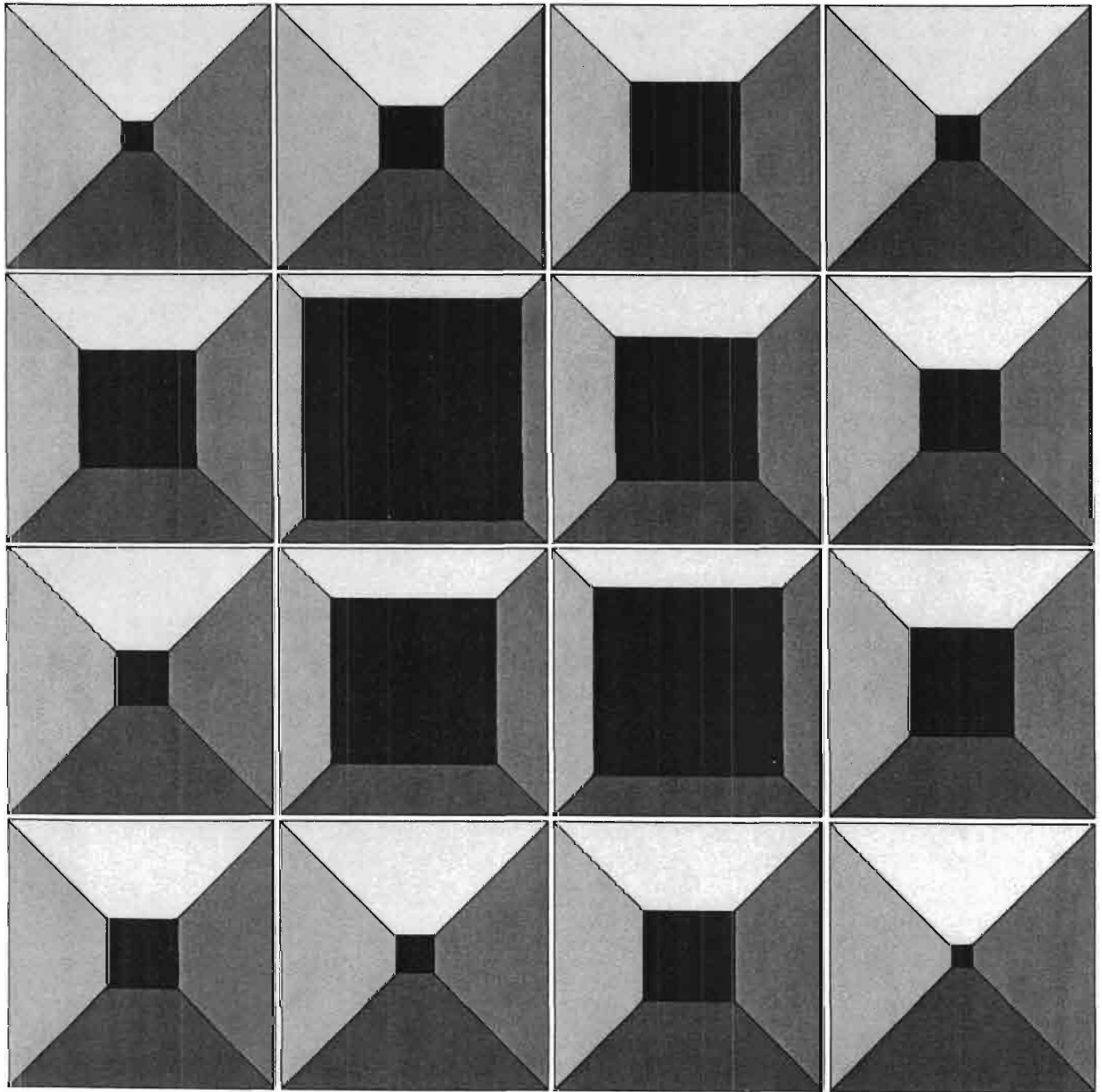
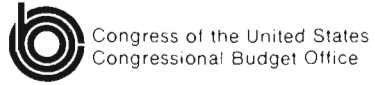


Reducing the Federal Budget: Strategies and Examples

February 1980



**REDUCING THE FEDERAL BUDGET:
STRATEGIES AND EXAMPLES**

**The Congress of the United States
Congressional Budget Office**

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CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, D.C. 20515

Alice M. Rivlin
Director

ERRATA SHEET

REDUCING THE FEDERAL BUDGET
STRATEGIES AND EXAMPLES

- Page 24, eighth line of first paragraph should read: "savings of roughly \$94 million in 1981 and \$696 million over the next five years."
- Page 25, fourth line of second paragraph should read: "according to CBO projections, in 1981 the CPI will increase at a slower rate than the modified CPI."
- Page 35, first line of second paragraph should read: "The Lump sum death benefit (255)"
- Page 90, last line of third paragraph should read: "the U.S. domestic market."
- Page 92, first line of first paragraph should read: "When Social Security benefits were first paid in the 1930s,"

PREFACE

This paper was written in response to a request by Robert N. Giaimo, Chairman of the House Budget Committee, and seven other Members of the Committee--Barber B. Conable, Richard A. Gephardt, Norman Y. Minetta, Leon E. Panetta, Ralph S. Regula, Paul Simon, and Timothy E. Wirth--for a report on the possible strategies that could lead to a reduction in the size of the federal budget.

The report was prepared by all divisions of the Congressional Budget Office under the supervision of Alfred B. Fitt. Robert L. Faherty and Francis S. Pierce edited the manuscript and coordinated its preparation for publication. The various drafts were typed by Norma A. Leake, Linda B. Brockman, Janet L. Fain, Shirley Hornbuckle, Marsha L. Mottesheard, and Kathleen M. Quinn.

In keeping with CBO's mandate to provide objective analysis, the report contains no recommendations.

Alice M. Rivlin
Director

February 1980

Congress of the United States

House of Representatives

Washington, D.C. 20515

December 20, 1979

Dr. Alice Rivlin
Director
Congressional Budget Office
Washington, D.C.

Dear Dr. Rivlin:

In a few months we will have to make difficult and complicated decisions on the Federal budget for fiscal 1981. Faced by a worsening economy, upward pressures on spending, strong support for tax cuts, and major resistance to any cutbacks in programs from affected groups, we have the duty to forge jointly a responsible budget resolution.

As part of this effort we believe significant reductions will have to be made in a number of Federal programs. Rather than courting irresponsible, last minute budget cut amendments which have not been carefully analyzed, we would prefer to prepare systematically for these questions, taking advantage of the best resources we have available.

We request that CBO undertake a report on the possible strategies that could lead to a reduction in the size of the Federal budget. This report should include among other things an examination of programs and program areas which may have outlived their usefulness, may be beneficial but are incorrectly targetted, or may fund functions more appropriately handled by other levels of government or the private sector.

CBO's analysis should include an estimate of the magnitude of the budget saving not only in FY 1981, but in future years, that would result from the action and the persons who would be adversely affected by such a budget cutback.

As you are aware, effective budget strategy must take a multiyear perspective. Therefore, we would like CBO's study not to be confined to steps that are feasible only in fiscal year 1981 but to look at the budget reduction issue

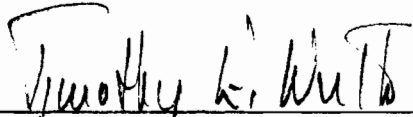
Dr. Alice Rivlin
December 20, 1979
Page Two

in a five year perspective.

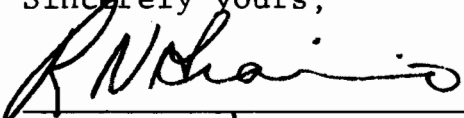
To be of most use, we would like to have this report as early as we can next year, before the new budget cycle gets too far along.

Thank you for your assistance,

Sincerely yours,




Timothy E. Wirth



Robert N. Giaimo



Norman Y. Minetta



Ralph S. Regula



Barber B. Conable



Leon M. Panetta



Paul Simon



Richard A. Gephardt

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SUMMARY

The size of the federal government, measured by spending, has grown from less than 18 percent of Gross National Product (GNP) in the late 1950s to about 22 percent in recent years. Most of the growth can be accounted for by the adoption or enlargement of federal programs that entail benefits to individuals (for example, Medicare), and by the rising amounts of federal aid to state and local governments for a wide variety of public purposes.

If the Congress were to adopt no new programs, but simply continue current programs and policies, federal spending would probably continue to rise in real terms during the next five years, although not as fast as GNP. The main reason for the growth is that the number of people receiving Social Security and other federal retirement benefits will increase. Another reason is the probable real growth in defense spending (the projections in this report assume funding of the real growth in the January 1979 Administration Five-Year Defense Program as modified by Congressional action on the 1980 budget).

The growth of federal spending over the years, and the prospect that it will continue, have led to proposals for Constitutional or other restraints on Congressional appropriations. But while unease exists over the total amount of federal spending, there is consistent public support for the parts that make up the total. If the total is not to grow, something must be done about the parts.

Proposals for reducing federal spending can be grouped under five major strategies or rationales:

- o Management Efficiencies--ending duplication, ferreting out fraud and abuse, improving program administration, and the like.
- o Better Targeting--aiming benefit payments and subsidies at the most needy, while reducing or eliminating awards to others.
- o Shifting Responsibility to State and Local Governments--transferring federal activities that arguably could be performed as well or better at lower levels of government.

- o Shifting Responsibility to the Private Sector--reducing or ending some of the federal subsidies that over the years have been extended to private firms and individuals.
- o Revising Judgments as to What Can Be Afforded--reversing past policy decisions because they have proved to be too costly in the light of changing priorities.

A long list of examples of spending reduction proposals could be drawn up for each of the five strategies. The Congressional Budget Office (CBO) has analyzed 56 such proposals. They are listed by strategy, together with their estimated 1981-1985 effects on outlays, in Summary Table 1. The estimated savings are not totaled because some of the items are alternatives to others, and because possible ripple effects in still other programs preclude a precise estimate of aggregate net savings.

Some federal spending takes place on the tax side of the budget, in the form of "tax expenditures," which are special provisions in the tax code to encourage certain kinds of activity or to aid certain kinds of taxpayers. Because reducing tax expenditures has the same effect on the federal deficit (or surplus) as reducing spending, CBO has analyzed 16 examples of possible tax expenditure reductions. There are also 3 examples of revenue gains possible through additional withholding of taxes and improved enforcement by the Internal Revenue Service. These examples are listed, with their revenue effects, in Summary Table 2. The tax changes are not totaled for the same reasons applicable to the spending reduction items.

The inclusion of an item in this study, or its omission from it, does not imply a recommendation by the Congressional Budget Office. The CBO does not advocate any particular size for the budget, nor does it endorse any particular level of funding for specific federal programs. The items discussed are simply illustrative examples.

SUMMARY TABLE 1. ILLUSTRATIVE SAVINGS FROM CBO BASELINE PROJECTION, BY
REDUCTION STRATEGY, FISCAL YEARS 1981-1985: IN MILLIONS
OF DOLLARS

	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>I. Management Efficiencies</u>						
Administrative Improvements in Public Assistance Programs	325	350	375	400	440	1,890
Change in Trigger for Unem- ployment Insurance Extended Benefits	1,000	1,000	0	0	0	2,000
Reform of the Wage Board Pay System	260	610	780	870	950	3,470
Elimination of World War II Destroyers	129	27	20	31	35	242
Elimination of Certain GI Bill Benefits	70	60	50	40	30	250
Restructuring of Military Retirement Pay	-100	-90	-60	-20	20	-250
Change in Enlisted/Officer Ratio in the Armed Forces	16	35	57	83	110	301
Elimination of Dual Pay for Reservists Who are Federal Employees	35	39	42	46	50	212
Closing of the Clinch River Breeder Reactor Program	220	430	560	160	80	1,450
Modifications in Federal Compensation Practices	49	148	263	394	539	1,393
Elimination of Farm Defi- ciency Payments	0	914	1,049	353	111	2,427
Reduction of Soil and Water Conservation Program	94	128	147	158	169	696
Modification of Indexation of Federal Programs	3,500	3,500	5,700	7,600	9,700	30,000
<u>II. Better Targeting</u>						
Modifications in Trade Adjustment Assistance	150	200	250	250	250	1,100
Modifications in Child Nutrition Programs						
School Lunches	300	325	355	390	430	1,800
Food Stamps	1,180	1,312	1,400	1,460	1,530	6,880
Reduction of Funding for Youth Employment Programs	547	774	842	908	983	4,054
Restructuring of College Student Loan Programs	400	800	1,100	1,300	1,200	4,800

SUMMARY TABLE 1. (Continued)

	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
Retargeting of Basic Educational Opportunity Grants	100	400	400	300	300	1,500
Termination of Certain Social Security Benefits	455	1,215	2,280	2,880	3,150	9,980
Reduction of Funding for EPA Construction Grants	0	420	732	973	1,030	3,155
Reduction of Funding for Impact Aid	250	325	350	400	450	1,775
Elimination of Farm Disaster Payments	0	0	560	560	560	1,680
<u>III. Shifting Responsibility to State and Local Governments</u>						
Limiting of Federal Highway Aid	200	900	1,600	2,000	2,100	6,800
Elimination of the State Share of the Land and Water Conservation Fund	147	196	259	282	313	1,197
Elimination of Urban Park Grant Program	9	58	111	153	166	497
Termination of the Legal Services Corporation	250	341	369	399	432	1,791
Reduction of Funding for Criminal Justice Assistance	74	320	488	560	606	2,048
Reduction of Funding for Urban Development Action Grants	7	37	85	153	231	513
Reduction in the General Revenue Sharing Program						
Eliminate States	2,440	2,660	2,900	3,150	3,420	14,570
Limit Local Units	240	260	290	310	340	1,440
Increase of States' Share in Cost of Army National Guard	190	210	230	250	275	1,155
Phasing Out of Funding for Vocational Education	20	213	457	708	966	2,363
Reduction in Commitments for Subway Construction	10	230	420	525	645	1,830
<u>IV. Shifting Responsibility to the Private Sector</u>						
User Charges for Coast Guard Activities	600	650	700	760	820	3,530
Increase User Charges for Army Corps of Engineers Waterway Projects	980	1,010	1,070	1,120	1,200	5,380

SUMMARY TABLE 1. (Continued)

	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
Increased User Charges for Airports and Airways	910	980	1,060	1,120	1,200	5,270
Reduced Spending for Large Airports	100	200	300	400	500	1,500
Elimination of Solar Demon- stration and Application Projects	85	141	206	227	250	909
Elimination of Subsidies to the U.S. Postal Service	1,614	1,756	1,726	1,761	1,746	8,603
Establishment of Fees to Cover Costs of Food Product Inspections	310	320	331	343	356	1,660
Reimbursement of Veterans Administration by Third- Party Insurers	200	250	280	330	380	1,440
Elimination of Operating and Construction Subsidies for the Maritime Industry	130	160	189	221	254	954
V. Revising Judgment as to What Can Be Afforded						
Adjustment of Social Security Cost-of-Living Increases: 85 Percent of CPI Instead of 100 Percent	2,700	4,800	7,600	10,600	13,900	39,600
Once-a-Year Cost-of-Living Adjustments for Federal Retirees	803	1,044	1,086	1,141	1,212	5,286
Capping of Pay Raises for Fed- eral White-Collar Employees	950	760	710	630	380	3,430
Reduction of Funding for Community Development Grant Program	25	140	290	420	530	1,405
Reduction of Support for Health Professions Program	50	250	350	450	500	1,600
Reduction of Funding for CETA Public Service Employment, Title VI	523	572	630	689	758	3,172
Reduction of Funding for Lower- Income Housing Assistance Programs	100	100	200	500	900	1,800
Relaxation of Davis-Bacon Wage Requirements	134	144	153	160	168	759
Reduction of Spending by the Small Business Administration	50	125	160	195	230	760

SUMMARY TABLE 1. (Continued)

	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
Imposition of Fees for Outpatient Visits at Military Hospitals	76	76	76	77	77	382
Reduction in Procurement of Aegis Cruisers	25	155	356	651	877	2,064
Elimination of Procurement of the KC-10 Tanker	14	147	245	145	72	623
Termination of MX Missile Program and Expansion of Sea-Based Deterrent	873	1,507	1,574	2,035	3,905	9,894
Elimination of the Military Assistance Programs	0	110	120	130	150	510
Hospital Cost Containment	370	1,400	3,000	5,000	7,200	16,970

SUMMARY TABLE 2. ILLUSTRATIVE REVENUE INCREASES, FISCAL YEARS 1981-1985: IN BILLIONS OF DOLLARS

	1981	1982	1983	1984	1985	Cumulative Five-Year Revenue Increase <u>a/</u>
<u>Reduction in Tax Expenditures</u>						
Termination of Tax-Exempt Bond Subsidies						
Industrial development bonds	0.1	0.3	0.5	0.8	1.1	2.8
Pollution control bonds	0.1	0.1	0.2	0.2	0.3	0.9
Single-family housing bonds	0.6	2.1	4.8	8.4	12.0	27.9
Private hospital bonds	0.1	0.1	0.2	0.2	0.3	0.9
Student loan bonds	0.1	0.1	0.1	0.2	0.2	0.7
Limiting the Exclusion from Tax of Employer-Paid Health Insurance	2.0	1.7	1.4	1.1	1.0	7.2
Reduction of Medical Expense Deduction	1.2	1.3	1.4	1.6	1.7	7.3
Repeal of Percentage Depletion Allowance for Oil and Gas	1.8	2.1	2.2	2.2	2.5	10.8
Repeal of Expensing of Oil and Gas Intangible Drilling Costs	2.6	2.7	3.1	3.5	4.0	15.9
Repeal of Home Insulation Tax Credit	0.4	0.4	0.4	0.5	0.5	2.2
Repeal of Domestic International Sales Corporation Provisions	0.2	0.6	1.2	1.7	2.0	5.6
Taxation of a Portion of Social Security Benefits	5.0	6.0	7.1	8.3	9.6	36.0
Taxation of All Unemployment Insurance Benefits	3.1	2.9	2.5	2.1	1.8	12.4
Increase in Tax Rates on First \$100,000 of Corporate Income	2.5	2.8	3.1	3.4	3.7	15.5
Limiting of Home Mortgage Interest Deductions	0.8	0.9	1.0	1.1	1.3	5.1
Reduction of \$100,000 Capital Gains Exclusion on Homes Sales by Persons Aged 55 or Over	0.5	0.5	0.6	0.6	0.7	2.8
<u>Additional Withholding and Better Enforcement</u>						
Institution of Withholding on Interest and Dividend Income	6.5	3.3	3.7	4.2	4.6	22.3
Institution of Withholding on Independent Contractors	0.6	0.6	0.7	0.9	1.1	3.9
Increase in IRS Audit and Collection Resources ^b	0.2	0.7	1.1	1.5	1.9	5.3

SOURCE: Joint Committee on Taxation (JCT) staff, Department of Treasury, and Congressional Budget Office. Many of the estimates are preliminary and subject to change.

a/ Details may not add to totals because of rounding.

b/ Net increase after subtracting increased outlays for IRS budget.

