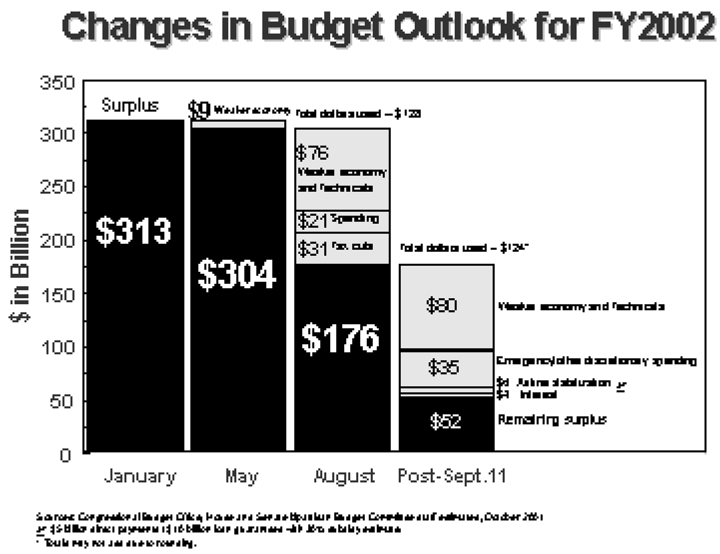
INFORMED BUDGETEER



BUDGET CHANGED, WITH CHANGES STILL TO COME

- We began the FY 2002 budget debate last spring with a pre-policy estimate of the budget surplus for 2002 topping $300 billion.

- As shown in the graph above, CBO in its August update already was significantly revising its surplus estimate by $138 billion to reflect a weaker economy ($76 billion) and legislated changes ($52 billion) of more spending and lower taxes.

- Not a month later, the terrorist attacks produced an almost immediate legislative response of a supplemental and an airline stabilization bill. To keep track of how these and further legislative developments, such as an economic stimulus package, will affect the budget, the bipartisan staff of both the Senate and House Budget Committees developed an estimate of the impact of the further weakening of the economy and of legislation agreed to thus far.

- The weaker economy may have reduced the surplus further by $80 billion because of lower revenues and increased outlays from automatic stabilizers (such as unemployment insurance) in 2002. In addition, the $686 billion appropriations level agreed to for 2002, the anti-terrorism supplementals, and the airline assistance bill all combine to increase spending by $41 billion in 2002, resulting in a 2002 surplus of $52 billion.

- If an economic stimulus package or other tax cuts or spending are enacted (or the economy worsens even further) that lose another $50 billion or so, then there would be a budget deficit in 2002. However, if the effects of such legislation or a worsening economy are limited to this year and next, then returning surpluses thereafter would still be possible, resulting in a continued pay down of the debt.

Possible Budget Outlook FY2002-2011
($ in Billions)

Fiscal Year	'02	'03	'04	'05	'06	'02-'11
TOTAL SURPLUS (CBO Aug.)	176	172	201	244	289	3,397
Changes to Date:						
Economic and Technical	80	56	8	0	0	144
FY 2002 discretionary spending[/a]	10	14	16	17	17	167
Emergency spending[/b]	25	22	21	21	22	229
Airline assistance[/c]	6	4	6	2	0	17
Subtotal changes	120	96	51	40	39	557
Interest	4	10	15	19	22	236
Total changes[/d]	124	106	66	59	61	793
Revised Total Surplus	**52**	**65**	**135**	**186**	**228**	**2,604**

Source: House and Senate Bipartisan Budget Committee staff estimates
/a Estimates assume appropriations of $686 billion in BA in 2002.
/b Estimates assume $40 billion in emergency spending associated with HR 2888. Of these amounts, $20 billion is carried forward in all subsequent years, in real terms.
/c Preliminary staff estimates; will be revised when CBO issues estimate of HR. 2926.
/d These changes do not include other possible claims on the surplus.

EMERGENCY RESPONSE FUND – PHASES 2 & 3

- On September 28, the President released an additional $1.85 billion out of the Emergency Response Fund for the terrorist attacks. On October 5, a third release added another $0.2 billion to the cumulative total, which now stands at $7.2 billion.

