEG. It focuses on the main issue which is under which conditions should one record a pension liability in the SNA .

THE MAIN RECOMMENDATION OF THE AEG MEETING

5. To the question "*Should liabilities/assets and associated economic flows of all pension schemes be recognised in the core accounts of SNA 1993?" the February 2006 AEG responded: "There was strong support within the AEG for the recommendation of the Task Force on Employers' Retirement Schemes to recognize the liabilities involved with all employer pension schemes, including unfunded ones, and any associated assets and transactions.*"

6. This is therefore to be considered the main recommendation of the AEG. However, the AEG added:

7. "The AEG saw that there are problems for several countries in drawing a distinction between pension schemes for government employees and social security schemes. The AEG felt it necessary to develop criteria that would distinguish between the several types of schemes. Possible criteria, among others, could be the employer/employee relationship or the nature of the liability. The ISWGNA will explore alternatives for developing criteria. The AEG noted the possibility, until such criteria are developed, of countries not including the liabilities for pensions of government employees in the core accounts but of including them together with the liabilities for social security schemes in supplementary accounts. The AEG also supported the possibility of including supplementary accounts for social security schemes."

8. While the first part of the AEG statement shows significant progress, the second part indicates that there are outstanding issues to be addressed, in particular for government employee pension schemes.

INTERPRETATION OF THE MAIN AEG STATEMENT.

9. The AEG confirmed that the new SNA should recommend recording a pension liability for all *employer* pension schemes.[4] *Employer* pension schemes are those in which there is a pension *promise* to the employee raising from the employment contract between the employer and the employee. The pension promise is analyzed as a deferred salary. In this context, the reasoning by the AEG is the same as the reasoning in business accounting standards: the employment contract gives to the pension promise made by the employer the status of a *pension liability* (and, in national accounts, of a financial asset of the employee). This applies to private employers as well as to public employers, as the employment contract is the same or similar. It also applies whatever the mode of funding of the pension benefits (i.e, whether funded or pay-as-you-go). The focus is on the existence of the liability, not the way to fund it.

10. However, it is useful to precise that the AEG recommendation only applies to employer

pension schemes where the employer continues to be directly responsible for the pension obligation,[5] even after it has made its contribution. On the contrary, the AEG recommendation does not apply to employer schemes where the employer has no more obligation for pension benefits accrued in any period once it has made the agreed contribution to the scheme.

11. Thus the recommendation of the AEG should be better written as following: *the new SNA records as a pension liability all pension promises made on the basis of an employment contract and whereby the employer remains responsible for the pension obligation even once it has made the agreed contribution to the scheme.* This precision is useful in particular because it shows that some "multi-employer pension systems" that are based on an employment contract but where the employers have no more obligation after they have contributed to the scheme are excluded from the AEG recommendation. This exclusion applies to some types of government sponsored pension schemes. We will return to that later.

12. The current SNA recommends recording a pension liability when the scheme is *funded*. The new AEG recommendation should not be understood as discarding this criterion, but as extending it. Thus the complete recommendation should be written as: *the new SNA records as a pension liability (1) all pension promises made by funded pension schemes (funded meaning having financial or non financial assets dedicated to meeting the pension obligation) and, (2), all pension promises made by employer schemes, even unfunded.*

13. This extension to all employer schemes is fully justified. The complete arguments can be found in the Task Force report to the AEG. We will limit ourselves here to list them without additional comments: it aligns with business standards; it avoids treating differently defined benefits schemes from defined contribution schemes; it clarifies the situation on under-funded schemes; it clarifies and improves the compilation of accrual cost of labour. Thus this recommendation will contribute to a better measure of the main aggregates and of the balance sheets of employers and households in the new SNA.

14. However, the second part of the AEG statement shows that there remains issues to be clarified.

ISSUES TO BE CLARIFIED

15. There are two issues that remain to be clarified. The first one is conceptual and pertains to the *borderline between employer schemes and social security schemes*. The second one regards the implementation of the main AEG recommendation. In both cases, the situation of *government pension schemes for its own employees* is at the center of the issue.

16. Before starting to discuss these remaining issues, let's however not forget the very positive side of the debate up to now. In particular, one should keep in mind that there is unanimity to accept the main AEG recommendation for non-government employer schemes, meaning all private and public corporations' employer schemes. This is already an excellent positive conclusion of the discussion.

