MAINTAINING BUDGETARY DISCIPLINE: SPENDING AND REVENUE OPTIONS

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The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Numbers in the text and tables may not add to totals because of rounding.

ERRATA

In the print version of this report, option 400-03 (Eliminate the Essential Air Service Program) states in the test that eliminating the program would save $4.8 billion from 2000 to 2009. That estimate is incorrect. The correct estimate is $480 million, as shown in the table accompanying the option. This electronic version contains the corrected text for the option.

Preface

This volume compiles 250 specific policy options for reducing federal spending or increasing revenues in a wide variety of programs. Prepared at the request of the House and Senate Budget Committees, it is intended to help policymakers maintain budgetary discipline and accomplish related policy goals. The report is similar to the compendiums of policy options for reducing the deficit that the Congressional Budget Office (CBO) prepared from 1980 to 1997.

The policy options included in this report come from many sources, and the Congress has considered most of them at some time in the past. In keeping with CBO's mandate to provide objective and impartial analysis, the discussion of each option presents the cases for and against it as fairly as possible. CBO does not endorse the options included, nor does exclusion of any proposal imply a recommendation for or against it.

The report begins with an introductory section that discusses the major rationales for budgetary discipline and explains how to use the information presented in this volume. Part One includes more than 200 options for reducing spending, organized by the functional categories of the budget—national defense; international affairs; general science, space, and technology; and so on. Each functional category is introduced by a page of background data and information on recent spending trends within that function. Part Two presents more than 50 options for generating revenues. The report concludes with an appendix listing the scorekeeping guidelines used to enforce the discretionary spending limits and pay-as-you-go requirement of the Budget Enforcement Act of 1990 (as amended).

All divisions of the Congressional Budget Office contributed to this report, which was coordinated by Sandy Davis, Steve Lieberman, and Barry Anderson. Sandy Davis also prepared the introductory section. The spending options were coordinated by David H. Moore, R. Mark Musell, R. William Thomas, and Bruce Vavrichek. The revenue options were coordinated by Diane Lim Rogers and Roberton Williams. Budget authority and outlay estimates were coordinated by Tom B. Bradley, Paul R. Cullinan, Peter H. Fontaine, and Michael A. Miller. The staff of the Joint Committee on Taxation prepared most of the revenue estimates. The background pages for each function were prepared by David H. Moore and Peter H. Fontaine, with assistance from Keith Mattrick. Laurie Brown designed the interactive version of the report, with technical support from Frank Gibbs. Barry Anderson designed the cover.

Sherry Snyder supervised the editing of the report, and Kathryn Quattrone oversaw production. Major portions were edited by Leah Mazade, Christian Spoor, and Liz Williams. The authors owe thanks to Sharon Corbin-Jallow, Judith A. Cromwell, Denise Jordan, Angela Z. McCollough, Ronald Moore, L. Rae Roy, and Simone Thomas, who typed the early drafts. Kathryn Quattrone prepared the report for publication, and Laurie Brown prepared the electronic versions for CBO's World Wide Web site, both assisted by Martina Wojak-Piotrow.

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April 1999

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Introduction

Until recently, large and persistent deficits dominated the federal budget. For most of the past two decades, lawmakers struggled to find common ground on new policies that would eliminate those deficits. In the 1980s, their efforts met with little success; but in the 1990s, a strong economy and the end of the Cold War combined with a series of three multiyear budget agreements—in 1990, 1993, and 1997—to produce a dramatic reversal in the federal budgetary outlook.

The reversal happened with stunning speed, well in advance of predictions. Fiscal year 1998 ended with a sizable surplus of about $70 billion in the total budget (that is, including Social Security and the Postal Service, which are off-budget). The Congressional Budget Office (CBO) projects that under current policies and current assumptions about the economy, surpluses in the total budget will continue and will grow substantially. Over the 1999-2009 period, they are expected to total about $2.7 trillion. Excluding off-budget spending and revenues, small on-budget deficits continue through 2000 but give way thereafter to growing on-budget surpluses that are projected to total about $800 billion through 2009.[1]

Yet the emergence of projected surpluses, even sizable ones, does not mean that budgetary discipline should be abandoned. For at least four reasons, choices and trade-offs must be made, even in an era of surpluses.

1. Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2000* (April 1999), Table A-3, p. 68.

- If the economy weakens significantly, projected surpluses in the total budget could diminish or disappear, and the emergence of on-budget surpluses could be delayed. Major new budgetary commitments that were not offset would only hasten such a trend.

- Maintaining budgetary discipline would help ease the long-term budgetary pressures that will emerge with the aging of the baby-boom generation. In fact, annual deficits are projected to return as those pressures mount after 2010.[2]

- The discretionary spending limits and pay-as-you-go (PAYGO) requirement established by the Budget Enforcement Act of 1990 (BEA) are still in force.[3] In particular, the limits for 2000 allow for less spending than was appropriated for 1999. Trade-offs will be necessary to keep spending within those limits and still fund priority programs.

- Trade-offs will also be necessary to allow paying down the national debt. Reducing federal debt increases national savings and thereby promotes the economic growth that will be needed to help meet the long-term budgetary challenges facing the nation. The likely effects of a particular policy on the future growth and size of the economy is a key fiscal consideration for policymakers. In

2. For a discussion of the long-term outlook, see Congressional Budget Office, *Long-Term Budgetary Pressures and Policy Options* (May 1998).

3. The Balanced Budget Act of 1997 extended BEA procedures generally through 2002.

particular, major budgetary proposals—whether to reduce debt, cut taxes, increase spending, or address the long-term structural imbalances of Medicare or Social Security—should take those likely effects into account.

Although burgeoning surpluses may seemingly widen the range of policy options, they do not make them easy or obvious. For example, some policymakers would use surpluses (or a portion of them) to cover costs that are associated with certain proposals to reform Social Security or Medicare for the long term. Others favor proposals to overhaul the tax code. Those changes will be controversial and complex. Reaching a consensus on them is likely to be a difficult and protracted process. As lawmakers consider the various options, maintaining budgetary discipline will help preserve projected surpluses and lower the federal debt.

The prospect of continuing surpluses also does not dispense with the need to examine the effectiveness and efficiency of federal programs. Emphasizing the objectives underlying the Government Performance and Results Act of 1993 (GPRA) will assist policymakers in evaluating existing federal programs and in judging whether new programs should be substituted for outmoded or ineffective ones. Some policymakers favor converting the annual budget process to a biennial cycle in which an entire session of Congress would be devoted mainly to the oversight, evaluation, and reauthorization of federal programs.[4]

As policymakers consider these and other issues, they are likely to need a full range of budgetary options that produce savings. This volume lists spending and revenue options that would produce budgetary savings, either by cutting spending or increasing receipts.[5] The options generally are intended to help lawmakers maintain budgetary discipline. Some also can be used to satisfy other rationales for budgetary savings, such as limiting the overall size of the federal government, restructuring programs to achieve policy goals at lower cost, or improving the efficiency and effectiveness of federal programs to reach GPRA performance goals. Others can be used to eliminate narrow tax preferences or promote greater economic efficiency.

4. For data on program authorizations that expire in 1999, see Congressional Budget Office, *Unauthorized Appropriations and Expiring Authorizations* (January 8, 1999).

5. This volume is similar to the annual volumes CBO produced from 1980 through 1997 that listed options for reducing the deficit.

The Limits on Discretionary Spending in 2000 to 2002

For discretionary spending, which is controlled in annual appropriation acts, the Budget Enforcement Act establishes dollar limits for budget authority and outlays. In some years, separate limits have been set for broad categories of discretionary spending (such as defense, domestic, and international); in others, a single set of consolidated caps has covered all discretionary spending.[6] For fiscal year 2000, most discretionary spending is consolidated into an overall discretionary category. Separate caps are set for spending on highways, mass transit, and violent crime control. (Only outlay caps are established for the highway and mass transit categories.) After 2000, the violent crime category is combined with all other discretionary spending for enforcement purposes.

The limits on discretionary spending for 2000 cap total appropriations for the year below the level enacted for 1999, largely because of the record amount of emergency appropriations enacted last year. The amount of the shortfall depends on whether, or to what extent, those emergency appropriations are repeated as nonemergency appropriations for 2000 (see Table 1). For 2001 and 2002, total discretionary outlays are capped at or just below the limit for 2000.[7] Thus, relative to the levels enacted for 1999, spending cuts or offsets will be necessary to comply with the caps for 2000 and possibly for 2001 and 2002.

6. Separate discretionary categories are sometimes referred to as "firewalls" because they are created in part to preserve an overall level of spending for programs in that category. In general, spending cuts or offsets in one discretionary category may not be used to offset increases in another.

7. Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 2000-2009* (January 1999), Table A-1, p. 97.

Table 1.
Alternative Amounts of Discretionary Spending for 2000 Compared with Spending Caps
(In billions of dollars)

	Including Amounts for 1999 Emergencies	Excluding Amounts for 1999 Emergencies[a]
Budget Authority		
2000 Cap[b]	536	536
Amount to Preserve 1999 Real Resources		
Defense	290	281
Domestic and international[c]	287	279
Violent crime reduction	6	6
Total[d]	582	566
Amount over 2000 cap	46	29
Amount to Freeze 1999 Dollar Resources		
Defense	281	273
Domestic and international	275	267
Violent crime reduction	6	6
Total[d]	562	546
Amount over 2000 cap	25	10
Outlays		
2000 Cap[b]	573	573
Amount to Preserve 1999 Real Resources		
Defense	286	282
Domestic and international	284	281
Violent crime reduction	5	5
Highways	25	25
Mass Transit	5	5
Total	605	598
Amount over 2000 cap	32	25
Amount to Freeze 1999 Dollar Resources		
Defense	280	276
Domestic and international	279	277
Violent crime reduction	5	5
Highways	25	25
Mass Transit	5	5
Total	594	587
Amount over 2000 cap	22	15

SOURCE: Congressional Budget Office.
NOTE: Amounts to freeze 1999 dollar resources have no adjustment for inflation.

a. In 1999, $15.8 billion in discretionary appropriations was designated as emergency spending. The totals here exclude the estimated budget authority and outlays that result from assuming that those appropriations are repeated in 2000. About $6 billion of 1999 emergency appropriations funded certain mandatory programs and therefore are not reflected in this table.
b. The caps reflect discretionary spending limits as specified by the Office of Management and Budget in the sequestration preview report included in the President's budget, adjusted for CBO's estimate of contingent emergency releases that the President has not yet designated.
c. In 1999, an appropriation of $17.9 billion was provided for the International Monetary Fund to meet a periodic commitment for which funding was last provided in 1993. Such appropriations result in no outlays. The domestic and international totals here exclude the estimated budget authority that results from assuming that the appropriation is repeated in 2000.
d. This level does not include mass transit budget authority, which is not subject to a cap. Mass transit budget authority totals $1.1 billion in 1999.

During the mid-1990s, lawmakers constrained overall discretionary spending levels by making significant cuts in defense outlays, which now account for roughly half of total discretionary spending. The end of the Cold War made sizable defense cuts possible. Since 1990, defense discretionary outlays have fallen about 25 percent, while nondefense discretionary outlays have grown about 20 percent (in constant 1992 dollars).[8] Some lawmakers are concerned that further defense cuts would be ill-advised and believe that defense levels should be increased. Some also advocate reestablishing separate caps for defense and nondefense discretionary spending, a move that would prevent trade-offs between the two categories.[9]

Reaching a consensus on discretionary spending levels that do not exceed the caps will be difficult. The lure of growing surpluses may exacerbate the problem. Consequently, some lawmakers fear that conditions may be ripe for efforts to evade rather than comply with the discretionary caps for 2000 and beyond. As proof, they point to the record amount of emergency appropriations enacted for 1999.

The BEA permits the President and the Congress to designate new spending or revenues as emergency requirements, which are effectively exempt from the discretionary spending limits and PAYGO. Typically, the emergency designation is used to provide appropriations for unforeseen or unpredictable events, such as natural disasters or international emergencies. Under the BEA, emergency appropriations not related to the Persian Gulf War have ranged from about $1.5 billion (1991) to $22 billion (1999), averaging just under $9 billion annually. In some years, those amounts have been partially or entirely offset with rescissions of other discretionary appropriations. However, most of the record amount of emergency spending enacted for 1999, which was provided for a variety of purposes, was not offset, thus increasing concern that the emergency safety valve has become a loophole for sustained higher spending.[10]

CBO estimates that the President's budgetary proposals for 2000 would cause total discretionary outlays to exceed the outlay limit for that year by about $30 billion. The President proposes to partially offset that excess amount with certain new taxes and cuts in mandatory spending programs—proposals that the current BEA rules would count under the PAYGO requirement, not the discretionary spending limits.[11] Those proposals would require changes in BEA procedures, which the President also proposes. Some analysts contend, however, that such changes would weaken budgetary discipline since total discretionary spending would remain well above the capped levels.

Other Rationales for Budgetary Savings

Although all of the options included in this volume would produce budgetary savings that could be used to maintain budgetary discipline, some could also be used to promote other policy goals.

Some options, for example, could be used to reduce the size of government, limit its rate of growth, or scale back activities for which a federal role is questioned. Certain options, such as the one to reduce funding for the arts and humanities (option 500-12), would produce savings by eliminating a program or programs that some policymakers may consider to be inappropriate federal activities. Others, such as the one to eliminate funding for new empowerment zones and enterprise communities (option 450-06), would cancel programs or spending that may duplicate other federal or state programs. Several options would can-

8. *Budget of the United States Government, Fiscal Year 2000: Historical Tables*, p. 118.

9. Separate caps for defense spending were in place in 1991, 1992, 1993, 1998, and 1999.

10. For a discussion of trends and issues relating to emergency spending, see Congressional Budget Office, *Emergency Spending Under the Budget Enforcement Act*, CBO Memorandum (December 1998).