In recent years, federal spending has grown substantially--in nominal terms, in real terms (after adjusting for inflation), and relative to the size of the economy. The prospect that these trends will continue has generated numerous proposals to limit the federal budget through constitutional amendments, legislation, modification of the Congressional Budget Act of 1974, and cuts in existing federal programs.

This paper describes five general strategies for reducing federal spending along with illustrative examples of each strategy. Because nearly \$200 billion a year in federal activity takes the form not of outlays but of "tax expenditures"--that is, specially reduced, cancelled, or deferred taxes intended to assist people in specified circumstances or to induce taxpayers to change their behavior--the paper also provides examples of reduced tax expenditures. As background to these strategies and examples, the remainder of this chapter briefly describes the recent growth in federal spending, the sources of this growth, and some considerations for cutting back federal spending.

RECENT GROWTH IN FEDERAL SPENDING

Over the last 15 years, federal spending has increased at an average rate of 11 percent a year (see Figure 1). When the effects of inflation are eliminated, the real year-to-year increase in federal spending has averaged 3.6 percent. Relative to the size of the economy--as measured by the Gross National Product (GNP)--federal spending has also risen. Whereas federal unified budget outlays amounted to just under 18 percent of GNP in the late 1950s, during the last half of the 1970s they constituted 22 percent of GNP (see Table 1). Federal receipts have also grown substantially during the last two decades. They have not, however, grown as rapidly as spending, and consequently the gap between the amounts collected and spent by the federal government has been increasing.

Figure 1.
Federal Spending Increases, 1966-1980
(Annual Percentage Changes)

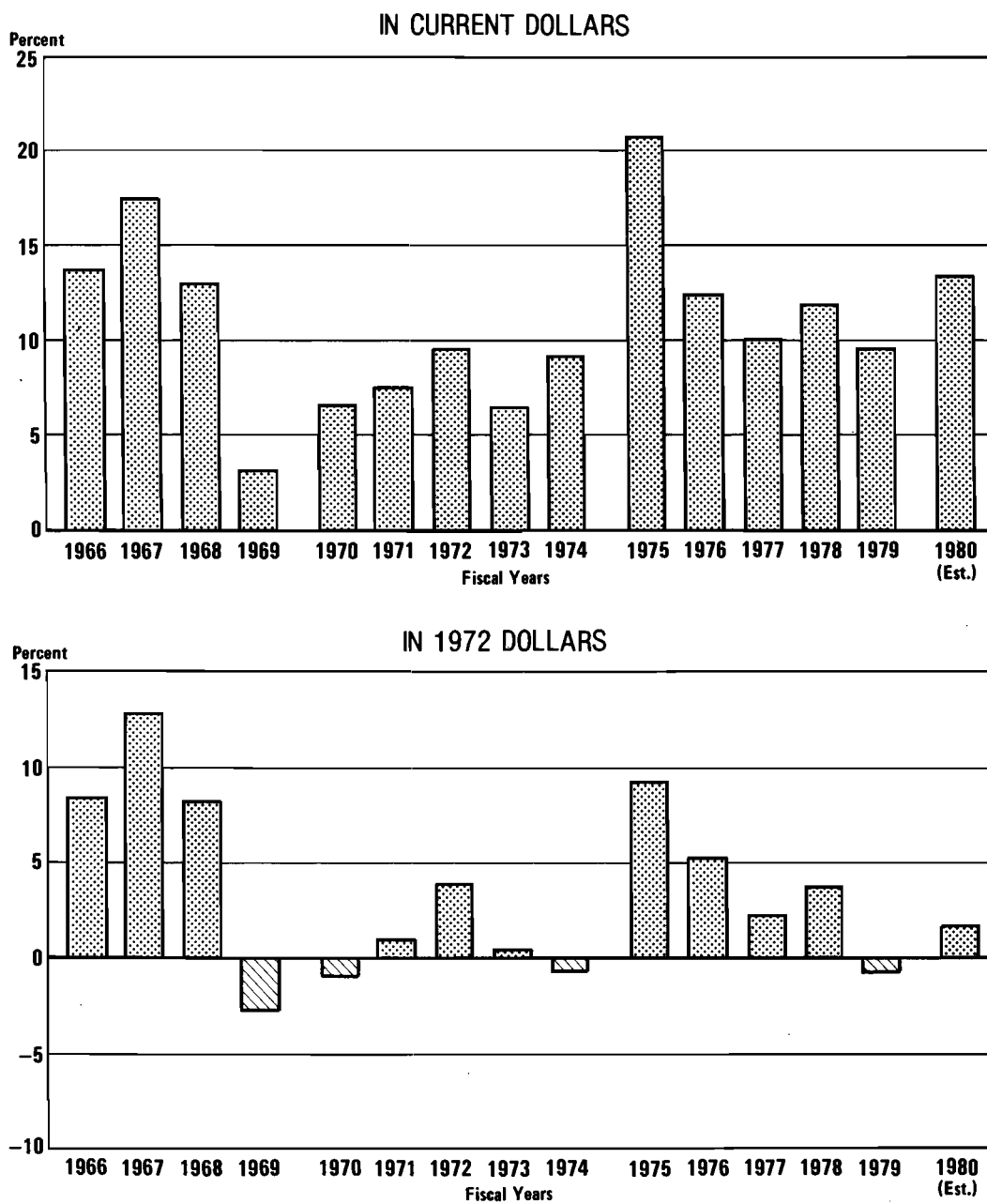


TABLE 1. FEDERAL ACTIVITY AS A PERCENT OF GNP, 1955-1979: FIVE-YEAR AVERAGES, UNIFIED BUDGET

	Receipts	Spending
1955-1959	17.2	17.9
1960-1964	18.4	19.1
1965-1969	18.9	19.8
1970-1974	19.2	20.4
1975-1979	19.4	22.0

If current policies were to continue unchanged, and no new programs were adopted, federal spending would nevertheless go on growing in nominal and in real terms during the next five years (see Table 2). This growth would be relatively modest, however, and not as fast as the projected growth in the economy. As a result, spending as a percent of GNP would decline substantially from the peacetime peak of 22.6 percent reached in fiscal year 1976.

TABLE 2. CBO BASELINE OUTLAY PROJECTIONS, FISCAL YEARS 1980-1985: IN BILLIONS OF DOLLARS

Outlays	1980	1981	1982	1983	1984	1985
In Nominal Dollars	560	619	687	750	812	883
In Constant 1972 Dollars	285	287	292	294	294	296
As Percent of GNP	22.3	22.3	22.1	21.4	20.6	20.1

SOURCE: Congressional Budget Office, Five-Year Budget Projections: Fiscal Years 1981-1985 (February 1980). Baseline projections assume a continuation of federal programs already legislated, but no new spending programs.

THE SOURCES OF GROWTH IN FEDERAL SPENDING

The growth in federal spending from year to year comes from four basic sources:

- o Increases in program participation caused by demographic and economic changes;
- o Adjustments made in response to inflation to maintain program benefits and services in real terms;
- o Momentum of prior program and contract commitments;
- o Initiation of new programs and activities without elimination of older programs.

Under current law, the federal government is obligated to provide benefits to all eligible persons under such entitlement programs as Social Security, food stamps, military and civilian retirement, and Medicare. The numbers of eligible persons, and hence program costs, are governed by demographic and economic factors. For example, the increase in the size of the aged population has meant, and will continue to mean, that the numbers of persons receiving Social Security benefits will increase. Not only do the newcomers to eligibility each year outnumber those who leave the roster because of death, but their entitlements are significantly higher because their past wages, upon which Social Security benefits are based, were higher. These two factors alone--increasing numbers of recipients and higher compensation histories--increased Social Security spending about \$4.5 billion between fiscal years 1979 and 1980.

During the past decade, policies have been adopted to protect the benefits of many federal programs from being eroded by inflation. Under current law, most federal entitlement programs--including Social Security, food stamps, federal military and civilian retirement, Supplemental Security Income, child nutrition, and veterans' pensions--have their benefits explicitly adjusted for increases in the cost of living either once or twice a year. Spending for Medicaid, Medicare, Aid to Families with Dependent Children, and a number of other programs is indirectly, but nevertheless automatically, adjusted for increases in inflation. Such automatic inflation-related adjustments caused federal spending to rise by about \$14 billion between fiscal years 1979 and 1980.

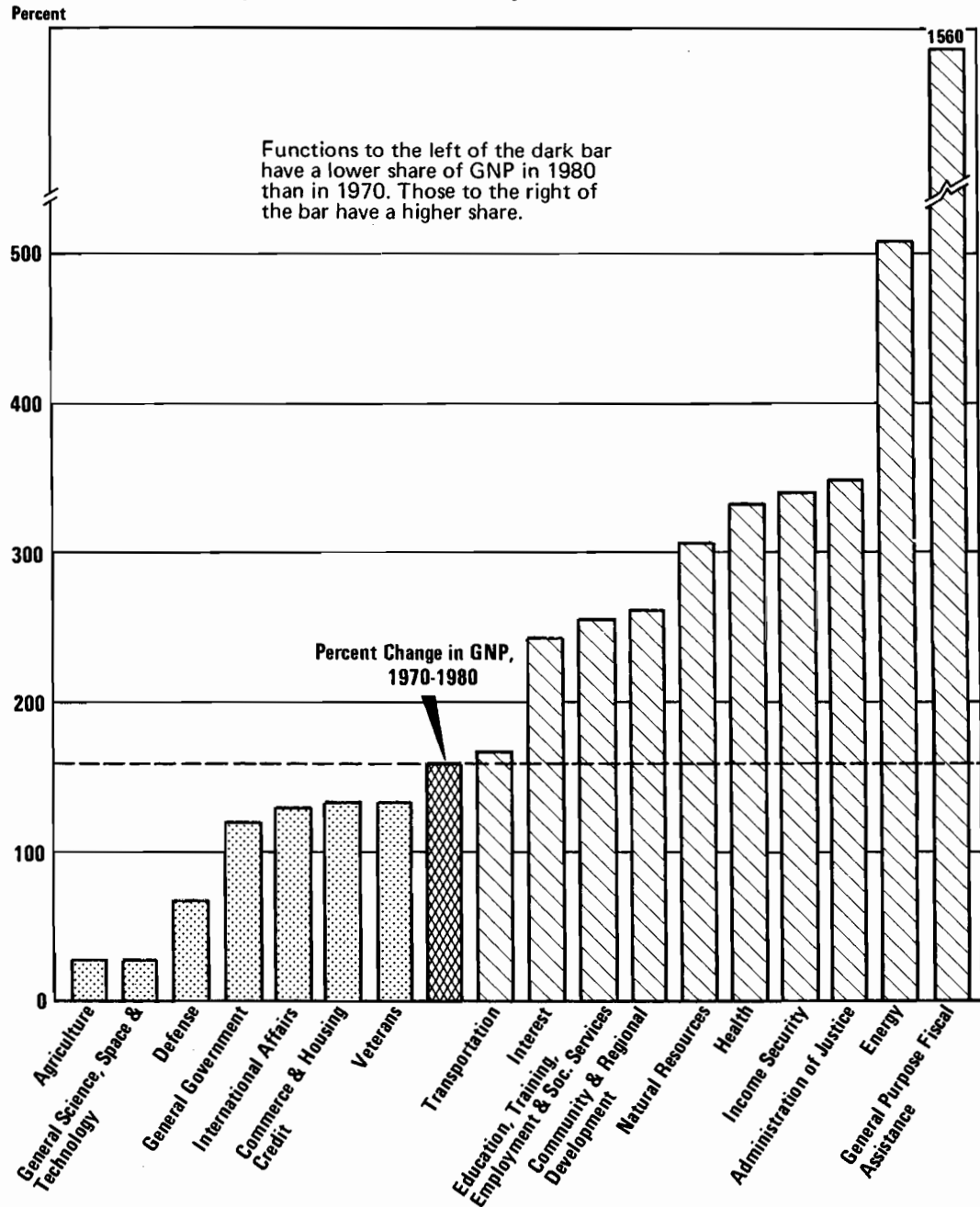
Spending increases also result from the momentum of previous program and contract commitments. In defense, program decisions are made to procure new weapons systems in one year, but actual spending for those systems may not occur for several years, after an extensive research and development period has elapsed. In housing, the federal government enters into commitments to subsidize low-income housing for as long as 30 years. The first spending for this housing may not occur until several years after the original commitment is made because of the delays in building the new units. About \$14 billion in the growth of federal spending between fiscal years 1979 and 1980 was caused by the momentum of spending decisions taken in previous budget years.

New programs represent a fourth source of increased spending. New programs have been passed in virtually every area of federal activity. Some of the major programs that have come into existence since the early 1960s include Medicaid, Medicare, food stamps, General Revenue Sharing, Community Development Block Grants, section eight housing, the Comprehensive Employment and Training Act (CETA), Basic Educational Opportunity Grants, the Law Enforcement Assistance Administration, Urban Development Action grants, urban mass transit grants, agricultural deficiency payments, and the strategic petroleum reserve.

The four sources of growth have generated very different increases in spending in terms of the various budget functions. During the past decade, spending for energy has increased by over 500 percent, while outlays for agriculture have grown by less than 50 percent (see Figure 2).

In conclusion, the growth and shape of the current federal budget is largely the consequence of decisions, not of the current Congress, but of past Congresses. The forces at work to influence those earlier decisions (and to discourage their reversal) were mainly three: the changing age composition of the U.S. population since the middle of this century, about which the Congress could do nothing; the pressures on the Congress over the same period to adopt or enlarge the federal role in caring for the old, the sick, the hungry, the poor, and the jobless; and the persistent claims from states and local governments for federal help in meeting the cost of highways, parks, sewage treatment facilities, and innumerable other state and local activities.

Figure 2.
Percentage Changes in Federal Outlays, Fiscal Years 1970-1980



CONSIDERATIONS FOR CUTTING BACK

Any attempt to reduce the growth of federal spending will require long-term planning and budgeting and careful examination of the candidates for reduction.

Planning Ahead. Under present legislative budgeting procedures, the Congress makes a preliminary determination in May for the fiscal year starting October 1, then adopts a final budget resolution just before that year begins. By then it is too late, as a practical matter, to make any significant change in the budget; its size has been dictated by the state of the economy and legislation previously enacted. If the Congress is to make major changes in the allocation of federal resources or in the extent of federal responsibilities, it must plan them several years in advance.

The possibility of achieving a reduced level of federal activity would be enhanced if proposed changes were phased in gradually rather than implemented abruptly. The lives of most Americans are shaped by an assumption of stability in the programs and commitments of their government. When change is in order, so is an allowance of a reasonable time to adjust to the new arrangements. Moreover, a powerful force working against any reduction in the size of the federal government is the momentum of the status quo. Every federal program is of benefit to someone and in consequence has a vocal constituency. Proponents of change must meet charges of heartlessness, indifference to the nation's security, misunderstanding of the facts, and lack of principle.

Attempts to reduce federal spending should take a long-run view for another reason. Oftentimes the savings from a legislative reduction are quite modest at the outset, becoming significant only after five years or more. Indeed, sometimes long-run savings can be gained only by spending more in the short run.

In addition, attention should be paid to the legislative cycle. The Congressional authorizing committees cannot and do not deal with every subject every year. Reduction proposals should be timed to come before the Congress when the program in question is due for review, or when it has not been reviewed in recent years.

Reviewing All Programs. The federal budget cannot be held down or cut back by appealing to some simple mathematical formula.

Whatever device was used to fix an upper limit to federal spending--for example, no more than 20 percent of last year's GNP, or year-to-year growth limited to no more than half the inflation rate--the resulting restraints would still have to be distributed one way or another across the range of federal activities. It seems quite unlikely that any sizable part of the budget could be reduced by an across-the-board cut. Furthermore, cuts cannot be applied to interest on the national debt--or to any outstanding contractual obligation of the federal government.

Some cuts cannot be made without reducing related government activities; others involve possibly self-defeating actions; still others pose particularly difficult choices. To take several examples, 9 percent of the government's full-time permanent employees--172,000 people--are responsible for providing patient care in the Veterans Administration (VA) hospital system; almost 90,000 are in the Customs Service and the Internal Revenue Service; and nearly 3 percent--56,000 people--are in the Federal Aviation Agency, most of them watching radar screens in air traffic control centers. Unless VA patient loads were reduced--which would mean restricting eligibility for such care--it would be a difficult matter to defend lower staffing in the VA hospital system. Similarly, it is to be doubted that the Congress would want to vote for less efficient collection of the taxes it has enacted, or to invite greater risks for air travelers. Exceptions of this kind are certain to overwhelm any standard reduction formula. Difficult value judgments and explicit political choices will be an unavoidable part of any concerted budget reduction effort.

Specific proposals for cutting federal spending tend to fall into several major strategies or rationales. Five strategies are identified here:

- o Management Efficiencies. Savings could be made through consolidating programs, ending duplication, ferreting out fraud and abuse, and improving program administration.
- o Better Targeting. Outlays could be reduced by targeting benefit payments and subsidies on those persons and jurisdictions that need them most, and by reducing or eliminating awards to others.
- o Shifting Responsibility to State and Local Governments. Some of the activities of the federal government arguably could be better performed, or properly should be performed, at the state or even the local level, where there can be more responsiveness to particular situations and a more direct accounting to the electorate, and where there may also be more ability to foot the bill.
- o Shifting Responsibilities to the Private Sector. Over the years, the federal government has increasingly subsidized activities in the private sector. Now may be an appropriate time to consider transferring the costs of such subsidies back to private firms and individuals.
- o Revising Judgments as to What Can Be Afforded. Every year the Congress rejects worthwhile new claims on federal resources on the general ground that the government cannot afford to do everything asked of it. But the Congress does not systematically go back and review programs already on the books to see if there are some that should be cut back on the grounds that they can no longer be afforded.

