Testimony of

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before

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Chairman Specter, Ranking Member Leahy, and members of the committee thank you for the privilege of appearing today to discuss S. 3274: The Fairness in Asbestos Injury Resolution (FAIR) Act of 2006. In doing so, let me emphasize that the views that I present today are my own; the Council on Foreign Relations is a non-partisan think tank that does not take advocacy positions on legislation.

To begin, I wish to make a few points:

? The FAIR Act would create a new mandatory federal spending program.

? The FAIR Act would raise new federal revenues.

? Both the scale of the mandatory spending and the size of the revenues are highly uncertain; there is no guaranteed relation between them. Regardless of their ultimate scale, however, most of the spending will occur quite quickly and necessitate new federal borrowing. Revenues raised under the Act will flow in much later.

These observations do not differ in any way from those that I made during my previous appearance before this Committee. However, my position at that time - Director of the Congressional Budget Office - required that my analysis take the law at face value and be devoid of recommendations. At this time, I would make the additional points:

? It is implausible to take the FAIR Act at face value. The fund envisioned is similar in spirit to the Pension Benefit Guaranty Corporation. Under current law, the PBGC is expected to rely exclusively on "private money" (assets of pension funds and premiums). It is widely agreed that these sources will be insufficient to meet pension commitments and that a future Congress and administration are guaranteed to turn to the taxpayer to make up the shortfall. When FAIR Act benefits exceed fund resources, a future Congress and administration are equally likely to turn to the taxpayer for the shortfall.

? This is the wrong time to create new federal mandatory spending. Indeed, the most central budget challenge is the need to have less mandatory spending in the years to come.

? Recent modifications to the FAIR Act have not significantly changed these fundamental features of its design.

Let me discuss these issues further in turn.

## A New Mandatory Spending Program

The FAIR Act would establish the Asbestos Injury Claims Resolution Fund (the "Fund") to compensate those injured by asbestos. The Fund would be located within the Department of Labor. Individuals could no longer pursue damages in any federal or state court. Instead, they would submit claims to the Administrator. If judged to be valid, awards would be paid based on criteria and amounts in the legislation.

In its initial cost estimate of the FAIR Act, the Congressional Budget Office has stated that "amounts expended to pay claims and administer the fund would be considered new federal direct spending." Although the exact amounts of future mandatory spending are difficult to project, the CBO has estimated that the legitimate claims could grow to between $120 billion and $150 billion over the next 50 years (a total that does not include outlays for debt service and administrative expenses).

As is obvious, there is tremendous uncertainty surrounding any projection over a period as long as 50 years. Moreover, there are significant shortcomings in the data on which to base such a projection - limited data on settlements that have already occurred and pending claims. Moreover, it is necessary to anticipate the behavior of claimants in an entirely new environment, leading to greater uncertainty of future claims. Finally, the projection will face the usual difficulties concerning the future of economic variables such as interest rates. The overall scale of new mandatory spending is quite difficult to ascertain.

In sum, given the act of removing asbestos litigation from the tort system, the establishment of medical criteria and damage award amounts, and the location of the Fund in the Department of Labor, it is straightforward that dollars flowing out of the Fund constitute mandatory federal spending - and on a potentially very large scale.

## New Federal Receipts

The dollars paid into the Fund would be treated in the budget as federal revenues. The FAIR Act is intended to collect a total of roughly $140 billion over the first three decades of its existence. However, the maximum revenues collected could fall short of this amount - very little is known regarding the viability of firms over such a long period.

In addition to uncertainty regarding the total revenues collected, the Administrator of the Fund has considerable discretion to adjust assessments in order to raise revenues needed to meet the funds operations. Accordingly, individual firms face risks of payments that may rise over time.

## The Need for Federal Borrowing

The CBO (and others) estimate that the fund would face substantial start-up pressure and spend more than half of the total outlays in the first 10 years. In contrast, the anticipated revenue will arrive much more evenly over the first 30 years. As a consequence, the Administrator of the fund will need to borrow funds to bridge the shortfall. This borrowing will exacerbate Treasury borrowing at time when the retirement of the baby-boom generation and the demands of existing mandatory spending programs (especially Medicare, Medicaid, and Social Security) will likely already be straining federal fiscal policy.

The additional borrowing will carry interest costs that will add to the level of mandatory spending and contribute to the long-term costs faced by the fund - and thus the federal budget - and raise the odds that the Fund might become insolvent.