11. Congressional Budget Office, *Analysis of the President's Budgetary Proposals for Fiscal Year 2000*, p. 5.

cel or cut back spending that many people believe is more appropriately undertaken by the private sector —for example, the option to eliminate the Department of Energy's applied research program for fossil fuels (option 270-01). The option to eliminate the Essential Air Service program (option 400-03) would end an activity that benefits certain localities but may not serve the wider public.

Other options would enable lawmakers to eliminate programs that may have outlived their usefulness, may have achieved the purposes for which they were created, or might be better performed outside the federal government. For example, the option to eliminate certain subsidies provided by the Rural Utilities Service (option 270-05) would end a program that many people assert has accomplished its original objectives. One goal of the option to sell federal assets that support the Southeastern Power Administration (option 270-07) would be to end a federal activity that the private sector may be able to perform more efficiently. Some people support the option to eliminate antidrug advertising (option 800-05) because they argue that there is no clear evidence that such advertising works.

Lawmakers may also want to consider options that would restructure programs to achieve program goals at lower cost. A number of national defense options may offer such opportunities. Option 050-24, for example, would consolidate military exchange systems and introduce incentives for more efficient operations. The option to restrict eligibility for student loans by using home equity to determine financial need (option 500-07-C) would improve the targeting of federal assistance under the student loan program. Another option, to simplify and limit Medicare's cost-sharing requirements (570-13-A), is meant to encourage beneficiaries and providers to use medical services more prudently. A number of options would establish cost-based user fees for businesslike services that the government now provides without charge.

Certain revenue options would produce savings by eliminating preferential treatment in the tax code for particular activities or forms of income and by providing more evenhanded treatment of taxpayers generally. For example, options REV-09 through REV-12 would restrict the tax-favored treatment of nonretirement fringe benefits.

Many of the options are relevant to the requirements of the Government Performance and Results Act of 1993 in that they could be used to improve the efficiency and effectiveness of federal programs. That act requires federal agencies to prepare annual performance plans that establish measurable goals for program performance and that match expected goals with a certain level of funding. Performance measures are now included with agency budget requests in the President's annual budget submission. They are intended to help policymakers hold departments and agencies accountable for programs that do not effectively and efficiently accomplish their objectives, as indicated by their performance measures. If programs fall short of those measures, the law intends that policymakers be confronted with certain critical decisions, including whether those programs should be restructured or have their funding reduced or eliminated.

Exclusions and Limitations

The options for budgetary savings in this volume stem from various sources, including legislative proposals, the President's budget, past CBO deficit reduction volumes, Congressional and CBO staff, other government entities, and private groups. Although the options are intended to reflect a broad range of possibilities, they are neither ranked nor comprehensive. The inclusion or exclusion of a specific option does not represent an endorsement or rejection of that option by CBO (see Box 1). As a nonpartisan Congressional staff agency, CBO does not make policy recommendations.

The options exclude policy changes that are not counted under the Budget Enforcement Act. Thus, options that would affect off-budget programs (Social Security and the Postal Service) or that fully fund existing deposit insurance commitments are not included. Also excluded are options affecting any program or requirement for which the discretionary spending limits are automatically adjusted. Those programs and requirements include spending designated as an emergency requirement (also excluded from PAYGO), appropriations for continuing disability reviews of certain benefit payments, the International Monetary Fund, international arrearages, and initiatives to com-

Box 1.
Changes in Options from Previous Volumes

Not all of the options included in the Congressional Budget Office's last published compilation (1997) of spending and revenue options appear in the current volume. Some of the options, or very similar ones, have been enacted into law. An example is the option to extend and broaden the Federal Communications Commission's authority to auction licenses to use the radio spectrum. Other options—for example, a proposal affecting assistance to people who rent housing in rural areas—have been dropped because programs were modified to improve their effectiveness.

Since the 1997 volume was issued, projected surpluses have replaced projected deficits. A number of revenue options that had the sole or primary purpose of raising revenues to close the budget deficit have therefore been dropped. Increasing marginal tax rates on individuals and corporations and imposing a value-added tax are two examples. Other revenue options in the previous volume—for example, options to limit pension contributions or to tax capital gains from home sales—have been dropped because recently enacted measures indicate movement toward increasing rather than decreasing tax benefits in specific areas.

ply with the earned income tax credit. Further, asset sales that CBO estimates would result in net costs to the federal government are excluded. For example, selling the assets of the Tennessee Valley Authority (TVA) may result in net federal costs because a private operator may not be able to charge prices for electricity that are sufficiently high to pay the TVA's outstanding debt to the government.[12]

The volume focuses on options that would produce near-term budgetary savings; it excludes broad policy options or integrated approaches for budgetary savings—for example, comprehensive proposals to reform major programs, such as Social Security or Medicare, or those proposals to revise the tax code. Such options generally make more fundamental changes that take longer to carry out and are directed principally at the longer-term budgetary or economic horizon.

The options in this volume facilitate the case-by-case review of individual programs. The volume therefore excludes certain types of governmentwide options that would produce savings in many programs or agencies. Such options would, for example, freeze spending across the board, eliminate an entire department or major agency, or make an across-the-board cut in federal salaries. Savings for such options cannot always be reliably estimated because they may affect numerous programs and may simply result in a shift in spending among programs or accounts. Moreover, such options cut effective and ineffective programs alike.

Some of the options affecting states, localities, or the private sector may involve federal mandates. The Unfunded Mandates Reform Act of 1995 establishes procedures intended to control such mandates. It also requires CBO to estimate the costs to states and localities of any mandates imposed by new legislation that the Congress is considering. Individual options in this volume do not include estimates of any potential mandates. However, they may discuss that issue where appropriate.

The calculations accompanying the individual options do not include savings in federal interest costs. Interest savings typically are estimated as part of a comprehensive budget plan, such as the Congressional budget resolution, but such adjustments usually are not made for individual options of the type discussed in this volume.

12. The Balanced Budget Act of 1997 (BBA) changed the treatment of asset sales under the BEA. Previously, asset sales were not counted for any purpose under the BEA. Therefore, the proceeds from the sale of a government asset could not be counted under the discretionary spending limits or the PAYGO requirement and could not be used to offset spending increases or tax cuts under those disciplines. The BBA modified that rule to prohibit counting only asset sales that would result in a net cost to the federal government. Guidelines for calculating the net cost of an asset sale are included in the BEA scorekeeping guidelines contained in the BBA conference report (see U.S. House of Representatives, *Balanced Budget Act of 1997*, conference report to accompany H.R. 2015, Report 105-217 (July 30, 1997), p. 1012). The scorekeeping guidelines are reprinted in the appendix. For a discussion of issues raised by the sale of power assets, such as the TVA, see Congressional Budget Office, *Should the Federal Government Sell Electricity*, CBO Study (November 1997).

Finally, subsequent CBO cost estimates, which generally accompany any bill reported by a Congressional committee, may not match the savings estimates shown in this report. The policy proposals on which the cost estimates are based may not precisely match the specifications used in developing the options. Further, the budget baseline estimates or levels against which the proposals ultimately are measured may have been updated and thus would differ from those used here.

Using This Volume

Part One of this volume lists options to reduce spending, and Part Two lists options to increase revenues. Spending options are categorized according to the functional categories of the budget—national defense (050), international affairs (150), general science, space, and technology (250), and so on. Each spending option is further identified as affecting either mandatory or discretionary spending. For each function, an introductory page provides summary information and historical data on overall mandatory and discretionary spending trends within that function.

The options are numbered individually and include, where appropriate, references to related options in the volume and to relevant CBO publications. Spending options are numbered beginning with the number for the functional category within which they are grouped. For example, defense spending options are numbered 050-01, 050-02, and so on. Closely related options are grouped together under a single number, with individual options identified by a letter suffix. (For example, 050-01-A and 050-01-B both cut strategic nuclear force levels.)

For each option, the volume provides general background, discusses the pros and cons of the proposal, and estimates the annual budgetary savings (that is, the cut in spending or the increase in revenues) for the 2000-2009 period. Cumulative savings are summed for the first five years of that period (2000-2004) and for all 10 years. The projected savings for mandatory spending and revenue options are computed from baseline levels estimated to occur under current law.[13] Savings for discretionary spending options generally are calculated from the level appropriated for 1999. Savings for a few discretionary spending options, principally those affecting certain housing subsidies, are calculated from adjusted baseline levels explained in the background discussion for those options. New or increased fees may be classified as offsets to spending (offsetting receipts or collections) or as new revenues (governmental receipts).[14]

Scorekeeping Guidelines

The BEA includes scorekeeping guidelines to ensure that the budgetary effects of legislation are measured consistently and in accord with standard conventions (see the appendix). Among other things, those guidelines identify discretionary and mandatory accounts, specify how to account for legislation that crosses between the discretionary spending and PAYGO enforcement categories, provide for the scoring of asset sales and lease purchases, and set forth rules for various other budgetary transactions.

The guidelines, however, are subject to interpretation, and CBO and the Office of Management and Budget (OMB) sometimes view them differently. Those differing interpretations may affect how certain options are counted under BEA procedures. OMB estimates are final for the purpose of BEA enforcement. CBO estimates are advisory under the BEA but generally are used in the Congressional budget process.

13. For cost estimates of revenue legislation, CBO is required by law to use estimates provided by the Joint Committee on Taxation. JCT estimated most of the revenue options included in this volume. CBO prepared the estimates for the option to expand Medicare coverage to certain state and local government employees (REV-18) and the option involving taxable Social Security and Medicare wages for the self-employed (REV-19).

14. The term "user fee" is not a formal budget category. It is an informal term that generally refers to collections from individuals or entities that benefit from or are regulated by some federal program, and the collections are used solely to support that program. In general, if the fee supports a business-type activity, it is classified as an offset to spending. If it is based on the government's sovereign power to tax, it is classified as a revenue. User fees classified as spending offsets may be further classified as either mandatory or discretionary, depending generally on the type of spending legislation in which the fee is included.

The Interactive Budgetary Discipline Volume

An interactive version of this report is available on CBO's Web site (www.cbo.gov) in HTML. That version allows users to search the options in four ways, singly or in combination:

- By type of option—spending (by budget function) or revenue,
- By spending category (discretionary or mandatory),
- By agency (the federal agency whose programs would be affected by the option), and
- By word or phrase.

For example, a user could search for all options related to natural resources and the environment (budget function 300) that affect discretionary spending; all options that would produce savings in mandatory spending within the Department of Health and Human Services; all options that deal with submarines; or all options that eliminate something (a program, some kind of assistance, or some other key factor).

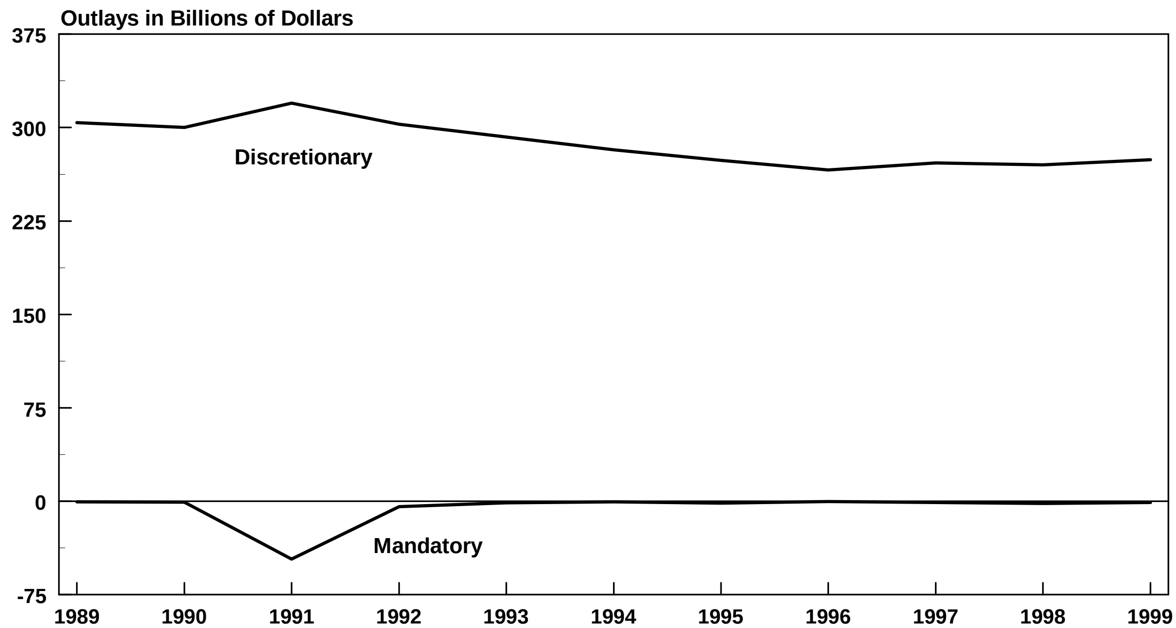
Part One

Spending Options

050

National Defense

Budget function 050 comprises spending for national defense. Although 95 percent of that spending falls within the Department of Defense, function 050 also includes the atomic energy activities of the Department of Energy and smaller amounts in the budgets of other federal departments and agencies. CBO estimates that discretionary outlays for function 050 will be about $274 billion in 1999. Discretionary budget authority of $280 billion was provided for national defense in 1999. Mandatory spending in that function usually shows negative balances because of payments made to federal agencies. In 1991, those receipts were unusually large because of reimbursements by foreign governments for some of the costs of the Persian Gulf War. Over the past decade, outlays for national defense have declined from 27 percent of federal government spending to 16 percent.