This chapter contains brief descriptions of 56 possible actions that could lead to reduced federal spending, listed by

groups in the order of the strategies described above. Many of those potential cuts could fit into more than one strategy. In the appendix, these same examples of possible cuts are categorized by budget function.

AN EXPLANATION OF THE ILLUSTRATIVE EXAMPLES

The collection of potential cuts in this chapter is by no means exhaustive; many others could be added. Still others have been omitted because, while they could achieve savings, no single legislative action would bring them about--for example, military base closures, which the Department of Defense asserts would lead to eventual annual savings of over \$400 million.

Each of the examples used to illustrate the five reduction strategies would violate the status quo. There are arguments both for and against enacting each of them. CBO offers the illustrations, not as recommendations, but only as examples of the kinds of issues the Congress will confront in the course of any concerted effort to reduce the size of the federal sector.

BASIS FOR THE SAVINGS ESTIMATES

The savings estimates contained in this chapter are derived from CBO's five-year budget projections for fiscal years 1981-1985, except where a different source is specifically stated. ^{1/} These five-year projections are not a forecast of what will happen. Rather, they are intended to answer the question: What might the federal budget look like in each of the next five years if the policies embodied in the budget actions taken by the Congress through 1979 are continued unchanged--save for adjustments for inflation and for the growth in entitlement programs?

Obviously, the outlay pattern projected by CBO for any particular program is subject to errors in the economic assumptions used and in the estimating methodology. Savings from that projected pattern are subject to similar considerations. Time has not permitted detailed analysis of the possible secondary or ricochet effects that a cut in one federal program might have on other federal programs.

^{1/} Congressional Budget Office, Five-Year Budget Projections: Fiscal Years 1981-1985 (February 1980).

STRATEGY I: MANAGEMENT EFFICIENCIES

Administrative Improvements in Public Assistance Programs

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
325	350	375	400	440	1,890

One possible means of reducing the cost of public assistance programs would be to establish a nationwide monthly income reporting system, along with a one-month retrospective accounting system. In the current system, the various programs use several different accounting periods. The Supplemental Security Income (SSI) program calculates benefits on the basis of income expected over the coming quarter (quarterly prospective), the Aid to Families with Dependent Children (AFDC) program has no specific rules but is usually monthly prospective, and the food stamp program is monthly prospective. Reporting changes in income status is usually a responsibility of the recipient between periods of recertification.

This proposal would determine each month's benefits on the basis of the previous month's income. The recipient would be required to mail a monthly income status form to the public assistance office before benefits were calculated and a check mailed. A 1976-1977 pilot program suggests that such changes could result not only in budgetary savings but also in simplified eligibility determination, more rapid processing of initial applications, and increased responsiveness to changing needs of recipients.

The major savings would be generated through the monthly reporting requirement, which would reveal changes in income not reported or detected under the current discretionary system. Such a system would improve the efficiency of program operation through more accurate calculations of benefits for those with fluctuating incomes and by more rapid elimination of those who have become ineligible.

Change in Trigger For Unemployment Insurance Extended Benefits

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
1,000	1,000	0	0	0	2,000

Under current law, the federal government pays half the cost of 13 weeks of additional unemployment insurance benefits for those who have exhausted the regular benefits provided by state law. The extended benefits are payable only when a state's insured unemployment rate exceeds a prescribed formula level, or when the national insured unemployment rate exceeds 4.5 percent. When the national trigger is reached, extended benefits are payable in every state, including those with low unemployment rates. If the national trigger were eliminated, the savings would reach \$2 billion during the next five years, given current CBO economic assumptions, or about a 2 percent reduction in estimated total unemployment insurance outlays during the period.

The immediate losers would be unemployed persons in states with low unemployment rates. The argument in favor of the proposal is that providing extended benefits to those persons acts as a disincentive to seeking work despite the comparatively better opportunities in their areas. The argument against the proposal is that unemployment is individual; the fact that most of one's neighbors are employed is of no help to one who has exhausted the regular benefits without being able to find employment. According to this view, the disincentive effects should be dealt with by administrative controls rather than by cutting off benefits entirely.

Reform of the Wage Board Pay System

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
260	610	780	870	950	3,470

The hourly rates of federal wage board (blue-collar) workers are adjusted annually in an attempt to maintain comparability with wage rates paid by the private sector in the same locality. Under certain provisions of current laws and regulations, however, the 400,000 federal wage board workers may receive about 8 percent more than their private-sector counterparts in similar jobs, with a few entitled to as much as 20 percent more. Recent limits on federal pay raises have reduced such differences over private-sector rates, but the laws and regulations remain.

The Administration has repeatedly recommended changes in the wage board system in order to eliminate the 8 percent differential. If the changes are enacted, the five-year outlay savings through 1985 could approach \$3.5 billion. This estimate of savings assumes, however, that federal wage board workers would be granted a catch-up raise in fiscal year 1981 to make up for past limits on federal pay raises, and that no further limits would be imposed over the next five years. If a catch-up raise is not permitted in fiscal year 1981 and limits on pay raises continue, then the 8 percent differential would be eliminated. In those circumstances, wage board reform would result in a pay system that corresponds more closely to private-sector practices, but would not result in outlay savings.

Proponents of the proposed changes argue that the present system is overgenerous to wage board workers and unfair to federal taxpayers. Unions and others opposing the changes assert that there is wide variation in private-sector practices, and that some are similar to the federal system. They also contend that the reforms are selective, dealing only with those aspects of the wage-setting mechanism favorable to employees, while continuing those aspects of the system tending to depress federal wage rates.

Elimination of World War II Destroyers

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
129	27	20	31	35	242

The Navy has proposed to retire 12 destroyers built more than a third of a century ago. This year, however, the Congress directed that the 12 destroyers be retained in the fleet for use by the Navy Reserve. If they were phased out in 1981, the five-year savings through 1985 could be about \$242 million.

While the old destroyers could be used for reserve training purposes, it is unlikely that they could play any future combat role. Thus, the reservists trained on them would, in any event, have to be assigned to other vessels with systems very different from those on which they had been trained.

Elimination of Certain GI Bill Benefits

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
70	60	50	40	30	250

Under the GI Bill, veterans are eligible for correspondence and flight training to assist them in readjusting to civilian life. The effectiveness of this training in the readjustment process, however, has been repeatedly questioned. Under current law, all eligibility for the use of Readjustment Benefits will expire at the end of 1989. If the correspondence and flight training benefits were eliminated in 1981, the five-year savings by 1985 would be about \$250 million. About 53,000 veterans would be affected in 1981, and about 16,000 in 1985.

Those who question these benefits point to the fact that veterans' flight training is known to be used mainly for recreational purposes, and that correspondence training--with its low completion and placement rates--confers little benefit in return for the expenditure. The argument against eliminating the benefits is that individuals would be deprived of an earned benefit promised to them by the government when they were in the armed forces. A few veterans, moreover, make use of the training to advance their careers.

Restructuring of Military Retirement Pay

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
-100	-90	-60	-20	20	-250

Military pay reforms almost invariably involve higher costs in the first few years, although they may save large sums in future years. The example used here is just such a case.

Under the current military retirement system, most of those who leave before completing 20 years of service receive no pension; at 20 years, retirees become eligible for a pension, payable immediately and equal to half the basic pay rate in effect on the day of retirement. This scheme may contribute to the departure of too many persons after 4 or 5 years' service, at a time when they have become trained and experienced, and the retention of too many with between 10 and 19 years' service, who may contribute to an excess of supervisors.

The proposal presented here has three elements: (1) to base military retirement pay on the individual's highest three pay years, phasing in this change over a three-year period; (2) to provide a deferred annuity at age 60 for those who leave after fewer than 20 years' service, beginning immediately; and (3) immediately to increase selective bonuses after 10 years' service to retain enlisted men and women whose skills are in short supply.

Savings from such steps would not begin to appear until the fifth year, but they could grow to \$360 million annually by 1990, and they would continue to increase until after the turn of the century.

The shift to "high-3" pay as a basis for retirement checks may be opposed on the ground that it would eventually result in entitlements about 10 percent smaller than under the present system of using the final pay rate as the basis. Opponents may also argue that any change in retirement pay must apply only to those entering the military after enactment of the change, which would delay savings for 20 years. But if the change is phased in over three

years, the effect would be to honor all retirement credits actually earned before the change. The shift to "high-3" would make the military system consistent with that of the federal civil service, and it would eliminate the advantage available to those who can time their retirements to coincide with pay increases. The deferred annuity and bonuses would help to retain a larger proportion of persons with 5 to 10 years of experience, which is consistent with many analysts' judgments about sound force management.

Change in Enlisted/Officer Ratio in the Armed Forces

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
16	35	57	83	110	301

Some observers believe that the ratio of enlisted personnel to officers in the armed forces could be increased with no loss of military effectiveness. The ratio in recent years has been about 6.4 enlisted persons for every officer. Before the Vietnam buildup, the ratio was about 6.8 to 1. If over the next five years the ratio was gradually increased to 6.6 to 1, the cumulative savings would be about \$300 million; in the following five years the savings would be considerably greater. (This assumes that promotion policies would be adjusted to keep average grades at today's levels.)

A possible explanation for the current high proportion of officers is that the drawdown since the peak of force numbers in the late 1960s has been heavier in enlisted ranks, where turnover is greater and tenure guarantees are fewer. Increases in technical complexity may, however, justify having more officers relative to enlisted personnel than in earlier years. The science of defining officer requirements is sufficiently inexact and subjective to preclude a firm case for any particular ratio.

Elimination of Dual Pay for Reservists Who Are Federal Employees

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
35	39	42	46	50	212

Federal civilian employees who are reservists in the armed forces receive both civilian and military pay during their two-week annual period of active duty for training. They also receive their regular vacation entitlement (13, 20, or 26 days, depending on length of service) in addition to the two-week absence for military training. The Administration has repeatedly recommended paying such federal employees the greater of their civilian or reserve salaries, rather than both. Adopting this change would save over \$200 million in the next five years.

Those who favor such a change point out that the dual pay practice is generally not followed by private employers, nor by the federal government itself when a reservist is called up for state duty. Under those circumstances, the employee receives only the higher salary. Moreover, the practice may attract disproportionately large numbers of federal employees to the reserves, despite the greater likelihood that their civilian jobs would excuse them from a military mobilization. The counterargument is that the change could have an adverse effect on reserve recruiting and retention--in a force already falling short of its manning goals.

Closing of the Clinch River Breeder Reactor Program

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
220	430	560	160	80	1,450

The Clinch River Breeder Reactor (CRBR) project has been a subject of controversy for years. Although it was not included in the President's budget for 1980, the Congress appropriated \$173 million for the purpose; the President's 1981 budget recommendation is once again to stop funding the CRBR.

The project aims to demonstrate that a commercial-scale liquid metal fast breeder reactor could be operated reliably and safely as part of a public utility electric supply system. Objections have been based on cost and safety grounds, on concern over proliferation of nuclear weapons materials, and on engineering and technical doubts. Some authorities assert that a French-designed breeder reactor is more highly developed and could be licensed in the United States with only minor design changes.

The five-year savings of almost \$1.5 billion from a CRBR shutdown would be net, allowing an estimated \$150 million for termination costs.

Accepting the President's recommendation with respect to fiscal year 1981 funding for the CRBR does not necessarily imply permanent rejection of the idea of having fast breeder reactors in the United States. In consequence, the savings achievable under this option might someday be overmatched by spending on more technologically advanced fast breeder reactors.

Modifications in Federal Compensation Practices

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	1981	1982	1983	1984	1985	
Workmen's Compensation	5	14	27	44	63	153
Civil Service						
Disability	30	90	158	233	316	827
Civil Service						
Retirement	<u>14</u>	<u>44</u>	<u>78</u>	<u>117</u>	<u>160</u>	<u>413</u>
Total	49	148	263	394	539	1,393

In a series of reports, the General Accounting Office (GAO) has recommended stricter eligibility requirements for federal workmen's compensation and civil service disability, as well as certain technical changes that would reduce regular civil service annuities for future retirees. All the changes combined might reduce 1985 outlays for the affected programs by about 2 percent.

Federal Workmen's Compensation. GAO believes that this program is subject to abuse, both in the determination of initial eligibility and in the continuation of benefits. It recommends that the employing agency be allowed to appeal workmen's compensation awards and to require physical examinations by physicians chosen by the agency. GAO also recommends reinstating an initial three-day waiting period before any compensation is payable. These changes, according to some observers, would bring the program more in line with state workmen's compensation practices.

Civil Service Disability. A federal employee is eligible for civil service disability retirement if unable to perform one or more significant functions of his or her present job, whereas to qualify for Social Security disability the applicant must be unable to hold any gainful employment. The probability that males aged 30 to 50 will receive civil service disability is at least 50 percent greater than it would be if private sector standards were adopted. Outlay reductions resulting from stricter eligibility standards would not be large, since most disabled annuitants are also eligible for regular retirement; but there would be some general revenue increase, since fewer people would qualify for the tax advantage that accompanies disability retirement.

Civil Service Retirement. GAO notes that federal retirees benefit from cost-of-living increases that occur before they actually retire. Under current law, employees have the option of calculating their annuities as if they had retired before the previous cost-of-living adjustment. In addition, the first cost-of-living increase after retirement is not prorated to reflect the number of months in retirement status. The argument against changing this is that, because the retiree's benefit is based on the average of the three highest salary years, the practical effect in most instances is to make the penultimate year's salary the base, and consequently the present rules do not result in double adjustments for cost-of-living increases.

Elimination of Farm Deficiency Payments

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
0	914	1,049	353	111	2,427

Since 1965, the level of price support for major export commodities--wheat, feed grains, cotton, and rice--has been gradually adjusted downward to world price levels. As part of a planned, gradual adjustment process, deficiency payments have been made to participating farmers whenever the market price of a commodity falls below its target price. In recent years, farmers have demonstrated a willingness and ability to supply the needs of consumers at prevailing world prices. Therefore, deficiency payments have largely fulfilled their function and some believe that they could now be eliminated without detriment to U.S. agriculture. Elimination of deficiency payments could result in savings of \$2.4 billion over the next five years.

Those who support elimination of these payments argue that three other components of the agricultural programs--price support loans, a multiyear storage program, and acreage diversion payments--could probably hold farm production and income within reasonable bounds. Furthermore, they believe that deficiency payments concentrated in the hands of a few large-scale farmers tend to be capitalized into land values, making it more difficult to enter farming and resulting in higher food prices.

Proponents of deficiency payments argue that they are needed to induce farmers to take land out of use when surplus production threatens. In their judgment, price support loans, the storage program, and acreage diversion payments would not, by themselves, offer a sufficient incentive to farmers to participate in commodity programs and thereby help stabilize agriculture prices and supply.

Reduction of Soil and Water Conservation Program

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
94	128	147	158	169	696

Total federal outlays in fiscal year 1981 on the construction of erosion control facilities and the channeling of streams will be about \$585 million under current law; part of this spending is for obsolete programs begun in the days of the Dust Bowl and chronic Appalachian erosion. Today, most soil erosion problems result primarily from modern farming practices. Elimination of obsolescent soil and water conservation activities could result in savings of roughly \$146 million in 1981 and \$775 million over the next five years. These obsolescent activities, in particular the channeling of streams, destroy needed wetlands, which other federal programs attempt to preserve. Wetlands have become much more valuable to society in recent years because of their relative scarcity, their importance to wildlife and water quality, and their ability to store fresh water or maintain water tables.

In many cases, the value of incremental agricultural production from drained land probably does not justify the required public investment. Even in those cases where direct economic benefits can be shown, the total benefits of such projects may not outweigh the economic costs, plus the detrimental effects on wildlife, water storage, and water quality, according to some analysts.

Proponents argue that unquantifiable benefits to local residents and to future generations justify continuation of the challenged programs.

Modification of Indexation of Federal Programs

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
3,500	3,500	5,700	7,600	9,700	30,000

Some people contend that the Consumer Price Index (CPI) exaggerates the rise in the cost of living because of an inappropriate measurement of home ownership costs. If a different index, modified to correct for such distortions, were promptly adopted as the measure for adjusting federal benefits now tied to the CPI, outlay savings over the next five years could be about \$30 billion. The affected programs would be Social Security, railroad retirement, Supplemental Security Income, veterans' pensions, and military and civil service retirement, with about 44 million primary beneficiaries plus their dependents.

If the modified index did not go into effect until the benefit adjustments due to be made in 1981, the switch could mean higher rather than lower federal outlays for several years. The reason for this is that, according to CBO projections, the CPI will increase at a slower rate than the modified CPI, while the reverse would hold for 1980 and the 1982-1985 period. Of course, such projections are subject to great uncertainties. If each index were to rise as projected, however, and if the CPI was used for 1980 benefit adjustments and the modified index for benefits in 1981 and later years, there would be higher costs until about 1984, compared to making no switch at all. If the switch were delayed until the adjustment due in 1982, the cumulative savings through 1985 would be reduced to about \$10 billion.

The goal in indexing benefits is to permit beneficiaries to enjoy the same standard of living they could "buy" when they first became beneficiaries, despite subsequent rises in the cost of living. Consequently, the most accurate and representative indexing method should be used. But analysts disagreed as to the "best" index for the purpose. Furthermore, some analysts assert that use of the CPI has not meant overcompensating most beneficiaries for inflation. They argue that the combination of indexed benefits and unindexed other income has at best meant that the total standard of living for beneficiaries has stayed even, and that many have suffered a real decline in recent years.

STRATEGY II: BETTER TARGETING

Modifications in Trade Adjustment Assistance

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
150	200	250	250	250	1,100

Workers who lose their jobs because of foreign competition, and thus qualify for Trade Adjustment Assistance (TAA) payments, currently receive both TAA and unemployment insurance benefits. The General Accounting Office has suggested that TAA payments be limited to those who have exhausted their unemployment benefits and be payable at the same level as the unemployment benefits. This approach could save almost half of current program expenditures, now projected to be \$2.35 billion over the next five years.