## The "Sunset" Provisions Should Not Be Taken At Face Value

As written, the FAIR Act provides that the Fund will "sunset" in the event that it becomes foreseeable that revenues specified in the legislation are not sufficient to meet obligations for awards, administrative expenses, debt service, and borrowing.

This approach is extremely unlikely to insulate taxpayers from meeting the demands of the new mandatory spending. First, as has been clear throughout debate over the FAIR Act, the entire exercise is fraught with uncertainty. This uncertainty will not dissipate with the enactment of the legislation. Rather, it will continue and confound the ability of Fund administrators and the federal government to identify the need to sunset the Fund.

Second, the sunset provision raises a fundamental question of equity. When a claimant files will in part determine the compensation for injuries. Two individuals with identical cases could file only weeks apart: one would be processed and receive and award from the Fund; the second returned to a future tort system with unknown outcomes.

Third, the most likely outcome is that a future Congress faced with the precedent of having paid awards, an unexpected need to sunset the Fund, and the prospect of transparent inequities among claimants will choose to modify the legislation and avoid a sunset. Mandatory spending will continue; any revenues will be raised from an unknown source and the remainder of the necessary funds will be borrowed.

As noted earlier, these new spending pressures will arrive at precisely the wrong time. At present mandatory spending is the core component of a federal fiscal policy that is unsustainable over the next 50 years. The demands for spending generated by the existing Social Security, Medicare, and Medicaid programs will soon exceed one-half of all federal spending and contribute to a rising demand for budgetary resources. The growth - largely fueled by health care costs - will likely be of such a scale that the United States economy cannot grow fast enough to alleviate budgetary pressure. Moreover, a strategy of "taxing our way out of it" would likely raise federal revenues to levels that so damage economic performance as to be unsuccessful. Put simply, mandatory spending growth must fall; not rise.

Recent Changes to the FAIR Act Do Not Alter the Basic Problems

The FAIR Act has evolved considerably over time and continues to be modified. On the revenue side, provisions have been added to address hardships for firms and inequities. Unfortunately, at present no one can tell who will receive the adjustments and for how long. Moreover, once a few firms receive an adjustment it seems likely that more will seek to reduce their payments, cutting into the revenues. At the same time, the Administrator can employ surcharges to offset these adjustments. How will this process work out?

On the spending side, a provision was included to add consideration to victims of hurricane Katrina and the devastation at the World Trade Center. This provision appears to have been added to address concerns from the debate on the FAIR Act that these and other victims are left out of the bill, while extraordinary consideration is given to residents of Libby, Montana. But while this new provision stops short of providing hurricane and terrorism victims the same benefits afforded to Libby victims, the addition of any new class of claimants will raise demands for spending to an uncertain degree. Moreover, while the language of the new bill limits this additional class of victims solely to those from 9/11 and the 2005 natural disasters, this inclusion sets a new precedent for future Congresses to be sympathetic each time there is another devastating hurricane or natural disaster that calls for eligibility of new victims.

In addition, recent changes to the provisions for dormant claims may turn out to do little to reduce the potential demands of these claimants on the fund. It is not obvious how many claims will be eliminated as the Act continues to allow claims against manufacturers if they have not established trusts.

Conclusion

Injury and illness resulting from the past use of asbestos is an important policy problem and there are legitimate concerns about the current system: (a) the potential economic consequences (e.g., bankruptcy) of the cost of asbestos cases to firms and insurance companies; (b) the uncertainty to claimants of the ability of firms to pay compensation, and the parallel uncertainty to firms of their overall exposure to claims; and (c) the degree to which the tort system permits and rewards "frivolous" claims on the basis of either undesirably low standards of proof or even fraudulent evidence.

Viewed from these perspectives, the FAIR Act is a puzzling initiative in that it does not directly solve any single of these perceived problems. It relieves companies of tort liabilities, but provides no certainty on payments by companies because assessments are unknown at this time and the legislation a putative sunset that would result in companies again facing court settlements. It provides a schedule of claimant compensation, but the same sunset provisions make the ultimate receipt of compensation uncertain. Finally, it establishes medical criteria for and damage caps for specific awards, policies that could be could directly addressed in the context of the current tort system without exposing the U.S. taxpayer to the risk of meeting the costs left over from an under-funded trust fund.