050-01-A REDUCE U.S. FORCES TO START II LEVELS BY 2007

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	570	90
2001	580	260
2002	1,560	590
2003	1,610	1,000
2004	950	1,370
2005	1,690	1,410
2006	1,920	1,480
2007	1,590	1,730
2008	1,130	1,700
2009	1,170	1,480
Cumulative		
2000-2004	5,270	3,310
2000-2009	12,770	11,110

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-01-B, 050-02, and 050-03

RELATED CBO PUBLICATION:

Letter to the Honorable Thomas A. Daschle regarding the estimated budgetary impacts of alternative levels of strategic forces, March 18, 1998.

The second Strategic Arms Reduction Treaty (START II) will require the United States to cut its long-range nuclear forces to 3,500 warheads by 2003—roughly one-third of the 1990 level. START II was ratified by the Senate in 1996, but it faces an uncertain future in Russia's parliament, the Duma. Presidents Clinton and Yeltsin have agreed to delay full implementation of the treaty until December 31, 2007, in an effort to encourage ratification by the Duma. However, the forces to be dismantled by that date must be made inoperable by the end of 2003.

The Clinton Administration decided in 1994 to begin cutting its forces to START II levels to save money and to encourage Russian ratification of the treaty. But those plans were thwarted after several years of Russian inaction and Congressional directives prohibiting further cuts in U.S. forces. As a result, today's forces remain largely consistent with the START I treaty, and the Administration has decided to keep them at those levels until the Duma ratifies START II. Currently, the United States deploys 500 Minuteman III intercontinental ballistic missiles (ICBMs) with three warheads each, 50 Peacekeeper ICBMs with 10 warheads each, 18 Trident submarines (each carrying 192 warheads on 24 missiles), and 94 B-52H, 94 B-1B, and 21 B-2 bombers.

Once the Duma ratifies START II, the Administration plans to achieve the 3,500-warhead limit by eliminating all 50 Peacekeepers, four Trident submarines, and 23 B-52H bombers by the end of 2007. It will also reduce the number of warheads on Minuteman III missiles from three to one and on Trident D5 missiles from eight to five and will redesignate its B-1B bombers as conventional bombers.

This option would follow the Administration's plan to reduce U.S. forces to START II levels even if the Duma does not ratify the treaty. Those cuts would be made by the end of 2007, the treaty's modified implementation date. The primary motivation would be financial; those changes would save $570 million in 2000 and nearly $13 billion through 2009 relative to START I levels. Most of the savings would come from avoiding three substantial investments: buying D5 missiles, refueling the four oldest Trident submarines and converting them to carry D5s, and manufacturing more Peacekeeper missiles. (This option would not save any money relative to the Administration's plan since that plan already assumes the cuts.) Savings could be $700 million higher through 2009 if the forces were retired by 2003, the original implementation date for START II.

Supporters of this approach argue that keeping long-range forces at today's levels is unnecessary. According to several reports, Russia will have trouble maintaining its forces at START I levels. Many of its missiles and submarines are nearing the end of their service life, and production of replacements has slowed to a trickle or stopped altogether. For that reason, several prominent former opponents of START II in the Duma have recently urged ratification. Some advocates of this option also argue that adopting it will encourage the Duma to ratify the treaty.

Critics argue that U.S. forces should remain at START I levels. They oppose any unilateral disarmament. They also worry that Russia might build up its nuclear forces if a hard-line government came to power. In their view, the Duma will only ratify the treaty if it is faced with a robust U.S. START I force.

050-01-B REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,250	190
2001	1,340	590
2002	2,500	1,260
2003	2,560	1,810
2004	2,010	2,260
2005	2,670	2,360
2006	2,400	2,500
2007	2,650	2,810
2008	1,720	2,690
2009	1,780	2,380
Cumulative		
2000-2004	9,660	6,110
2000-2009	20,880	18,850

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-01-A, 050-02, and 050-03

RELATED CBO PUBLICATION:

Letter to the Honorable Thomas A. Daschle regarding the estimated budgetary impacts of alternative levels of strategic forces, March 18, 1998.

This option would go one step farther than the previous alternative (050-01-A). It would reduce the number of missiles and submarines below the levels planned by the Administration for START II but keep the number of warheads at START II levels. Specifically, it would retire four additional Trident submarines and 200 Minuteman III intercontinental ballistic missiles by 2003, retaining 10 Tridents and 300 Minuteman IIIs. To keep the same number of warheads, the smaller Trident force would carry seven warheads on each missile instead of five (see option 050-02). Minuteman III missiles would carry one warhead. This option would keep the same number of nuclear bombers as option 050-01-A, each carrying an average of 16 warheads. In all, those forces would carry nearly 3,500 warheads—almost the same number that the Administration proposes for START II.

Compared with keeping U.S. forces at START I levels, this option would save $1.3 million in 2000 and $20.9 billion through 2009. Most of those savings—which were outlined in option 050-01-A—would come from reducing forces to the START II levels planned by the Administration and thus do not represent savings from the Administration's budget plan. However, this option would save an additional $680 million in 2000 and $8.1 billion through 2009 compared with the Administration's plan; those extra savings would come from reduced operation and support costs (from retiring 200 Minuteman ICBMs and four additional Trident submarines) and lower levels of investment spending (from canceling production of the D5 missile after buying five in 1999, extending the service life of fewer Minuteman missiles, and forgoing the Administration's plans to reconfigure four Trident submarines under START II so they can carry new D5 missiles).

During the Cold War, this option might have raised concerns about stability. By putting more nuclear "eggs" in fewer baskets, the United States would have increased its vulnerability to a surprise attack. But today those concerns have become less acute. The United States may now decide that it can save money safely by deploying its warheads on fewer weapon systems. However, this option would retain three types of nuclear systems (the so-called nuclear triad) and thus provide a margin of security against an adversary's developing a new technology that would render other legs of the triad more vulnerable to attack.

This option has a number of potential disadvantages, including those raised in option 050-01-A about cutting forces below START I levels before Russia ratifies START II. Carrying more warheads on D5 missiles would reduce the targeting flexibility of U.S. planners, and deploying fewer submarines might increase their vulnerability to Russian antisubmarine forces. Unilaterally cutting forces would also limit the United States' ability to increase the number of warheads it deployed if Russia decided not to abide by START II. Indeed, some critics argue that unilateral cuts would reduce U.S. leverage to get Russia to ratify START II.

050-02 TERMINATE PRODUCTION OF D5 MISSILES AFTER 1999

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,120	160
2001	1,120	520
2002	2,280	1,110
2003	2,350	1,620
2004	1,600	2,020
2005	1,640	1,970
2006	1,400	1,760
2007	1,330	1,610
2008	340	1,300
2009	350	940
Cumulative		
2000-2004	8,470	5,430
2000-2009	13,530	13,010

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-01-A and 050-01-B

RELATED CBO PUBLICATION:

Rethinking the Trident Force (Study), July 1993.

Under the first Strategic Arms Reduction Treaty (START I), the Navy plans to deploy a force of 18 Trident submarines. Each one will carry 24 D5 missiles—the most accurate and powerful submarine-launched ballistic missile (SLBM) in the U.S. inventory. Today, the Navy has 10 Trident submarines armed with D5s and eight armed with older C4 missiles. To keep 18 submarines, it must convert the eight older subs to carry D5s as well. To arm that force, CBO estimates, the Navy will have to purchase a total of 540 D5 missiles, 360 of which it has already bought.

If Russia ratifies START II, the Administration plans to reduce the Navy's Trident submarines to 14 by 2007 to comply with that treaty. It will probably cut the number of warheads on each missile from eight to five (for a total of 1,680) to keep the number of U.S. warheads near the ceiling allowed by START II.

This option would terminate production of D5 missiles after 1999 and retire all eight C4 submarines by 2005. The Navy would then have 360 D5s—13 more than it says it needs to support a 10-submarine force. Like the Administration's plan for START II, this option would wait to retire the C4 submarines until after the turn of the century to encourage Russian compliance with START II and to give the United States flexibility to stay at higher START I levels if Russia does not comply. To retain 1,680 warheads, the option would increase the number of warheads on each D5 missile from five to seven.

Compared with keeping today's START I forces—as the Congress is requiring until Russia ratifies START II—this option would save $1.1 billion in 2000 and $13.5 billion through 2009. The savings would come from canceling missile production ($8 billion), retiring all eight C4 submarines rather than upgrading them ($3.3 billion), and operating fewer subs ($2.2 billion). Compared with the plan assumed in the Administration's 1999 budget, which would retire only four C4 submarines, this option would save $5 billion through 2009.

Terminating production of the D5 has several drawbacks. Loading more warheads on existing missiles would reduce their range by roughly 20 percent, limiting the areas in which submarines could operate. It would also reduce the flexibility of the force, since missiles with fewer warheads can cover more widely dispersed targets. Deploying D5 missiles with seven warheads would also constrain the United States' ability to expand its SLBM force by adding back the extra warheads if Russia violated or never ratified START II. In addition, reducing the fleet to 10 submarines could increase its vulnerability to attack by Russian antisubmarine forces.

Nevertheless, some people may consider the capability retained under this option sufficient to deter nuclear war. Although the missiles' range and the submarines' patrol areas would be smaller, they would still exceed the levels planned during the Cold War—when Russia had more antisubmarine forces and the United States intended to deploy the D5 with eight large warheads (W-88s). Moreover, less targeting flexibility might not reduce the nuclear deterrent: 1,680 warheads deployed on 336 missiles might not deter an adversary any more than if they were on the 240 missiles called for in this option. Also, the smaller likelihood of nuclear war and Russia's atrophying nuclear forces may have weakened the rationale for the United States to be able to increase its forces rapidly by adding warheads to the D5. In fact, since the U.S. ability to do that is one of Russia's biggest concerns about START II, adopting this option could make passage of the treaty more likely.

050-03 REMOVE PEACEKEEPER MISSILES AHEAD OF START II RATIFICATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	10	10
2002	60	50
2003	140	110
2004	400	220
2005	1,090	460
2006	940	680
2007	960	830
2008	980	930
2009	1,000	960
Cumulative		
2000-2004	610	390
2000-2009	5,580	4,250

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-01-A and 050-01-B

The second Strategic Arms Reduction Treaty (START II) requires both Russia and the United States to eliminate land-based missile systems that carry the largest numbers of warheads apiece. Those systems include the Peacekeeper missile for the United States and the SS-18 for Russia—the so-called heavy intercontinental ballistic missiles (ICBMs). Many analysts consider START II's eradication of all ground-based missiles with multiple warheads a major accomplishment. They argue that those warheads—10 on each heavy ICBM—are inherently more vulnerable to attack than warheads mounted on submarine-launched missiles, and therefore their very existence is destabilizing.

Although START II was ratified by the U.S. Senate in January 1996, it is stalled in the Russian Duma. Duma watchers suggest various explanations for the delay, including protests against NATO expansion, worries about the final status of the Anti-Ballistic Missile Treaty, and the perception of inequalities in the START II treaty that favor the United States. Other analysts suggest that Russia's economic difficulties will result in unilateral reductions in the country's nuclear arsenal independent of any treaty.

The Administration has stated that it intends to continue deploying Peacekeeper until Russia ratifies START II. This option, by contrast, would eliminate those missiles by the end of 2003 regardless of the status of START II ratification. Maintaining the 50 deployed Peacekeepers costs a total of about $200 million a year. However, this option would save approximately $5.6 billion over a 10-year period compared with remaining at today's START I levels. A large part of those savings would come from not buying additional missiles for future flight tests. Compared with the Administration's plans for START II, which assume the elimination of Peacekeeper by 2007, savings from this option would total $800 million.

Opponents of this option might argue that only the United States' determination to maintain its stockpiles at START I levels can ensure that Russia will ratify START II. Also, unilaterally eliminating Peacekeeper missiles would reduce the U.S. arsenal by 500 warheads—or 8 percent of the 6,000 deployed warheads allowed under START I. Moreover, since the warheads on Peacekeeper are some of the most accurately and quickly delivered ones in the U.S. arsenal, their deterrent value may be greater than that percentage indicates.

Conversely, unilateral elimination of Peacekeeper might have a significant influence on the Russian Duma in ratifying START II. Russia's perception of the threat posed by Peacekeeper is probably greatly increased by the country's lack of reliable early-warning information. Thus, getting rid of Peacekeeper could produce a disproportionate increase in Russia's sense of security. For precedent, proponents could cite President Bush's unilateral withdrawal of substantial numbers of U.S. tactical nuclear weapons in 1991. Within days of that event, Secretary Gorbachev made a similar pledge to remove large numbers of Soviet tactical weapons.

050-04 REDUCE THE SCOPE OF DOE'S STOCKPILE STEWARDSHIP PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	100	60
2001	150	120
2002	220	190
2003	290	260
2004	360	320
2005	370	360
2006	380	370
2007	390	380
2008	400	390
2009	410	400
Cumulative		
2000-2004	1,120	950
2000-2009	3,070	2,850

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-05

RELATED CBO PUBLICATION:

Preserving the Nuclear Weapons Stockpile Under a Comprehensive Test Ban (Paper), May 1997.

The Department of Energy (DOE) has developed the Stockpile Stewardship Program to preserve the long-term reliability and safety of U.S. nuclear weapons without testing them by exploding them underground. To carry out the program, DOE plans to continue operating both of its weapons-design laboratories (Los Alamos and Lawrence Livermore) and its engineering lab (Sandia). It will also construct several new facilities to provide data on the reliability and safety of nuclear weapons as they age. In addition, DOE will conduct "zero-yield" tests at the Nevada Test Site so it can keep enough skilled technicians there to be able to resume testing nuclear weapons by exploding them underground if the United States decides that doing so is in the national interest—a capability that the President has ordered DOE to retain.

DOE plans to spend an average of $2.6 billion a year over the next 10 years on what has historically been known as weapons research, development, and testing. Adjusted for inflation, that amount exceeds spending in 1980, when the United States was maintaining an arsenal of some 25,000 warheads and designing and building new ones. To some observers, a budget of that size today is excessive and unnecessary.

