CONGRESSIONAL BUDGET OFFICE
PAY-AS-YOU-GO ESTIMATE

November 30, 2001

H.R. 2926
Air Transportation Safety and System Stabilization Act

As cleared by the Congress on September 21, 2001

SUMMARY

H.R. 2926 (enacted as Public Law 107-42) provides compensation for the victims of the four terrorist-related aircraft crashes of September 11, 2001. The act also limits the liability of air carriers involved in the crashes on September 11, 2001, to the amount of insurance coverage the companies had for such events. The act provides assistance to U.S. passenger and cargo airlines through $5 billion in grants, up to $10 billion in federal credit assistance, extended deadlines for tax payments, and reimbursements for certain increases in insurance premiums. H.R. 2926 allows air carriers to purchase certain insurance coverage from the federal government for damage or loss sustained by third parties during domestic flights. Finally, the act allows the Secretary of Transportation to relieve air carriers of liability above $100 million to third parties if the air carrier is a victim of a terrorist act in the 180 days following enactment. If that occurs, the federal government will be responsible for any liability to third parties above $100 million.

CBO estimates that H.R. 2926 will cost $13.6 billion over the 2001-2006 period. Nearly half of this cost—about $6 billion—is for compensation to victims of the airline crashes on September 11, 2001. The amount of such compensation is difficult to predict with precision. CBO has no information about the financial circumstances of any of the victims, nor has the Department of Justice issued the guidelines or procedures that will be used to determine compensation levels. Actual payments could be higher or lower than the estimated amounts.

CBO cannot predict how much the government will have to spend to cover the potential liabilities that it has assumed under this legislation for damages due to terrorist acts. Our estimate of the cost of the insurance coverage that the government is selling to airlines under H.R. 2926 incorporates an expected value of payments from the program—a weighted average that reflects the probabilities of various outcomes, from zero damages up to very large damages due to possible future terrorist attacks. The expected value can be thought of as the amount of an insurance premium that would be necessary to just offset the risk of

providing this insurance; the difference between that value and the premiums that are actually being charged is the estimated cost of the insurance program.

CBO's estimate of the act's costs does not include the government's potential liability for damages to third parties caused by acts of terrorism over the next four months. The government would likely be responsible for any such damage in excess of $100 million—but CBO has no basis for estimating the likelihood of such incidents or the magnitude of such costs.

H.R. 2926 designates the provisions that provide grants and loan guarantees for airlines as emergency legislation—and thus, not subject to pay-as-you-go procedures. Those provisions account for $7.0 billion of the $13.6 billion in spending estimated to result from this act. CBO estimates that other provisions, which count for pay-as-you-go purposes, will increase direct spending by $6.6 billion over the 2001-2006 period.

In addition, CBO estimates that H.R. 2926 reduced revenues by $1.4 billion in 2001 and will increase revenues by $1.4 billion in 2002. The net change in revenues over fiscal years 2001 and 2002 is zero.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 2926 is shown in the following table. The costs of this legislation fall within budget function 400 (transportation).

BASIS OF ESTIMATE

CBO estimates H.R. 2926 will increase direct spending by about $13.6 billion over the 2001-2011 period. The act also shifts certain tax payments from 2001 to 2002, but does not change the total amount of revenues collected.

Changes in Direct Spending

CBO estimates that, over the 2001-2006 period, H.R. 2926 will increase direct spending by about $6 billion for compensation to victims of the terrorist acts, $5 billion in grants to air carriers, $2 billion to cover the costs of credit assistance to air carriers, $400 million for the cost of insurance provided by the government to air carriers, and $160 million for reimbursement to air carriers for the increase in the cost of certain insurance premiums.