- Of the $1.85 billion in the second release, 94 percent ($1.74 billion) goes to the Department of Defense. Of the $0.2 billion in the third release, half is for aid to the Afghan refugees through the Departments of Agriculture and State. Most of the balance of the funds are for the Executive Office of the President related to homeland security.

BA Transferred From the Emergency Response Fund
($ in Millions)

Agency	2001
First Release of funds:[/a]	**5,115.1**
Defense	2,548.0
Nondefense	2,567.1
Second Release of Funds:[/b]	
Department of Defense	**1,736.0**
Intelligence	124.0
Reduce vulnerability to terrorist incidents	218.0
Improved command and control	318.0
Increase operations to ensure full readiness	644.0
Increase inventory of precision munitions	215.0
Crisis response, including family assistance and remains ID	217.0
Legislative Branch	**83.2**
Capitol Police, overtime compensation	40.3
Architect of the Capitol	32.4
Senate	5.3
Library of Congress	2.5
Office of the Attending Physician	1.5
House of Representatives	1.3
Judicial Branch	
Heightened court security	**19.7**
Executive Office of the President	
Relocation of Eisenhower Executive Office Building Staff	**6.7**
Federal Drug Control Programs	
NYC High Intensity Drug Trafficking Areas, replace equip.	**2.3**
Subtotal, Second release of funds	**1,847.9**
Third release of funds:[/c]	
Executive Office of the President	**81.3**
Unanticipated needs, Office of Homeland Security	51.0
Office of Administration, Office of Homeland Security	25.5
National Security Council, Directorate to Combat Terrorism	4.8
Department of Agriculture	
Purchase and deliver food to Afghanistan and refugees	**50.0**
Department of State	
Assistance to Afghan refugees	**50.0**
Department of Justice	
Establishment of the Special Master's office	**7.3**
Department of Defense	
Upgrade Presidential aircraft fleet	**7.0**
Department of Veterans Affairs	
VA cemetery administration	**0.2**
Subtotal, third release of funds	**195.9**
TOTAL RELEASE	**7,158.9**
Defense	4,291.0
Nondefense	2,867.9

Source: OMB
/a Detailed information on the first release of funds (September 21, 2001) can be found in *Budget Bulletin* issue 27.
/b This funding was made available on September 28, 2001.
/c This funding was made available on October 5, 2001.

- To date, of the $7.2 billion released, nearly 60 percent ($4.3 billion) has gone to Department of Defense operations, and 40 percent ($2.9 billion) has gone to nondefense programs. Of the $40 billion promised, $33 billion remains to be allocated ($20 billion of which still needs to be enacted.

CENSUS REPORTS ON U.S. POVERTY

- On September 25th, the Census Bureau reported that the poverty rate for 2000 was 11.3 %, a rate statistically equal to the all-time low of 11.1% recorded in 1973, and a one-half percentage point drop from the 1999 level of 11.8%.

- The poverty threshold varies by family size and composition and is adjusted every year for inflation. For 2000, a family of four was considered poor if its annual income was less than $17, 462.

- The Census Bureau noted that the median household income in 2000 was $42,148, essentially equal in inflation-adjusted value to the all-time high median income recorded in 1999.

- Several groups with historically high poverty rates made considerable progress in 2000. The poverty rate for people under 18 years old dropped to 16.2% in 2000 (down from 16.9% in 1999) – the lowest for that group since 1979. Blacks (22.1%) and female-headed households (24.7%) had their lowest ever poverty rates in 2000. While Blacks remained disproportionately poor, the difference in poverty rates between Blacks and White non-Hispanics narrowed during the 1990s. In 1993, the Black poverty rate was 23.2 percentage points higher than for White non-Hispanics; by 2000 this difference had fallen to 14.6 points.

- Although overall real median income remained flat, some groups did experience gains or losses. Hispanic and Black households hit new all-time highs in median income of $33,447 and $30,439 respectively. Female-headed households saw their median income increase by 4% from $27,043 to $28,116.

