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INFORMED BUDGETEER

WHAT IS THE FARM BILL'S REAL COST? (HINT: MORE THAN ADVERTISED)

- Farm Bill conferees have reached a "framework agreement" for this year's farm bill pending CBO's scoring. This framework is supposed to fit within the $73.5 billion that the FY 2002 Budget Resolution allocated to the Agriculture Committees for 2002-2011.

- For budgeteers and taxpayers, the evolution of this bill has defied budget logic. To review – of the $73.5 billion allocated to the Agriculture Committees, $66.15 billion was held in a reserve fund and was not to be released if it would reduce the on-budget surplus below the level of the Medicare Hospital Insurance Trust fund. Adoption of the 2002 budget resolution and tax relief bill was accompanied last summer by plentiful rhetoric from the current Senate Budget Committee Chairman about how they invaded the Medicare trust fund. But what happened in the fall? Both Budget Committee Chairmen released the Ag Reserve fund anyway because they determined it did not invade the Medicare trust fund when considered against the April 2001 CBO baseline.

- Savvy budgeteers could allow themselves a knowing smile for noting that the absence of a 2003 budget resolution was not an insignificant factor in the farm bill conference. Without a new resolution, the conference report could still be evaluated by the Budget Committee Chairmen against the old resolution and a very old baseline.

- CBO has updated its baseline three times since last April. The most recent agriculture baseline (March 2002) has increased due to declining commodity prices. Compared to the baseline estimate of April 2001, the latest baseline has increased by nearly $10 billion for the same 10 years, as shown in the table below.

Farm Bill Baselines and FY 2002 Budget Resolution Assumption
(outlays by fiscal year, $ in billions)

	FY 2002	FY02-11
CBO April 2001 Farm Bill Baseline	12.7	97.6
Budget resolution 2002 (Increase farm bill funding assumption)	7.4	73.5
Total Budget Resolution assumption	20.1	171.1
CBO March 2002 Baseline	16.9	107.2
Difference March 02 - April 01 baseline	4.2	9.6

Source: CBO

- This means that the cost of the conferenced farm bill will exceed the $73.5 billion allocation when it is finally scored against the new baseline, because many policies are closely tied to current commodity prices and federal payments rise when prices fall. The *Budget Bulletin* hopes that the lack of a 2003 Budget Resolution was not due to the fact that the farm bill really costs more than $73.5 billion.

GDP AND REVENUE

- Real GDP grew at a 5.8% annual rate in the first quarter (January-March), according to the advance estimate provided by the Commerce Department. This was above most analysts' recent expectations and surely higher than the forecast the CBO used in March when it revised its baseline budget projections.

- However, the strong economic growth data should not lead to optimism about FY 2002 revenue. Revenue for the same 3 months was down about 10% versus last year, and, so far, April non-withheld individual income and employment taxes are running well below the levels of the previous two years. In the short-run, revenue is being driven by technical factors such as the amount of revenue generated for a given amount of GDP, not GDP itself.

- A preliminary Republican SBC estimate – assuming no further legislation – is for total revenue to be about $1,910 billion for FY 2002. The CBO March baseline projected revenue at $2,006 billion. That was before the enactment in March of the Job Creation and Worker Assistance Act of 2002, which was estimated to reduce 2002 revenue by $52 billion.

THE OUTLOOK FOR TERRORISM INSURANCE

- Since the World Trade Center attack, the insurance industry has decided that it can not afford to continue offering terrorism coverage unless the federal government develops a program to pool terrorism risk. Most actuaries now do not believe they can adequately quantify the risk of terrorism as well as they can for other insurable events such as natural disasters. It is too difficult to predict when terrorists will strike and how much damage will result.

- Some policymakers believe the absence of terrorism coverage will prevent entrepreneurs from obtaining financing for massive construction projects and hinder the economic recovery. In response, the House last November passed a bill (H.R. 3210) establishing a risk pool that would encourage the insurance industry to continue offering terrorism coverage. However, disagreement in the Senate about limiting the award of punitive damages resulting from such an attack thwarted enactment of the bill.