This option would reduce the scope of the stewardship program by consolidating the two design laboratories and halting all testing activities at the Nevada Test Site. However, it would preserve the other elements of the stewardship program, including the Dual-Axis Radiographic Hydrotest (DARHT) facility at Los Alamos and the National Ignition Facility (NIF) at Lawrence Livermore. Taken together, the changes in this option would reduce employment by about 2,000 people. They would also save $100 million in 2000 and almost $3.1 billion through 2009 compared with the Administration's 1999 budget.

Those savings assume that weapons-design activities would be consolidated over five years at Los Alamos, which developed most of the weapons that are likely to remain in the stockpile. Lawrence Livermore's primary focus would become other scientific research. To ensure that the warheads it developed could be reliably maintained, some designers from Lawrence Livermore would be relocated to Los Alamos. However, a cadre of weapons scientists would remain at Livermore to act as an independent review team for Los Alamos's efforts. To provide them with challenging work, Livermore would keep large computational facilities for modeling the complex processes inside nuclear weapons and would build NIF as currently planned. (Alternatively, stewardship activities could be consolidated at Lawrence Livermore, but the savings would be lower.)

To some people, this option would cut the planned stewardship program too deeply. They believe that the program is the minimum effort necessary to maintain the nuclear stockpile without underground testing. In their view, scientists will need new facilities to obtain data on reliability that were formerly provided directly by such testing. They also contend that consolidation would reduce competition and peer review, result in the loss of some facilities that could not easily be transferred, and eliminate Lawrence Livermore's central unifying mission (and thus its motivation for excellence). For those reasons, the President has directed DOE to retain both labs. Closing the Nevada Test Site would increase the time needed to resume underground testing if Russia started a new arms race or the United States discovered a serious problem with its stockpile that could only be corrected by testing. Closing the test site would also stop scientists from conducting "subcritical" experiments to learn more about how aging affects the plutonium components in nuclear weapons.

To other people, this option would not cut deeply enough. In their view, keeping part of a second lab and building DARHT and the $1.2 billion NIF are unnecessary to support the nuclear stockpile. Furthermore, they claim, those facilities might allow DOE scientists to continue designing and testing weapons and circumvent the test ban. Even if DOE has no such intentions, the perception of such a capability could make it difficult to convince countries such as India, which are critical of the United States' plans to preserve its nuclear weapons under a test ban, that the United States has really given up designing new weapons. Critics also argue that NIF should be funded outside the nuclear weapons program if it can help scientists understand how to harness fusion for civilian energy, as supporters claim.

Finally, some analysts are fundamentally opposed to a U.S. moratorium on testing (which will become permanent if the United States ratifies the Comprehensive Test Ban Treaty). They contend that the only way to ensure the reliability of U.S. nuclear weapons is to explode those weapons underground. They also worry that by halting the development and testing of new types of weapons, the United States will lose the skilled people necessary to preserve the stockpile. This option does not address the test ban directly, but the cuts it would make to the laboratories would probably be resisted by test-ban opponents.

050-05 CANCEL DEVELOPMENT OF THE TRITIUM PRODUCTION ACCELERATOR

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	240	150
2001	220	200
2002	130	170
2003	30	80
2004	0	20
2005	0	0
2006	0	0
2007	0	0
2008	0	0
2009	0	0
Cumulative		
2000-2004	620	620
2000-2009	620	620

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-04

RELATED CBO PUBLICATIONS:

Estimated Budgetary Effects of Alternatives for Producing Tritium (Letter), August 27, 1998.

Preserving the Nuclear Weapons Stockpile Under a Comprehensive Test Ban (Paper), May 1997.

Tritium gas is an essential ingredient for nuclear weapons. Because the gas, which is a radioactive isotope of hydrogen, decays at a rate of 5.5 percent a year, the Department of Energy (DOE) must replenish the tritium in U.S. nuclear weapons every several years. That means the department must have access to a reliable supply of the gas.

The United States has not produced tritium since 1988, when it shut down its last production reactor for safety reasons. Since then, cuts in the size of the U.S. nuclear arsenal have allowed DOE to recycle tritium from weapons that are being dismantled. However, if the United States keeps its arsenal at the levels specified in the first Strategic Arms Reduction Treaty (START I)—which is its current policy—it will need new tritium after 2005.

For the past several years, DOE has examined several alternatives for producing tritium, including building a new production accelerator or using commercial nuclear reactors owned by utility companies. Recently, it decided in favor of the second approach, using one or more existing reactors operated by the Tennessee Valley Authority. But to ensure that the United States will have a backup source of tritium if that approach experiences difficulties, DOE will continue to design and develop an accelerator, stopping short of actual construction.

This option would cancel DOE's efforts to develop the tritium production accelerator as a backup source and instead rely entirely on reactors for the nation's tritium needs. Doing that would save $240 million in 2000 and about $620 million through 2009 compared with DOE's most recently released estimate of the cost to develop the accelerator as a backup.

Advocates of canceling the accelerator point out that the technology for producing tritium in nuclear reactors has been well proved over decades. They contend that the United States should not continue to fund a technology that has yet to be proved at full scale and is several times more expensive than the reactor approach. In addition, using commercial reactors allows DOE to produce only as much tritium as it needs, when it needs it, without having to invest in costly infrastructure.

Canceling further work on the accelerator, however, would eliminate the nation's backup source for tritium. DOE says doing that would be premature until it is certain that all regulatory and political hurdles to using commercial reactors can be addressed. For example, the United States and other proponents of the Nuclear Non-Proliferation Treaty have for decades encouraged other countries to avoid using commercial reactors for nuclear weapons purposes. A study by DOE argues that the proliferation issues raised by using a commercial reactor are "manageable," but many people in the nonproliferation community disagree. Besides avoiding that sensitive issue, the accelerator has several other advantages. It offers the potential for producing new types of medical isotopes and for converting nuclear waste to less radioactive forms that are more easily stored and handled. That potential can only be gauged through further research.

050-06 REDUCE PROCUREMENT OF THE VIRGINIA CLASS NEW ATTACK SUBMARINE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	220	10
2003	360	80
2004	610	170
2005	1,850	390
2006	2,050	820
2007	2,300	1,250
2008	2,540	1,680
2009	2,000	1,930
Cumulative		
2000-2004	1,190	260
2000-2009	11,930	6,330

SPENDING CATEGORY:

Discretionary

As a result of the Quadrennial Defense Review, the Navy is reducing its force of attack submarines from 80 in 1996 to 50 by 2003. To meet that ambitious schedule, the Navy is decommissioning some of its Los Angeles class (SSN-688) submarines before they reach the end of their 30-year service life. Even as it is discarding older subs, though, the Navy is building newer ones. It ordered three Seawolf class submarines in the late 1980s and 1990s and is procuring the Virginia class New Attack Submarine (NSSN) to be their lower-cost successor. The reason for the additions is that the Joint Chiefs of Staff believe that the Navy will need 10 to 12 very quiet submarines by 2012 to compete with Russia's newest subs, which have become quieter, making them harder to locate and track.

The Virginia class submarine is designed to be as quiet as the Seawolf but will be smaller and slower, carry fewer weapons, and not be able to dive as deep. Although the Seawolf was designed primarily to counter the more severe threat posed by Russian submarines in the open ocean, the Virginia is being developed to operate in coastal waters close to potential regional foes.

The Navy ordered the third and last Seawolf in 1996 and the first Virginia in 1998. It plans to buy one Virginia class submarine in 1999, none in 2000, one each in 2001 and 2002, none in 2003, and one each in 2004 and 2005. Beginning in 2006, the Navy will purchase two or three subs per year. Under that plan, 14 Virginia class submarines would be authorized between 2000 and 2009. (The President's 2000 budget would add the purchase of one sub in 2003.)

This option would save money by keeping the Los Angeles class submarines in service until the end of their normal 30-year life and slowing procurement of the Virginia class. To help maintain the industrial base for building subs and to modernize the fleet, the option would produce a Virginia in 2001 and 2002 as now planned, skip 2003, and then build one per year from 2004 to 2009. At that pace, eight Virginia class subs would be authorized between 2000 and 2009.

Producing the Virginia at low annual rates would save a total of almost $12 billion over the next 10 years. Most of those savings would occur after 2004, when the submarines would be produced at a lower rate. (The savings shown through 2004 reflect fewer long-lead items that would be purchased in those years.) A lower production rate, however, would increase the cost of each submarine by roughly $200 million for the eight authorized between 2000 and 2009.

During the Congressional debate on producing the third Seawolf, the Navy emphasized that although Russia is financially strapped and therefore cannot operate its nuclear submarine fleet up to potential, it is still investing money to buy new, very quiet attack submarines at low rates. The Seawolf and the Virginia would both be quiet enough to meet the Joint Chiefs' goal of competing with those new Russian subs. Procuring a total of 10 Virginias in addition to the three Seawolfs would enable the Navy to field a force of 13 very quiet submarines by 2012, meeting the Joint Chiefs' requirement.

050-07 REDUCE THE NUMBER OF AIRCRAFT CARRIERS AND AIR WINGS TO 10

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,310	480
2001	4,420	1,330
2002	1,140	2,110
2003	1,170	2,090
2004	1,200	1,970
2005	2,170	1,520
2006	5,590	1,910
2007	1,310	2,780
2008	1,350	2,670
2009	1,420	2,390
Cumulative		
2000-2004	9,240	7,980
2000-2009	21,080	19,250

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-08 and 050-09

RELATED CBO PUBLICATION:

Improving the Efficiency of Forward Presence by Aircraft Carriers (Paper), August 1996.

The aircraft carrier is the centerpiece of the U.S. Navy. The Administration's defense plans call for a fleet of 12 carriers—11 active ships plus one, manned partly by reserves, that can also be used for training. Those ships will require a total of 10 active and one reserve air wings to provide combat capability. They will also be accompanied by a mix of surface combat ships (usually cruisers and destroyers) and submarines to attack planes, ships, and subs that threaten the carriers. The surface combatants and submarines can also attack targets on land.

In the aftermath of the Cold War, some policymakers have argued that the United States does not need a force of 12 carriers. The total capability of U.S. tactical aircraft in the Navy and Air Force will substantially exceed that of any regional power that seems potentially hostile. Moreover, the capabilities of U.S. ships are unsurpassed worldwide.

This option would immediately retire one conventionally powered aircraft carrier and one nuclear-powered carrier. By the end of 2000, the Navy would have 10 carriers (nine active ships and one partial reserve carrier for training purposes). In addition, this option would eliminate one active air wing, leaving nine active and one reserve wings to match the number of carriers.

Compared with the Administration's planned forces, those cuts could save $1.3 billion in 2000 and $21 billion over the next 10 years. Of that amount, $9 billion would result from not buying new carriers in 2001 and 2006, as now planned. The remaining savings of $12 billion would come from reduced operating costs associated with retiring two carriers and an air wing. Those estimates include the cost of decommissioning the retiring ships—roughly $100 million apiece. (Reducing the number of carriers could also lower the number of surface combatants, submarines, and aircraft that the Navy would need to accompany them. Thus, the Navy might save additional money on procurement and operations by not having to purchase and operate as many other new ships and aircraft. Conversely, the Navy might need those ships to perform other missions, such as forward presence, once it had fewer carriers.)

Although reducing the force to 10 carriers might not impair the United States' ability to fight and win two regional wars (according to one analysis by the Department of Defense), having fewer ships would limit the Navy's ability to keep three carriers deployed overseas most of the time. That could substantially increase the strain put on the carrier force as long as policymakers continued to use aircraft carriers to respond to crises or to provide U.S. presence overseas as extensively as they have in recent years. With fewer ships available, the time that those ships spent at sea could increase. The high-quality sailors the Navy needs would therefore spend more time away from their homes and families, perhaps making them less inclined to stay in the service.

The Navy might be able to maintain more overseas presence with carriers by bringing new crews to the ships while they were at their foreign posts rather than waiting for them to return home. (The Navy does that with some minesweepers.) In addition, the Navy could use ships other than carriers (such as large flat-deck amphibious vessels or Aegis cruisers) to help maintain U.S. presence overseas.

050-08 REDUCE PROCUREMENT OF DDG-51 DESTROYERS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	810	40
2001	820	250
2002	840	440
2003	1,060	640
2004	0	700
2005	0	530
2006	20	390
2007	70	240
2008	120	230
2009	170	230
Cumulative		
2000-2004	3,530	2,070
2000-2009	3,910	3,690

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-07

The DDG-51 destroyers of the Arleigh Burke class would be used in a war to protect aircraft carrier battle groups and to attack land- and sea-based targets. The ships incorporate the Aegis combat system, which is designed to stop attacks on a battle group by large numbers of enemy aircraft with antiship missiles, and the Tomahawk missile, which would attack targets on land. Compared with previous classes of destroyers, the DDG-51 incorporates other improvements in speed, weapons, armor, and (to some degree) stealth.

The Administration plans to buy 12 more DDG-51s from 2000 through 2003—at a rate of three per year—before the program ends. Under this option, by contrast, only eight DDG-51s would be bought from 2000 through 2003, at a rate of two per year. Purchasing four fewer ships during that period could save $810 million in budget authority in 2000 and $3.9 billion over 10 years—about $3.6 billion in procurement costs and $300 million in operating costs.

Reducing the number of DDG-51s by four would still leave the Navy with a highly capable force of surface combatants to counter regional threats. With the 80 Aegis ships that would eventually be available under this option (27 CG-47 Ticonderoga class cruisers, the 45 DDG-51s funded through 1999, and eight future DDG-51s), two could be assigned as escorts to each of the 12 aircraft carrier battle groups, leaving 56 available for independent operations. The Navy would also have large numbers of DD-963 Spruance class destroyers and FFG-7 Oliver Perry class frigates for additional antisurface, antisubmarine, and land-attack missions.

