INFORMED BUDGETEER

SKY-HIGH LOAN SUBSIDY FOR AMERICA WEST

- In January, America West Airlines received a $429 million loan, of which $380 is guaranteed by the federal government. Because of the complexities of the deal, OMB has only recently announced it will record $172 million in subsidy BA for the guarantee. In exchange for this 40 percent federal subsidy, the company owes the government $130 million in fees over the 7-year life of the loan, as well as 18.8 million warrants, which give the government the option of purchasing approximately one-third of the company's common stock at a low cost. As this type of federal credit assistance has few precedents (the Chrysler bailout being one), cutting-edge budgeteers may want to familiarize themselves with it.

- The Air Transportation Safety and System Stabilization Act, enacted September 22, 2001, provides up to $10 billion in loan guarantees to help airlines recover from losses associated with the September 11th terrorist attacks and includes a permanent indefinite appropriation to fund the subsidy associated with that volume of loans. America West applied for such a guarantee on November 13, 2001, and closed on the loan on January 18, 2002. No other airlines have received a loan, although numerous smaller airlines have applied, and applications are expected from US Airways and perhaps United Airlines.

- Under procedures established by the Federal Credit Reform Act of 1990, the subsidy cost of any federal credit instrument is the estimated net cost to the government over the life of the loan, calculated on a present value basis. The estimated subsidy cost for this loan guarantee is $172 million. The relatively large fees the company will pay the government over the term of the loan ($130 million) helped keep down the federal subsidy cost.

- In exchange for the loan guarantee, America West also gave the government 18.8 million warrants. These warrants give the government the option to purchase 18.8 million shares of the airline at $3 each. Although America West shares closed at $3.20 on May 23, 2002, this is not as good of a deal as it may appear on the surface. It will be difficult to exercise the warrants because there are only 10.5 million freely traded shares in the hands of the public and the warrants represent approximately one-third of the company's common stock. Selling 18.8 million new shares (even if not all at once) would significantly depress the share price.

- As an added twist, the FY 2002 supplemental appropriations bill, passed by the House on May 24, 2002, contains a provision prohibiting any additional loan guarantees in 2002, pushing any potential deals (after America West) into 2003. The Senate voted last week to strike similar language from its version of the supplemental. CBO estimates this provision would shift $393 million in subsidy BA from 2002 to 2003. However, the House has directed CBO to use the more generous OMB scoring of the provision, which would credit the bill with shifting $1.254 billion in subsidy BA from 2002 to 2003.

CORRECTING "FOR THE RECORD"

- In a recent column of numerical factoids, *Time* magazine's "For the Record" (May 27, 2002) asserted that the FY2001 federal surplus the US Treasury reported last fall has since been significantly revised into a large deficit.

***Time's* For The Record**

$515 billion Amount of revised [sic] U.S. budget deficit for fiscal year 2001

$127 billion Amount of budget surplus announced last fall for the same period

Source: *Time Magazine*, May 27, 2002

- Fortunately, one sharp-eyed reader – Senator Hollings, who knows a surplus when he sees one – was understandably puzzled by this supposed fact and brought it to the *Bulletin's* attention. Perhaps had *Time* somehow confused emerging deficits for FY2002 and future years with what actually happened in FY 2001?

- It turns out *Time* magazine was confused. While both of the numbers *Time* printed are real and correct numbers from Treasury documents, *Time's* description is wrong.

- The actual cash surplus – the number that people are used to looking at when assessing the fiscal picture of the US government – remains the figure reported last fall: $127 billion for FY 2001. This "cash position" figure has not been revised. However, the Treasury has reported an alternative picture of the federal fiscal position using a different accounting approach – accrual budgeting.

- In March, the Treasury's Financial Management Service published the *Financial Report of the United States Government* for FY 2001 (http://www.fms.treas.gov/cfs/index.html). This document is based on audited financial statements of federal entities and employs accrual-based financial reporting to provide information about the government's future obligations based on changes in commitments already made.

- Although the *Financial Report* has been published in previous years, this is the first year that the report has included a statement that reconciles the $642 billion difference between the government's net operating cost (accrual-basis) with the actual cash surplus reported by Treasury (see table below).

United States Government Reconciliations of Net Operating Revenue/(Cost) to the Budget Surplus for FY 2001
($ in billions)

	2001
Budget Surplus	**127**
Minus:	
Components of operating that are not part of the budget surplus:	
Increase in military health and pension liabilities	407
Increase in liability for veterans compensation	139
Increase in liability for civilian employee benefits	50
Increase in environmental liabilities	6
Depreciation expense	21
Increase in benefits due and payable	8
Decrease in taxes receivable	2
Increase in other liabilities	13
Prior period adjustments	-1
Premium on early buyback of public debt	11
Seigniorage and sale of gold	-1
Increase in accounts payable	5
Components of budget surplus that are not part of operating cost:	
Capitalized fixed assets	-34
Increase in accounts receivable	-2
Decrease in inventory	1
Increase in other assets	-4
Principle repayments of pre-credit reform loans	20
Net amount of all other differences	1
Net operating cost	**-515**

Source: Financial Management Service, Financial Report of the United States Government FY 2001.

- The value provided by the additional information in the accrual-based portion of the table is the change (recognized in FY 2001) in the federal government's long-term revenues or costs that result either from legislation enacted that year or from changes in actuarial, interest rate, or other technical factors that affect pre-existing federal commitments.