	By Fiscal Year, in Billions of Dollars					
	2001	2002	2003	2004	2005	2006
CHANGES IN DIRECT SPENDING						
Victims' Compensation Fund						
Estimated Budget Authority	0	0.4	2.4	2.4	0.8	0
Estimated Outlays	0	0.4	2.4	2.4	0.8	0
Grants to Air Carriers for Direct Losses						
Budget Authority	5.0	0	0	0	0	0
Estimated Outlays	2.3	2.7	0	0	0	0
Credit Assistance for Air Carriers						
Estimated Budget Authority	0	2.0	0	0	0	0
Estimated Outlays	0	0.5	1.5	0	0	0
Reimbursement of Insurance Costs						
Estimated Budget Authority	0	0.2	0	0	0	0
Estimated Outlays	0	0.2	0	0	0	0
Cost of FAA-Provided Insurance						
Estimated Budget Authority	0	0.4	0	0	0	0
Estimated Outlays	0	0.4	0	0	0	0
Total Changes in Direct Spending						
Estimated Budget Authority	5.0	3.0	2.4	2.4	0.8	0
Estimated Outlays	2.3	4.2	3.9	2.4	0.8	0
CHANGES IN REVENUES						
Estimated Revenues	-1.4	1.4	0	0	0	0

Victims' Compensation Fund. H.R. 2926 establishes a compensation fund for victims of the four terrorist-related aircraft crashes of September 11, 2001. The fund will provide monetary compensation for the economic and non-economic losses (including pain, suffering, and loss of companionship) of individuals that were injured and the families of those killed in these attacks. CBO estimates that the fund will pay about $6 billion over the 2002-2005 period to compensate victims.

The act directs the Attorney General to appoint a special master to administer the fund. (That appointment was made on November 26.) Within 90 days of enactment of H.R. 2926, the special master must issue regulations for accepting claims and hearing evidence. Victims seeking compensation from the fund must submit a claim within two years after the regulations are issued. By submitting a claim with the special master, victims will waive their rights to compensation through federal or state courts. The act requires the special master to determine the amount of compensation, based on the harm to the claimant, the facts of the claim, and the individual circumstances of the claimant, within 120 days after a claim is filed. Under the act, the amount of compensation payable from the fund will be reduced by the amount of compensation victims receive from other sources—for example, life insurance, pension funds, death benefit programs, and other government payments related to the crash.

CBO has no information about the specific circumstances of any particular victims of the September 11 attacks, nor does it have any basis for judging how much compensation any individual victim or victim's family ought to receive. For the purpose of this estimate, CBO has assumed that the average compensation will be similar to that awarded to victims of previous aircraft crashes, with some reduction to reflect other compensation available to the victims. To make that determination, CBO consulted trial attorneys, mediators, and insurance carriers that specialize in aircraft disasters. On this basis, CBO estimates that the compensation paid from the fund would average between $1.5 million and $2.0 million for each deceased victim on the ground at the sites of these attacks. Compensation in airline accidents has varied substantially, depending on such factors as the circumstances of the crash, the earnings potential of the victim, the number of dependents involved, and the state in which the case was resolved. Similar variations can be expected in the payments for the September 11 attacks.

The number of victims of the attacks is still uncertain. New York City officials have repeatedly lowered their estimate of the number of victims killed or missing as a result of the attack on the World Trade Center from over 6,000 a few weeks ago to about 3,300 at the time of this estimate (excluding passengers on the aircraft). A further decline is possible. Press reports have estimated that the number of dead or missing ranges from 2,700 to 3,000. For the purpose of this estimate, CBO assumes that the death toll for the World Trade Center attack will end up between 2,700 and 3,300, excluding passengers on the aircraft. Another 125 people were killed on the ground at the Pentagon.

CBO believes that most of the passengers of the aircraft involved in these incidents are likely to seek compensation through the civil courts because passengers on the flights can potentially recover more from the air carriers than from the special master. Conversely, we believe that nearly all of the relatives of the victims who were on the ground and those injured are likely to seek compensation from the special master. By pursuing claims through the special master, these parties would not need to establish the airlines' liability under state law. In addition, the act limits the liability of air carriers for the crashes on September 11, 2001, to their insurance coverage for such events. It appears that the insurance coverage of American Airlines and United Airlines is probably sufficient to cover passengers' claims, but would be inadequate to resolve the claims resulting from victims on the ground.