A. Borderline between employer schemes and social security

17. Unfortunately, the explanation of the issue will need somewhat of a “détour”.

18. It is common to speak of the “three pillars for retirement”: (1) the first pillar being usually a government sponsored system which ensures a minimum old-age pension to all citizens, without any relation between contributions and benefits; (2) the second pillar, additional to the first, constitutes the largest retirement benefit for most people, and is generally collectively (meaning not individually, but for a group of beneficiaries) organized and financed through specific contributions in part paid by employers, in part by employees or self-employed; (3) the third pillar is constituted by pure individual saving systems (such as life-insurance).

19. There is consensus on the first pillar. Nobody is proposing to record a pension liability for such systems. There is also consensus on the third: these schemes are funded, so one should record a pension liability (in the core accounts). The remaining issue regards the second pillar.

20. In some countries, a “pure employer paradigm” is prevalent for the second pillar.[6] In these countries, the pension obligation of any individual arising from employment is established on an individual basis between the employer and the employee. There may be no entiltlement for some employees, but if there is one, it is clear to the employee that its employer remains responsible for the pension obligation. In this system, there is no special role[7] for government as a provider of second pillar pensions except for those civil servants who are employed on terms providing for a pension when it acts as employer and not as government. For the countries in which this “pure employer paradigm” is prevalent, the AEG recommendation is perfectly adapted.

21. However, in what could be called a “collective paradigm” (Sweden, France, Germany, Italy, Spain, and others), the second pillar is essentially organized in a unique vast system under the control of the government. All (or nearly all) employers (and thus their employees) are obliged to belong to a scheme where the employers themselves have no responsibility to manage an associated fund or to ultimately provide the pension. All contributions from employers are passed to this central scheme, and the employers themselves, once their contribution is made, have no more obligation. This is a system where the government (and not employers) acts as the pension scheme manager for all employees. This scheme is in general pay-as-you-go, thus unfunded, and defined benefits. There is a relation between the amount of benefits and contributions. In that sense, it differs from the first pillar. Such schemes have therefore some of the characteristics of *employer* schemes, because they are based on contributions linked to the employment contract, but, at the same time, they are *independent* from employers in the sense that the employers have no more obligations to the scheme when they have paid the agreed contribution.

B. Are these schemes to be called "social security"?

22. In the last paragraph, I have avoided the use of the term "social security" to qualify the schemes typical of the second pillar in continental Europe. The problem when using the term "social security" is that, for "anglo-saxon" countries, "social security" is limited to the "first pillar", while in the second group of countries, it encompasses the second pillar, and in particular these large government sponsored independent multi-employer schemes referred to above. Thus the term social security has two different meanings, and this has constantly confused the debate. The author of the present paper had first proposed to the AEG to adopt a "large" definition of "social security" in the new SNA which would go along with the view of the second group of countries. However, the AEG has not accepted this solution. If one adopts the other view, the term "social security" would be limited to the first pillar, i.e. "government sponsored system which ensures a minimum old-age pension to all citizens, without any relation between contributions and benefits". There is no problem in accepting this limitative definition. It is purely an issue of terminology. But then comes the question of how to qualify all the schemes that are located between pure employer schemes and this "social security", in particular those "government sponsored autonomous multi-employer schemes". Thus, in the present paper, I have tried to qualify each scheme with precise qualifiers, avoiding the use of the general term "social security", and thus leaving, cowardly, the choice of the final definition of the terms "social security" to the editor of the SNA.

23. The question arises of what should we do with the pension promises of these *government-sponsored independent multi-employer schemes*?

24. Some could say that, if the pension promises of these schemes have the same strength than the traditional employer schemes' pension promises, then one should record a pension liability and assign this liability to the government which finally acts as the "sponsor" of these schemes. The AEG did not take any specific decision regarding these government sponsored schemes. But, based on the remark made in the first section whereby the main AEG recommendation applied only to employer schemes where the employer remained responsible for the pension liability even after having paid its contribution, one can say that the AEG implicitly did not recommend recording a liability for these schemes. In addition, the few papers of the Task Force that discussed this issue recommended to not record a pension liability for these schemes *in the core accounts*, but, instead record them in a set of special "*supplementary pension accounts*", outside the core accounts. Two main arguments can justify this. The first is that there are doubts on the nature of the pension obligation for these schemes: while there is virtually no doubt that that a pension will be paid, there is doubt about its exact amount. So the pension obligation is weaker than for pure employer schemes (we will discuss that more completely in section IV). The second argument is that it is not clear who should bear the pension liability. If one attributed it to the government this would mean to record, under traditional accounting, an enormous liability for the government (reaching 400% of GDP in some countries), without any assets attached to it. The box below, titled "contribution assets", discusses this issue.

