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PBGC: Budgeted Premium Hikes Seem Improbable

The President's Proposed Budget for 2007, released today, shows much larger future PBGC premiums under the Administration's pension reform proposal than are likely to be practically or politically feasible as the proposal is structured.

As a result, the projections are probably best used as a mathematical illustration of how high premiums would need to rise, at a minimum, to pay down PBGC's existing deficit over a period of roughly a decade. It should be noted that Administration numbers assume that claims over the next decade would drop very sharply from the average of the last four years. More pessimistic assumptions would require even higher premium increases to eliminate the deficit.

Table 1 shows the Administration's base case premium projections and their estimates of the increases in PBGC premiums if the Administration's proposal were passed. The projected increases can be found in the Analytical Supplement to the Budget on page 276, (as numbered on the page, not the PDF), and the base case projections are on page 729 of the Appendix to the Budget. For simplicity, the 2008-2011 base figures, which are not shown in the Budget, are assumed to be flat with 2007, in order to allow totals to be calculated.

Table 1: Premium Projections from Proposed Budget ($ billions)

Year	Base	Additional	Total
2005 Actual	1.6		1.6
2006 Estimated	1.7		1.7
2007 Projected	2.3		2.3
2008 Projected	2.3	4.2	6.5
2009 Projected	2.3	4.2	6.5
2010 Projected	2.3	4.2	6.5
2011 Projected	2.3	4.2	6.5

Under the Administration's proposal of January 2005, all or almost all of these premium increases would have to come from the variable premium charged to firms with pension underfunding. The other source, fixed premiums, is only slated to increase from $19 per participant to $30 per participant, with future increases based on the rate of wage inflation. The initial jump in fixed premiums compared to 2005 would only be about $350 million per year, rising modestly over the remaining years. Further, the fixed premium increases should already be in the baseline figures, since they were included in the recently passed Deficit Reduction Act.

The following table shows the breakdown of fixed and variable premiums for 2008 implied by the Administration's projections of PBGC premiums if its pension reform proposals were passed. 2008 is assumed to be the first year for which the changes would take effect. The figures in later years would be very similar, if we assume underfunding remains flat.

Table 2: Projected Breakdown of premiums ($ billions, except %)

Year	Total	Fixed	Variable	Implied Rate
2008	6.5	1.1	5.4	1.8%

The final column illustrates why these projections are extremely unlikely to be borne out in reality. Systemwide corporate pension underfunding is assumed to start at $300 billion today and to remain constant. (PBGC states that systemwide underfunding is $450 billion on a termination basis, which would not be the basis for calculating premiums. Adjusting for differences in the two calculations, it appears unlikely that the premium base would even be as high as $300 billion.)

The variable premium would have to be raised from 0.9% of underfunding under current law to 1.8% or more. Further, it is quite improbable that underfunding would remain this high if the variable premium rate were set at such a level. The large bulk of pension underfunding is at companies that could easily afford to contribute enough cash to eliminate their underfunding, through borrowing if not cash flow. Variable premium rates this high, applied universally, would certainly spark substantial additional funding. In this respect, it is important to realize that the large majority of pension underfunding is not charged any variable premium at all under current law, due to various exceptions that would be eliminated under pension reform. So, even the nominal current level of 0.9% would be a significant increase in practice for most firms.

Raising the variable rate still higher than 1.8%, in order to gather the same receipts from a less underfunded universe, would drive still more firms to borrow to fund their pension plans. This could lead to a classic insurance “death spiral” in which eventually the only companies left with underfunding would be the ones with no cash or borrowing capacity. Such firms could be driven into bankruptcy by very high PBGC premiums. Thus, there is a serious practical limitation to the amount that can be raised through variable premiums based on underfunding. Much higher per capita premiums could work, but these are not in the Administration's proposal and have their own drawbacks. (See "PBGC: Premium Hike Possibilities" at www.coffi.org, for a more detailed discussion of the issues.)

Given the very low probability that PBGC premiums would come in at these levels, even assuming the Administration's version of pension reform passed, it may be most useful to view the Budget numbers in another light. They do serve as a mathematical illustration of how much premiums would need to increase in order to have a shot at eliminating PBGC's existing deficit over 10 years or so. However, these premium levels, high as they are, probably only serve as a minimum estimate. There is an implicit assumption underlying these figures that PBGC claims will drop sharply from recent levels. For example, PBGC's October 2005 White Paper on pension reform (see www.pbgc.gov) shows a median estimate for aggregate claims over the next 10 years of $12 billion in today's dollars. This would put claims for an entire decade at a level lower than at least one recent year. For that matter, a GM pension termination has been estimated as a potential $31 billion loss for PBGC.

One technical note; there is a one-year time delay on most premium figures shown in the Budget, due to the combination of the cash basis accounting used in the Budget and the fact that most pension plans are on a calendar year basis. Thus the premium changes for Fiscal 2006 would generally not be collected until Fiscal 2007.