The act also requires compensation for victims who were injured. The number and extent of injuries suffered in these incidents has not been publicly documented, but press reports indicate that hundreds of victims were hospitalized following these attacks, some with very severe injuries. It is possible that other injuries may not yet have been reported or even surfaced. For this estimate, we assume that a few thousand injured victims will receive compensation ranging from several thousand dollars for minor injuries to several million dollars for those severely injured—and that these payments will add $300 million to $500 million to the cost of the compensation fund. Payments for each victim will be determined by the particular circumstances of that victim.

Grants to Air Carriers for Direct Losses. Under the act, the President may provide up to $5 billion in grants to U.S. air carriers as compensation for losses sustained as a direct result of the terrorist attacks on September 11, 2001. The act directs the Secretary of the Treasury to allocate such funds based on passenger capacity and cargo carriage. Under this provision, air carriers can only be compensated for losses sustained between September 11, 2001, and December 31, 2001.

Based on the losses sustained by air carriers to date, CBO estimates that air carriers will be able to claim losses totaling at least $5 billion by December 31. The Treasury disbursed $2.3 billion in September (fiscal year 2001), and we estimate the remaining $2.7 billion will be paid in fiscal year 2002.

Cost of Credit Assistance for Air Carriers. H.R. 2926 establishes an Air Transportation Stabilization Board, consisting of the Secretary of Transportation, the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and, as a nonvoting member, the Comptroller General. The act allows the stabilization board to provide loan guarantees or direct loans worth up to $10 billion to U.S. air carriers. The board is required to ensure that the federal government is compensated for the risk of extending this credit assistance, and may accept warrants, stock options, or preferred stock in order to participate in any financial gains of a borrower.

Under procedures established by the Federal Credit Reform Act of 1990, the subsidy cost of a federal direct loan, loan guarantee, or line of credit is the estimated long-term cost to the government, calculated on a net present value basis. We estimate that the credit assistance provided under the act will cost about 25 percent of the total amount borrowed and that air carriers will borrow about $8 billion of the available amount. Hence, we estimate this provision will cost about $2 billion. This estimate is based on information from industry experts, investment analysts, and the recent credit ratings of air carriers by Moody’s and Standard and Poor’s. Information on credit ratings is useful because credit ratings reflect analysts’ expectations of corporate defaults. Shortly after the attacks, the ratings of airlines were reduced to reflect the sharp reduction in the number of passengers and other financial stresses on the airlines. Ratings from Moody's and Standard and Poor's range from Baa to Caa and from A to CCC respectively, with the largest carriers in the middle of those ranges. For this estimate, we assumed that most airlines will request and receive loan guarantees roughly proportionate to their size.

In evaluating the risk to the government of extending credit to U.S. airlines, CBO considered other provisions of this act that will affect the financial position of air carriers, including $5 billion in grants, limited liability, insurance coverage from the Federal Aviation Administration (FAA), and reimbursement for increases in certain insurance premiums. In addition, we considered the impact that other government actions will have upon aviation security and the costs of the air carriers. Some air carriers may not withstand their current financial strain, but we expect the Air Transportation Stabilization Board will exercise its discretion when choosing which air carriers to assist. In addition, because the act will impose new constraints on airlines that borrow under this program, federal credit assistance may not be attractive to air carriers in the strongest financial position. Consequently, CBO expects that neither the strongest nor the weakest air carriers will participate in the program.

Regulations issued by the Office of Management and Budget require that the board guarantee less than 100 percent of the value of any loan. For this estimate, we assume that the board will guarantee at least 90 percent of the outstanding balance. The regulations also require borrowers to pay fees that would escalate each year the loan is outstanding. Such fees will reduce the cost of providing credit assistance.