Some analysts argue, however, that the DDG-51 is not optimally designed to fight in coastal areas. In their view, investing in a new class of ship that is better suited for coastal warfare could make more sense than continuing to buy ships designed to fight and defeat the Soviet navy. The Navy is designing such a new ship: the DD-21 land-attack destroyer. It is intended to be highly stealthy, operate relatively close to the shore, and be armed with large numbers of land-attack and antisubmarine weapons.

The Navy expects to order the first DD-21 in 2004. The Congress could end the DDG-51 destroyer program now instead of reducing procurement rates until then, as this option envisions, but the industrial base for surface combatants could suffer. The two shipyards that build destroyers would probably have to reduce their workforce, losing the know-how specific to producing those ships. Rebuilding that workforce or subsidizing it until the DD-21 was ready for production could prove expensive, especially if the new ship encountered delays in the design stage.

Nevertheless, reducing the number of DDG-51s could have some disadvantages as well. It would give the Navy fewer ships that can perform multiple missions such as strike and antiair, antisurface, and antisubmarine warfare. (The DD-21 will not have the Aegis antiair combat system.) In addition, although the U.S. Navy is less likely now to confront an opponent (like the Soviet Union) capable of launching saturation attacks against it, combat with regional powers is likely to bring its ships into coastal areas, where they have less time to react to threats. In that situation, the Navy could benefit from the quicker reaction of the Aegis system.

050-09 REDUCE PURCHASES OF THE NAVY'S F/A-18E/F

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	874	165
2001	673	389
2002	595	596
2003	489	597
2004	489	552
2005	398	496
2006	302	433
2007	246	358
2008	261	300
2009	864	384
Cumulative		
2000-2004	3,120	2,300
2000-2009	5,190	4,272

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-07, 050-10, and 050-12

RELATED CBO PUBLICATIONS:

A Look at Tomorrow's Tactical Air Forces (Study), January 1997.

Letter to the Honorable Curt Weldon regarding the estimated cost of three tactical aircraft programs to reflect changes resulting from the 1997 Quadrennial Defense Review, July 1998.

The F/A-18 is the workhorse of the Navy's fleet of carrier-based fighter aircraft. It has operated from the decks of aircraft carriers since the early 1980s and now makes up almost three-quarters of the fighters in the Navy's air wings. The Marine Corps also uses F/A-18s to provide fighter cover for its expeditionary forces. The earliest model of the aircraft, the F/A-18A/B, has been gradually replaced with the F/A-18C/D. The last eight C/D models were ordered in 1998; those planes will keep the C/D production line open at least through 2000. Potential foreign sales might keep that model in production after 2000, but no contracts have been signed.

In 1991, the Navy announced plans to develop an E/F variant of the F/A-18, which it began purchasing in 1997. Over the next 10 years, the Navy intends to replace all of its C/D models with E/Fs, for a total purchase of 548 E/F models.

The E/F features several modifications: a longer fuselage, larger wings, and more powerful engines than the C/D. Those changes should enable the E/F to carry a larger load of weapons, or carry a combat load about 40 percent farther, while retaining most of the speed and maneuverability of the earlier version. According to Boeing, the plane's manufacturer, the E/F also has a smaller "signature" than its predecessor, which should make it less visible to enemy sensors.

With that greater capability comes greater cost. By the Congressional Budget Office's estimate, the E/F version will be 69 percent more expensive than the C/D model. That higher cost will contribute to the problems that the Department of Defense (DoD) is expected to have affording its long-term plans for tactical aircraft: in addition to buying F/A-18E/Fs for the Navy, the department plans to purchase sophisticated and costly F-22 fighters for the Air Force and large numbers of Joint Strike Fighters for both of those services as well as the Marine Corps. Buying those three types of aircraft would push the share of service budgets spent on fighters well above past levels.

The Navy could save money by purchasing fewer E/F models and filling out its fleet requirements with F/A-18C/Ds. The resulting, less capable force might be acceptable since the fighter fleets that potentially hostile countries can field for the foreseeable future will have limited capabilities.

If the Navy bought no more than 154 F/A-18E/Fs (92 aircraft between 2000 and 2009), it could replace a small part of its fleet with those and replace the rest with C/Ds. That option would save almost $5.2 billion over the next 10 years. Although such savings would make DoD's plans for fighter aircraft more affordable, losing the increased range and other improvements of the F/A-18E/F could be an unacceptable price. The United States relies solely on carrier-based aircraft for some of its missions. And the Navy may need planes with long ranges that can survive in hostile environments for a regional conflict.

050-10 DEFER PURCHASES OF THE MARINE CORPS'S V-22 AIRCRAFT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	0	0
2004	26	5
2005	637	137
2006	548	310
2007	554	483
2008	586	535
2009	601	560
Cumulative		
2000-2004	26	5
2000-2009	2,952	2,030

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-09

RELATED CBO PUBLICATION:

Moving the Marine Corps by Sea in the 1990s (Study), October 1989.

The V-22 aircraft, which entered production in 1997, will help the Marine Corps perform its amphibious assault mission (seizing a beachhead in hostile territory) and its subsequent operations ashore. The plane's tilt-rotor technology enables it to take off and land vertically like a helicopter and, by tilting its rotor assemblies into a horizontal position, to become a propeller-driven airplane when in forward flight. As a result, the V-22 will be able to fly faster than conventional helicopters. The Marine Corps argues that the plane's increased speed and other design features will make it less vulnerable when flying over enemy terrain and will provide over-the-horizon amphibious assault capability.

Despite all of those advantages, the Bush Administration tried to cancel the V-22, largely because of its price tag. Each aircraft bought for the Marine Corps is expected to have a procurement unit cost of $62 million, on average—considerably more than most conventional helicopters. Notwithstanding that cost, the Congress has continued to fund the V-22, and the Marine Corps plans to buy a total of 360 planes. (The Air Force may eventually buy 50 V-22s for its special-operations forces, and the Navy plans to buy 48 for combat search-and-rescue missions and for logistics support of its fleet.)

The Marine Corps expects, however, to acquire several other planes at the same time. During many of the years that it is purchasing V-22s, the service also plans to buy large numbers of Joint Strike Fighters (JSFs) to replace its short-range bomber, the AV-8B, and its F/A-18 fighter attack aircraft. JSFs are expected to be relatively inexpensive as tactical fighters go—costing perhaps 60 percent of the price of the Air Force's sophisticated F-22. But when bought in quantity and combined with the cost of the V-22, their purchase would bring peak annual spending on the V-22 and JSF to almost $6 billion—nearly five times the amount requested for Marine Corps combat aircraft in this year's budget. If the Marine Corps cannot increase funding for those aircraft, it may have to modernize either its fighter fleet, its airborne amphibious assault fleet, or both more slowly.

This option would halve the Marine Corps's annual procurement of V-22s during the 2004-2009 period, when both V-22s and JSFs would be bought. As a result, the service's average funding requirements during those years would decrease to a little over $5 billion. That sum may be more manageable than the Marine Corps's current plan and would save almost $3 billion over 10 years.

Deferring purchases of V-22s would have some drawbacks, however. The current amphibious assault fleet is made up of CH-46 and CH-53 helicopters that are more than 30 years old, on average. The CH-46s would remain in the fleet until their average age approached 50 if the V-22s deferred under this option were bought beginning in 2013, when V-22 purchases decrease sharply under current plans. (If the Marines had to engage in an extensive modification effort to retain those helicopters longer, the savings shown at left would be lower.) Plus, the amphibious assault fleet provides more unique services than the Corps's fighter attack fleet. The Marines can probably count on the Navy's carrier-based F/A-18 aircraft to provide them with additional firepower, but they cannot get aerial amphibious assault assets anywhere else. Also, cutting V-22 purchases might decrease the Corps's ability to perform humanitarian missions and other peacekeeping activities, which have grown more common in recent years.

050-11 REDUCE AIR FORCE TACTICAL FORCES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	305	242
2001	629	543
2002	649	615
2003	669	648
2004	690	674
2005	712	698
2006	734	721
2007	757	744
2008	780	767
2009	805	791
Cumulative		
2000-2004	2,942	2,722
2000-2009	6,730	6,442

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-12

RELATED CBO PUBLICATION:

A Look at Tomorrow's Tactical Air Forces (Study), January 1997.

Today's Air Force includes about 20 tactical air wings—roughly 13 on active duty and seven in the part-time reserves. (An Air Force tactical air wing traditionally consists of 72 combat planes, plus another 28 for training and maintenance purposes.) Substantial disagreement exists about whether all of those air wings are necessary, since U.S. tactical aircraft enjoy overwhelming superiority compared with the forces of any regional power that appears potentially hostile to the United States.

This option would reduce the Air Force's tactical fighter forces to 18 air wings by the end of 2000. That pace of reductions should be feasible inasmuch as the Air Force has cut the size of its fleet quickly in the past: it eliminated six air wings between 1990 and 1992 and another six by the end of 1996. Reducing the number of Air Force wings from 20 to 18 would lower the service's operating costs by $305 million in 2000 and $6.7 billion through 2009.

Further savings might be possible if the Air Force accompanied the force reduction with a reorganization that increased the number of planes per squadron and eliminated more squadrons. That practice (known as "robusting") allocates resources more efficiently, since each squadron or wing has high fixed costs. Increasing all Air Force squadrons to 24 planes could add significantly to the savings shown at left, though only if the Department of Defense (DoD) restructured units and bases to reduce overhead costs.

A reduction to 18 Air Force wings might leave the United States with an acceptable number of capable fighters. Even in terms of simple numbers, U.S. fighter inventories exceed those of any potential regional aggressor. Also, U.S. aircraft are more sophisticated than those of potential enemies.

However, retaining only 18 wings in the Air Force would not meet the military's current estimate of its requirements. Today's force planning assumes that the United States needs to be able to fight virtually simultaneous wars in two regions of the world—one in the Middle East and another, perhaps, in Asia. Winning two nearly simultaneous regional conflicts would require a minium of 20 air wings, DoD has suggested.

Some analysts would also argue that additional cuts in Air Force wings ignore a major lesson from the Persian Gulf War: that aerial bombardment by tactical aircraft can be very effective and may greatly accelerate the end of a war, thus reducing loss of life among U.S. ground troops. A sizable inventory of tactical aircraft—perhaps more than would be maintained under this option—might therefore be a wise investment.

050-12 REDUCE PURCHASES OF THE AIR FORCE'S F-22

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	113	11
2001	268	62
2002	440	161
2003	2,009	427
2004	2,082	1,019
2005	2,129	1,542
2006	2,104	1,819
2007	2,554	2,021
2008	4,784	2,438
2009	4,034	3,254
Cumulative		
2000-2004	4,912	1,680
2000-2009	20,516	12,754

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-09, 050-11, and 050-14

RELATED CBO PUBLICATION:

A Look at Tomorrow's Tactical Air Forces (Study), January 1997.

The F-22 is being developed as the Air Force's next premier fighter aircraft. It is scheduled to enter the fleet in about seven years and will replace the F-15. The Air Force wants the F-22 to cruise at supersonic speeds as well as to be stealthy (that is, more difficult for enemy sensors to detect). F-22s will also have highly effective avionics that could make them more capable than other fighters in many types of combat.

However, the F-22 has experienced repeated delays, reductions in quantity, and increases in price over its almost 20-year development. Early in the program, the Air Force expected the plane to begin entering its fleet in 1995. But on the basis of current plans, the aircraft will not be fielded before 2006. Likewise, in early program plans the Air Force expected to buy more than 700 F-22s. After a series of cuts, the latest plan would buy only 339 aircraft—enough for about three air wings. That reduction occurred in part because the Air Force cut its number of tactical air wings, but cost increases played a role as well. Such cuts have increased the unit cost of the F-22. In an early study of the affordability of its plans, the Air Force estimated that each F-22 would cost about $75 million (in 2000 dollars). Now the service may well pay almost $125 million apiece (in 2000 dollars) for the plane, even if it makes no further cuts to planned purchases.

Despite all of those problems, the F-22 is the only tactical fighter program to survive from the Cold War period. The other two fighters that the Department of Defense has on its plate—the Joint Strike Fighter and the Navy's F/A-18E/F—entered development after 1990. That fact, combined with the F-22's complex design, has led some people to suggest that the F-22 is a legacy of the Cold War—a plane designed to fight hordes of sophisticated Soviet fighters rather than the modest regional fighter forces it is more likely to encounter today. As a result, they recommend canceling the F-22, or at least making further reductions to planned procurement.

This option would follow in the Air Force's footsteps and decrease the quantity procured, in this case by 219 planes. As a result, a total of 120 F-22s would be bought under this option, enough to let the Air Force field an air wing of the sophisticated fighters. The option assumes that the 219-plane cut would be evenly distributed over the F-22's purchase period. Cutting those planes would save $113 million in budget authority in 2000 and about $21 billion over the 2000-2009 period.

Such a "silver-bullet" purchase could still provide enough F-22s to perform those missions for which the service might need the plane's level of stealth and other performance advantages over existing Air Force aircraft. It might also permit the manufacturer and the Air Force to learn how to build and operate a plane as complex as the F-22. But it would make the Air Force's fighter fleets, which are already aging under current plans, even older. Buying 219 F-15s to replace the cut in F-22 purchases would remedy that problem, however. Although the F-15 is much less capable than the F-22, it is far more capable than the fighters of almost any of the United States' regional adversaries. A one-for-one offset of F-15s for F-22s would lower the total savings from this option to $9 billion.

050-13 CREATE COMMON NATO AIRLIFT AND CUT U.S. C-17 COSTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	1,879	180
2003	909	697
2004	380	934
2005	286	786
2006	215	586
2007	190	403
2008	196	316
2009	203	248
Cumulative		
2000-2004	3,168	1,811
2000-2009	4,258	4,150

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-14

RELATED CBO PUBLICATIONS:

Moving U.S. Forces: Options for Strategic Mobility (Study), February 1997.

