CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

December 4, 2003

Pension Stability Act

As ordered reported by the Senate Committee on Health, Education, Labor, and Pensions on October 29, 2003

SUMMARY

The Pension Stability Act would make changes to the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code that would affect the operations of private pension plans. Specifically, the bill would make changes to the way pension liabilities are calculated for certain pension plans, which would affect both pension contributions and premiums paid to the Pension Benefit Guaranty Corporation (PBGC).

CBO and the Joint Committee on Taxation (JCT) estimate that enacting the bill would increase federal revenues by $4.9 billion over the 2004-2008 period and reduce revenues by $190 million over the 2004-2013 period. CBO estimates that the bill would increase direct spending by $367 million over the 2005-2013 period. In addition, CBO estimates the bill would increase spending subject to appropriation by $1 million annually over the 2004-2006 period, assuming appropriation of the necessary amounts.

CBO has reviewed the non-tax provisions of the bill and determined that they contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Those provisions also would impose no costs on state, local, or tribal governments.

The bill would make changes to ERISA that would temporarily alter existing private-sector mandates related to the funding of private, defined-benefit pension plans. CBO estimates that the net effect of those provisions would be to reduce the direct cost of the mandates imposed by ERISA on plan sponsors.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the Pension Stability Act is shown in the following table. The costs of this legislation would fall within budget function 600 (income security).

	By Fiscal Year, in Millions of Dollars									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
CHANGES IN REVENUES										
Estimated Revenues	2,719	3,636	1,137	-1,026	-1,566	-480	-1,136	-1,620	-1,045	-809
CHANGES IN DIRECT SPENDING										
Estimated Budget Authority	0	132	102	82	26	25	0	0	0	0
Estimated Outlays	0	132	102	82	26	25	0	0	0	0
CHANGES IN SPENDING SUBJECT TO APPROPRIATION										
Estimated Authorization Level	1	1	1	0	0	0	0	0	0	0
Estimated Outlays	1	1	1	0	0	0	0	0	0	0

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

BASIS OF ESTIMATE

For the purposes of this estimate, CBO and JCT assume the bill will be enacted early in 2004.

Revenues

The bill would temporarily replace the interest rate used in determining pension funding and variable-rate premiums paid to the PBGC. Under current law, such liabilities and premiums are determined using the interest rate on 30-year Treasury securities. The bill would replace that rate through December 31, 2006, with the rate of interest on amounts conservatively invested in long-term corporate bonds. Because this change would reduce the contributions sponsors would have to make toward their pension plans, taxable profits would increase and yield higher tax receipts. JCT estimates that the bill would increase federal revenues by $2.7 billion in 2004 and by $4.9 billion over the 2004-2008 period; it would reduce revenues by an estimated $190 million over the 2004-2013 period.

Direct Spending

Temporary Replacement of the 30-Year Bond Rate. Under current law, pension plans are required to determine whether they are fully funded by discounting future pension liabilities using the interest rate based on the moving four-year average for 30-year Treasury bonds. Sponsors of plans that are considered underfunded must make contributions to their plans in addition to paying variable-rate premiums to the PBGC based on the amount of underfunding. The Pension Stability Act would allow plans to use interest rates on high-grade, long-term corporate bonds to discount their liabilities during plan years 2004, 2005, and 2006. The exact rate to be used by plans would be determined by the Secretary of the Treasury.

Interest rates on corporate bonds are generally higher than those on Treasury bonds. Using a higher interest rate to discount liabilities results in lower projections of the cost of future liabilities. Therefore, firms would have to contribute less to their plans and pay less in variable-rate premiums. Based on information provided by the PBGC, CBO assumes that the applicable corporate bond rate would be roughly 150 basis points higher than the interest rate on 30-year Treasury bonds. CBO estimates that using this higher rate to discount liabilities would reduce the liabilities of underfunded plans by about $30 billion by plan-year 2007. As a result, we estimate that premium receipts would decrease by $367 million, or 4.7 percent, over the 2005-2013 period. Because the PBGC's premiums are offsetting collections to a mandatory spending account, reductions in premium receipts are reflected as increases in direct spending.

The use of higher interest rates could have other effects on the PBGC's costs, but the direction and magnitude of these effects are uncertain. On the one hand, the use of higher interest rates to discount future liabilities would reduce sponsors' contributions, improve their financial position, and make it less likely that they would eventually become bankrupt. Thus, the policy might reduce the number of plans that the PBGC ultimately takes over. On the other hand, the lower contributions would mean that the underfunding for plans that eventually become the responsibility of the PBGC would be greater, thus adding to the agency's costs.

Spending Subject to Appropriation

The legislation would establish a commission designed to study issues related to defined-benefit pension plans and issue a report by December 31, 2005. The commission would be composed of 11 representatives from the executive and legislative branches, plus two members of the public appointed by the President. Commission members would not be compensated for their work, but travel and other expenses would be paid for by various government agencies. Based on the experience of other commissions of similar scope, CBO judges that this provision would cost about $1 million annually over the 2004-2006 period.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

CBO has reviewed the non-tax provisions of the bill and determined that they contain no intergovernmental mandates as defined in UMRA. Those provisions also would impose no costs on state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

The bill would make changes to ERISA that would temporarily alter existing private-sector mandates related to the funding of private, defined-benefit pension plans. Changing the interest rate required to be used by plans to determine the present value of their pension obligations would reduce the direct cost of the mandates now imposed by ERISA on sponsors of pension plans.

PREVIOUS CBO ESTIMATES

On November 21, 2003, CBO transmitted a cost estimate for H.R. 3108, the Pension Funding Equity Act of 2003, as passed by the House of Representatives on October 8, 2003. H.R. 3108 would replace the 30-year Treasury rate with a corporate bond rate for a period of two years (plan-years 2004 and 2005), rather than the three-year period specified by the Pension Stability Act. CBO estimated that H.R. 3108 would decrease premium receipts by $279 million over the 2005-2013 period and increase revenues by $304 million over the 2004-2013 period.

On November 18, 2003, CBO transmitted a cost estimate for H.R. 1776, the Pension Preservation and Savings Expansion Act of 2003, as ordered reported by the House Committee on Ways and Means. H.R. 1776 contained various pension reform proposals, including a provision to replace the 30-year Treasury bond rate with a corporate bond rate for three years, the same period of time provided by the Pension Stability Act. CBO estimated that this provision of H.R. 1776 would decrease premium receipts by $469 million over the 2005-2013 period. The estimate for the Pension Stability Act differs from that for H.R. 1776 because CBO revised the methodology it used to determine premium receipts once the Treasury rate is reinstated.

ESTIMATE PREPARED BY:

Federal Revenues: Annabelle Bartsch
Federal Outlays: Geoffrey Gerhardt
Impact on State, Local, and Tribal Governments: Leo Lex
Impact on the Private Sector: Daniel Wilmoth

ESTIMATE APPROVED BY:

Robert A. Sunshine
Assistant Director for Budget Analysis

G. Thomas Woodward
Assistant Director for Tax Analysis