25. After this long détour, we can now explain why the main frictional element of the debate concerns the schemes organized by the general government <u>for its own employees</u>. These

schemes are generally large (the pension liability is estimated between 20 and 80% of GDP) unfunded defined benefits systems. They are classical *employer* schemes and fall therefore *naturally* in the category referred to in the main AEG recommendation, for which a pension liability should be recognised in the core accounts of the new SNA.

26. Now, in countries where the “collective paradigm” is prevalent, the government has two functions regarding pension schemes: (1) organize a specific pension scheme for its own employees and (2) organize a large multi-employer scheme for the private sector’s employees.[8] What is essential to understand is that both functions are not distinctively different regarding the nature of the pension promise they make. Thus, experts of these countries have some difficulty to understand why the SNA would record a liability for the government scheme for its own employees (and thus a pension asset for government civil servants) but no liability for the very similar system that the government sets up for the rest of the society (thus no pension asset for private sector employees). This looks all the most strange when, in some of these countries, the government precisely want to show (or want to change things so) that, basically, the two systems are the same! To illustrate even more the difficulty of the situation, it is not so difficult to imagine that one of these governments could (and in some countries, it is even its political objective) change the functioning of its current specific government employees scheme to make it be part of the large general scheme for private employees. Thus, while remaining consistent with the AEG recommendation, this government would be able to wipe out, by a magical stroke, the pension assets of the civil servants and its own pension liability![9]

27. So here is where we are on the conceptual side. On one side, the majority of the AEG does not see why the government as an employer should not be treated as corporations: there is indeed a similar employment contract in both cases. On the other side, some countries do not see why the employees of a private corporation who are (by obligation) part of the government sponsored independent multi-employer scheme would not have a pension asset when government employees would have one. In other words, they see that the treatment of both pension schemes, the general one for private sector employees and the specific one for government employees, should be treated exactly similarly.

C. What solutions are there to resolve this real difference of perception?

28. One solution would be to have both the non autonomous government system for its own employees and the government sponsored autonomous multi-employer system pension liabilities recorded similarly but outside of the core accounts. However, this does not correspond to the vision of the majority of the AEG.

29. Another solution could be to include the liabilities of both systems in the core accounts rather than exclude both. However, the recording of a pension liability for the government sponsored independent unfunded schemes for private sector employees would pose serious accounting problems, as explained in the box below.

D. “Contribution” assets?

30. In traditional accounting, if one recognised a pension liability for the government sponsored independent unfunded schemes for private sector employees, one would add an enormous liability to the government (from 200 to 400% of GDP depending on country), without any asset, thus a pension scheme with a massive negative net worth. One would also record a massive imputed property income to households, resulting in the government being in structural deficit. This would be strange. It is difficult indeed to assign to the government the totality of the pension liability: the government is not the employer of the private sector employees; it only acts as the organizer of the system. Second, no institution could exist with such a negative net worth. Finally, to show a structural deficit when it is possible that the system is in fact in constant cash equilibrium in the future, would be a wrong message to markets.

31. One possible recording for these schemes, if we wanted absolutely to show for them a pension liability, would be to record for them a corresponding asset. What would be the asset? It would be the net present value of the future compulsory contributions to this government sponsored pension scheme. However to record such an asset is not possible in the SNA. It would be an accounting heresy. However, it is interesting to note that this is exactly how are shown the accounts of the very large Swedish Inkomstpension (which falls exactly in our category of government-sponsored independent unfunded schemes, and is, in addition, a “notional defined contribution” scheme, NDC[1]). It is also interesting to note that such a presentation would be a very sensible information for economists, because what counts really for monitoring these schemes is not the pension liability in itself, it is the possible mismatch between the liability and the “contribution” asset. This difference is indeed the net present value of the projected deficit of the system which is the variable that policy makers want to control. In such a complete set of accounts, it is only the difference between the “contribution” asset and the pension liability, and not the totality of the pension liability, that would be assigned to the government, which is indeed the “final” sponsor of the system. This complete accounting system would be quite attractive but cannot be implemented in the core accounts of the SNA. First, because the SNA excludes the recording of an asset resulting from future taxes or compulsory social contributions. A second difficulty would be that one would need to create counterpart liabilities, because any financial asset has, in the SNA, a counterpart as a liability. Thus the counterpart of those “contribution assets” would be notional “contribution liabilities” of contributors (households, businesses, government). But this would create another large set of imputed values in the accounts. It is therefore strongly recommended, if this idea of “contribution assets” is to be followed-up, to limit their inclusion in the supplementary accounts, without counterparts for other sectors.