The regulations require the board to consider only those applications received on or before June 28, 2002. Based on information from air carriers, CBO expects that sufficient demand exists for most of this credit assistance to be used. Because the board will need time to review applications, we expect the board to issue guarantees during fiscal years 2002 and 2003. The administrative expenses of the board will be the highest during those two years. Hence, we estimate that administering the program will cost about $10 million in 2002, $6 million in 2003, and $2 million a year for the remaining years of the program.

Aviation Insurance Programs. H.R. 2926 makes several changes related to insurance coverage for air carriers. Prior to September 11, 2001, U.S. air carriers purchased war and terrorism risk insurance for domestic flights from private insurance companies to guard against liabilities for passengers, crew, equipment, and third parties on the ground. The federal government provided such insurance only for aircraft engaged in international flights. Private insurers typically limited their coverage to between $750 million and $2 billion in aggregate per occurrence, depending on the size of the air carrier.

Soon after the attacks, insurance companies throughout the world refused to insure air carriers for liability above $50 million, per occurrence, for losses to third parties that occur as the result of war or terrorism. In addition, the insurers of air carriers imposed a $1.25 per passenger surcharge for insuring against liabilities for war or terrorism risk to passengers and crew up to the previous amount of coverage limits and against liabilities to third parties—but only up to $50 million. Under this act, the Secretary may reimburse air carriers for the increase in premium costs for coverage through October 1, 2002.

In addition, following enactment of H.R. 2926, the FAA began providing third-party war-risk (including terrorism) liability insurance to U.S. air carriers that will cover losses above the $50 million available from private insurers. The FAA insurance covers twice the total liability coverage in force on September 11, 2001. The FAA is charging $7.50 per aircraft departure for that insurance. CBO estimates that the government's payments to cover increased insurance premiums and the government's provision of insurance coverage will cost at least $560 million in 2002.

Finally, the act allows the Secretary to relieve air carriers of liability above $100 million to third parties if the air carrier is a victim of a terrorist act in the 180 days following enactment. If that occurs, the federal government will be responsible for any liability to third parties above $100 million. The potential cost of accepting such liability could be very large, but CBO has no basis for estimating either the likelihood or the cost of such liability.

Reimbursement of War-Risk Insurance Costs. Air carriers have paid premiums into a government revolving fund for war-risk insurance coverage during certain international operations. At the start of fiscal year 2002, that fund had a balance of about $85 million. H.R. 2926 allows the Secretary of Transportation to use the balance of this fund and any new premiums collected by the FAA to reimburse air carriers for the cost of paying the $1.25 per passenger surcharge imposed by private insurers to cover liabilities for war or terrorism risk.

Reimbursement only applies to insurance coverage that ends before October 1, 2002, and any reimbursement payments must be made within 180 days of enactment. Including spending of the premiums that we expect the FAA will collect from air carriers for third-party war-risk liability insurance, CBO estimates about $160 million will be spent to reimburse airlines for increases in insurance premiums in 2002.

Cost of Insurance Provided by the FAA. H.R. 2926 allows the Secretary of Transportation to provide insurance against loss or damage from operating an aircraft in domestic air commerce, if the President decides such operations are necessary for national security or for conducting foreign policy, or are in the interest of air commerce. To implement this provision, the FAA has offered to insure air carriers against liabilities to third parties (i.e., people and property on the ground) for damages due to acts of war or terrorism. By providing insurance for domestic flights of air carriers, H.R. 2926 exposes the federal government to potentially huge liabilities. CBO has no basis for estimating the likelihood of such events. Instead, our estimate of the cost of this provision is based on the difference between what the FAA is charging to provide such insurance and the amount that would be necessary to compensate private-sector insurers for the risk the federal government is incurring.