Assessing Future Trends in the Defense Burdens of Western Nations (Paper), April 1993.

The C-17 Globemaster III is a four-engine transport aircraft that can carry at least 110,000 pounds of cargo for 3,200 nautical miles without aerial refueling. Because it is designed to land at small airfields with short runways, the C-17 could help meet transport needs within a theater of combat as well as over long distances. The current plan for transporting U.S. forces to regional conflicts calls for a fleet of 120 C-17s. At the same time, seven of the United States' European allies in the North Atlantic Treaty Organization (NATO) are planning to buy a total of 289 transport aircraft to carry reaction forces to crisis spots outside the territory of NATO members, in accordance with NATO's Strategic Concept.

This option would create a common NATO airlift fleet of 20 C-17s (similar to the common NATO AWACS fleet based in Germany, for which the United States pays 41.5 percent of operating and modernization costs). Twenty C-17s that the Air Force plans to buy in 2002 and 2003 would be transferred to NATO, which would reimburse the Air Force for them by the beginning of each year in order to comply with full-funding requirements. The average cost of those planes is about $200 million apiece.

A common NATO airlift fleet would enable the allies to deploy forces to a crisis zone, while allowing the United States to draw on those assets for non-NATO missions under the Combined Joint Task Force (CJTF) concept approved in 1996. That concept allows NATO members—with consensus from the alliance—to use NATO assets for missions other than defense of a member state.

Assuming that the United States paid 41.5 percent of the cost of the NATO airlift fleet, this option would achieve net savings for the country of $3.2 billion over five years and $4.3 billion over 10 years, including net savings of $200 million per year in operation and support costs once all 20 aircraft were delivered. It also would give the European allies faster access to strategic airlift than would otherwise be the case.

This option would face two main obstacles, however. The first is the European countries' desire to protect their defense industries by building their own strategic transport plane. The seven countries involved have committed to a joint program to develop the Future Large Aircraft (FLA), to be produced by the Airbus consortium. That plane would carry less cargo than the C-17 and be cheaper (at $75 million apiece). Alternatively, the Europeans could consider buying Airbus commercial aircraft, although such planes are more difficult to load and unload, cannot carry very large cargo, and cannot land on some shorter or unpaved runways. Enthusiasm for developing the FLA is waning, however. In an indication that they will consider alternatives, Britain, France, Spain, and Belgium have all solicited bids from U.S. firms for a total of 143 aircraft, and Britain intends to lease four C-17s or their equivalent.

The second obstacle involves the political ramifications of relying on NATO to provide part of the U.S. Air Force's lift capability. The CJTF concept, designed to let European coalitions act without U.S. involvement, is new and evolving. Conceivably, if a NATO member opposed a mission (such as France opposing military action against Iraq), it might be able to veto U.S. use of NATO assets. Some Members of Congress might find that saving money would not outweigh the risk of diminishing the U.S. ability to act unilaterally if necessary.

050-14 DEFER PROCUREMENT OF TACTICAL AIRLIFT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	195	19
2001	199	82
2002	138	134
2003	143	143
2004	0	130
2005	0	84
2006	0	43
2007	0	22
2008	0	8
2009	0	4
Cumulative		
2000-2004	675	508
2000-2009	675	669

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-12 and 050-13

The C-130 Hercules is an airlift plane that the Air Force uses to transport cargo and supplies within a theater of operations. The C-130 is much smaller than strategic airlifters like the C-17 or C-5, which can carry about three times more weight over much longer distances, and it cannot carry the largest types of equipment. Still, the C-130 remains the critical element of the Air Force's tactical airlift fleet, with 236 E models (some dating back to the early 1960s) and 286 newer H models in service.

To produce the version that the Air Force is now buying, the J model, Lockheed Martin took the basic airframe of the C-130 and upgraded some of the plane's systems. For example, the C-130J includes a new engine that is more powerful and fuel efficient and an integrated avionics system that eliminates the need for a flight engineer. The Air Force plans to replace the least reliable 150 of its current C-130s with J models and modernize the rest through the so-called C-130X program. That modernization would standardize the C-130 fleet by installing a common cockpit and would upgrade avionics, including a navigational system required by international air traffic management accords.

For 1999, the Congress continued a pattern of authorizing a larger purchase of C-130s than the Administration requested—three J models rather than the one that the Air Force asked for. The Air Force has not adjusted its plans to reflect those additional aircraft. Its plans call for no C-130Js in 2000 and 2001, two each in 2002 and 2003, eight in 2004, and 10 in 2005.

This option would postpone procurement of C-130Js until 2004. Compared with the recent history of Congressional appropriations for the aircraft, that postponement would save a total of $675 million in budget authority, resulting in outlay savings of $508 million over five years and $669 million over 10 years.

The C-130J is now being produced for foreign sales, but Lockheed is close to completing those orders. The President's 2000 budget does not call for any C-130J purchases by the Air Force in 2000 or 2001, despite reports that large-scale procurement might be accelerated from 2004 to 2000 to avoid possible costs from shutting down and reopening the production line. The Air Force says a temporary shutdown of C-130J production would also affect the cost of the F-22 fighter, which is built at the same plant. (Any additional costs for F-22s are not included in the estimates of savings from this option.)

Critics of deferring C-130J acquisition might argue that it would leave the Air Force with a less capable fleet of intratheater airlift planes. Ultimately, an older fleet could prove more expensive to operate and support. Lockheed Martin contends that the annual cost of operating and supporting a C-130J will be lower than for older C-130s because it has a smaller crew and is easier to maintain.

Although the average C-130E is more than 30 years old, it has flown an average of 21,875 hours—well below its planned 40,000-hour service life. The Air Force had not planned to begin retiring those older C-130s until 2002, but the additional unrequested authorizations by the Congress have led to decisions to retire some of the planes with years of service life remaining. Since the Air Force flies its C-130Es an average of 567 hours per year for active-duty forces and 425 hours to 450 hours per year for reserve crews, it should be able to retain most of those planes well past 2004.

050-15 CANCEL THE ARMY'S COMANCHE HELICOPTER PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	80	94
2001	326	296
2002	353	395
2003	291	379
2004	285	322
2005	103	129
2006	718	159
2007	821	432
2008	1,583	890
2009	1,655	1,272
Cumulative		
2000-2004	1,334	1,486
2000-2009	6,214	4,368

SPENDING CATEGORY:

Discretionary

RELATED CBO PUBLICATION:

An Analysis of U.S. Army Helicopter Programs (Study), December 1995.

Many of the Army's helicopters are beyond the end of their useful service life. Initially, the Army had planned to replace some of those older scout, attack, and utility helicopters with more than 5,000 new Comanche (RAH-66) helicopters. Comanche has had a troubled development program, however. The utility version of the helicopter was dropped in 1988 because the program had become too costly. In 1990, the size of the planned purchase was reduced from more than 2,000 aircraft to just under 1,300. Later, the Army delayed the projected start of Comanche production from 1996 to 2005. And last December, the Army requested another restructuring of the program, which could further affect its schedule.

Those changes in the objectives and size of the Comanche program have caused the procurement cost per helicopter to nearly double since the program began—from $11.5 million (in 1999 dollars) in 1985 to $21.2 million, based on current Army estimates. With that cost growth, Comanche is now more expensive than the Army's Apache (AH-64) attack helicopter. That cost increase is particularly significant for a helicopter whose development was originally justified on the basis of its being less expensive to buy, operate, and maintain than other attack helicopters. Moreover, the General Accounting Office and the Department of Defense's Inspector General (DoD IG) have stated that costs could grow by as much as another 30 percent. Comanche's high cost calls into question the prudence of pursuing this as-yet-undeveloped aircraft instead of continuing to buy existing, less costly helicopters.

The primary advantage of Comanche over existing aircraft is its sophisticated stealth, avionics, and aeronautics technologies. However, some analysts would argue that the helicopter, which was conceived at the height of the Cold War, will no longer face threats of the same scale or sophistication as those for which it was designed. According to the DoD IG, the Army has not reexamined the mission requirements for Comanche in any depth since the end of the Cold War. Comanche is intended both to serve as a scout for Apache and to fill the scout and light attack role independently. But whether Comanche really does have a unique role to play in Army aviation is unclear. The Army is planning to use Apaches in both scout and attack roles for the next 15 to 20 years, as it did successfully during the Persian Gulf War. The Army also used armed scout helicopters, known as Kiowa Warriors, in the Persian Gulf both as scouts for Apache and as light attack aircraft.

This option would cancel the Comanche program. The Army has already purchased enough Apaches to fill the attack role assigned to 13 of its 18 divisions, but it does need to replace the aging Cobras assigned to the attack aviation units of the remaining divisions. This alternative would buy 519 Kiowa Warriors by the end of 2009 to replace the Cobras still in service. Net savings would total about $6.2 billion over the 2000-2009 period. Some of the savings could be used to fund a program to continue development of advanced helicopter technologies. Abandoning the Comanche program, however, would mean that the Army would have to rely on helicopters designed in the 1960s and 1970s for years to come.

050-16 CANCEL THE ARMY'S CRUSADER ARTILLERY PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	170	98
2001	429	305
2002	453	381
2003	428	355
2004	626	439
2005	589	430
2006	832	524
2007	595	666
2008	623	656
2009	534	613
Cumulative		
2000-2004	2,106	1,578
2000-2009	5,279	4,467

SPENDING CATEGORY:

Discretionary

The Army plans to invest $13.5 billion (in 1999 dollars) to develop and procure the Crusader artillery system for rapidly deployable and forward-deployed forces. The Crusader—which includes a self-propelled howitzer and a resupply vehicle—is considered by the Army to be technologically advanced and significantly more effective than the service's current artillery systems.

Supporters cite several reasons why Crusader is needed. The Paladin, the Army's most modern artillery system, is too slow to keep up when armored forces advance. Its range is shorter than that of several foreign systems available to potential adversaries. And Paladin's peak firing rate of four rounds per minute is significantly slower than the 10 to 12 rounds per minute that the Army says it needs. Crusader's current design includes an automated resupply system, which makes a higher firing rate possible and reduces the crew size to six from Paladin's nine. Crusader is also designed with more sophisticated automation and better crew protection.

Some observers, however, question whether a heavy system such as Crusader has a role in the lighter, more mobile force envisioned for the future Army. Some analysts also question how much improvement Crusader will actually deliver. Crusader may only be 9 kilometers per hour faster than Paladin. And it has already encountered some technical difficulties. The original concept called for a gun using liquid propellant. The Army had to abandon that technology in 1996 because of technical and schedule problems. Some Crusader subsystems embody technological innovations that have not yet been proved, and some have no backups in case of failure. For example, if the automatic munition reloader fails, Crusader will not be able to fire at all since it cannot be loaded manually. Those technical risks could prevent Crusader from meeting some of the Army's key requirements. If it failed to do so, Crusader could be no more effective than currently available systems.

Although no existing alternative system meets all of the Army's requirements, some could meet many of those requirements and offer significant improvements over Paladin. A recent report by the General Accounting Office identified the German PzH 2000 self-propelled howitzer or an improved Paladin system as viable alternatives to Crusader. The PzH 2000, for example, fires eight to 10 rounds per minute, and its cross-country speed of 45 kilometers per hour is within the range required for Crusader.

This option would cancel the Crusader program and provide funds to procure 815 PzH 2000 systems with resupply vehicles. That purchase of a new system could hedge against potential threats while freeing $5.3 billion for the Army to pursue other promising technologies. For fire support in fast-moving advances, the Army could rely on those newer systems or on the multiple-launch rocket system, which it used successfully in that role during the Persian Gulf War.

050-17 CANCEL THE ARMY'S TANK UPGRADE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	642	94
2001	356	344
2002	495	418
2003	513	451
2004	197	441
2005	101	298
2006	-12	154
2007	-9	52
2008	-2	11
2009	-2	0
Cumulative		
2000-2004	2,203	1,748
2000-2009	2,277	2,263

SPENDING CATEGORY:

Discretionary

RELATED CBO PUBLICATION:

Alternatives for the U.S. Tank Industrial Base (Paper), February 1993.

The shrinking of the U.S. military—coupled with the disappearance of a long-time foe and the unprecedented peacetime investment in modern weapons that occurred in the 1980s—has sharply reduced the need for new weapons. In particular, the Army now has enough of the latest type of tank, the Abrams, to equip the forces it plans to field for the foreseeable future. As a result, the Army does not intend to buy new tanks for at least the next 15 years.

Instead, the Army has proposed upgrading about 1,000 M1s (the first model of the Abrams) to a later configuration, designated the M1A2. The upgrade program, which began in 1991 and ends in 2003, has two major goals: to increase the capability of Army tanks and to keep the facilities that produce tanks in business pending the need for a new tank to replace the Abrams. (Most of those facilities are owned by the government and operated by private contractors.)

During the Bush Administration, the Army advocated closing the tank production line and putting it in mothballs. In March 1992, General Colin Powell, then Chairman of the Joint Chiefs of Staff, testified that the Army's current tank was the best in the world. That statement runs counter to the Army's current rationale for upgrading tanks, which is that it needs better ones. Indeed, although the M1A2 is 20 percent more capable than the M1 model (as measured by one scoring system developed for the Defense Department), converting 1,000 M1s to M1A2s would increase the total capability of the Army's 7,880 Abrams tanks by only 3 percent. That slight increase in capability would come at a high price—a total of about $3 billion over the next 10 years.

This option would cancel the Army's upgrade program but would keep some of the major components of the tank industrial base in a mothballed status. By preserving production facilities, the United States would retain the capability to make new or existing types of tanks in the future. Mothballing the government-owned facilities would require an initial investment. But after taking those costs into account, this option would still save $642 million in 2000 and a total of $2.3 billion over 10 years.