32. In passing, it is interesting to note that this complete accounting system helps to understand why the SNA should show a pension liability for the general government towards its employees in all institutional arrangements, i.e. whether it organizes the pension benefits for its own employees within a specific employer system, or within the large general independent multi-employer scheme. In the first case, because it falls naturally under the main AEG recommendation. In the second case, because there is an implicit “contribution liability” of the government towards the independent multi-employer pension scheme.

E. Implementation issues

33. The second reason for some countries to be concerned by the recording of a liability for government employee schemes is with the implementation of this recommendation. One must recall that its implementation requires the use of actuarial methods to compile the liability as the net present value of the future pension obligations. This implies difficult estimates, which are today the core business of professional actuaries. The details of the method used by the *actuaries* can be found in the Task Force's papers.

34. In this context, while business accounting standards (in particular the international IAS 19, but there are other equivalent recommendations on a national basis) now strongly recommend the recording of the pension liability using these methods, it is not certain that businesses will all implement it. Moreover, not all governments implement such a calculation. In both cases, it would be quite impossible for a statistical office to undertake such calculations without the help of the employer itself. In this context, the concern focuses on the calculation of the liability for the scheme for government employees, which is a large and quite obvious amount in the national accounts, as the government appears as an individual institutional sector. Thus the implementation of the SNA recommendation would imply a cooperation with government services which is not for the moment guaranteed in all countries. The concern of statisticians of these countries is compounded by interrogations on the quality of this calculation, and its particular dependence on the major parameter of the calculation: *the discount rate*. This parameter commands the value of the liability and the value of the imputed property income (that itself impacts the public deficit). While the AEG has backed the proposal of the Task Force to recommend the use of a "discount rate for government bonds with a maturity adapted to the structure of the benefits", even thus defined, this rate is probably subject to some interpretation and arbitrariness.

35. However, finally, the AEG did not reject the recommendation on the basis of its difficulty of implementation. Indeed, one can consider that it is the right moment for the SNA to embark statisticians in such actuarial calculations. The businesses are going in this direction. Already a number of OECD or non OECD governments have done or are starting these calculations, pushed by public sector accounting standards. There is thus already quite a large and growing experience on using these methods. Also, there will be several years before the implementation of the new SNA, a period which can be used to make pilot studies. In any case, it will always be possible to separate these estimates from the other estimates, even in the core accounts. An OECD paper presented during the Task Force showed a way to preserve existing accounting balances while offering new alternative balances. Finally, for European countries, it would always be possible, if necessary, to calculate a specific balancing item "net lending/borrowing" adapted for the "Excessive Deficit Procedure", which would exclude the elements calculated on an actuarial basis.[10]

36. The arguments regarding the difficulty of implementation did not, therefore, deter the AEG from formulating its main recommendation. However, the conceptual issue presented above needs further work.

POSSIBLE SOLUTIONS TO THE CONCEPTUAL ISSE

37. The AEG proposed two first possible solutions to resolve the conceptual issue. However, both solutions would have the disadvantage of not improving international comparability. This is why a necessary condition was introduced. The below paragraphs comment this necessary condition and the two solutions discussed at the AEG meeting. It is important to note that these solutions are first directions of work. There may be other and better solutions that were up to now not envisaged. A European task force is going to be convened, and a second meeting of the Task Force on Pension Schemes could be organised later this year. There was indeed a strong commitment of the recent March 2006 UN Statistical Commission to reach a consensual solution for this issue.

A. A necessary condition for a solution

38. The two solutions discussed by the AEG imply that countries could, in their national accounts, treat differently pension schemes that are close to each others. Thus, it is important to note that a <u>necessary</u> condition for the two solutions to be accepted is the creation of a <u>set of supplementary pension accounts</u> where one would record the special “pension obligations” that may be not recorded in the core accounts. Indeed, without these new supplementary accounts, international comparability would not progress: government pension schemes could be treated in a different way across countries. Users should therefore have the information that allows them to have the full picture, even if this picture is in two parts, one in the core accounts, one in supplementary accounts.