Currently, the FAA offers this insurance through January 11, 2002, but it may extend the program. As long as the FAA offers insurance for less than the market price, CBO expects that air carriers will continue to purchase insurance from the FAA. According to the FAA, the agency hopes that air carriers will resume purchasing third-party war-risk insurance from private insurers, but the timing of such a transition is uncertain and depends on ongoing negotiations with air carriers and insurers. For this estimate, we assume that the FAA will offer third-party war-risk insurance through the end of fiscal year 2002.

Some private insurers have recently began to reenter the market for additional third-party war-risk liability insurance and are offering to cover up to $1 billion in such losses. Although some industry experts believe that companies cannot profitably provide insurance against risk of war or terrorist incidents because such risks are unknowable, we assume that insurance companies would only offer insurance (and air carriers purchase such insurance) to the extent it made economic sense. Several foreign air carriers have apparently purchased such coverage.

Based on the premiums those private insurers are charging—$1.85 for each passenger for $1 billion of coverage—CBO estimates that if all domestic air carriers purchased such insurance they would pay nearly $1 billion for coverage in 2002. That estimate is based on information from insurance brokers and other industry experts, which also suggests that about 25 percent of private-sector premiums are for commissions or other administrative costs that are not applicable to the federal government. In addition, information on historical premiums from the reinsurance industry suggests that insurers reduce premiums by about 25 percent in the years following a catastrophic loss as liquidity concerns ease. Hence, CBO estimates that the FAA would have to charge premiums of at least $500 million to adequately compensate the government for the risk of insuring domestic flights in 2002.

The FAA is charging a premium of $7.50 per aircraft departure, which CBO estimates would generate less than $100 million in fiscal year 2002, if the FAA program remains in place for one year. For this estimate, we assume that, on average, total airline departures this year will be 15 percent less than historic growth rates would have indicated. Subtracting the premiums that we estimate air carriers will pay the FAA, CBO estimates the net cost to the federal government of providing insurance for less than market rates will be at least $400 million in 2002.

That estimate is based on private insurance rates for up to $1 billion in coverage, per incident, for damages to third parties caused by acts of war or terrorism. However, information from the FAA indicates that the agency is providing much more coverage—between $2 billion and $4 billion per incident—for many air carriers. CBO has no basis, however, for estimating the cost of these levels of coverage that are higher than private insurers are willing to provide. Hence, our estimate represents a lower bound on the expected value of the federal cost of providing third-party war-risk insurance.

Liability for Acts of Terrorism. For any act of terrorism within 180 days of enactment, the Secretary may certify that an air carrier was a victim of terrorism. After such certification, such an air carrier will not be liable to third parties for more than $100 million for all claims, and the federal government will be responsible for any liability above such amount. No punitive damages may be awarded against an air carrier or the government under such circumstances. By authorizing the Secretary of Transportation to accept unlimited liability for future terrorist acts (through March 21, 2002), H.R. 2926 could expose the federal government to potentially huge liabilities. CBO, however, has no basis for estimating either the likelihood or the cost of such a liability. Some of this liability—up to $2 billion or $4 billion per incident—is covered under the act's provisions authorizing the FAA to sell third-party war risk insurance. CBO, however, has no basis for estimating either the likelihood or cost of liabilities above $1 billion per incident.

Changes in Revenues

For eligible carriers, H.R. 2926 extends the due date for excise, withheld income, and payroll-related tax deposits for 180 days after enactment. Based on information provided by the Joint Committee on Taxation, CBO estimates that enacting H.R. 2926 reduced revenues by $1.4 billion in 2001 and will increase revenues by $1.4 billion in 2002. The net revenue effect over fiscal years 2001 and 2002 will be zero.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table.

The totals shown below are different from the totals shown earlier because the act designates the provisions that provide grants and loans to air carriers as emergency legislation. The costs of those provisions—$7.0 billion over the 2001-2003 period—are exempt from pay-as-you-go procedures.

	By Fiscal Year, in Millions of Dollars										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Changes in outlays	0	1,000	2,400	2,400	800	0	0	0	0	0	0
Changes in receipts	-1,400	1,400	0	0	0	0	0	0	0	0	0

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