- The news from the Census reports was not uniformly positive. First, men who worked full-time, year-round saw their real median earnings drop by 1 percent from $37,701 to $37,339 between 1999 and 2000. Second, the number of households with income $8,000 or more below the poverty line has remained constant at about 4.3 million in recent years despite the economic expansion.

INSURERS PRESS FOR GOVERNMENT ACTION

- In the wake of the World Trade Center (WTC) attack, many insurers released estimates of what they thought their potential exposure would be as a result of ensuing policy claims. As more information has become available, many insurers have revised their figures upward to reflect the realization that their exposure is greater than they initially anticipated. The latest industry loss estimates, as reported by nearly ninety individual insurers and reinsurers, add to more than $19 billion.

- Much of the uncertainty surrounding the insurance industry's loss estimates stems from the difficulty of calculating their exposure to business interruption and worker compensation claims. In general, claims for property and life insurance are enumerable events. Physical and collateral damage can be measured with relative precision. However, companies may report business interruption claims even though they have not incurred property damage because they are unable to access their facilities or conduct business due to the rescue efforts. Also, worker compensation claims resulting from respiratory injuries and stress may not surface for years.

- Although industry loss estimates are currently $19 billion, estimates of the ultimate impact of the WTC attack on the insurance industry are estimated to be well upwards of $30 billion. This $10 billion or greater gap in the two figures is explained by the way in which insurers typically report loss estimates. In reporting loss estimates, usually insurance companies report their net exposures, including their offsetting reinsurance coverage. Most insurers do not report their gross exposure as an insurable loss. In a less large-scale disaster, this practice would not be a cause for concern. And in fact many reinsurers offer each other retrocessional coverage (reinsurance for reinsurers). But due to the magnitude of the devastation on September 11th, there exists the possibility that some reinsurers may be unable to indemnify their policyholders.

- The insurance industry appears adequately capitalized to cover the total impact of the WTC attack, and Standard & Poors has indicated that most major reinsurers should be able to absorb losses without jeopardizing their credit ratings. The top four global reinsurers (General Re, Munich Re, Swiss Re and Employers Re) are likely to incur $5.3 billion in losses as a result of the WTC attack, large by itself but not crippling, considering that they collected $46.3 billion in net premiums during 2000. Of the roughly 180 reinsurers that make up the entire industry, most are rated BBB or higher and are not likely to be significantly downgraded.

- Even so, insurers fear that subsequent terrorist attacks may significantly deplete their reserves. In response to this fear, some insurers have advocated that the government create a reinsurance program for acts of terrorism, so that they can limit their exposure to such events. Similar legislation, intended to mitigate the cost of natural disasters, has been proposed in the past.

- Introduced in the 106th Congress, H.R. 21 (The Homeowners' Insurance Availability Act) proposed a federal program to provide **reinsurance** for natural disasters. Although many provisions are well articulated in the legislation, the Secretary of Treasury would have considerable discretion to implementing the program.

- The bill envisioned that existing state-sponsored and private insurers would be eligible to participate. Insurance contracts would be auctioned in at least six regions of the country. The minimum price of such protection would be determined by the Secretary of the Treasury based on the recommendation of a new government actuarial board.

- Participating insurers would pay their premiums into a reinsurance trust fund from which disbursements could only be made if the damage within a state or region exceeded a certain threshold. If the costs of a prospective disaster exceeded the trust fund balance, the Secretary would be authorized to borrow funds to cover the shortfall. The loan would then be repaid with future premiums from the reinsurance trust fund. The bill sets an initial limit on the amount of liability for one event at $25 billion, though the Secretary could increase that; the bill also authorizes the Secretary to set an overall limit on the number and amount of policies that may be issued. Although the budgetary impact of such legislation is uncertain, CBO's cost estimate concluded that the reinsurance would be priced too low and would therefore result in the need for government support.

- Alternatively, H.R. 785, introduced this session, would permit insurance companies to accumulate reserves in a tax deferred disaster protection fund without committing the Treasury to underwrite reinsurance. Currently insurers build loss reserves with after tax income. Under the proposed law, the American Academy of Actuaries believes that the taxes would be paid when the fund is drawn down thus matching the "recognition of income with the loss event."