39. While the principle of these supplementary accounts has been recommended by the AEG, they have now to be described in detail so that the editor can concretely incorporate them in the SNA. Proposals have been made in the paper presented by the European CMFB to the Task Force. A box of the present paper also suggests the recording of pension “contribution assets”. All these points should be discussed by a special task force or by the Task Force on Pension Schemes in conjunction with Eurostat, under the aegis of the ISWGNA.

40. Regarding the solutions themselves, the AEG proposed two directions of work: (1) a pure “opt-out” option, and, (2) the exploration of “new criteria”.

B. The “opt-out” solution.

41. This solution underlies the AEG wording whereby: *“The AEG notes” that “some countries” prefer “not including the liabilities for pensions of government employees in the core accounts but of including them together with the liabilities for social security schemes in the supplementary accounts.”*

42. One could call that an implicit “opt-out” option. The central recommendation of the SNA would remain to record pension liabilities for all employer schemes in the core accounts. Simply, the SNA would “note” that, without specific reasons, some countries record them in supplementary accounts. The advantage of this solution is that it is simple and allows all to implement what countries think is best. As long as the data is available in the supplementary accounts, it allows users to have the information (and possibly re-treat it). The view of the strong majority of the AEG remains the central conceptual view of the new SNA, implicitly

meaning that, may be, in the future, the "other countries" will join in.[11] Thus this solution has some advantages. However, it is more an "ad-hoc" compromise than a good solution, and the recent UN Statistical Commission has shown its preference for a real conceptual solution based on the development of "new criteria".

C. The "new criteria" proposal.

43. This is why the AEG *"felt it necessary to develop criteria that would distinguish between the several types of schemes. Possible criteria, among others, could be the employer/employee relationship or the nature of the liability. The ISWGNA will explore alternatives for developing criteria."*

44. What is suggested here? The main AEG recommendation is based on one single criterion: the existence of an employment contract. As we have seen, many participants in the debate do not accept to record a liability in the core accounts in the case of employer schemes where the employer has no more obligations to the scheme after having paid its contribution. Thus the existence of a pension promise linked to an employment contract can be seen as not being a *sufficient* condition to transform the pension promise into a pension *liability*.

45. This is why the AEG proposed to find other criteria that could be used, <u>in addition to the employment contract</u>, to recognize or not a pension liability. For the moment, criteria based on the different types of schemes (employer *versus* social security, autonomous *versus* non autonomous, etc), have been discussed and need to be better specified. Further work would be welcome on this. However, useful new criteria could also result from focusing on the "*nature*" of the pension promise and thus responding to the following questions: is the pension promise a full liability? Is it rather a provision or a contingent liability?

46. This conceptual solution would be based on distinguishing between these different *degrees* of pension promises. Indeed, in business and public accounts, a distinction is made between a (full) liability, a provision (a liability of uncertain timing or amount), and a contingent liability (an obligation whose existence depends on the future occurrence of factors independent of the unit or an obligation which cannot be measured with sufficient reliability). Transposed in the national accounts, this solution would be to record "full pension liabilities" in the <u>core</u> national accounts and "pension provisions" or "pension contingent liabilities" in the <u>supplementary</u> set of pension accounts.

47. The *legal ground* of the promise could be one criterion, among others. Indeed, in some countries there is no *legal* recognition of the value of the pension promise by the government for its employees. In Germany, for example, the Supreme Court has recently rejected an appeal of some civil servants who contested a *retroactive* modification of their pension rights. The Court judged that, while the Constitution guaranteed them a right to pension, the law did not guarantee them the value of this pension nor the mode of calculation of this pension. Also, in France very recently, the government, by law, decreased *retroactively* the pension rights of its civil servants (despite massive strikes). Thus experts of these two countries, in agreement with others, are concerned to qualify this pension promise of the government to its employees as a full liability.

The same argument is used by many others to exclude the recording of a pension liability for social security schemes, because it can be changed by law.

48. However, legality should not probably commend macro-economic accounts and thus this should not be the unique additional criterion. Here are some additional criteria that could be taken into account.

