Senate Budget Committee Republican Staff
BUDGET BULLETIN
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INFORMED BUDGETEER

CONFERENCE BEGINS ON HIGHWAY BILL

- Last week, conferees held their first meeting on the bill reauthorizing highway and transit programs for 2004-2009. While no one outlined a clear path to getting to an enacted bill, one dichotomy was clear from the opening statements: the Senate bill is "paid for," or it is not. While some members carried over the mantra, continuously invoked during consideration of the Senate's version of the bill, that the bill was "fully offset," others observed that, despite the good intentions to offset the bill, they were never quite fulfilled. The following table (representing the latest CBO and JCT estimates and updating previous *Bulletin* versions of the table) summarizes the effect of the three highway proposals in competition in the conference.

SURFACE TRANSPORTATION REAUTHORIZATION
Totals for 2004-2009 ($ billions)

	Senate-Passed SAFETEA	House-Passed TEA-LU	President's 2005 Budget (CBO Reest.)
Highways			
Contract Authority	263	232	212
Obligation Limitation	245	228	212
Outlays	222	211	201
Transit			
CA=Obligation Limitation	47	41	36
Discretionary BA	10	10	8
Subtotal-Transit Resources	57	52	44
Outlays from CA	46	43	40
Outlays New from Disc. BA	13	14	12
Subtotal Transit Outlays	59	56	52
TOTAL			
Contract Authority Only	310	273	248
Total BA (CA + Disc. BA)	**319**	**284**	**256**
Obligation Limitations	291	269	248
OUTLAYS /a	**268**	**254**	**241**
REVENUES – Highway Trust Fund			
CBO Baseline	228	228	228
Outlays > Baseline Revenues by:	40	26	13
Revenue Effects from Bills /b	17	-6	1
TOTAL REVENUES UNDER BILL	**245**	**222**	**229**
INCREASED SPENDING/TAX CUTS NOT PAID FOR – INCREASE IN FEDERAL DEFICIT	**22**	**32**	**12**

NOTE: CBO estimates for outlays, JCT estimates for revenues. Totals may not add due to rounding
a. Outlays reflect only spending from highway trust fund resources; does not include outlays from discretionary appropriations for mass transit.
b. A positive number is an increase in revenues, a negative number is a decrease in revenues.

- Remember that under the last highway bill (TEA-21), the mantra was that all gas tax and related receipts into the highway trust fund should be used only for highway and transit spending. In other words, the overall federal deficit or surplus would not benefit from gas tax "user fees," nor would the general fund subsidize highway trust fund spending. So consider how each of the proposals adheres (or doesn't) to that test by examining the cash that each proposal would bring in to the federal government over the 6-year period and how much cash would be spent.

- For the Senate bill, CBO estimates that outlays from highway trust fund resources (not including any transit outlays from discretionary appropriations) would total $268 billion. JCT estimates the bill would add $17 billion in net additional receipts to the $228 billion in baseline receipts, meaning that the federal government would spend $22 billion more than it would take in if the Senate bill were enacted.

- In comparison, the House bill would spend $14 billion less in outlays than the Senate bill. But it also would cut, rather than raise, taxes, so that the House bill in total would generate $23 billion less in receipts than the Senate bill. As a result, the House bill would increase the federal deficit by $32 billion -- $10 billion more than the Senate bill. Even the President's proposal, which includes hardly any additional receipts to pay for its smaller increases in spending, would increase the federal deficit by $12 billion over the authorization period.

- So why would some argue that the bill is fully paid for or is $8 billion short of being paid for? Such snapshots require narrowing the view from the federal government's perspective (real cash, in and out) to the highway trust fund perspective, which involves "crediting" things to the trust fund or moving budget entries from the general fund to the trust fund or vice versa. From a trust fund perspective, the Finance Committee, as guardian of the trust fund who defines what goes into it, had made a commitment to the chairman and ranking member of the Senate Budget Committee (who are also both members of the Finance Committee) to pay for some of the non-cash transfers that were employed to create additional room in the trust fund for highway and transit spending. But under this commitment, the Finance Committee was able to get consent to add the last $8 billion in revenue offsets before going to conference.

- Besides all the other more well-known puzzles related to this highway conference (overall funding level, donor/donee), this issue of "pay-fors" looms. How much of the bill will conferees decide must be paid for (or, how much of an increase in the deficit will the conferees and the Administration agree to let the bill cause)? And will all of the revenue offsets thus far being used in the Senate bill still be available when the conference report is filed, since many of them are also being used in other bills that might be enacted first? The next *Bulletin* will examine this question of the same offsets being used in multiple bills.

DOES IT COST MONEY TO SAVE MONEY?

- At the end of this month, the National Flood Insurance Program (NFIP, operated by the Federal Emergency Management Agency – FEMA) faces expiration after yet another in a series of short-term extensions. Two bills pending in Congress appear to try to shore up this ailing program in exchange for granting a longer-term extension.