Assuming continuation of past trends, those most likely to be affected by the change will be in blue-collar occupations in manufacturing industries, notably apparel, textiles, coal, leather, transportation equipment, electronics, and steel.

The argument for the change is that TAA recipients should not receive more generous payments because they happen to be unemployed for a specialized reason. The counterargument is that higher tariffs could prevent this type of unemployment, but would be costly to consumers generally. Special TAA benefits are therefore justified as compensation for those who must pay the price of the government's policy of lowering trade barriers.

Aside from budgetary savings, the proposed changes could well improve the functioning of labor markets. TAA, like other unemployment-based assistance programs, creates a disincentive for seeking work, an effect probably magnified in TAA's case by the greater relative size of the payments. The likely result is to deter workers from seeking jobs in other industries, thus bolstering their attachment to a single industry and vitiating the adjustment goals the program is intended to attain.

Modifications in Child Nutrition Programs

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
School Lunches	300	325	355	390	430	1,800
Food Stamps	1,180	1,312	1,400	1,460	1,530	6,880

Under current law, children from families with incomes of up to 125 percent of the Department of Agriculture's poverty guidelines may receive free school lunches, which the federal government subsidizes at \$1.21 each. In fiscal year 1981, this means that a family of four with income up to \$10,050 may receive an annual lunch subsidy of about \$220 for each child enrolled in a participating school. Children from families with incomes between 125 and 195 percent of the poverty level pay 10 cents for their lunches, with the federal government contributing \$1.10, or about \$200 per child annually. For all those above 195 percent of the poverty level (\$15,700), the government pays a subsidy of about 36 cents per meal, or \$65 annually for each participating child.

This proposal would target subsidies more directly to low-income children, who also tend to benefit the most nutritionally. Free lunches would be available to families with annual incomes of up to \$8,900; lunches priced at 10 cents would be available up to \$14,090; and the annual federal subsidy to families with incomes above that amount would be reduced by \$9 per child. Under the proposal, federal costs could be reduced by about \$300 million in fiscal year 1981 and the five-year savings could reach nearly \$1.8 billion.

While there would be some reduction in the numbers of children participating under the proposal, this would not be likely to have any significant nutritional impact. Studies have shown that participants in the income ranges that would be most adversely affected by the proposal have no better diets than nonparticipants.

Savings could be further increased, up to \$1.5 billion a year by 1985, if the present duplication of school lunch and food stamp subsidies were ended. Food stamp benefits are calculated

on the assumption that all family members eat three daily meals at home. School lunch subsidies aim to meet one-third of a child's daily nutrition requirement. About 43 percent of the households benefiting from the food stamp program also participate in the school lunch program. The effect of the overlap is to subsidize four instead of three meals daily for about 6.8 million children.

Reduction of Funding for Youth Employment Programs

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	1981	1982	1983	1984	1985	
Youth Conservation Corp	56	58	61	63	66	304
Young Adult Conservation Corps	227	292	318	344	374	1,545
Summer Youth Employment Program	<u>264</u>	<u>424</u>	<u>463</u>	<u>501</u>	<u>543</u>	<u>2,195</u>
Total	547	774	842	908	983	4,054

The Youth Conservation Corps (YCC) and the Young Adult Conservation Corps (YACC) in combination provide 25,000 year-around and 40,000 summer jobs to young people aged 15 to 23, irrespective of family income levels. The Summer Youth Employment Program (SYEP) provides an additional 750,000 summer jobs for young people who qualify as "economically disadvantaged." Youth in YCC and YACC work mostly on conservation projects involving state and federal lands, while those in SYEP undertake a variety of projects determined largely by Comprehensive Employment and Training Act (CETA) prime sponsors. Although the projects undertaken in these programs generally yield tangible benefits and give the young people an acquaintance with the demands of real work (promptness, for example), most of the activities would probably be classified as nonessential, and they generally do not include useful training.

If the YCC and YACC programs were completely eliminated, and if funding for the SYEP were cut by 50 percent, the cumulative five-year savings through 1985 would be about \$4.1 billion.

The immediate consequence of funding cuts would obviously be a loss of jobs and income. While the year-around youth unemployment rate would rise by only 0.4 percentage point, the effects during the summer would be more serious, particularly in inner-city neighborhoods.

The argument for eliminating the YCC and YACC programs is that they are not targeted on people in financial need, and that the work performed through the programs, if it is worth doing, should be financed in the regular budgets of the state and federal agencies involved. The argument for reducing SYEP funding is that its apparent underlying purpose--averting urban unrest during summer school vacation periods--can be accomplished without such large federal expenditures. Furthermore, because they lack an organized training component, SYEP jobs provide few, if any long-term benefits for the participants.

Restructuring of College Student Loan Programs

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
400	800	1,100	1,300	1,200	4,800

The federal government has two main student loan programs. In the Guaranteed Student Loan (GSL) program, the government pays banks and other lenders a fee (which varies with interest rates, and is called a special allowance) to induce them to make loans to students. The loans also carry a 7 percent interest rate, paid by the government while the student is in school and by the borrower afterward. The GSL program is not based on need. Last year, students borrowed about \$3 billion in GSLs. The other main program, under which \$600 million in loans were made during 1979, is the National Direct Student Loan (NDSL) program. NDSL capital is provided by federal appropriations (90 percent) and the 3,100 colleges that administer the program (10 percent). The funds revolve, with repayments helping to finance new loans. The borrowers pay no interest while in school and 3 percent thereafter. Over the years, the federal government has contributed about \$4.5 billion to the NDSL program. NDSLs are available only to needy students.

The annual federal outlays for GSLs are now about \$1.3 billion, having risen rapidly in the last year since the Congress removed all family income ceilings on those who could have their interest payments subsidized. NDSL appropriations in recent years have been about \$300 million annually.

Program costs could be substantially reduced by making three changes: (1) limiting eligibility for the in-school interest subsidy to needy students; (2) charging a uniform 7 percent rate to all borrowers on leaving school; and (3) providing all loan capital through government borrowing instead of by paying a special allowance to private-sector lending institutions. If these changes were effective for 1981, there would be about 1.9 million highly subsidized loans that year instead of 2.8 million.

The main argument for this option is that interest-free loans are a costly and unnecessary subsidy to students who have adequate family resources and other means to cover their college costs. The counterargument is that even middle- and upper-income families have temporary difficulties in meeting high college costs, and that the federal government should help such families spread the costs beyond the immediate college years.

Retargeting of Basic Educational Opportunity Grants

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
100	400	400	300	300	1,500

Basic Educational Opportunity Grants (BEOGs) are currently payable to postsecondary students attending school at least halftime. The amount of a grant is equal to \$1,800 less a family contribution calculated according to a federal formula. Under the contribution formula, students from families with annual incomes of up to about \$25,000 are generally eligible for BEOGs. Under the more demanding contribution formula that was in effect before enactment of the Middle Income Student Assistance Act of 1978, however, the cut-off point for BEOG eligibility was about \$15,000 in family income.

Returning to the pre-1979 contribution formula obviously would diminish benefits for middle-income students. About 600,000 students would lose all BEOG eligibility, a 24 percent decline, and most others would receive less than they do under current law. Reimposing the old schedule would have no impact on students from very low-income families, nor would it significantly affect awards for students at low-cost institutions whose grants are already constrained by the provision that no BEOG may exceed half the cost of attendance.

It seems unlikely that the 1978 change has made any difference in middle-income student decisions about attending college, though it may have affected whether they choose to attend high-cost or low-cost colleges. Thus, reducing BEOG funding might affect the distribution of students among types of schools. It could also lead to increased demand for other forms of student assistance, such as student loans.

The main argument for eliminating grants to less needy students is that they will attend college anyway, and no high priority federal purpose is served by enabling them to attend more costly institutions. The counterargument is that it is appropriate for the federal government to ease the financial burdens of middle-income families with children in college, and to broaden their choice of colleges, whether or not the federal aid influences the basic decision to attend.

Termination of Certain Social Security Benefits

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Phase Out Student Benefits	200	800	1,400	1,900	2,100	6,400
Phase Out Survivor Benefits for Parents of Children Aged 16 and 17	25	90	500	525	535	1,675
Eliminate Minimum Benefit	65	135	160	205	225	790
Eliminate Lump Sum Death Benefit	<u>165</u>	<u>190</u>	<u>220</u>	<u>250</u>	<u>290</u>	<u>1,115</u>
Totals	455	1,215	2,280	2,880	3,150	9,980

Both the Ford and the Carter Administrations have recommended phasing out Social Security student benefits, which are payable to unmarried dependents between 18 and 21 if they are full-time students. (Dependent benefits otherwise stop at age 18.) The entitlement was created in 1965 legislation and is not based on need. The Congress has greatly expanded other forms of student assistance since 1965; phasing out the Social Security benefit would eliminate some duplication of payments.

In his 1980 budget, President Carter proposed phasing out the survivor benefits for parents of children aged 16 and 17, eliminating the minimum benefit, and eliminating the lump sum death benefit. None was enacted by the Congress.

Survivor benefits are paid the parent (typically, the mother) of children until they reach age 18. If the parent's benefit (but not the children's) was stopped when the dependent turned 16, annual savings would by 1985 exceed \$500 million. The change is based on the assumption that the parent of a child aged 16 or 17 is not homebound and can join the work force.

The minimum benefit is usually paid to retirees who spent most of their working careers in noncovered employment, typically in government. Many of those eligible for the minimum benefit have earned pensions under other programs. Those actually in need could be directly protected by Supplemental Security Income (SSI) and other welfare programs.

This lump sum death benefit (\$225) is paid to all surviving families. Where the need exists, the SSI program is an alternative method by which this support could be provided.

Reduction of Funding for EPA Construction Grants

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
0	420	732	973	1,030	3,155

The Environmental Protection Agency (EPA) makes grants to states and municipalities for the planning, design, and construction of wastewater treatment facilities. EPA usually provides 75 percent of the construction costs, and 85 percent if the project involves innovative technology. Because the states must use or lose their allocated funds within specified periods, the projects receiving funding are those "ready-to-go," rather than those higher up on the priority ranking but not yet ready. The result is that about 26 percent of all EPA construction grant money (\$22.5 billion between 1973 and 1979) may have been used for lower-priority projects. If funding eligibility were limited to three project types--secondary treatment projects, advanced waste treatment projects, and new interceptor sewers--and if the use or lose period were lengthened, federal funds could be more effectively used, even with a 26 percent cut in the program.

The counterargument is that most of the lower-priority projects ought to be constructed eventually. The consequence of reduced EPA funding would be a stretching out of the period before "point sources" of pollution would be controlled. At the current rate of obligation, that period is about 40 years. While states and municipalities might still construct the projects no longer covered, they would have to bear the costs involved.

Reduction of Funding for Impact Aid

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
250	325	350	400	450	1,775

For many years, administrations and the Congress have argued over Impact Aid (also known as School Assistance for Federally Affected Areas); the principal controversy has been over whether to continue compensating local school districts for children whose parents either live or work on federal property, but not both. In recent years, the Congress has lowered expenditures for such children, but outlays on their behalf, about \$250 million a year, still go to 4,100 school districts. If the payments were eliminated altogether, savings over the next five years would approach \$1.8 billion, or about one-third of the projected outlays if the program were unchanged.

The case for the reduction is that the local school districts involved are not necessarily losing tax revenue or experiencing financial hardship because of the federal presence, since the parents either live or work on local taxable property. Indeed, areas with substantial numbers of highly paid federal workers may have their property values enhanced by the federal presence. Furthermore, in some states the infusion of federal dollars serves only to reduce the amount of state aid allotted under state equalization programs.

The counterargument is that termination of the program would cause financial and budgeting shocks in the affected districts, some of whom receive almost 7 percent of their education funding from this source (although for most the payment is 2 percent or less).

Elimination of Farm Disaster Payments

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
0	0	560	560	560	1,680

The Congress has provided disaster payments to producers of wheat, feed grains, cotton, and rice for several years. If pending legislation is enacted, disaster payments will be made available through the 1981 crop year, while expansion of a subsidized federal crop insurance program is also underway. These programs are partly duplicative. Elimination of disaster payments after the 1981 crop could result in cumulative five-year savings of about \$1.7 billion.

Disaster payments encourage crop production in high-risk regions that are not ideally suited to farming. They tend to be distributed to a very few producers, who often receive payments on a regular basis; and their availability discourages participation in crop insurance programs.

Elimination of disaster payments would have varied effects. Some farmers in high-risk producing regions would not be able to afford federal crop insurance, even at subsidized premium rates. Others would seek diversification, such as livestock production, as an alternative to specialized crop farming.

The savings that would accrue from the permanent elimination of disaster payments could be used to subsidize crop insurance premium rates, thus spreading the benefit over many more farmers than under the present arrangements. Alternatively, the savings could benefit taxpayers generally, with crop insurance premium rates set to spread overall costs to farmers rather than reduce them.

STRATEGY III: SHIFTING RESPONSIBILITY TO STATE AND LOCAL GOVERNMENTS

Limiting of Federal Highway Aid

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
200	900	1,600	2,000	2,100	6,800

Expenditures on the Federal Aid Highway System will average \$8.5 billion a year during the next five years. If federal responsibility were limited to the Interstate System, to the primary road system (which with the Interstate System forms an integrated national network), and to bridge replacement, the 1981-1985 savings would approach \$7 billion, and savings would in future years exceed \$2 billion annually.

The effect would be to shift back to the states the full responsibility for a variety of highway programs, including the secondary road system, urban roads, pavement marking, removal of hazards, rail-highway crossings projects, and the 3-R program (resurfacing, rehabilitation, and restoration).

One argument for such a change is that the states are fully able to decide for themselves the standard of convenience and safety they wish to achieve on their local road systems, as well as to raise the funds to meet whatever standards they choose. Each 1 cent in gasoline taxes applied nationwide raises about \$1 billion. A uniform 2.5 cent increase in all states would make up for the loss of federal grant funding under this option.

A majority of all states--28--have not raised their gasoline tax rates since the OPEC price rises began in 1973. Their average tax rate per gallon is 7.7 cents. The average in the 23 jurisdictions that have had tax increases in the last seven years is 9.5 cents. Whereas state gasoline taxes accounted for about 20 percent of the price of gasoline in 1973, the current share is about 7 percent. One apparent effect of the federal highway grant program is to permit state legislators to avoid raising gasoline taxes to pay for the nonfederal highway programs they favor.

An argument against such a change is that the nation's road network, from the interstate highways to the least-traveled back road, should be regarded as a whole, and that a loss of federal funding for the local parts of the whole will have adverse national effects in terms of transportation costs and lives lost.

Elimination of the State Share of the Land and Water
Conservation Fund

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
147	196	259	282	313	1,197

The Land and Water Conservation Fund (LWCF) has two components: 40 percent of the fund is for federal purchases of land for parks, wildlife refuges, and recreation centers; the other 60 percent is allocated to the states on a 50-50 matching basis for the acquisition and development of outdoor recreation facilities. If the state share were reduced in 1981 and ended thereafter, the annual savings would exceed \$300 million by 1985.

Grants to state governments for state park land acquisition and similar purposes were not a federal responsibility until the mid-1960s. With virtually no exceptions, the states have provided the required matching funds since the program's inception, and the program enjoys wide support. In a sample of eight states, LWCF grants accounted for 18 to 37 percent of the state land development and acquisition budgets.

The argument for ending grants to the states from the LWCF is that state recreation programs mainly serve state residents or vacationers from other states whose expenditures provide income in the host state. Thus, each state has the responsibility for deciding what program its own taxpayers are willing to support; it has no claim on taxpayers nationwide.

The case for continuing the federal grant program is primarily on "quality of life" grounds. The quantity of land is fixed and, as the years go by, the expense of acquiring public recreation areas will inevitably climb. If the land is not acquired now, future generations of Americans will have less recreational opportunity than the present generation. While the nationwide benefits accruing from any particular investment in state park lands are not directly measurable, it is argued that such investments serve the national interest.

Elimination of Urban Park Grant Program

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
9	58	111	153	166	497

The Congress in 1978 enacted a five-year grant program for the support of urban park and recreational facilities. The savings from ending the program (assuming that it would otherwise be renewed on expiration of the current authorization) would total almost \$500 million during the next five years.

The argument for eliminating the urban park grant program is the same as that for ending the state share of the Land and Water Conservation Fund. In both cases, federal funds simply substitute for local funds. It is not clear that the national taxpayer should support a level of local recreational opportunity that local taxpayers are unwilling themselves to support.

The counterargument holds that there is a national interest in preserving or improving the "quality of life" for urban residents.

Termination of the Legal Services Corporation

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
250	341	369	399	432	1,791

The Legal Services Corporation (LSC) is a private, nonprofit corporation established in 1974 legislation. Through about 360 local programs, employing 7,000 lawyers, it provides legal assistance to the poor in civil matters. Most of the poor now have access to LSC programs, although some persons are barred by reason of geography and although the effectiveness of the program is limited by large caseloads.

There is no reliable basis for estimating the costs that would be incurred if the federal role in the program were ended. Presumably, some of the existing local programs would be continued, with state or local funding replacing the federal funds. In other cases, the program would be discontinued altogether.

The American Bar Association takes the position that "every lawyer, regardless of professional prominence or workload, should find time to participate in serving the disadvantaged." If the practicing lawyers in the United States were to give an average of one hour a week in pro bono legal service to the poor, the effect would be a level of service equivalent to the current federal program.

Proponents of direct federal funding point out that the Legal Services Corporation was created because access by the poor to civil legal assistance was demonstrably inadequate, and that there is no reason to suppose that matters would be different if the corporation were done away with. Opponents argue that the responsibility, if any, for correcting the situation does not lie with the federal government; and that a more universal program could be achieved by regulation at the state and local level--a change that is not likely to occur so long as federal funding is available for civil legal assistance to the poor.

Reduction of Funding for Criminal Justice Assistance

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
74	320	488	560	606	2,048

The Justice System Improvement Act of 1979 revised and continued a 12-year-old program by which the federal government makes grants to state and local governments in connection with efforts to deal with crime and juvenile delinquency. If the federal government's role were reduced to maintaining a national research and statistics program, the annual cost would be about \$50 million instead of nearly \$600 million. Savings through 1985 would reach \$2 billion.