Closing the tank production line would have some disadvantages, however. Without an upgrade program, the U.S. inventory would include fewer of the most capable M1A2 tanks. As regional powers acquired better tanks, the absence of M1A2s might erode the United States' advantage in a war, even though the M1A1 remains a highly capable tank. Perhaps the most important drawback of this option is that some companies that manufacture tank components might close and thus be unavailable to produce tanks in the event of a crisis. A related concern is the potential loss of workers whose skills are unique to tank manufacturing.

050-18 RESTRUCTURE OFFICER ACCESSION PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	69	67
2001	128	126
2002	183	181
2003	221	220
2004	228	228
2005	234	234
2006	240	240
2007	247	247
2008	253	253
2009	259	259
Cumulative		
2000-2004	829	822
2000-2009	2,062	2,055

SPENDING CATEGORY:

Discretionary

In recent years, the military services have slightly increased their annual number of officer accessions (new officers who enter the service). This option would keep overall accessions at the level planned by the Department of Defense but would alter the sources of new officers. Specifically, it would draw more officers from lower-cost commissioning programs—the Reserve Officer Training Corps (ROTC) and Officers Candidate School/Officer Training School (OCS/OTS)—and fewer from the more costly service academies. In addition, it would place a ceiling on the amount that could be spent on each ROTC scholarship recipient. Those changes would save $69 million in 2000 and a total of nearly $2.1 billion through 2009.

At present, each service academy graduates slightly fewer than 1,000 second lieutenants or ensigns a year. This option would reduce that number to 625 by cutting the size of the entering class for the three academies from a combined total of nearly 3,000 to 1,875. The estimated savings from that action reflect only the costs that would change in the near term, such as operating expenses and pay for faculty and cadets. (Those savings would be partially offset by additional costs of about $122 million over five years to procure officers from OCS/OTS and ROTC to replace those from the academies.) In the longer term, savings might also accrue from changes in the academies' physical plant.

Supporters of the service academies have contended that they are necessary to produce future military leaders. That argument has not persuaded most Members of Congress, but past attempts to impose cuts at the academies have been only partly successful. Although class size has declined modestly, academy graduates account for a larger share of officer accessions now than in the early 1980s (14 percent versus 9 percent). This option would restore the accession percentage of academy graduates to its 1980 level by 2002. There is little evidence that the academies have already reduced their class size to the minimally efficient level, as supporters have claimed in arguing that further cuts would not produce savings.

Proponents of the option point out that taking a smaller share of the officer corps from the academies would lead to more diversity, since relatively more officers would come from ROTC and OCS/OTS. Moreover, they contend, the military has drawn much greater percentages of its officers from those sources in the past without any loss of effectiveness.

050-19 REVISE COST SHARING FOR MILITARY HEALTH BENEFITS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	460	388
2001	584	552
2002	591	580
2003	598	593
2004	606	603
2005	615	611
2006	624	620
2007	633	629
2008	642	639
2009	652	648
Cumulative		
2000-2004	2,839	2,716
2000-2009	6,005	5,863

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-20

RELATED CBO PUBLICATION:

Restructuring Military Medical Care (Paper), July 1995.

Some 7.7 million active-duty service members, military retirees, and their families in the United States are eligible to use the military health care system, yet only 5.4 million actually do. Because the Department of Defense (DoD) does not require users to enroll, many of them choose to seek military care on a case-by-case basis to augment other insurance coverage. Thus, military planners face major uncertainties about their patient load and health care costs each year.

The military health system offers three types of coverage: Tricare Prime, a plan similar to health maintenance organizations; Tricare Standard, a traditional fee-for-service insurance program; and Tricare Extra, a preferred provider option. Beneficiaries must enroll in Tricare Prime if they wish to use it, but they may use Tricare Standard or Extra without enrolling.

This option would make three changes to that system. First, all beneficiaries (except those on Medicare) would have to enroll in either Tricare Prime or Standard before using the military health care system. The annual enrollment fee for Tricare Prime would remain the same (zero for active-duty personnel and their families and $230 for single coverage or $460 for family coverage for retirees). Under Tricare Standard, however, active-duty personnel would pay no fee but retirees would pay $115 a year for single or $230 for family coverage. Second, DoD would adjust enrollment fees for inflation by the annual rate of change in the consumer price index. Third, users of Tricare Prime would pay copayments at military facilities for outpatient care and prescription drugs, just as they do at civilian providers. In addition, all retirees (regardless of the plan they used) would pay small copayments if they received care at military facilities.

Together, those three changes would lower discretionary appropriations by $460 million in 2000 and $6 billion through 2009. The savings would stem from enrollment fees, increased copayment charges, and more prudent use of care by beneficiaries. This estimate assumes that the Congress would reduce DoD's appropriations by the amount of revenue collected under the option. However, if the Congress revoked DoD's automatic reimbursement authority, the estimate would take the form of an offset to mandatory spending.

By requiring beneficiaries to enroll, this option would help DoD identify who uses its system. Military providers need to plan for the health care needs of a defined population to develop per capita budgets and build cost-effective delivery networks. (Such savings, however, are not included in this estimate.)

Proponents could argue that the value of DoD's health benefits has risen with advances in medical technology, so users should expect to bear some of the associated cost, just as employees of private firms have. In addition, charging copayments would help curb excessive use of services by creating the same incentives for beneficiaries who receive care on-base as for those who use civilian providers. It would also eliminate the inequity of providing more generous benefits to people who live near a military hospital or clinic.

On the negative side, military families and retirees would view higher charges as an erosion of their benefits. Retention and morale might suffer, even though this option would still offer service members and their families more generous health benefits than many government or private-sector employers do.

050-20 DOWNSIZE THE MILITARY MEDICAL SYSTEM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	247	98
2001	847	478
2002	2,097	1,356
2003	3,349	2,497
2004	4,225	3,532
2005	4,990	4,386
2006	5,345	4,954
2007	5,725	5,372
2008	6,132	5,776
2009	6,568	6,192
Cumulative		
2000-2004	10,765	7,961
2000-2009	39,524	34,641

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-19

RELATED CBO PUBLICATION:

Restructuring Military Medical Care (Paper), July 1995.

The extensive medical system run by the Department of Defense (DoD) is the chief source of health care for some 5.4 million people in the United States. DoD argues that the system is necessary to ensure care for service members in wartime. During peacetime, military medical personnel train for war and provide care for active-duty members, their dependents, and retirees and their families. This option would substantially reduce the size of the military health system and instead rely on the Federal Employees Health Benefits (FEHB) program for most peacetime care.

During the Cold War, military medical requirements for wartime were based on the scenario of a large conventional conflict in Europe. But DoD's more recent planning scenarios have led to sharp reductions in medical requirements. Today, between military facilities, hospitals run by the Department of Veterans Affairs (VA), and civilian facilities that have agreed to provide beds in the event of a national emergency, the United States has more than twice the hospital capacity needed to meet wartime demand.

According to a 1995 study by RAND, DoD could eliminate all but 11 of its 80 U.S. hospitals (reducing the wartime capacity by more than two-thirds) and still be able to meet about 60 percent of its total wartime requirement for 9,000 beds. That is a much higher percentage than it met during the Cold War. Civilian and VA hospitals, which only fill about 60 percent to 70 percent of their capacity, on average, would provide the remaining beds during wartime.

Carrying out such an aggressive restructuring of the military medical system would offer substantial savings: $98 million in outlays in 2000 and nearly $35 billion through 2009. Those estimates reflect both the savings from operating a smaller military system and the costs of providing coverage under the FEHB program for beneficiaries other than active-duty service members. (DoD would pay the same share of the premiums for FEHB health plans that the federal government pays for employees at other agencies.)

DoD has no plans to make such deep cuts to its health care system. Military medical officials argue that their facilities and the care they provide in peacetime are essential for recruiting and training physicians and ensuring medical readiness. Downsizing that system to such an extent would require DoD to modify the way it trains and prepares for wartime. For example, it would need to strengthen ties with the civilian sector to provide wartime training for military medical personnel and to ensure an adequate supply of wartime beds.

Critics of this option might also point out that enrolling in a plan offered by the FEHB program would require beneficiaries to pay substantially more out of pocket, on average, than they do now for care in the military system. Nevertheless, some FEHB plans would offer improved coverage and so might be worth the higher out-of-pocket costs. Moreover, the value of DoD's health benefits has grown dramatically with advances in technology and medical practices. Thus, it might be reasonable for military beneficiaries to share more of the costs associated with those advances—as many people covered by employer-sponsored plans in the private sector already do.

050-21 CLOSE AND REALIGN ADDITIONAL MILITARY BASES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	-539	-167
2003	-1,156	-552
2004	-275	-603
2005	664	-166
2006	764	293
2007	402	460
2008	1,559	815
2009	2,595	1,531
Cumulative		
2000-2004	-1,970	-1,322
2000-2009	4,015	1,611

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-25

RELATED CBO PUBLICATIONS:

Review of *The Report of the Department of Defense on Base Realignment and Closure* (Letter), July 1998.

Closing Military Bases: An Interim Assessment (Paper), December 1996.

Beginning in the late 1980s, the Department of Defense (DoD) sought to reduce its operating costs by closing unneeded military bases. Significant reductions in force structure at the end of the Cold War made many bases unnecessary. Because political and procedural difficulties had long made closing bases nearly impossible, the Congress set up four successive independent commissions on base realignment and closure (or BRAC). Those commissions recommended shutting or realigning (moving departments and facilities at) hundreds of military installations in the United States, Puerto Rico, and Guam. When all of the actions from the four BRAC rounds are completed, DoD will save about $5.6 billion a year in operating costs, it estimates.

This option would authorize two additional rounds of base closures and realignments. In the long run, such actions can produce substantial savings. However, they require some up-front investment, so costs would increase in the short run. Between 2000 and 2009, this option would reduce DoD's costs by a net total of $4 billion. Beginning in 2012, the department could realize recurring savings of around $4 billion per year. Those estimates are based on DoD's experience and current projections for the four earlier rounds of base closings. (The estimates do not include the costs of environmental cleanup, since DoD is obligated to incur such costs regardless of whether it operates or closes bases.)

Closing and realigning additional military bases is consistent with DoD's overall drawdown of forces. By several measures, planned force reductions significantly exceed the projected decrease in base capacity. For example, the department intends to cut the number of military and civilian personnel by 34 percent from the 1990 level. But according to DoD, when all of the previously agreed base closures and realignments have been carried out, the military will still have about 23 percent more base capacity than it needs.

The Secretary of Defense asked the Congress in early 1998 to authorize two more rounds of base closures. In *The Report of the Department of Defense on Base Realignment and Closure* of April 1998, DoD stated that opportunities exist for further cutbacks and consolidations at several types of bases—such as defense laboratories, test and evaluation installations, training facilities, naval bases, aircraft installations, and supply facilities.

Although some analysts believe that DoD should further reduce the number of military bases, others feel that the BRAC cuts have gone far enough in matching the planned reductions in forces. The base structure, they say, should retain enough excess capacity to accommodate new risks to national security that could require a surge in the number of military forces. Opponents of more closures also cite the possible economic effects on local communities. Some suggest that savings could be made by demolishing certain buildings or by achieving other operating efficiencies short of closing bases.

050-22 INCREASE COMPETITION BETWEEN DoD AND PRIVATE-SECTOR HOUSING

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	576	29
2001	588	250
2002	601	417
2003	614	499
2004	627	561
2005	640	596
2006	654	623
2007	668	639
2008	682	653
2009	697	667
Cumulative		
2000-2004	3,006	1,755
2000-2009	6,347	4,933

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-26

RELATED CBO PUBLICATION:

Military Family Housing in the United States (Study), September 1993.

Most military families receive cash allowances for housing and rent or purchase dwellings in the private sector. About one-third, however, live rent-free in on-base housing provided by the Department of Defense (DoD). It costs the federal government about 35 percent more to provide a housing unit than it costs to rent a comparable unit in the private sector. Despite the cost, DoD does not plan to phase out its inventory of housing. Instead, the department is experimenting with public/private partnerships that could provide private capital to replace or revitalize on-base housing units, many of which are nearing the end of their service life. Those partnerships are proceeding more slowly than planned, however, leaving many families in substandard units. Moreover, it is uncertain whether such partnerships will reduce the long-run costs to DoD of providing housing.

One reason that DoD provides housing is that on-base units are in high demand among military families. That demand partly reflects the benefits of the on-base lifestyle. But survey data show that the low cost of on-base units to service members is an even more important factor. The allowance that families living in DoD housing forfeit (in effect, the rent they pay) equals only about 60 percent of the costs that the federal government incurs in providing a unit.

This option would reduce the demand for on-base housing by requiring it to compete with private-sector housing. All military families would receive the cash allowance and be free to choose between DoD and private-sector units. DoD—and any firms providing housing in partnership with it—would act like a private landlord, setting rents for on-base units at market-clearing levels (levels at which there would be neither excess vacancies nor waiting lists). They would revitalize or replace an on-base housing unit only if its value to service members (the market-clearing rent it could command) was sufficient to cover both operating costs and amortized capital costs. That criterion would limit DoD to revitalizing or replacing only about 25 percent of its existing housing stock, the Congressional Budget Office estimates. Over the long run, DoD and its partners would cease to provide units in markets where they could not successfully compete with private-sector housing.

Total savings from this option could amount to more than $6 billion through 2009. The primary source of savings would be lower revitalization and replacement costs as DoD retired aging units rather than investing in ones that could not cover their costs in competition with private-sector housing. Additional savings might result from more efficient management as on-base units were forced to compete with private housing. The housing costs that service members pay out of pocket would not change. If the rents paid to DoD exceeded the housing allowances paid to members living in DoD units, the excess would be returned to service members as a whole through an increase in allowance rates.

This option would let DoD focus on its warfighting mission rather than on real estate management. The change would eliminate waiting lists for on-base units and equalize the value of the housing benefits that DoD provides to families living on- and off-base. Nonetheless, families that chose to live on-base would face higher costs than they do today. In addition, this option would represent a significant break with military tradition. As a result, it could have a negative impact on morale unless it received strong public support from senior military leaders.