- Because private insurers did not offer flood insurance at affordable rates, the National Flood Insurance Act was enacted in 1968 to make available federal flood insurance in communities that agree to implement flood plain management rules to reduce future flood damage. Currently, the federal government has nearly $700 billion of flood insurance policies in force. The goal of flood insurance was to reduce the need for the federal government to step in with ad hoc relief payments and reconstruction loans after a flood has occurred. As with any insurance, homeowners and businesses purchasing flood insurance would pre-fund potential future losses. The program also encourages preventive measures to reduce future losses through (1) the development of flood maps, and (2) the requirement that local communities use floodplain management ordinances that would regulate where new construction occurs.

- So how has actual experience compared to the goal? The General Accounting Office (GAO) has argued in testimony and reports for at least the past decade that the NFIP is not actuarially sound: by design, income from premiums is not sufficient to build reserves that will meet future expected flood losses. Why? About 30% of the 4.5 million policies in place are subsidized by the federal government. Because some structures were built before NFIP completed its flood mapping (showing where communities should not build because of a high flood risk), the law intentionally charges an insurance premium representing only about 38% of the full premium they otherwise should pay to reflect the increased flood and loss risk they face (so the federal subsidy on these for these structures is 62%, worth about $500 million annually).

- In addition, GAO highlights certain properties (nearly 50,000) that have suffered repeated losses from floods (two or more losses greater than $1,000 in a 10-year period). Such properties represent only 1% of all policies, but have accounted for about one-third of the historical claims. Half of these repetitive-loss properties are located in only three states: Texas, Louisiana, and Florida. Many of these properties have had cumulative claims that exceed the value of the structure. The combination of those properties receiving a subsidy or suffering repetitive losses (often, the same properties fall in both categories) means that a small subset of policies accounts for a disproportionate share of costs.

- CBO, in its last budget options report (March 2003), examined two options that would address each of these problems. Phasing out the subsidy for those owners not currently paying the full-risk premium would save $0.6 billion over five years. This option first appeared in CBO's 1987 budget options volume and has been repeated seven times since then. Alternatively, CBO most recently estimated that dropping flood insurance coverage for those properties that make repeated claims would save about $1 billion over five years. This option has appeared in the last four CBO volumes. Both of these approaches would use a good-business approach of removing existing incentives that encourage risky behavior. But given their longevity as CBO options, it appears that Congress is in no hurry to enact either one of them.

- Certainly none of these savings would materialize as a result of either of the competing versions of the Flood Insurance Reform Act of 2004 (H.R. 253, as passed by the House, and S. 2238, as passed by the Senate). These bills would provide a long-term extension (through 2008) of the program while promising, as the title they share advertises, to "reform" it as well. But in fact, neither of the bills would make any of the direct changes in the program that would immediately reduce the exposure of the federal government to the costs of future flood losses. Instead, the bills authorize appropriations ranging from $300 million to $500 million over the next five years for various mitigation efforts for the subset of properties that have cost the program $4.6 billion since 1978.

- If those additional amounts are ever appropriated, then increased mitigation through elevation, relocation, demolition, or flood-proofing could result in fewer claims paid by NFIP following a flood. CBO estimates that the initial for the bills' mitigation programs could be recouped through lower claims after 5 to 10 years depending on the incidence and severity of future floods. But the mitigation approach adopted by these two bills would result in no net savings to the federal government because the federal government would be paying to help owners maintain their property in some way rather than force them to face the economic cost of their decision to continue with risky behavior (as contemplated in the CBO options).

- If, for some reason, some owners refuse to participate in these federal mitigation programs, then under the Senate bill the NFIP would increase their (usually subsidized) premium by 50 percent. Under the House bill, such owners who refuse mitigation would see their premiums increase even further, to the fully unsubsidized level. In addition, H.R. 253 would make such owners ineligible for disaster relief they otherwise might have received above and beyond the flood insurance payouts they would get under their policies. Though this universe of recalcitrant owners is likely to be small, some mix of these policies to discourage uncooperative behavior would generate net savings to the federal government, although those small savings would be insufficient to make the program actuarially sound.

BUDGET QUIZ

Question: A recent Reuters report said: "The price keeps going up at the pump for U.S. consumers. . .to a *record* $2.064 on [May 24, 2004], the government said. . . .When adjusted for inflation in 2004 dollars, the *highest* gasoline price would have been $2.99 a gallon in March 1981, according to the Energy Department's analytical arm [the Energy Information Administration]." Can both be true?

Answer: No. But what is hard to tell from this and similar bits of reporting is whether it is the press arguing that recent gasoline prices are at record levels or whether it is an "arm" of the federal government saying that. Certainly, the EIA gets it analytically right by adjusting for inflation. Then, anyone can tell that current prices of around $2 per gallon is about a third less than the highest, or record, price of $2.99 that occurred 23 years ago. So why do some persist in saying that current prices are "record highs"?

Consider the case of a group of reporters, all of whom were earning an annual salary of $50,000 in 1981. Today, all but one in that group of reporters is now making $100,000, meaning their purchasing power has barely kept up with inflation and they are essentially in the same place as 23 years ago. [$50,000 x (2004 GDP Composite Deflator=1.082)/ (1981 GDP Composite Deflator=0.5562) = $97,267.] But one of that group is now making only $80,000 -- $30,000 "more than" 23 years ago. Who would argue that the lone reporter is making a "record" salary at $80,000, when nearly 20% of purchasing power has been lost? If this example makes sense, then maybe the press will be able to resist perpetuating the cheap claims of nonexistent "records."