There is some evidence that many ongoing programs now funded by the federal government would be continued even if federal assistance were phased out. Of 3,086 criminal justice projects ending in 1978 that were eligible or intended to be taken over entirely by state or local funding, 84 percent were continued.

It is less clear that new innovative projects would be started if federal assistance were no longer available. Judged by criteria adopted by the Law Enforcement Assistance Administration, however, fewer than 2.5 percent of the 1978 block grants supported innovative programs.

Proponents of the present program argue that elimination of federal grants would be a major threat to the progress that state and local governments have made in coping with crime and juvenile delinquency, and that the changes made by the 1979 legislation have addressed the deficiencies that marked earlier efforts. Advocates of a limited federal role argue that, after 12 years and more than \$7.7 billion, the federal government and the states have had ample opportunity to experiment with innovative approaches; that there is no persuasive evidence that the rate of crime or the quality of criminal justice administration have been significantly affected by the federal program; and that, if states place a high priority on criminal justice programs, General Revenue Sharing funds are available for that purpose.

Reduction of Funding for Urban Development Action Grants

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
7	37	85	153	231	513

In 1979 the Congress authorized the use of up to 20 percent of Urban Development Action Grant (UDAG) funding in connection with "pockets of poverty"--deteriorated areas of otherwise financially healthy cities. If this action were reversed and the total program funding cut back by 20 percent, annual savings by 1985 would approximate \$230 million.

The UDAG program assists communities with commercial, industrial, and housing development. Communities use the grants either for public works or to provide loans or grants to private firms or developers.

The southern and southwestern regions of the United States benefit most from the "pockets of poverty" eligibility concept, and would bear much of the cost of its loss. The cities that would be eliminated, however, rank in the top half of all cities in terms of fiscal condition, and many would probably fund economic development projects from general revenues or other local sources. But inevitably some UDAG projects would not go forward, with consequent erosion of the local tax base and loss of prospective jobs and housing.

The case for this reduction proposal is that the affected cities are in relative terms not distressed, and thus need no help from a program enacted in the first instance to assist "severely distressed" cities. The counterargument is that there is no evidence that "pockets of poverty" grants are spent less efficiently than other UDAG grants.

Reduction in the General Revenue Sharing Program

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Eliminate States	2,440	2,660	2,900	3,150	3,420	14,570 <u>a/</u>
Limit Local Units	240	260	290	310	340	1,440

a/ These savings are estimated against the CBO baseline projection. Against the Administration's proposal, the savings would be \$11,425 million.

General Revenue Sharing (GRS) payments to state governments have been steadily declining in real terms and were only about 2 percent of state general fund expenditures in 1979. Eliminating states from GRS would, therefore, have only a small overall impact, but the effects would be unevenly distributed since states vary considerably in their financial positions and in the proportion of GRS funding passed through to local units of government.

Rather than prohibiting GRS aid for all jurisdictions of a given type, eligibility might be based on relative need. The example used here eliminates local units in which the per capita personal income exceeds 125 percent of the national average. It is to some extent arbitrary, for income is not a wholly adequate measure of either the needs or the capacities of governments. (The estimated savings are based on limited data; actual savings may be less.)

General Revenue Sharing was originally viewed as a vehicle to shift some of the national tax burden from regressive state and local taxes onto more progressive federal taxes, while allowing state and local officials broad discretion over the use of the funds. The issue now arises whether increases in the progressivity of state and local taxes and increased competition for federal dollars warrant continuation of the program in its current form.

Increase of States' Share in Cost of Army National Guard

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
190	210	230	250	275	1,155

The 344,000 members of the Army National Guard serve two functions. They are part of the nation's reserve military forces; and they are used by the states to keep order when other police and security forces are inadequate, for assistance after natural disasters, for holiday traffic patrols, and for other state purposes. The states pay salary costs only when the Guard is actively performing a state mission; they pay nothing else toward the cost of the insurance role the Guard fulfills. This option would require the states to pay 10 percent of the total cost of maintaining the Guard.

The argument in favor of the change, aside from the federal savings that would occur, is that it is reasonable to ask state governments to bear at least a part of the ongoing costs of state military units; and that, if the states had to pay some part of the costs, they would examine more carefully the needed size and capability of their Guard units. Opponents might well argue that the Guard's size is determined by federal mobilization requirements and that its state functions are simply auxiliary duties.

Phasing Out of Funding for Vocational Education

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
20	213	457	708	966	2,363

Federal support accounts for about 10 percent of national expenditures for vocational education. Since the program is funded in advance, first-year outlay savings would be modest if it were gradually phased out; they would grow rapidly in the later years, however, reaching nearly \$1 billion in 1985.

While some vocational education programs might be jeopardized if federal support stopped, it is likely that states and localities would increase their own support for such programs to make up for at least part of the difference. In 1980, 29 percent of total federal budget authority for vocational education (\$226 million) was targeted on programs for handicapped, minority, economically disadvantaged, and non-English-speaking students. Historically, states and localities have not made a major effort to provide vocational education services to the population groups that might be most affected by a loss of federal funding.

The basic argument for ending federal support for vocational education is that such education entails relatively high costs per student, while the available evidence suggests that most vocational education graduates do not command higher wages or enjoy lower unemployment rates than similar high school graduates without such training. Supporters of the program contend that it encourages some students to complete high school, that the training does improve the earnings potential of some participants, and that if some aspects of the program are ineffective the remedy is to improve the training, not end federal support for it.

Reduction in Commitments for Subway Construction

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
10	230	420	525	645	1,830

The Urban Mass Transit Administration will have unfunded commitments of about \$1.2 billion at the end of fiscal year 1980 for new subway systems in Atlanta, Baltimore, Buffalo, Detroit, and Miami. If these commitments are met, but no new ones undertaken, the savings in outlays over the next five years will be in the range of \$250 million. In addition, if the new starts component of the President's Transportation Energy Initiative were eliminated, the savings would total \$300 million over the next five years. If construction of Washington, D.C.'s new rail system were halted at the 69 miles of track for which funds are now available, federal savings would total \$1.3 billion through 1985. Beyond 1985, savings from all these changes would total about \$2 billion more.

The argument against embarking on new subway systems is based on doubts about their cost-effectiveness. Typically, they save little, if any, energy; have only transitory effects on congestion and pollution; carry very large operating deficits; and, of themselves, have only a minor effect on land use. Funds spent on alternatives, such as buses, exclusive lanes for high-occupancy vehicles, and coordinated traffic signals, are much more productive.

The counterargument is that each proposed new subway system has its own unique costs and benefits, and that generalizations about such systems cannot be decisive with respect to any one of them.

STRATEGY IV: SHIFTING RESPONSIBILITY TO THE PRIVATE SECTOR

User Charges for Coast Guard Activities

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
600	650	700	760	820	3,530

The Coast Guard provides short-range navigational aids--such as buoys and other channel markings--without which commercial shipping in U.S. inland and coastal waters would be substantially more hazardous, difficult, and costly. The capital and operating costs of these navigational aids could be recovered from the shipping industry, just as highway users pay for the cost of highways.

The Coast Guard also engages in search and rescue operations for private mariners who are lost or otherwise in trouble. About 70 percent of such missions involve recreational boaters. With 10 million recreational boats of all kinds, an annual registration fee of less than \$25 would recover the search and rescue costs attributable to recreational boaters.

The argument for charging the shipping industry for navigational aids is that efficiency is enhanced when users of various modes of transportation pay the costs of each mode. The argument for charging recreational boaters is simply that it would be fair for the beneficiaries of this special service to bear the cost rather than the average taxpayer.

An argument against imposing such user charges is the likely disruptive impact on the shipping and boating industries and the difficulty of establishing fair cost allocations among the various kinds of users.

Increased User Charges for Army Corps of Engineers Waterway
Projects

Savings by Fiscal Year (in millions of dollars)					Cummulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
980	1,010	1,070	1,120	1,200	5,380

During the next five years the Army Corps of Engineers will spend about \$5.7 billion for construction and operating costs in connection with the nations's network of inland waterways, and to help maintain deep-draft ports. Under a recent enactment, an inland waterway user charge in the form of a 4 cents per gallon fuel tax will take effect in 1981 and rise to 8 cents in five years. The estimated 1981-1985 collections of that user tax will cover about 6 percent of the relevant federal expenditures in the same period.

Full recovery of costs would require an increase of 64 cents per gallon in the tax paid by inland waterway users, and could result in five-year taxpayer savings of almost \$5.4 billion. In all likelihood, the threat of such a large tax increase would cause marginal navigation projects to be dropped, thus reducing the size of the required tax.

The argument for increasing waterway user charges turns on both efficiency and equity. More efficient use of the country's resources will be achieved if the rates for barge transportation reflect the economic costs of that mode. Shippers choose modes in part on the basis of rates, and when the rates for one mode are much more heavily subsidized by taxpayers than the rates for other modes, some traffic is diverted from more efficient to less efficient modes. The equity argument is that it is unfair to ask the taxpayer to subsidize a profitable and growing private industry.

The argument against full-cost waterway user charges is that they would disrupt the barge industry, at least in the short term, and that most of the higher costs would be passed on to shippers and ultimately to consumers in the form of higher prices.

Increased User Charges for Airports and Airways

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
910	980	1,060	1,120	1,200	5,270

The Federal Aviation Administration (FAA) spends over \$3 billion a year, mostly on operating the airport and airway system, on grants-in-aid for airport construction, on purchases of facilities and equipment, and on research and development. Some of these expenditures are funded through user charges (primarily an 8 percent tax on passenger tickets) paid into the Airport and Airway Trust Fund.

The FAA estimates that in 1978 commercial users paid 88 percent of their share of the costs while general aviation users paid 14 percent of their share. Having all users of the airway system more nearly pay their own way would encourage more efficient use of airports and airways, and would be more fair as well. Increased user charges would probably permit budget savings of about \$5.3 billion over the next five years. User charges on general aviation would increase seven-fold, by an average of over \$3,000 per plane. This is equivalent to about a 15 percent increase in average operating costs. Little change would be required in commercial aviation charges. The general taxpayer would continue to subsidize the roughly 25 percent of FAA expenditures that represent public interest costs and other nonattributable costs.

An argument against this proposal is that greatly increased taxes might disrupt the general aviation industry. This disruption could be minimized by using the trust fund surplus (now around \$3.5 billion) to introduce increased user charges gradually.

Reduced Spending for Large Airports

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
100	200	300	400	500	1,500

The Federal Aviation Administration budget could be reduced by eliminating large and medium hub airports from the airport and airway development grant program. These airports are close to financial self-sufficiency already, and could replace the lost funds through user fees on commercial and general aviation. Commercial airlines are the most important users of these airports, and they would pay most of the increased fees. This change would reduce federal outlays by about \$100 million in 1981 and over \$500 million in 1985 for a total five-year savings of about \$1.5 billion.

The Senate Commerce Committee has reported a bill (S. 1648) proposing this change. In addition, the bill would use the resulting federal savings and the existing surplus in the Airport and Airway Trust Fund to reduce the 8 percent ticket tax to 2 percent. The loss in revenues from the decreased ticket tax proposed by this bill would be greater than the projected budget savings.

Elimination of Solar Demonstration and Application Projects

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
85	141	206	227	250	909

Projected expenditures for solar demonstration and application projects for fiscal years 1981-1985 total \$1,026 million. After allowing \$117 million for the costs of terminating programs prematurely, elimination of the solar demonstration and application projects could result in five-year budget savings of \$909 million.

Some of the technologies financed by this program, notably solar (nonphotovoltaic) generation of electricity, have been criticized as being so costly as to be uneconomical, relative to other technologies, under all foreseeable circumstances. Critics of the demonstration and application program have argued that more basic research on materials, such as corrosion resistance in solar heating and cooling and silicon production in photovoltaics, would provide a more effective method for the government to stimulate development of these technologies in commercial application. Recent moves by the private sector into solar power suggest that, once the basic research has been provided, the private sector develops promising technologies rapidly, without public demonstration programs.

The argument against elimination of the solar demonstration and application projects is that the cost and performance of many technologies is so speculative that private industry will avoid them, even though some may ultimately prove economically viable. Such technologies, which could not be developed by the private sector in the near term, could be significantly delayed or permanently overlooked unless the government underwrites the risk through demonstration projects. In addition, the criteria by which the private sector might evaluate investments in solar technology could be narrower than those implied by national energy policy.

Elimination of Subsidies to the U.S. Postal Service

	Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
	1981	1982	1983	1984	1985	
Revenue Forgone	878	1,112	1,174	1,301	1,286	5,751
Public Service	736	644	552	460	460	2,852
Total	1,614	1,756	1,726	1,761	1,746	8,603

The Postal Service's "revenue forgone" subsidy reimburses it for providing free postage to blind and handicapped persons and for carrying second, third, and fourth class mail at reduced rates. The lower rates mainly benefit nonprofit organizations, small newspapers, libraries, and educational institutions.

The public service subsidy is for services that by their nature cannot be made cost effective, such as delivery to isolated areas and on Saturday. The authorized level of the subsidy is already scheduled to drop at the rate of \$92 million a year until it reaches \$460 million in 1984.

Revenue forgone costs could be shifted to those now paying reduced rates. Postage for these mailers would increase on the average by 45 percent. The public service costs could be shifted by curtailing services (at a cost of inconvenience to the beneficiaries) or by increasing rates to all mail users by about 2 percent.

Proponents of reduced rates for special classes of mailers argue that such rates promote the flow of news and of educational, cultural, literary, and charitable materials. Opponents argue that, with respect to small newspapers, the true effect is to subsidize the rates paid by advertisers and the profits of proprietors; with respect to nonprofit institutions, they argue that the subsidy is not well-targeted and causes overuse of the mails for charitable appeals.

Proponents of continuing public services such as delivery to remote areas and delivery six days a week argue that people have come to depend on them, and that it would be unfair to abandon such services. Opponents argue that those who live in

remote areas are no more entitled to full mail service than they are to full fire protection at public expense. As for Saturday deliveries, they argue that because of holidays there are already at least nine weeks in the year when mail is delivered on only five days, and that people could readily adjust to such a schedule for all the other weeks in the year.

Establishment of Fees to Cover Costs of Food Product Inspections

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
310	320	331	343	356	1,660

The Federal Grain Inspection Service is supported in part by fees, but its administration and field supervision costs are not covered by the collections. The Food Safety and Quality Service provides inspection and grading services principally for the nation's meat and poultry products. The government makes no charge for such meat and poultry inspections. If the costs of both services were fully charged to shippers and processors, the savings to the general taxpayer would exceed \$350 million annually by 1985.

The argument in favor of the charge is that the cost of inspection is like any other cost of complying with the law and should be borne by the food industry, especially since the users of the service are readily identifiable and collection costs would not be great.

Opponents might well contend that, since the charges would be passed on to the general public, they would contribute to inflation and be regressive in the distribution of inspection costs.

Reimbursement of Veterans Administration by Third-Party Insurers

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
200	250	280	330	380	1,440

Virtually all health insurance policies now contain a clause excluding reimbursement for covered services performed in Veterans Administration (VA) health care facilities. If a pending legislative proposal to prohibit the inclusion of such clauses is enacted, the outlay savings would approach \$400 million by 1985.

Under the proposal, the VA would remain responsible for the full cost of treatment for service-connected conditions; but for treatment of a non-service-connected condition, the third-party insurer would have to reimburse the VA on the same basis as it would a private-sector hospital.

About 88 percent of the cost of treatment for 6 percent of VA patients would be shifted to insurance carriers under this proposal. Inasmuch as health insurance premiums are actuarially established, the effect over time would be a slight increase in premium rates. The general public would still be paying for the care of veterans, but partly through higher health insurance premiums instead of entirely through taxes.

Elimination of Operating and Construction Subsidies for the Maritime Industry

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
130	160	189	221	254	954

The Maritime Administration pays a construction cost differential subsidy to U.S. shipyards so that they can meet the competition of foreign shipbuilders. It also pays operating cost differential subsidies to U.S. shipping companies, again for the purpose of meeting competition from foreign countries. If the two subsidy programs were ended, the savings in the first five years would approach \$1 billion. Because the operating differential subsidy is a contractual obligation with respect to a particular ship, and typically for 20 years, it would take about that long to capture all the savings this option would generate.

The argument for such a step is that only three or four ships a year are built with the construction subsidy, so that the program has minimal effects in maintaining shipbuilding capacity.

If the subsidies were ended, there would be some loss of emergency naval shipbuilding capacity, some possible adverse effects on U.S. export and import prices, and some loss of employment in shipbuilding regions and in the industries that furnish shipbuilding materials.

STRATEGY V: REVISING JUDGMENTS AS TO WHAT CAN BE AFFORDED

Adjustment of Social Security Cost-of-Living Increases: 85
Percent of CPI Instead of 100 Percent

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
2,700	4,800	7,600	10,600	13,900	39,600

Every July, Social Security benefit payments are adjusted upward by amounts equivalent to the percentage rise in the CPI during the preceding year. If the law were changed so that the July 1, 1980, increase and all subsequent annual increases were limited to 85 percent of the inflation rate instead of 100 percent, the outlay savings would be very large--nearly \$14 billion a year by 1985.

One argument for such a limitation is that Social Security benefits are not subject to income or payroll taxes, so that a 10 percent cost-of-living adjustment provides greater after-tax protection for a Social Security beneficiary than it does for a person whose income is the same, but taxable. While this reasoning supports some limitation on Social Security cost-of-living adjustments, it does not lead to a specific limitation; an 85 percent limit was chosen as being within a plausible range of limits.

Opponents of any such change point out that the average total incomes of Social Security beneficiaries are below those of persons still in the work force, so that thus they are already less able to cope with the escalating cost of living. Furthermore, the suggested change would mean abandoning the commitment made by the Congress in 1972 legislation to protect fully the elderly and the disabled from the impact of inflation.

The issue ultimately comes down to the question of whether, when nationally real personal incomes are level or falling, some groups in the population should be given greater protection against the effects of inflation than other groups. Current law gives greater protection to Social Security beneficiaries.