49. One criterion could be the *guarantee* given by the employer to the employee of the accrued amount of pension. *Guarantee* would mean that employers are, *legally or by past practice*, bound to fulfill their contractual pension obligation vis-à-vis individual employees. If this guarantee is given, then the pension promise would be a liability recorded in the core financial accounts (as F6). When, on the contrary, the amount of the pension is *not guaranteed*, and in particular when the employer does not commit itself that the value of the past obligation will remain unchanged, in particular when the formulae underlying the value of the obligation can be changed retroactively to the detriment of the beneficiary, then the pension obligation would not have the characteristics of a pension liability classified as F6 in the SNA. In this case, the pension promise has the characteristic of a provision or a contingent liability and would be recorded in the *supplementary set of pension accounts*.

50. Another criterion could be the recognition of the liability by the institution itself. In particular, the fact that the employer/sponsor records in its own accounts a pension liability should be considered, in practice, a sufficient (but not necessary) condition that the pension promise is indeed a pension liability for the SNA.

51. It is important to note that this “nuance” between two types of pension promises is not an “ad-hoc” invention, built only for the purpose of trying to absolutely find a compromise. It builds on the difference in business accounting between liabilities, provisions and contingent liabilities. For example, the wording “*by past practice*” is directly extracted from the business accounting concept of “constructive obligation”. It is not a heresy that this is reflected in the SNA.

52. These criteria may therefore lead to a good accounting solution that is applicable both by countries where the “pure employer” paradigm is the prevalent second pillar than by countries where the “collective paradigm” is prevalent. In particular, when governments have themselves recorded a liability in their own accounts, this should be considered a sufficient condition to record a liability in the core accounts of the SNA. On the contrary, when the government do not record a pension obligation at all or record the amount as an off-balance sheet memorandum item, then the national accountants should verify if the pension promise is a liability, a provision or a contingent liability using the above conditions and record it accordingly, in the core accounts or in the supplementary accounts.

53. It is interesting to note that these additional criteria give an accounting rationale to the fact that the SNA would not record pension liabilities for social security schemes. Indeed, it is a typical case where the government can change retroactively its obligations by law. When, in some countries, this is also the case for schemes set up by government for its own employees, this justifies that these countries would be allowed to record these liabilities in the supplementary accounts, alongside those of social security, and not in the core accounts.

54. It is important to insist once more on the fact that this solution goes along with the creation of the set of supplementary accounts. Thus it does not exclude from the SNA the information on the pension obligations of some government sponsored schemes. It simply shows some of them (those not having the status of a full pension liability) in the supplementary set of accounts and not in the core accounts. In this context, the recording of this amount in the supplementary accounts rather than in the core accounts will be a proof that this amount is not *guaranteed* by government to its own employees!

OTHER AEG DECISIONS PERTAINING TO PENSION SCHEMES.

55. While the present paper has focused on the main recommendation of the AEG, it would be a lost opportunity to not mention the other decisions taken by the AEG regarding liabilities of pension schemes.

56. The most important additional question was linked to the treatment of *explicit* exchanges of *implicit* pension liabilities. In the recent years, a number of countries experienced large one-off transactions between pension systems and the government linked to pension reforms or to partial privatizations of public corporations. In Europe, at least three transactions of that type occurred in the last decade (France: *France-Télécom*, *EDF*; Belgium: *Belgacom*) involving amounts of several decimal points of GDP. In Japan, a large transaction (called '*Daiko Henjo*': "Pay Back" or "Return"[12]) occurred in 2004, amounting to 0.6% of GDP. In all these cases, the transaction is clearly (and officially) presented as an exchange (in principle a *balanced* exchange) of a pension obligation for the future against a lump-sum today. This transaction is therefore not supposed to change the net wealth of the units involved in the transaction: cash is paid or received on one hand, but a financial obligation is passed on the other hand. However, the difficulty raised with the SNA is that these transactions may occur between schemes for which the SNA may not recognize a pension liability, for example, social security, or, in the SNA 93, unfunded government employee schemes. Faced with this situation, which is not specifically discussed in the SNA 93, experts in national accounts decided up to now to record the counterpart of the lump-sum received by the government as a <u>capital transfer</u>, thus improving the net lending/borrowing of the government and, thus, its net worth on the year of the transaction.[13] This came after a first long (and painful) discussion in Europe in 1996, and was confirmed by Eurostat in February 2004.