- In the absence of federal action, most reinsurers withdrew terrorism coverage from insurers at the end of December, when 70% of reinsurance contracts came up for renewal. Reinsurers insure insurance companies and provide them with an addition channel for spreading risk. Insurers find it more difficult to manage their exposure to liability without reinsurance, so their ability to offer affordable insurance policies for unquantifiable risks is constrained.

- Unlike reinsurers, insurance companies are regulated by state agencies and can not withdraw insurance coverage unless they receive prior regulatory approval. Therefore, depending on what point in the year companies originated their policies, it would take insurers almost a year to unwind their direct exposure to terrorism risk if they were to receive regulatory approval. To date the insurance industry has successfully lobbied 45 state regulators to exclude terrorism coverage from their existing policies. The five states without exclusions include California, New York, Florida, Georgia and Texas.

- Even so, more than half of the states continue to require insurers to include "standard fire policy" protection in their contracts. Despite the terrorism exclusion, this means insurers would still be responsible for paying claims resulting from a terrorist attack if the damage was caused by a fire which could increase the cost of policies. GAO has testified that fire damage was responsible for most of the damage caused in the World Trade Center attack.

- As the insurance industry continues to withdraw coverage, banks increasingly have to absorb the risk that the property they finance could be destroyed by a future terrorist attack. Most banks require borrowers to maintain total insurance coverage on any mortgage. However, many policyholders were in technical default when their terrorism coverage lapsed in early January.

- Most banks are urging their borrowers to obtain new terrorism risk insurance policies. Those companies that can even find new coverage will certainly pay higher premiums. Conceivably, companies without terrorism insurance may also face difficulty refinancing their mortgages. Both of these possibilities are likely to cause borrowers to pay higher borrowing costs and place additional strain on their ability to service their debt. Recently, the Bond Market Association announced its members have canceled or postponed more than $7 billion of commercial mortgage loans as a result of the reduced terrorism coverage in the insurance market.

- Without terrorism insurance, new high profile construction projects are also unable to obtain financing. Commercial developers who do find terrorism coverage are either offered insufficient or prohibitively expensive protection. Understandably, investors and lenders are reluctant to invest in new marquee or trophy construction projects that face significant terrorism risk.

- As insurers and reinsurers withdraw from the market for terrorism insurance, they are not only taking with them their expertise in the area of spreading risks but also their ability to assess claims and make payments. This means that if the government decides not to establish a terrorism reinsurance pool now, and later decides that it wants to help victims of a future attack, its ability to respond in a timely manner could be significantly impaired because it will be woefully inexperienced in assessing claims and making payments.

- Given the public policy problem, what is the outlook for consideration of insurance legislation over the next month? The Senate leadership is in the process of crafting a unanimous consent agreement that is acceptable to both Republicans and Democrats. However, a satisfactory compromise has not been reached on how to address limitations on punitive damages.

Framework for Terrorism Bill in the Senate

- The Senate proposal that is being used as the basis for negotiating a unanimous consent agreement was crafted by Senators Dodd, Gramm, Sarbanes, and Daschle last fall. The proposal addresses the problem of reduced availability of terrorism insurance by establishing a two-year program that provides a federal backstop to property and casualty insurers who incur losses as a result of a terrorist attack. Participation would be mandatory for commercial insurers and optional for personal lines. Life and health insurance are specifically excluded.

- Federal aid would be available to the insurance industry only after it incurs more than $10 billion in losses. Individual companies would be eligible for assistance sooner if their losses exceed their proportion of the industry-wide deductible, which is calculated according to their market share. The government's liability would be capped at $89 billion. CBO estimates the program could cost between $4-6 billion over the next ten years. The inclusion of language limiting punitive damages would have no impact on the legislation's cost.