If the decision should be that the government cannot afford to continue to give such protection, then consistency would require imposing limits on the cost-of-living increases paid under other federal programs, such as civilian and military retirement. Whether an identical or a different limit would be appropriate would depend on further analysis of specific programs and proposals. But extension of the limiting principle to the other programs could lead to further annual savings in excess of \$4 billion in 1985.

Once-a-Year Cost-of-Living Adjustments for Federal Retirees

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
803	1,044	1,086	1,141	1,212	5,286

The monthly benefits of federal civilian and military retirees are adjusted twice a year to reflect current changes in the CPI. Both Budget Committees have recommended that the cost-of-living adjustments for federal retirees be made only once a year, as is the practice for Social Security benefits. If this were done effective July 1, 1980, the annual outlay savings (based on the CBO projection of future inflation rates) could exceed \$1.2 billion by 1985.

The cost of such savings would, of course, fall on retired federal personnel, both military and civilian. The argument for the change is that it would bring about consistency of treatment, at least with respect to the frequency of inflation adjustments, for all federal retirement programs. Retired government workers would no longer receive greater protection against inflation-caused erosion of their benefits than that accorded Social Security retirees. But the federal retirees could argue that their pay while in active service was kept below comparability with the private sector by limits imposed for budgetary reasons, and that the twice-a-year inflation adjustment they now receive is a proper, though rough, recompense for the pay caps imposed on them during their working lifetimes.

Capping of Pay Raises for Federal White-Collar Employees

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
950	760	710	630	380	3,430

In the CBO baseline cost projection, salary levels for federal white-collar employees are assumed to rise 10.3 percent in 1981 and an average of 8.6 percent annually in the next four years. If, instead, the increases were capped at 7.5 percent, the savings would exceed \$3.4 billion over the five-year period.

White-collar federal workers' salaries are, by law, adjusted annually in order to maintain comparability with compensation paid for similar work in the private sector. In recent years, the annual adjustment has for budgetary reasons usually been held below the level that surveys indicate is necessary to maintain comparability. The Administration has proposed legislation that would, if enacted, significantly alter the policies and procedures for determining comparability, particularly in the consideration of fringe benefits, and could lead to lower annual adjustments. Pending enactment and full development of the Administration's proposed reforms, the Congress could continue the practice of accepting an arbitrary cap on white-collar pay raises.

Federal workers would argue that repeated pay caps destroy the principle of comparability and threaten the ability of the government to maintain a qualified and competent work force. Although federal benefits may differ from those available in the nonfederal sector, opponents of arbitrary limits on white-collar pay increases believe that further caps would be both unfair and unwarranted.

Reduction of Funding for Community Development Block Grant Program

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
25	140	290	420	530	1,405

NOTE: The estimated year-by-year and cumulative savings are based on six-year old data, and are thus subject to severe qualification.

Outlays for the Community Development Block Grant (CDBG) program could be reduced by eliminating assured funding for the one-third least-needy large cities, or about 200 out of nearly 600.

The loosely restricted CDBG funds are currently used by cities for a large number of purposes, making it difficult to estimate the precise effect of any loss of funds. But program regulations require some targeting on neighborhoods with concentrations of needy persons, with a large share of all CDBG spending going to housing rehabilitation and neighborhood upgrading programs. If funding were eliminated, such services could be cut back.

The CDBG program is second only to CETA as a source of relatively unrestricted federal funds for those cities that are eligible, and for some of these cities CDBG funding accounts for more than half of all federal grants received.

There is no evidence that the almost 200 least-needy beneficiary cities spend their CDBG funds less wisely or efficiently than the other beneficiary cities. The argument for a funding cutback must therefore rest on the general ground that the federal government cannot afford to continue all programs at current levels.

Reduction of Support for Health Professions Programs

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
50	250	350	450	500	1,600

Eliminating capitation grants to all medical and other health professions schools would save about \$600 million over the next five years. If the schools chose to increase tuition to offset the lost revenues, tuitions would increase by \$140-\$230 for nursing students and as much as \$780 for medical students. Students might choose to cover such tuition charges through increased borrowing, which already averages about \$18,000 (over four years) for medical students. While the debt load is high in absolute terms, it is low in relation to the beginning net income of physicians, now over \$50,000 a year.

Another \$1 billion could be saved over the next five years by phasing out the National Health Service Corps (NHSC) scholarships and the NHSC itself. The scholarships now average about \$12,700 a year for each recipient and are given to 6,660 students, including 9 percent of all medical students. Eliminating the scholarships would probably not affect total medical school enrollments, but the students would increasingly come from higher-income families. Ending the NHSC and the NHSC scholarship program would reduce access to medical care for people in underserved areas. In 1979, 870 areas and 818,000 people were served by the National Health Service Corps.

The basic argument against the NHSC is that it represents excessive federal involvement in the direct delivery of medical care. The federal government pays the full cost of the health care providers. The presence of such federally paid practitioners diminishes the attractiveness of the area for private practitioners, and thus may preclude long-run marketplace solutions to the problem.

Reduction of Funding for CETA Public Service Employment Title VI

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
523	572	630	689	758	3,172

By the end of fiscal year 1980, approximately 200,000 public service employment (PSE) jobs will be funded under Title VI of the Comprehensive Employment and Training Act (CETA). If average PSE enrollments were reduced to 150,000 during each of the next five fiscal years, the total outlay savings in Title VI would equal approximately \$3.2 billion.

The stated aim of the Congress in reauthorizing CETA in 1978 was to provide Title VI jobs for 20 percent of the number of unemployed in excess of 4 percent of the total labor force, and for 25 percent of that number if the national unemployment rate is above 7 percent. Funding for fiscal year 1980 finances approximately 40 percent of the statutory goal, while fiscal year 1981 funding for an average of 150,000 jobs would fulfill about 15 percent of the statutory goal.

Reducing the number of Title VI jobs would cause an increase in unemployment; however, the size of this increase depends on the extent of fiscal substitution--that is, on how many PSE jobs would have been created anyway by state and local governments or community-based organizations. The federal government is likely to bear some of the costs of increased unemployment through other federal programs, including unemployment compensation, Social Security, food stamps, public assistance payments, Medicaid, and veterans' benefits. Those increased costs would offset some of the direct job cost savings. The size of the offsets would depend on the extent of substitution, but expenditures would be likely to increase by \$100 to \$300 million in fiscal year 1981. Recent changes in CETA in 1978--increased targeting and PSE wage restrictions--decrease the likelihood of substitution in comparison to prior, less restricted PSE programs.

Reduction of Funding for Lower-Income Housing Assistance Programs

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
100	100	200	500	900	1,800

Every year, the federal government increases the number of lower-income families for which it makes long-term rent subsidy commitments. About 240,000 families will be added during 1980 to the 2.8 million households for which such commitments are currently outstanding. The Administration has requested funding sufficient to aid what it estimates will be an additional 300,000 families in 1981. Maintaining the 1980 increment of 240,000 in 1981 and thereafter would result in annual savings of \$500 million by 1985. Raising tenant rent payments in subsidized housing from the current maximum of 25 percent of family income to 30 percent of income would result in additional savings and would reduce outlays even relative to current policy, rising to \$900 million in 1985.

Lowering the number of new subsidy commitments would, of course, reduce the number of additional families receiving housing assistance. The 1980 increment of 240,000 represents one of the lowest program growth rates in recent years; even so, it is an 8 percent increase in the number of lower-income persons receiving aid.

Raising tenant rent payments would cost assisted families an average of about \$25 extra a month; but their out-of-pocket housing costs would still be well below the 39 percent of income that the typical unassisted lower-income renter now pays.

Long-term funding requirements could also be reduced if more reliance were placed on existing housing instead of on new construction or substantial rehabilitation. The Administration's proposed program mix in fiscal year 1981 is 40 percent existing housing and 60 percent new construction or substantial rehabilitation. If instead the mix were 50-50, outlays would be about \$350 million more during the five-year period (because of the shorter lead time required to lease existing units), but savings would begin to appear in 1986 and would amount to several billion dollars over the 30-year life of the subsidy commitments. To the extent that the program also serves to bolster the housing construction industry, this change would mean somewhat less support for that purpose.

Relaxation of Davis-Bacon Wage Requirements

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
134	144	153	160	168	759

The 1931 Davis-Bacon Act and 77 related federal statutes require that wages paid on most federal and federally assisted construction projects equal the prevailing wage in the local area of the project. Where there is no majority of workers paid at an identical rate, the wage scale paid to at least 30 percent of local workers is used. The practical effect, particularly in urban areas, is that workers on federal projects receive union scale, instead of an average locality rate. Repeal of Davis-Bacon might result in outlay savings of more than \$160 million a year by 1985 in just the three largest federal construction programs: military, Environmental Protection Agency construction grants, and ground transportation construction.

The estimated cost of the Davis-Bacon requirement, as given above, is based on recent studies by the General Accounting Office and the Council on Wage and Price Stability. Those studies have been criticized for using limited data and failing to adjust for asserted productivity differences. To the extent that higher-paid workers are more productive, higher wages may not translate directly into higher costs.

Defenders of Davis-Bacon argue that it saves the government money by excluding unqualified contractors and by preventing labor relations problems at construction sites. They also contend that the law's requirements add stability to the construction industry, thereby making less difficult the recruitment, training, and maintenance of skilled labor.

It is probable that repeal of Davis-Bacon would lead not only to some reduction in construction costs on federal projects, but would also tend to reduce upward pressures on wage rates at nonfederal projects in the same localities. While there would probably be some offsetting costs of the kind claimed by the critics of repeal, their magnitude cannot be calculated.

Reduction of Spending by the Small Business Administration

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
50	125	160	195	230	760

The Small Business Administration (SBA) provides management, technical, and financial assistance to small businesses. If its projected spending were cut back by 20 percent, the outlay savings during the next five years would be over \$750 million.

Several different measures would permit a reduction in SBA expenditures. A 20 percent cut in both the direct and the guarantee loan programs would lower outlays for loans, losses, guarantee repurchases, and administrative costs. If SBA borrowers were charged the government's cost for the capital loaned--instead of about 2 percent less--annual savings after several years would exceed \$40 million. Another measure to limit SBA spending would be to revise the definition of a small business. Under the current definition, about 96 percent of all nonfarm businesses now qualify for SBA assistance.

Imposition of Fees for Outpatient Visits at Military Hospitals

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
76	76	76	77	77	382

Free medical treatment tends to generate excessive use of medical services. Outpatient visits to military hospitals are now free to all eligible beneficiaries. Last year the President's Defense Resource Management Study (DRMS) recommended a charge of \$3 for all outpatient visits except by persons on active duty. If such a charge were made, the estimated direct savings would be about \$75 million a year. A probable additional advantage, not subject to costing, is that the quality of care would be likely to go up as the number of unnecessary visits went down.

The costs of this change would fall entirely on those using the military hospital system for their care, of which the largest group would be the dependents of enlisted personnel. The imposition of outpatient charges for dependents could adversely affect recruitment and reenlistment. But the change would improve equity to some extent, for many military dependents receive their care in nonmilitary facilities, and they are not reimbursed for the first \$100 spent annually for such care.

Reduction in Procurement of Aegis Cruisers

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
25	155	356	651	877	2,064

The CBO baseline projection used in estimating 1981-1985 spending assumes that 11 Aegis cruisers will be procured in that period. If the number were cut back to one a year, the five-year outlay reduction would exceed \$2 billion. (The Administration has recently proposed 1981-1985 procurement of 16 Aegis cruisers.)

The Navy contends that carrier strikes near the Soviet homeland would be an important means of gaining control of the seas during a major European conflict. The Aegis cruiser would have sophisticated missile-defense systems that, the Navy argues, are necessary to protect U.S. carriers within the range of Soviet land-based airpower. In peacetime, the existence of such highly capable ships in the fleet could increase the credibility of a U.S. naval presence, wherever the fleet is deployed.

Proponents of a slowdown in Aegis procurement point out that the sophisticated systems involved have yet to be proved in sea trials. They also argue that the combat scenario for which the Aegis cruiser is ultimately designed is an unlikely one, and that it would be better to keep up procurement of less-expensive (though less-capable) ships, thereby making it easier to sustain the widespread deployments that may be required of the Navy.

Elimination of Procurement of the KC-10 Tanker

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
14	147	245	145	72	623

This option would end procurement of all 14 KC-10 tankers assumed in the CBO baseline projection for fiscal years 1981-1985. (The Administration recently increased its procurement objective for this period to 20.)

The KC-10 is a wide-bodied jet (the DC-10) modified to accomplish aerial refueling. Its purchase is justified by the need to refuel cargo and tactical aircraft during long, nonstop transits associated with Persian Gulf and other Third World contingencies. Because of its large size and range, the KC-10 is much better suited to long-range deployments than the existing, smaller KC-135 tankers. The fleet of about 600 KC-135s is primarily committed to refueling strategic bombers in the event of a nuclear war.

The long range of the KC-10 is much less important for a faraway conflict, however, if the United States secures overflight and landing rights at intermediate stops, as it has in most previous airlift operations. Furthermore, even without overflight and landing rights, KC-135s could refuel U.S. cargo and tactical aircraft in a Third World mission. The KC-135s devoted to this effort would not, however, then be immediately available for strategic bomber refueling, were a nuclear war to occur with little warning.

Termination of MX Missile Program and Expansion of Sea-Based Deterrent

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
873	1,507	1,574	2,035	3,905	9,894

If the MX missile program were halted, and if a portion of the savings were shifted to the more rapid development of the Trident II missile and to the procurement of eight Trident submarines during the next five years (instead of the five assumed in the CBO baseline projection), the 1981-1985 savings could approach \$10 billion. Some of these savings would be offset in the long run by the higher operating costs of a sea-based system and, if Trident procurement were limited to an additional eight submarines, the United States would have less strategic capability than is currently planned.

The case for and against the MX is too complex to be thoroughly summarized in a page. The points below merely highlight some of the issues.

Advocates of the MX believe that the United States should maintain a triad of strategic forces--consisting of bombers, ballistic missile submarines, and land-based missiles--each capable of surviving a Soviet first strike. The MX missile system, they argue, is needed because existing land-based missiles could be vulnerable to a Soviet strike by the mid 1980s. The MX could also provide other advantages, including the capability for more reliable command and control links and an increased capability to attack such "hard" targets as missile silos and command bunkers.

Opposition to the MX missile system has centered on its hard-target destruction capabilities, and the potential cost of insuring that a reasonable number of missiles could survive a Soviet first strike. Without the restraints of the Salt II treaty, the Soviets could expand their arsenal of missiles aimed at the MX system, which could substantially increase the costs of a survivable MX missile system. These costs, and environmental problems associated with the MX, have led some to think that, if federal spending must be reduced, development and deployment of the more accurate Trident II missile aboard additional Trident submarines might provide sufficient capability.

Elimination of the Military Assistance Program

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
0	110	120	130	150	510

The Military Assistance Program (MAP) provides military equipment and services to support the military forces of U.S. allies. Today eight countries receive significant amounts of MAP funds, with the Phillipines and Portugal receiving the most. The Administration has greatly reduced MAP in favor of credits and foreign military sales backed by U.S. guarantees. This option would eliminate MAP entirely beginning in fiscal year 1982.

The Administration has supported the elimination of MAP, apparently on the judgment that the U.S. allies can retain strong forces without this aid. On the other hand, the high cost of importing petroleum, coupled with the weak world economy, has created serious problems in some countries of strategic importance to the United States (Turkey, for example). Thus, it may be necessary to continue providing equipment and services to some countries, either through MAP or through other means.

Hospital Cost Containment

Savings by Fiscal Year (in millions of dollars)					Cumulative Five-Year Savings
<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
370	1,400	3,000	5,000	7,200	16,970

Federal outlays for Medicare and Medicaid would be reduced by an estimated \$370 million in 1981, increasing to \$7.2 billion in 1985, if the Congress were to enact the Administration's legislative proposal for limiting hospital revenue increases from 1979 levels. Other payers, such as state governments, private insurers, and individuals, would benefit proportionately. Total savings, public and private, are estimated at \$40 billion over the next five years. The impact of the proposal would be large enough to lower the estimated 1985 CPI by 0.6 percentage point.

The rationale for the proposal lies in the nature of the market for hospital services. The role of physicians in medical decision making, combined with extensive third-party payment arrangements, eliminates much of the pressure to contain costs that is found in markets for other services.

Opponents of the measure allege that the limitation on revenue growth would force hospitals to cut down on essential services and expose them to increased deficits or reduced surpluses. Physicians might suffer a reduction in hospital-provided resources available in their practices. Patients might lose access to some services, and could find the quality of care not improving as much as it otherwise would have (although they would pay less for care).

The advantages of the approach include substantial savings in expenditures, a relatively small amount of red tape for a regulatory proposal, and the opportunities provided for states to substitute their own cost containment programs. Disadvantages include a brake on investment by hospitals in new technologies and unequal treatment of similar hospitals.

CHAPTER III. SAVINGS ON THE REVENUE SIDE: REDUCTIONS IN TAX EXPENDITURES AND TIGHTER ENFORCEMENT OF EXISTING LAW

The previous chapter discussed ways of reducing federal spending. But a significant amount of government economic activity involves not direct spending but the giving of subsidies in the form of lower taxes to certain groups or categories of people. These subsidies are called "tax expenditures" since they are in most respects equivalent to spending.

Tax expenditures are designed to stimulate or encourage particular kinds of activity, or to provide benefits or ease hardships for specified kinds of taxpayers. Like most "entitlement" spending programs, all those who meet the established eligibility requirements are entitled to receive the tax savings; the total revenue losses cannot be controlled by the Congress without making changes in the underlying eligibility rules. And like direct spending programs, these tax subsidies provide real economic benefits to those who receive them. Efforts to cut back the subsidies are resisted just as strongly as are cutbacks in direct spending programs. This chapter describes 16 illustrative examples of reductions in tax expenditure subsidies.

Additional revenue could be raised under current law if some of the taxable income that now goes unreported were collected and if existing laws were better enforced. Three illustrative examples are given for establishing a system of withholding taxes on interest and dividends, and on the income of some "independent contractors," and for increasing Internal Revenue Service (IRS) resources for audits and enforcement.