57. This is now completely changed and will not be possible in the future SNA, as the AEG agreed that "*when the obligation to pay pensions passes from one unit to the other, this should be recorded as a transaction in pension liability even if neither unit has previously recorded them*.[14]"

58. One good reason for this decision is that the pension obligation, which may not have had before the status of a full liability, becomes a full liability <u>because of the transaction itself</u>, simply because its value has been recognised by both parties. Some may still see that there is a contradiction in recognizing a pension liability for a unit for which one does not in principle recognize a pension liability. This can be resolved by several accounting means, such, for example, as creating a virtual unit, devoted to "hold" this liability. But other solutions, such as to record a pre-payment of contributions, are possible.[15] In any case, thanks to the AEG decision,

the net worth of the government will remain unchanged in the period of the exchange, which is satisfying for the rationale of accrual accounting.

59. The second important additional decision of the AEG clarified the case of schemes labeled as social security but which may include two sub-branches: one functioning as a social security system, one functioning as a saving scheme. The current SNA says (Par 13 of Annex IV): *Social security schemes may be either funded or unfunded. <u>Even when separate funds are identified, they remain the property of the government and not of the beneficiary of the schemes</u>*. Some interpreted this sentence as saying that when any scheme is imposed and controlled by government (which is the main definition of social security in the SNA 93), it should not be treated as a saving scheme, even if it has characteristics of saving schemes (e.g. even if it is funded).

60. On the contrary, the AEG recommended that "*a liability should be recorded for schemes that are funded and where the benefits are related to the contributions <u>even though the schemes may be described as social security scheme</u>*."

61. The consequence will therefore be, in the case of these mix schemes, to recommend separating the sub-scheme which has the characteristics of a saving scheme (in particular, when it is funded) from the other one and recognizing a liability for this scheme, even if it is imposed and controlled by the general government.[16]

[2] The complete short minutes of the AEG are available on the UNSD web site. The recommendations of the AEG regarding pension schemes AEG (Issue #2, papers SNA/M1.06/03.1 and SNA/M1.06/03.2) can be found in pages 19 to 21 of this document.
[3] «Record a pension liability » is equivalent in SNA to "record the scheme as a saving scheme", with all associated transactions: in particular, when a liability is recognised, contributions are treated as savings, pension benefits are treated as dissaving, and a property income to households is imputed.
[4] This includes general government as an employer of its own employees.
[5] To be fully rigorous one should say here the "net" pension obligation (i.e. the pension liability *minus* assets detained by the pension scheme on behalf the employer). The qualifier "net" will sometimes be implicit in the rest of the paper.
[6] A large part of the following paragraphs were kindly inspired by A. Harrison.
[7] However, in some countries, the government can act implicitly or explicitly as the last guarantor of private employer pension promises, when the latters fail to their obligations (bankruptcy, for example).
[8] Paradoxically, one could even say that, in some of these countries the only significant "pure employer" type employer scheme is the one organised by the general government for its own employees!
[9] This very annoying issue was raised with the AEG. The author of the present paper proposed to the AEG that, in any case, a liability should be recorded for the government, whether or not it system for its employees is organized through a non autonomous or an autonomous system. The last paragraph of the box "contribution assets", gives a justification to this proposal.
[10] The EDP debt already excludes pension liabilities.
[11] Such a compromise was adopted in the SNA 93 for the allocation of FISIM, and, finally, after some years, all countries have accepted to allocate FISIM.
[12] *Daiko* means to carry out something on behalf of someone, *Henjo* means to return.
[13] It would be however wrong to think that the recording as a capital transfer is <u>always</u> "favorable" to the government. It is favorable on the year of the payment of the lump sum, but it is unfavorable in the next years as pension benefits are paid. On the long run, the net wealth is unaffected. In other words, the issue is strictly limited to an accrual issue.
[14] The decision of the AEG is specific to *balanced* transactions (i.e. where the asset exchanged with the pension obligation is equal to the value of the pension obligation). If the exchange is unbalanced, then, obviously, part of it should be treated as a capital transfer.
[15] Some experts might prefer this presentation as pre-payment of contributions. This "technical" alternative solution

had been proposed during the discussions in Europe. It has exactly the same recordings as the recognition of the pension liability, but using alternative titles and codes.

[16] This is consistent with the recent decision of Eurostat (*Eurostat, New decision on deficit and debt, 2/3/2004*).

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