- As Treasury Secretary O'Neill points out in his summary message in the *Financial Report*, the "primary difference [about 45%] between the accrual deficit and the budget surplus is the recognition of expanded military retiree health benefit costs [TRICARE for life] provided by the National Defense Authorization Act. . .[enacted] on October 30, 2000." In the accrual presentation of military health liabilities, $293 billion out of the $407 billion total increase recorded for 2001 is a direct result of TRICARE, demonstrating how significant an expansion in the government's long-term entitlement cost TRICARE has caused.

- The second largest difference between last year's accrual deficit and the budget surplus is attributable to a recorded increase in the cost of veterans compensation ($139 billion). Like the balance of the change in military health and pension liabilities, the increase in liability for veterans compensation was due to changes in actuarial assumptions.

- Sincere kudos to Senator Hollings – a truly informed and savvy budgeteer – for detecting *Time's* confusion over Treasury's different ways of presenting fiscal information. Bravo for Treasury as well for providing broader and more complementary views of the government's fiscal outlook.

WE'RE IN A "DEBT ISSUANCE SUSPENSION PERIOD"

- On May 16, 2002, the federal government reached the current statutory debt limit of $5.95 trillion. As of that date, Treasury was unable to borrow, and the Secretary of Treasury was unable to carry out his financial management responsibilities using the normal methods.

- In a letter to Congress dated May 14, 2002, the Secretary declared that a "debt issuance suspension period" would be in effect for the period May 16, 2002 through June 28, 2002. Why did he do that, and what does it mean? The action gives the Secretary more options to manage funds when borrowing has reached the statutory limit.

- Subsection (k) of 5 U.S.C. 8348, enacted after the 1985 debt limit crisis, authorizes the Secretary to redeem securities or other invested assets of the Civil Service Retirement and Disability Trust Fund (CSRDF) before maturity to prevent the amount of public debt from exceeding the debt ceiling. (Once the debt ceiling is raised, the CSRDF must be fully restored to where it would have been if the disinvestment had not been made.)

- However, the same law also provides that, prior to disinvesting CSRDF assets, the Secretary must first determine that a "debt issuance suspension period" exists. A debt issuance suspension period is defined as any period for which the Secretary has determined that debt obligations of the U.S. may not be issued without exceeding the debt ceiling.

- Furthermore, the duration of the declared debt issuance suspension period is important, because the amount of CSRDF assets that the Secretary may disinvest is limited to the total amount of civil service retirement and disability benefits authorized to be paid during the debt issuance suspension period (roughly $4.2 billion per month is paid out in civil service retirement and disability payments).

- The last time the government bumped up against the debt limit, back in November 1995, then-Treasury Secretary Rubin declared a 12-month debt issuance suspension period, which allowed him to disinvest $39.8 billion of CSRDF assets (12 months worth of benefit payments) and open up an equivalent amount of borrowing room under the debt limit. In February 1996, before the first suspension period was over, Secretary Rubin declared an additional 2-month suspension period, which allowed him to disinvest an additional $6.4 billion from the CSRDF.

- How did Secretary Rubin determine the duration of the debt limit suspension period? He asked for opinions from Treasury's General Counsel and from the Justice Department. The Justice opinion (written by then-Assistant Attorney General Walter Dellinger) states, since the law is silent on this, that the Secretary has discretion to identify the factors he will rely upon to designate the length of the suspension period. Any decision designating the length of a debt issuance suspension period must be reasonable, taking into account the Secretary's assessment of the period of time it would take for an increase in the debt limit to be enacted. Treasury's General Counsel concurred in that opinion.

- The Secretary decided, based on his determination of the seriousness of the impasse between the Congress and the President over acceptable terms for an increase in the public debt limit, that the impasse could continue until the next general election in November 1996. He concluded that he would be unable to issue any new debt during the next 12 months, and then disinvested CSRDF debt equal to 12 months of benefit payments.

- Secretary Rubin was soundly criticized, even investigated, for his actions. Congressman Nick Smith and 10 other members formed the House Task Force on the Debt Ceiling and Misuse of Trust Funds, and reported to Speaker Gingrich with a 34-page report in February 1996. The report concluded that the choice of a debt suspension period of 12 months was outside the scope of the law. The authors argued that the law does not permit a lengthy suspension period simply to allow the Treasury to generate cash, thereby bypassing congressional authority for determining the amount of debt that the U.S. government can issue.

- Secretary O'Neill has taken several steps to continue financial management without breaching the debt ceiling. Treasury canceled the sale of Patriot Bonds and State and Local Government Securities. The Secretary also suspended the investment of securities in the Government Securities Investment Fund (G-Fund), where some of federal employees' retirement fund contributions are invested. He has also suspended investment of CSRDF incoming contributions not immediately required to pay beneficiaries. And, since the "debt issuance suspension period" of a little over one month has been declared, he has disinvested about $4 billion of CSRDF assets.

- Absent congressional action soon, and in light of statements by many lawmakers that they will not vote to increase the debt limit, could Secretary O'Neill declare a longer debt issuance suspension period, allowing him to disinvest more of the $530 billion CSRTF? In the *Bulletin's* opinion it's certainly a possibility, though not without the threat of criticism similar to that received by Secretary Rubin.