The revenue estimates in this chapter are based in some cases on CBO's fiscal year 1981-1985 revenue projections, but many of the estimates come from the Treasury Department or the staff of the Joint Committee on Taxation and are based on different economic assumptions and estimating techniques. Because of this and because of complex interactions among the illustrative changes, the separate estimates cannot simply be added up to obtain a total revenue increase estimate.

REDUCTION IN TAX EXPENDITURES

Termination of Tax-Exempt Bond Subsidies for Mixed Public/Private Activities

States and localities have issued tax-exempt bonds for decades to finance a wide variety of public projects, such as schools, roads, sewer systems, and government buildings. In recent years, however, these bonds have been used increasingly to finance activities that are partly private and partly public. Since the interest on the bonds is exempt from federal taxes, states and localities can issue them at lower interest rates. The federal government thus indirectly subsidizes the activities financed with the bonds. Some possible reductions in these federal subsidies for partly private activities are described on the following pages.

Industrial Development Bonds

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	1.0	1.2	1.5	1.8	2.2	
Revenue Increase from Eliminating Tax Exemption on New Issues	0.1	0.3	0.5	0.8	1.1	2.8

Tax-exempt industrial development bonds (IDBs) are issued by state and local agencies to finance plant and equipment for private businesses. The exemption from federal tax makes it possible for IDB beneficiaries to obtain financing at lower rates than they would ordinarily have to pay.

Although the use of IDBs in the past was largely for manufacturing, most states now also issue them for retail trade and other commercial ventures, including shopping centers, supermarkets, office buildings, and even country clubs. For large national cor-

porations, investment banking firms often underwrite several IDB issues at one time, making it convenient to finance the opening or expansion of a number of outlets or facilities simultaneously in one or more states. In 1979 the volume of new IDBs reached \$7.7 billion, nearly double the 1978 total.

The argument for repeal is that the public interest is not served by subsidizing interest rates for private businesses, particularly when IDB financing is rarely targeted to geographic areas in need of assistance and probably has little effect on investment decisions. The counter claim is that lower interest rates stimulate investment and promote job development.

Pollution Control Bonds

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1983</u>	<u>1985</u>	
Revenue Loss Under Current Law	0.5	0.6	0.6	0.7	0.7	
Revenue Increase From Eliminating Tax Exemption on New Issues	0.1	0.1	0.2	0.2	0.3	0.9

From a modest 1971 total of \$80 million, the volume of pollution control bonds (PCBs) rose steadily to an estimated \$2.8 billion in 1978. PCBs finance 40 percent of all pollution control investments.

The availability of PCBs can have only limited influence on a company's decision to invest in pollution control equipment. Federal pollution control regulations are highly prescriptive, so that an existing firm must choose between making the required improvement or closing.

The main argument for eliminating this subsidy is that private industry should pay its own pollution control bills, just as it pays for complying with other requirements imposed by law. On the other hand, some argue that industry's efforts to avoid contaminating the environment confer a public benefit and thus warrant some subsidy from the public.

Single-Family Housing Bonds

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	1.1	2.8	5.4	9.1	13.8	
Revenue Increase from H.R. 5741	0.6	2.1	4.8	8.4	12.0	27.9

Beginning in the summer of 1978, the volume of local tax-exempt bond issues for single-family housing increased sharply. The proceeds were used to provide low-interest mortgage loans to selected homebuyers. While federal legislation introduced early in 1979 slowed the increase in these bonds, they still accounted for 15 to 20 percent of all long-term tax-exempt bonds issued in 1979. The current version of this legislation (H.R. 5741) would sharply limit the volume of single-family housing bonds, concentrating them primarily on low- and moderate-income home purchasers and in targeted economically distressed areas.

The argument for limiting these bonds is that they are not well-targeted to needy families or areas, cause large federal revenue losses, and tend to push up interest rates on other forms of state and local borrowing, imposing additional costs on state and local taxpayers.

The argument against limiting the bonds is that they make it possible for some families to obtain homes who would not otherwise be able to do so, and they assist localities in pursuing innovative area redevelopment strategies.

Private Hospital Bonds

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	0.5	0.6	0.6	0.7	0.8	
Revenue Increase from Repeal of Tax Exemption on New Issues	0.1	0.1	0.2	0.2	0.3	0.9

The use of tax-exempt bonds to finance private hospital construction has increased significantly in recent years. A total of \$3.4 billion in tax-exempt hospital bonds was issued in 1979, accounting for about 8 percent of all long-term tax-exempt financing in that year. Over half of all new hospital construction in 1979 was financed with tax-exempt bonds.

The argument for repealing the tax exemption for private hospital bonds is that most evidence indicates that there is a surplus of hospital beds in the United States, and that excess hospital beds contribute to increases in hospital prices. As a result, direct federal subsidies for hospital construction have been sharply cut back in recent years.

The argument against repealing the tax exemption for private hospital bonds is that, even though there may be an excess of hospital beds nationally, some areas still lack adequate hospital facilities. But tax-exempt bond financing may not be the best way of assisting such areas, since the local governments may not have the financial strength to obtain favorable bond ratings and thus gain access to tax-exempt bond markets.

Student Loan Bonds

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Effect
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	0.1	0.1	0.2	0.2	0.2	
Revenue Increase from Eliminating Tax Exemption on New Issues	0.1	0.1	0.1	0.2	0.2	0.7
Outlay Savings from Lower Special Allow- ance on New Issues	<u>a/</u>	<u>a/</u>	0.1	0.1	0.1	0.3

a/ Less than \$50 million.

Student loan bonds are issued to finance loans to college students. The federal government guarantees repayment of the loans and also pays the state or local lending agency a "special allowance" interest subsidy in addition to the 7 percent interest paid by students. This special allowance payment--currently 9 percent--is also paid to banks and other private lenders who make student loans, and is designed to make up for the difference between the 7 percent students pay and current commercial interest rates of about 16 percent. Because of the tax exemption on their bonds, however, state and local agencies pay less for funds than private commercial lenders. The combination of the tax exemption and the special allowance designed for commercial lenders thus gives state and local lenders a double federal subsidy.

About \$1.4 billion in student loan bonds has been issued to date, including \$600 million in 1979. By 1985, CBO estimates that the annual volume will be between \$900 million and \$2.3 billion.

While state and local lending agencies may make loans available to students who are unable to obtain them from private lenders, it is not clear that the agencies need a double subsidy to do so. The subsidy could be cut back either by making future student loan bonds taxable, or by lowering the special allowance paid to state lending agencies to reflect their lower cost of funds.

Limiting the Exclusion from Tax of Employer-Paid Health Insurance

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	15.2	17.8	21.0	24.5	28.7	
Revenue Increase from H.R. 5740	2.0	1.7	1.4	1.1	1.0	7.2

Employer contributions for employee health insurance plans are now tax-free income to the employee, in addition to being a deductible business expense.

The argument for limiting the exclusion from tax of employer-paid health care premiums is that it has led to overly liberal health insurance coverage, thereby driving up medical spending. One proposal for limiting the present exclusion is in H.R. 5740. It would restrict tax-free employer contributions to \$120 a month for family coverage. Such a limitation would affect about one-third of all employees by 1984.

The major benefit of a tightened exclusion would be the creation of incentives for taxpayers to reduce their spending for health insurance coverage, thereby generating incentives for the more economical use of medical resources. Over the long run, this change could generate sizable reductions in medical spending.

The principal argument against this limitation is that it could impose hardships on some workers and their families. Limiting the exclusion might also have little effect on the cost of medical services in the short run, since medical practitioners will need some time to change their procedures in response to new forms of health insurance coverage.

Reduction of Medical Expense Deduction

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	4.1	4.6	5.2	5.8	6.6	
Revenue Increase from Eliminating Separate Deduction for Individual-Paid Health Insurance	0.3	0.3	0.3	0.3	0.3	1.3
Revenue Increase from Raising Floor for Deductible Out- of-Pocket Expenses to 5 Percent of Adjusted Gross Income	1.0	1.1	1.2	1.3	1.5	6.0

Under current law, taxpayers who itemize their deductions can deduct half the cost of health insurance premiums (up to \$150 a year), plus most out-of-pocket medical expenses to the extent they exceed 3 percent of the taxpayer's adjusted gross income.

Eliminating the separate deduction for individual-paid health insurance premiums would increase the tax bills of about 7 million taxpayers by an average of \$40 to \$45 a year. Restoring the floor on deductible medical expenses to the pre-1954 level of 5 percent would cost an average of about \$100 a year for 10 million taxpayers.

The deduction of medical expenses above 3 percent is defended on the ground that such expenses are extraordinary, involuntary, and reduce a person's ability to pay income taxes. The separate deduction for health insurance premiums is based in part on the belief that the purchase of health insurance should be encouraged, and that some such provision is required to provide comparable treatment to those who pay for their own insurance and those whose coverage is financed by their employers.

Both of these rationales are subject to question. The widespread holding of health insurance, for example, makes the medical deduction in many cases a supplementary form of coverage that subsidizes uninsured expenditures, many of which involve elective services (for example, orthodontia and cosmetic surgery). Similarly, there is little indication that the separate deduction for health insurance premiums has much impact on the extent of private insurance coverage.

The proposals discussed here would probably have no significant impact on overall health care spending. If enacted, however, they would target the subsidy more narrowly on the "medically needy" instead of on the broad class of taxpayers who itemize their deductions.

Repeal of Percentage Depletion Allowance for Oil and Gas

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss from Percentage Depletion Allowance for All Minerals	2.6	2.9	3.1	3.3	3.6	
Revenue Increase from Disallowing Percentage Depletion for Oil and Gas	1.8	2.1	2.2	2.2	2.5	10.8

Most firms engaged in oil, gas, and mineral extraction are currently allowed to deduct a fixed percentage of their gross income as a "depletion" allowance. Calculating the depletion allowance in this way increases producers' deductions substantially over what they would be if cost depletion accounting were used. While this allowance has been eliminated for major oil and gas producers, "independents" can still use it. The percentage depletion rate for independents will be reduced over the next four years under current law, dropping from 22 percent in 1980 to 15 percent in 1984. Substituting a complete repeal would gain \$1.8 billion in increased revenues in 1980 and \$2.5 billion in 1985.

The argument for repeal is that the dramatic increase in the selling price of domestic oil has made this additional subsidy superfluous. The argument against repeal is that it might discourage some domestic production and thus increase U.S. dependence on foreign oil.

Repeal of Expensing of Oil and Gas Intangible Drilling Costs

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u> </u>
Revenue Loss Under Current Law	2.6	2.7	3.1	3.5	4.0	
Revenue Increase from Repeal of Expensing of IDCs	2.6	2.7	3.1	3.5	4.0	15.9

Under standard accounting practices, expenditures that improve assets yielding income over several years must be capitalized and deducted over the period in which the assets produce income. Taxpayers engaged in oil, gas, and mineral extraction can, however, deduct amounts spent for labor, materials, supplies, and repairs in the year they are paid--they may "expense" these costs rather than "capitalize" them. The result is equivalent to an interest-free loan to these taxpayers.

The argument for repeal is that, in light of recent increases in oil prices and the decontrol of all domestically produced oil, the subsidy provided by this provision is no longer necessary. It has usually been defended as a risk-reducing subsidy that encourages domestic production of oil, gas, and other minerals. Replacing expensing of costs with capitalization will not, however, affect the cost to a producer of unsuccessful exploratory drilling. Under normal capitalization rules, if no income-producing asset results, all costs are currently deductible in any event. Expensing of IDCs is thus largely a subsidy for low-risk drilling in already developed and producing fields.

The argument for retaining the subsidy is that repeal might discourage some domestic production and further increase U.S. dependence on foreign oil.

Repeal of Home Insulation Tax Credit

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	0.4	0.4	0.4	0.5	0.5	
Revenue Increase from Repeal	0.4	0.4	0.4	0.5	0.5	2.2

In the Energy Tax Act of 1978, the Congress established a 15 percent tax credit, up to a maximum of \$300, for home insulation and other energy conservation devices.

The argument for repeal of the credit is that it generally does not provide an effective incentive to marginal purchasers of insulation, but instead is a windfall to those who would have purchased insulation in any case. The credit has been used primarily by higher-income taxpayers who, in response to a near tripling in home heating costs, probably would have insulated without the credit. The credit may also have contributed to artificial increases in the cost of insulation.

The argument for the credit is that, although many of the beneficiaries would have insulated sooner or later without the credit, the subsidy may accelerate their purchases by a few years, thus reducing short-term U.S. dependence on foreign oil.

Repeal of Domestic International Sales Corporation Provisions

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>Increase</u>
Revenue Loss Under Current Law	1.5	1.6	1.7	1.9	2.0	
Revenue Increase from Repeal of DISC	0.2	0.6	1.2	1.7	2.0	5.6

Domestic International Sales Corporations (DISCs) are paper corporations established as a conduit for export sales and afforded a lower effective tax rate on their income as a general inducement to increase export sales. Most DISCs are wholly-owned subsidiaries of large corporations.

A tax expenditure arises because export-related profits of the parent corporation allocated to the DISC receive favorable tax treatment: one-half of the tax liability on these profits over a base level is allowed to be deferred indefinitely.

The principal objective of the legislation establishing DISC in 1971 was to increase exports as one means of improving the U.S. balance of trade and of increasing domestic employment. In addition, the statute was intended to partially offset existing tax incentives, both U.S. and foreign, that encourage U.S. companies to favor production abroad over production at home for sale abroad, and that give tax shelter to foreign companies competing in the U.S. domestic market.

If DISCs are to have the effect of increasing exports, the tax savings provided must be used either to reduce export prices or to increase export promotional activities over what they would have been without DISCs. Evidence indicates that some increase in promotional activities can be attributable to DISCs. There is no evidence, however, that the availability of DISCs has affected export prices or credit terms.

Critics of DISCs contend that this type of tax expenditure has many inefficiencies. They maintain that it is not flexible

enough to respond to changes in the overall U.S. trade position. In addition, they argue that DISCs benefit mostly the largest corporations, those in the least need of aid; and that other countries see it as an unfair tax subsidy under the terms of the General Agreement on Tariffs and Trade.

The tax benefits of DISCs could be reduced in a variety of ways. One method, similar to a 1978 Administration proposal, would be to phase out the tax benefits over a three-year period, beginning in 1981. The revenue effects are shown above.

The accumulated past earnings of DISCs could continue to be tax deferred as long as they remain invested in export-related assets. Alternatively, some or all of the accumulated tax liability could be recaptured over a specified period of years.

Taxation of a Portion of Social Security Benefits

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss from Ex- clusion of OASI and Railroad Retirement Benefits	10.3	12.4	14.5	17.0	19.6	
Revenue Increase from Taxing Half of Benefits	5.0	6.0	7.1	8.3	9.6	36.0
Revenue Increase from Taxing Benefits of Recipients with In- comes Over \$20-25,000	1.1	1.3	1.6	2.5	3.0	9.5

When Social Security benefits were first paid in the 1940s, they were exempted from income taxation by the Internal Revenue Service (not by the Congress) on the theory that they were general assistance to the elderly, who typically were poor. The revenue loss was negligible, because total annual Social Security payments then amounted to \$35 million and income tax rates were low. But in 1981, the exclusion from tax of Social Security and railroad retirement benefits will cost more than \$10 billion in revenues, and in 1985 nearly \$20 billion.

Critics assert that, while this tax exemption had its origin as a subsidy to the elderly, many of whom were poor, it now serves primarily to subsidize upper-income recipients who benefit most from the tax-free status of social security payments.

Taxing half of Social Security benefits has been proposed as a rough way of making the treatment of these payments similar to that of other retirement benefits. If this were done, Social Security recipients in the lowest income group, who make up nearly half of all beneficiaries, would pay on average \$1 more a year in income taxes than they do now. By contrast, the 1 percent of

beneficiaries whose incomes exceed \$50,000 a year would pay an average of more than \$1,000 in added income tax under this proposal (Table 3).

A more limited approach would tax benefits only for those taxpayers whose joint income, including Social Security, exceeds \$25,000 or whose individual income is above \$20,000. This change would be consistent with the current tax treatment of unemployment insurance benefits.

TABLE 3. INCOME TAX INCREASES RESULTING FROM THE TAXATION OF HALF OF OASDI BENEFITS, BY INCOME CLASS

Income Class (thousands of dollars)	Total Number of OASDI Beneficiaries Filing Returns (thousands)	OASDI Beneficiaries in Income Class as a Percent of All OASDI Beneficiaries Filing Returns	Average Increase in Income Tax Liability (dollars)
Less than 5	10,883	45.0	1
5 - 10	6,574	27.2	103
10 - 15	3,210	13.3	321
15 - 20	1,536	6.3	447
20 - 30	1,215	5.0	528
30 - 50	505	2.1	791
50 - 100	186	0.8	1,111
100 - 200	40	0.2	1,448
Above 200	14	0.1	1,272
Total	24,163	100.0	155

SOURCE: Department of Treasury Individual Income Tax Model, 1979 law at 1978 income levels.

Taxation of All Unemployment Insurance Benefits

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	1981	1982	1983	1984	1985	
Revenue Loss Under Current Law	3.1	2.9	2.5	2.1	1.8	
Revenue Gain from 1978 Act (compared to old law)	0.3	0.3	0.3	0.3	0.3	
Additional Revenue Increase from Full Taxation of Benefits	3.1	2.9	2.5	2.1	1.8	12.4

Before 1979, a series of Internal Revenue Service rulings served as the basis for exempting from taxation unemployment compensation paid under most government programs. The Revenue Act of 1978 altered this treatment by partially taxing benefits received by individuals with incomes over \$20,000 and married couples with incomes over \$25,000.

The revenue gain from the 1978 law change will amount to about \$300 million a year over the next five years. Because the income limits specified in the provision were set so high, however, the 1978 act did not affect the majority of taxpayers. If unemployment payments were made fully taxable for all individuals, the additional revenue gain would be about \$3.1 billion in 1981.

Expanding the current taxability of unemployment payments to include all workers would remove any differences in the tax treatment between privately paid unemployment compensation and government benefits. Supplementary unemployment benefits from private employers have always been considered fully taxable income because they are intended to replace lost taxable earnings. Removing the tax exclusion for unemployment benefits would also reduce the current law's incentives to low- and middle-income individuals to remain unemployed; the level of payments made to unemployed workers is now frequently close to the after-tax income they could receive from working.