- In contrast to the Senate bill, the House-passed bill would require the insurance industry to repay the federal assistance its receives, reducing its ten-year cost to $3.2 billion. Note that the CBO cost estimate for the House passed bill is a point estimate rather than a range. The inclusion of the company-specific deductibles in the Senate bill increased its complexity, hence the range. H.R. 3210 would ban all punitive damages.

HERE WE GO (SOMEDAY): FLOOR PROCEDURES

- According to the budget cycle, the Senate should have already debated the Committee-reported budget resolution for 2003, but it appears delay will continue instead. While we are waiting, well-prepared budgeteers will remember that there are special rules for consideration of budget resolutions and especially amendments to the resolution on the Senate floor.

- The resolution is privileged for consideration, and section 301(a) of the Congressional Budget Act requires that Congress complete action on the resolution on or before April 15th. Although Congress has, more often than not, missed this deadline, this is the first time in the past 10 years that the Senate did not at least begin consideration of the measure either before the April 15th deadline or at least within a few days of the Committee having reported the measure. If the Senate never takes up the budget resolution for 2003, it will be the first time in the history of the Budget Act that the Senate has failed to do so.

- Amendments to the budget resolution must be germane. The Committee-reported resolution forms the basis for germaneness. Amendments to strike language, or to change dates or numbers are considered to be per se germane. Note that, pursuant to Section 204(g) of the FY 2001 budget resolution, "Sense of the Senate" amendments are not germane. All other amendments are evaluated on a case-by-case basis by the Parliamentarian. A vote of 3/5ths of the Senators is required to waive the germaneness requirement or to overturn the ruling of the Chair.

- Senate procedures generally provide that a single amendment may not amend the underlying measure in more than one place, and an amendment that does so normally would be subject to a simple majority point of order. However, the Budget Act waives this prohibition for amendments to the budget resolution if the changes are required to maintain the mathematical consistency of the budget resolution. (In fact, mathematical consistency is a requirement of The Budget Act. If a resolution, or an amendment thereto, is not mathematically consistent, then it would face a point of order that could be waived by a majority vote.)

BUDGET QUIZ

Question: On April 1st the President announced that the federal government would turn Governors Island, located off the southern tip of Manhattan, over to New York state for a nominal fee. New York plans to use the island as a campus for the City University of New York. But the Balanced Budget Act of 1997 requires the island be sold at "fair market value." How can both be true?

Answer: We should begin with a brief history of the island. In 1637 the Dutch bought Nutten Island, as it was known at the time, from Native Americans for two axe heads, a string of beads, and a handful of nails. It became known as Governors Island because Dutch and later British governors would use the island as a retreat. But due to its strategic location in New York harbor, Governors Island became an important military base. For this reason, New York transferred the island to the federal government for $1 in order to protect the city from the British during the War of 1812. The island was used by the military until it was vacated by the Coast Guard in 1997.

The Balanced Budget Act of 1997 mandates "the Administrator of General Services shall, no earlier than fiscal year 2002, dispose of by sale at fair market value all rights, title, and interests of the United States in and to the land of, and improvements to, Governors Island, New York." The law also gives the State of New York right of first offer to purchase the island. At the time, the sale was assumed to generate $500 million. This estimate has since been revised down. The President's 2003 budget assumes the federal government would receive $300 million for the property in 2003. But the Administration recently announced it was going to sell the island to New York for a nominal amount. How is this possible? Can the Administration sell the land for a nominal amount and still comply with the mandate to sell the island for "fair market value?"

"Fair market value" is determined by what people would be willing to pay, which is determined by what they can do with the property. That value can be greatly influenced by local zoning decisions and restrictions placed on the sale by the federal government. The more that zoning limits what a property can be used for, the more the fair market value is depressed. Thus, New York City has a great influence over what constitutes the fair market value of Governors Island. It is probably fair to say that in the end, the amount the federal government receives for Governors Island will be significantly less than $300 million (but hopefully more than two axe heads, a string of beads, and a handful of nails).