Increase in Tax Rates on First \$100,000 of Corporate Income

	Revenue Change in Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss from Low Rates on First \$100,000 of Corporate Income	7.5	7.9	8.4	8.7	9.1	
Revenue Increase from Higher Rates	2.5	2.8	3.1	3.4	3.7	15.5

Under current law, the first \$25,000 of corporate income is taxed at 17 percent, the second at 20 percent, the third at 30 percent, the fourth at 40 percent, and all income over \$100,000 at 46 percent.

If the purpose of the lower rates on the first \$100,000 of corporate income is to stimulate corporate investment, the current rate structure has certain drawbacks. Since investment decisions are affected primarily by the tax rate paid on the extra dollars of new income earned by the investment, the current rates have little effect on the decisions of corporations with incomes over \$100,000, since they must pay the top rate of 46 percent on all new income. The maximum benefit from the lower rates for any single corporation is also only \$19,250 a year, a relatively small amount for many large corporations.

On the other hand, if the lower rates are seen as a way to subsidize small businesses, the current subsidy is poorly targeted. The majority of small businesses are not incorporated and thus do not benefit at all from the lower rates, despite the fact that those rates provide substantial incentives to incorporate for tax shelter purposes.

A less graduated rate structure with a higher bottom rate would counteract some of these drawbacks. One such illustrative rate structure is shown below. It would add an estimated \$2.5 billion to revenues in 1981, and \$3.7 billion in 1985.

<u>Taxable Income (dollars)</u>	<u>Current Law Rate (percent)</u>	<u>Proposed Rate (percent)</u>
\$ 0 - 25,000	17	30
25,001 - 50,000	20	30
50,001 - 75,000	30	35
75,001 - 100,000	40	40
100,001 and above	46	46

The revenue that would be gained from these changes might be used to fund other, possibly more effective, ways of helping small businesses. One possibility would be a special lower capital gains rate for "venture capital" investments in new small businesses.

Limiting of Home Mortgage Interest Deductions

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	14.8	17.4	20.5	24.2	28.6	
Revenue Increase from \$5,000 Cap	0.8	0.9	1.0	1.1	1.3	5.1
Revenue Increase From Converting the Deduction to a 25 Percent Credit	0.8	0.9	1.0	1.1	1.3	5.1

Home mortgage interest payments have always been deductible under the federal tax system, providing a substantial and widely popular subsidy for home ownership. The subsidy has been incorporated into prices and investment decisions throughout the economy and could not be eliminated without causing serious unfairness and dislocation.

At the same time, the tax revenue loss is large, and the subsidy has probably contributed to the serious decline in rental housing construction, because unsubsidized rents cannot compete with the tax advantages of home ownership.

While the tax advantages are substantial for taxpayers with incomes over \$30,000, the great majority of homeowners with incomes below \$20,000 receive little or no benefit from the mortgage interest deduction; almost 40 percent of all homeowners use the standard deduction and gain no direct benefit from the deductibility of mortgage interest.

One way to target the subsidy more directly on those who have greater need for assistance would be to place a cap on the amount of mortgage interest that may be deducted. If the cap were set high enough, most homeowners would not be affected, but the cap might reduce increases in the prices of more expensive homes, could lead to more rental housing construction, and would reduce the revenue loss to the federal government.

If the cap were set at \$5,000, only homeowners with mortgage principal of more than \$47,000 would be affected, assuming a 10.5 percent mortgage interest rate.

Alternatively, a credit equal to 25 percent of mortgage interest payments could be substituted for the deduction. This would provide tax savings to all homeowners, not just higher-income homeowners who itemize their deductions. The tax savings would also be a constant 25 percent of interest paid, rather than varying from 14 percent to 70 percent depending on the taxpayer's marginal tax rate. The revenue increase would be about the same as from a \$5,000 cap.

Reduction of \$100,000 Capital Gains Exclusion on Home Sales by
Persons Aged 55 or Over

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Loss Under Current Law	0.6	0.6	0.7	0.8	0.9	
Revenue Increase from Reducing Ex- clusion to \$50,000	0.5	0.5	0.6	0.6	0.7	2.8

The Revenue Act of 1978 contained a once-in-a-lifetime exclusion from capital gains tax of up to \$100,000 of profit on homes sold by persons aged 55 or over. This replaced a much more limited provision that applied only to less expensive homes and only to persons aged 65 or over.

One effect of this subsidy will be to encourage older homeowners to sell their residences and move to smaller quarters, thus freeing up some larger homes for younger, larger families. But the provision also considerably increases the investment value of homes and may divert investment funds away from other possibly more productive investments, such as business plant and equipment. Another disadvantage may be higher home prices, as buyers become willing to pay more in the expectation of future tax-free gains.

If the \$100,000 exclusion were cut back to \$50,000, and taxpayers were allowed to use it cumulatively, rather than for only one sale, the revenue loss would be cut back substantially. (All homeowners would continue to be able to shelter gains on home sales by reinvesting the full proceeds in another residence.)

ADDITIONAL WITHHOLDING AND BETTER ENFORCEMENT

Institution of Withholding on Interest and Dividend Income

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Increase from 15 Percent Withhold- ing on Interest and Dividends	6.5	3.3	3.7	4.2	4.6	22.3

It has been estimated that as much as \$14 billion in interest and dividend income goes unreported by taxpayers each year, resulting in billions of uncollected tax dollars. If 15 percent of such income were withheld at the source, more revenue would be collected, and tax evasion and fraud could be reduced. The revenue gain would result from a one-time speed-up of receipts in the initial year of enactment, and the collection of taxes on previously unreported income. While some taxpayers would undoubtedly continue not to report all of their interest and dividend income (and thus only 15 percent of it would be collected as a tax), many others would probably be induced into a full disclosure and would be taxed at an average marginal rate of 25 percent.

The proposal has been consistently and strongly opposed by the financial community on the grounds of excessive administrative costs and inconvenience. Yet banks, savings and loan associations, and dividend payers are already required to file annual information reports for all taxpayers who receive over \$10 in interest or dividend income, and the additional chore of withholding should not be unduly burdensome. The Internal Revenue Service would also incur additional administrative and compliance costs.

Institution of Withholding on Independent Contractors

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Revenue Increase from 10 Percent Withhold- ing on Independent Contractor Income	0.6	0.6	0.7	0.9	1.1	3.9

Recent studies have indicated substantial underreporting of income by so-called "independent contractors." These include realtors, insurance agents, construction workers, truck drivers, and others whose relationship with those from whom they receive income is not as close as the normal employer-employee relationship. A 1979 study by the Internal Revenue Service suggested that almost 50 percent of all workers who are currently treated as independent contractors by the IRS do not report any of their compensation.

The Administration has proposed legislation that would require that 10 percent of payments to independent contractors be withheld at the source for taxes. A subcommittee of the House Committee on Ways and Means reported a bill (H.R. 5460) late last year incorporating this Administration proposal, and action by the full committee is expected this year. The Administration estimates that 10 percent withholding would result in a revenue increase of at least \$600 million a year.

Increase in IRS Audit and Collection Resources

	Revenue Change by Fiscal Year (in billions of dollars)					Cumulative Five-Year Revenue Increase
	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	
Increase in Tax Revenues	0.3	0.8	1.2	1.7	2.1	6.1
Increase in IRS Resources (Outlays)	<u>0.1</u>	<u>0.1</u>	<u>0.2</u>	<u>0.2</u>	<u>0.3</u>	<u>0.8</u>
Net Revenue Increase	0.2	0.7	1.1	1.5	1.9	5.3

Note: Details may not add to totals because of rounding.

According to the Internal Revenue Service, every additional dollar appropriated for tax examination purposes generates \$4 to \$5 of tax revenues, and every additional dollar appropriated to collect unpaid accounts generates \$18 to \$20. On the basis of these estimates, an increase in IRS appropriations of \$50 million (5 percent of the current budget) in each of the next five years could provide net budget savings of about \$0.2 billion in 1981, growing to \$1.9 billion in 1985, with a five-year cumulative savings of \$5.3 billion. This option entails no increase in tax rates but only the more efficient collection of sums already owed the government under current law.

APPENDIX. SUMMARY TABLES OF ILLUSTRATIVE EXAMPLES CATEGORIZED BY
BUDGET FUNCTION

TABLE A-1. ILLUSTRATIVE SAVINGS FROM CBO BASELINE PROJECTIONS, BY BUDGET FUNCTION, FISCAL YEARS 1981-1985: IN MILLIONS OF DOLLARS

Budget Function	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>050 National Defense</u>						
Elimination of World War II Destroyers	129	27	20	31	35	242
Restructuring of Military Retirement Pay	-100	-90	-60	-20	20	-250
Change in Enlisted/Officer Ratio in the Armed Forces	16	35	57	83	110	301
Imposition of Small Fees for Outpatient Visits at Military Hospitals	76	76	76	77	77	382
Reduction in Procurement of Aegis Cruisers	25	155	356	651	877	2,064
Elimination of Procurement of the KC-10 Tanker	14	147	245	145	72	623
Termination of MX Missile Program and Expansion of Sea Based Deterrent	873	1,507	1,574	2,035	3,905	9,894
Increase of States' Share in Cost of Army National Guard	190	210	230	250	275	1,155
<u>150 International Affairs</u>						
Elimination of the Military Assistance Program	0	110	120	130	150	510
<u>250 General Science Space and Technology</u>						
None						
<u>270 Energy</u>						
Closing of the Clinch River Breeder Reactor Program	220	430	560	160	80	1,450
Elimination of Solar Demonstration and Application Projects	85	141	206	227	250	909
<u>300 Natural Resources and Environment</u>						
Reduction of Funding for EPA's Construction Grants	0	420	732	973	1,030	3,155
Elimination of the State Share of the Land and Water Conservation Fund	147	196	259	282	313	1,197
Elimination of Urban Park Grant Program	9	58	111	153	166	497
Reduction of Soil and Water Conservation Program	94	128	147	158	169	696
<u>350 Agriculture</u>						
Establishment of Fees to Cover Costs of Food Product Inspections	310	320	331	343	356	1,660
Elimination of Farm Deficiency Payments	0	914	1,049	353	111	2,427
Elimination of Farm Disaster Payments	0	0	560	560	560	1,680
<u>370 Commerce and Housing Credit</u>						
Elimination of Subsidies to the U.S. Postal Service	1,614	1,756	1,726	1,761	1,746	8,603
Reduction of Spending by the Small Business Administration	50	125	160	195	230	760

TABLE A-1. (Continued)

Budget Function	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>400 Transportation</u>						
Limiting of Federal Highway Aid	200	900	1,600	2,000	2,100	6,800
Reduction in Commitments for Subway Construction	10	230	420	525	645	1,830
User Charges for Coast Guard Activities	600	650	700	760	820	3,530
Elimination of Operating and Construction Subsidies for the Maritime Industry	130	160	189	221	254	954
Increased User Charges for Airports and Airways	910	980	1,060	1,120	1,200	5,270
Reduced Spending for Large Airports	100	200	300	400	500	1,500
Increased User Charges for Army Corps of Engineers Waterway Projects	980	1,010	1,070	1,120	1,200	5,380
<u>450 Community and Regional Development</u>						
Reduction of Funding for Community Development Block Grant Program	25	140	290	420	530	1,405
Reduction of Funding for Urban Development Action Grants	7	37	85	153	231	513
<u>500 Education, Training, Employment, and Social Services</u>						
Reduction of Funding for Youth Employment Programs	547	774	842	908	983	4,054
Restructuring of College Student Loan Programs	400	800	1,100	1,300	1,200	4,800
Retargeting of Basic Educational Opportunity Grants	100	400	400	300	300	1,500
Reduction of Funding for Impact Aid	250	325	350	400	450	1,775
Reduction of Funding for CETA Public Service Employment, Title VI	523	572	630	689	758	3,172
Phasing Out of Funding for Vocational Education	20	213	457	708	966	2,363
<u>550 Health</u>						
Hospital Cost Containment	370	1,400	3,000	5,000	7,200	16,970
Reduction of Support for Health Professions Programs	50	250	350	450	500	1,600
<u>600 Income Security</u>						
Administrative Improvements in Public Assistance Programs	325	350	375	400	440	1,890
Change in Trigger for Unemployment Insurance Extended Benefits	1,000	1,000	0	0	0	2,000
Modifications in Trade Adjustment Assistance	150	200	250	250	250	1,100
Modifications in Child Nutrition Programs						
School Lunch	300	325	355	390	430	1,800
Food Stamps	1,180	1,312	1,400	1,460	1,530	6,880

TABLE A-1. (Continued)

Budget Function	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>600 Income Security</u>						
Modifications in Federal Compensation Practices	49	148	263	394	539	1,393
Termination of Certain Social Security Benefits	455	1,215	2,280	2,880	3,150	9,980
Adjustment of Social Security Cost-of-Living Increases: 85 Percent of CPI Instead of 100 Percent	2,700	4,800	7,600	10,600	13,900	39,600
Reduction of Funding for Lower-Income Housing Assistance Programs	100	100	200	500	900	1,800
Modification of Indexation of Federal Programs	3,500	3,500	5,700	7,600	9,700	30,000
<u>700 Veterans' Benefits and Services</u>						
Elimination of Certain GI Bill Benefits	70	60	50	40	30	250
Reimbursement of Veterans Administration by Third-Party Insurers	200	250	280	330	380	1,440
<u>750 Administration of Justice</u>						
Termination of the Legal Services Corporation	250	341	369	399	432	1,791
Reduction of Funding for Criminal Justice Assistance	74	320	488	560	606	2,048
<u>800 General Government</u>						
None						
<u>850 General Purpose Fiscal Assistance</u>						
Reduction in the General Revenue Sharing Program						
Eliminate States	2,440	2,660	2,900	3,150	3,420	14,570
Limit Local Units	240	260	290	310	340	1,440
<u>900 Interest</u>						
None						
<u>950 Undistributed Offsetting Receipts</u>						
None						
<u>Several</u>						
Reform of the Wage Board Pay System	260	610	780	870	950	3,470
Elimination of Dual Pay for Reservists Who Are Federal Employees	35	39	42	46	50	212
Once a Year Cost-of-Living Adjustments for Federal Retirees	803	1,044	1,086	1,141	1,212	5,286
Capping of Pay Raises for Federal White-Collar Employees	950	760	710	630	380	3,430
Relaxation of Davis-Bacon Wage Requirements	134	144	153	160	168	759

TABLE A-2. ILLUSTRATIVE REVENUE INCREASES BY BUDGET FUNCTIONS, FISCAL YEARS 1981-1985: IN BILLIONS OF DOLLARS

Budget Function	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>050 National Defense</u>						
None						
<u>150 International Affairs</u>						
Repeal of Domestic International Sales Corporation (DISC) Provisions	0.2	0.6	1.2	1.7	2.0	5.6
<u>250 General Science Space and Technology</u>						
None						
<u>270 Energy</u>						
Repeal of Home Insulation Tax Credit	0.4	0.4	0.4	0.5	0.5	2.2
Repeal of Expensing of Oil and Gas Intangible Drilling Costs	2.6	2.7	3.1	3.5	4.0	15.9
Repeal of Percentage Depletion Allowance for Oil and Gas	1.8	2.1	2.2	2.2	2.5	10.8
<u>300 Natural Resources and Environment</u>						
Termination of Tax Exemption for Pollution Control Bonds	0.1	0.1	0.2	0.2	0.3	0.9
<u>350 Agriculture</u>						
None						
<u>370 Commerce and Housing Credit</u>						
Termination of Tax Exemption for Single-Family Housing Bonds	0.6	2.1	4.8	8.4	12.0	27.9
Termination of Tax Exemption for Industrial Development Bonds	0.1	0.3	0.5	0.8	1.1	2.8
Increase in Tax Rates on First \$100,000 of Corporate Income	2.5	2.8	3.1	3.4	3.7	15.5
Limiting of Home Mortgage Interest Deductions						
Revenue Increase From \$5,000 Cap	0.8	0.9	1.0	1.1	1.3	5.1
Revenue Increase From Converting the Deduction to a 25 Percent Credit	0.8	0.9	1.0	1.1	1.3	5.1
Reduction of \$100,000 Capital Gains Exclusion on Home Sales by Persons Aged 55 or Over to \$50,000	0.5	0.5	0.6	0.6	0.7	2.8
<u>400 Transportation</u>						
None						
<u>450 Community and Regional Development</u>						
None						

TABLE A-2. (Continued)

Budget Function	1981	1982	1983	1984	1985	Cumulative Five-Year Savings
<u>500 Education, Training, Employment, and Social Services</u>						
Termination of Tax Exemption for Student Loan Bonds	0.1	0.1	0.1	0.2	0.2	0.7
<u>550 Health</u>						
Termination of Tax Exemption for Private Hospital Bonds	0.1	0.1	0.2	0.2	0.3	0.9
Limiting the Exclusion from Tax of Employer-Paid Health Insurance	2.0	1.7	1.4	1.1	1.0	7.2
Reduction of Medical Expense Deduction						
Eliminating separate deduction for individual-paid health insurance	0.3	0.3	0.3	0.3	0.3	1.3
Raising floor for deductible out-of-pocket expenses to 5 percent of adjusted gross income	1.0	1.1	1.2	1.3	1.5	6.0
<u>600 Income Security</u>						
Taxation of All Unemployment Insurance Benefits	3.1	2.9	2.5	2.1	1.8	12.4
Taxation of a Portion of Social Security Benefits						
Revenue Increase from Taxing Half of Benefits	5.0	6.0	7.1	8.3	9.6	36.0
Revenue Increase from Taxing Benefits of Recipients with Incomes Over \$20-25,000	1.1	1.3	1.6	2.5	3.0	9.5
<u>700 Veterans' Benefits and Services</u>						
None						
<u>750 Administration of Justice</u>						
None						
<u>800 General Government</u>						
Institution of Withholding on Interest and Dividend Income	6.5	3.3	3.7	4.2	4.6	22.3
Institution of Withholding on Independent Contractors	0.6	0.6	0.7	0.9	1.1	3.9
Increase in IRS Audit and Collection Resources	0.2	0.7	1.1	1.5	1.9	5.3