050-23 TRANSFER COMMISSARY OPERATIONS TO A DoD-WIDE EXCHANGE SYSTEM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	930	709
2001	1,011	932
2002	1,093	1,045
2003	1,136	1,110
2004	1,173	1,155
2005	1,211	1,193
2006	1,250	1,232
2007	1,291	1,273
2008	1,332	1,314
2009	1,362	1,346
Cumulative		
2000-2004	5,343	4,951
2000-2009	11,788	11,309

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-24

RELATED CBO PUBLICATION:

The Costs and Benefits of Retail Activities at Military Bases (Study), October 1997.

The Department of Defense (DoD) operates two separate retail systems on its military bases for the benefit of current and retired service members and their families. One is a system of commissaries (supermarkets) that relies on an annual appropriated subsidy of about $1 billion. The other system, which does not directly receive appropriated funds, consists of the military exchanges that provide general retail stores and consumer services. Commissaries are part of a federal agency (the Defense Commissary Agency), whereas exchanges (which are organized under the Army and Air Force Exchange Service, the Navy Exchange Command, and the Marine Corps's exchanges) are nonappropriated-fund instrumentalities of the federal government. As a result, the employees of exchanges are not members of the civil service, and their managers are not constrained by all of the rules that govern federal agencies.

This option would save almost $12 billion between 2000 and 2009 by consolidating all exchanges and commissaries under a DoD-wide nonappropriated-fund retail entity and then gradually phasing out the commissary subsidy. Greater efficiency in DoD's retail operations would offset much of the lost subsidy. Consolidation would eliminate duplicative systems for distribution, purchasing, and personnel management. It would also free on-base grocery stores from the requirement to employ civil service personnel and from appropriated-fund acquisition rules, thus reducing their operating costs by between $140 million and $280 million annually.

More efficient operations would not entirely make up for the loss of the appropriated subsidy; some price increases at on-base stores would also be needed. Thus, one major disadvantage of this option is that it would reduce the benefits that on-base shopping provides to military personnel. Nonetheless, recent trends in costs and sales at commissaries suggest that the benefits they offer may no longer justify the cost of their subsidy. Between 1990 and 1998, the appropriated-fund subsidy rose from 17 percent of commissary sales to 19 percent. Moreover, the level of commissary sales—perhaps the most candid index of the stores' value to their customers—continues to fall. Sales declined by more than 20 percent between 1994 and 1998 (after adjusting for inflation), although the number of patrons with unlimited access to commissaries fell by only about 2 percent during that period. Commissaries in some parts of the country are finding it hard to compete with private grocers who offer store-brand products at low prices, warehouse format, long hours, and varied services.

One recent survey found that commissaries pay significantly more than the Army and Air Force Exchange Service for the same goods. Thus, much of the commissary subsidy may be going to benefit commissary suppliers rather than patrons. Military families might be attracted to a system of exchange-operated grocery stores that could obtain goods at lower prices and offer consumers their choice of name-brand or store-brand items, a variety of products and services in a single location, and convenient hours. Over the long run, this option might be a way to ensure continued access to on-base shopping for current and retired service members.

050-24 CONSOLIDATE AND ENCOURAGE EFFICIENCIES IN MILITARY EXCHANGE ACTIVITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	59	45
2001	83	74
2002	109	100
2003	112	109
2004	116	114
2005	119	118
2006	123	122
2007	127	126
2008	131	130
2009	134	133
Cumulative		
2000-2004	479	440
2000-2009	1,115	1,068

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-23

RELATED CBO PUBLICATION:

The Costs and Benefits of Retail Activities at Military Bases (Study), October 1997.

The Department of Defense's (DoD's) three military exchange systems—the Army and Air Force Exchange Service, the Navy Exchange Command, and the Marine Corps system—provide a wide array of retail stores and consumer services at military bases. With combined annual sales of approximately $9 billion, operating costs of about $2 billion, and 80,000 employees, the exchanges constitute one of the largest retail businesses in the United States.

The Congress does not directly appropriate funds to the exchanges, but DoD provides them with about $400 million worth of free services each year. Those services include maintaining the exterior of exchange buildings (such as roofs, windows, and heating and cooling systems), transporting goods overseas, and providing utilities at overseas stores. The exchanges' federal status offers other advantages as well: DoD exchanges are exempt from state and local excise taxes, have a monopoly over on-base sales of goods and services, and have access to free land and interest-free capital. Those exemptions and other subsidies are worth more than $1 billion a year, the Congressional Budget Office estimates.

A portion of that annual subsidy is translated into lower prices for military personnel and their families and into exchange earnings that support the services' morale, welfare, and recreation (MWR) programs. Yet another portion is absorbed by inefficiencies. Private retailers in the United States must be efficient to survive in the face of competition. The subsidies that exchanges receive, by contrast, alleviate the pressure of competition and allow the exchanges to operate in ways that private retailers could not afford to. For example, although economies of scale in the private sector often force private retailers to merge, DoD's three exchange systems remain separate—despite studies that have repeatedly shown that consolidation would reduce operating costs. Subsidies also distort the incentives that exchange managers face. Because DoD provides free utilities overseas, the Army and Air Force Exchange Service can operate an ice cream production line in Germany without regard to utility costs. And because DoD pays to transport goods overseas, the exchanges can ship beer and carbonated beverages abroad rather than buying them locally.

This option would consolidate the three exchange systems into a single entity and introduce incentives for more efficient operations. Rather than receive DoD support services free of charge, the exchanges would receive a lump-sum appropriation equal to the historical cost of those services and would (like DoD's industrially funded activities) reimburse the providers of those services. Over the long run, consolidating the three exchange systems could save about $50 million a year in overhead costs. Requiring the exchanges to reimburse DoD for support services would save another $40 million a year if it induced the exchanges to reduce the costs of those activities by 10 percent. In all, savings would total $1.1 billion between 2000 and 2009. Initially, the savings might provide additional funding for MWR activities. Over the long run, the increase in exchange earnings would allow DoD to provide its planned level of MWR activities with less support from appropriated funds.

050-25 DEMOLISH OBSOLETE AND EXCESS STRUCTURES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	-49	-36
2001	-37	-39
2002	-24	-26
2003	-11	-13
2004	51	36
2005	52	52
2006	53	53
2007	54	54
2008	56	55
2009	57	56
Cumulative		
2000-2004	-69	-79
2000-2009	203	192

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

050-21

This option would accelerate the demolition and disposal of various excess, obsolete structures owned by the Department of Defense (DoD). Such structures include military family housing, defense agency facilities, and runways, piers, towers, and fuel tanks. Although demolition would entail up-front costs, DoD would eventually save money because of the reduced costs for maintenance, utilities, and security. Estimates by DoD suggest that demolition projects pay for themselves in just five years and then continue to produce savings.

The defense drawdown has left excess structures at military bases. Many are in poor repair and have no remaining asset value. In some cases, they are dangerous eyesores; in others, the structures attract marginal users who benefit from occupying them only because the users are not required to pay the full costs of the utilities and other support that the base provides. DoD currently maintains about 32 percent more square feet of facilities per full-time worker (active duty and civilian) than it did in 1989.

In accordance with a management reform initiated by the Office of the Secretary of Defense in 1997, each of the military services has developed a demolition program. Those programs could result in the elimination of 80 million square feet of excess, obsolete buildings by 2003 and lead to annual recurring savings of $160 million. However, that initiative did not address excess, obsolete facilities occupied by the defense agencies (including the Defense Health Agency), the services' family housing, or structures other than buildings (such as piers, runways, and towers). This option would provide additional up-front funding of $60 million a year from 2000 to 2003 to demolish and dispose of those types of excess structures. The Congressional Budget Office estimates that this option would yield annual recurring savings of about $50 million beginning in 2004. Over the 2000-2009 period, CBO estimates, the additional demolitions could provide total net savings of approximately $200 million.

If it chose to, the Congress could allow DoD to use the savings from this option to repair and revitalize other military facilities. Although that approach would not result in any easily identifiable budgetary savings, it might nonetheless be a worthwhile investment because deferring repairs on buildings can ultimately result in higher annual costs for maintenance.

050-26 CREATE INCENTIVES FOR MILITARY FAMILIES TO SAVE ENERGY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	4	4
2001	27	27
2002	60	60
2003	75	75
2004	77	77
2005	78	78
2006	80	80
2007	82	82
2008	83	83
2009	85	85
Cumulative		
2000-2004	244	244
2000-2009	652	652

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-22 and 050-27

RELATED CBO PUBLICATION:

Military Family Housing in the United States (Study), September 1993.

The Department of Defense (DoD) spent almost $360 million last year on gas, electricity, and water for the approximately 230,000 family housing units that it owns in the United States. DoD's efforts to reduce those costs by promoting resource conservation have met with limited success. One reason is that service members living in DoD-owned housing do not pay for their utilities and may not even know how much gas, electricity, and water they use. Landlords in the private sector have found that utility use typically declines by about 20 percent when tenants are responsible for their own utility bills.

This option would install utility meters in DoD housing units, provide cash utility allowances to the families living there, and then charge for utilities based on actual use. Residents who spent less than their allowance could keep the savings; those who spent more would pay the extra cost out of pocket. The budget for allowances would be set equal to the expected cost of utilities under the new system, or about 80 percent of what DoD now spends. The department would allocate that amount among the different housing units on the basis of their size, energy efficiency, and geographic location. Once the program was established, the allowance budget for each year could be set equal to the previous year's actual utility charges plus an adjustment for inflation.

Because families that conserved aggressively would receive more in allowances than they would be charged for utilities, this option would reward people who made an effort to conserve energy. Families that did not economize would face utility bills in excess of their allowance. However, there is a risk that the allowances for some units might not accurately reflect their characteristics. People living in such a unit might find that the allowance did not cover all of their utility costs even after they had made reasonable efforts to conserve energy. (At their next duty assignment, however, they might benefit from an allowance that was too generous given the characteristics of their housing unit.)

The principal advantage of this option is that it would reduce DoD's costs by giving military families who live on-base the same incentives for conservation as most homeowners and renters—including military families living off-base. After an initial phase-in period (during which DoD would incur the up-front costs of determining allowance amounts, setting up a billing system, and installing meters), this option could provide DoD with total savings of about $650 million from 2000 through 2009.

Many DoD housing units already include a connection where a meter could be installed. Nonetheless, a temporary exemption from the metering requirement (and from the utility allowances and charges) could be given for some older units if the Secretary of Defense certified that metering them was not feasible.

050-27 ALLOW FEDERAL AGENCIES TO BARGAIN FOR ELECTRICITY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	158	158
2001	155	155
2002	133	133
2003	85	85
2004	26	26
2005	26	26
2006	26	26
2006	26	26
2008	26	26
2009	26	26
Cumulative		
2000-2004	556	556
2000-2009	684	684

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

050-26 and 270-07

RELATED CBO PUBLICATIONS:

Electric Utilities: Deregulation and Stranded Costs (Paper), October 1998.

Should the Federal Government Sell Electricity? (Study), November 1997.

The federal government spends more than $2 billion per year in the United States on electricity, of which about 50 percent is purchased through the Department of Defense (DoD). Although the government is a large consumer of electricity, it pays full retail prices. A provision in a continuing appropriation act for fiscal year 1988 (Public Law 100-202, section 8093) requires federal agencies to conform to state laws regarding electricity purchases. Some states have already allowed retail customers to choose their electricity supplier and negotiate lower prices. This option would let the federal government realize such savings in all states, regardless of state regulations on retail customers. The resulting savings could total around $684 million over 10 years if agencies' appropriations were reduced by the expected decrease in electricity bills.

The federal government would face lower electricity prices if it purchased power on a competitive basis. In that situation, suppliers would have an incentive to provide electricity at the lowest possible cost and offer new services. Under traditional regulation, utilities generally gave customers the same product: reliable electricity at a fairly high, but uniform, price. If the federal government was allowed to negotiate for electricity, suppliers would be encouraged to furnish a greater variety of electricity services—with different prices and different degrees of reliability, depending on what the federal government wanted or needed. Some states, such as California, Massachusetts, Pennsylvania, and Rhode Island, have already introduced retail competition, allowing all retail customers—including federal agencies—to choose their electricity provider. Any reduction in federal spending because of Congressional action would have to take into account that those states already allow price competition and others will allow it before 2009.

Several bills to restructure the electricity industry were introduced in the 105th Congress. They would have allowed all customers, not just the federal government, to buy electricity in a competitive market. A comprehensive electricity-restructuring bill like one of those may be needed for the federal government to realize all of the savings from negotiating lower prices for electricity. Otherwise, an electricity provider that once served the federal government might be reluctant to lose so large a customer and could try to impede the government's choice of suppliers. (In some parts of the country, no alternative suppliers may be available.) Also, the federal government could be subject to surcharges if it broke a contract with its old supplier. Such surcharges would diminish the savings from this option. The federal government might also be perceived as unfair if it was allowed to choose suppliers but no other retail customer was. Prices to other consumers could rise if the federal government chose a new supplier and the utility that once served it could not search for alternative buyers for the electricity.

050-28 SELL SURPLUS REAL PROPERTY OF THE DEPARTMENT OF ENERGY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	3	3
2002	3	3
2003	3	3
2004	3	3
2005	1	1
2006	1	1
2007	1	1
2008	1	1
2009	1	1
Cumulative		
2000-2004	12	12
2000-2009	17	17

SPENDING CATEGORY:

Mandatory

The Department of Energy (DOE) controls about 2.4 million acres of land, much of it surrounding sites in the West and Southeast that have contributed to the nation's efforts to develop nuclear weapons. DOE's Office of Inspector General (IG) recently identified 309,000 acres that it considers no longer essential to carrying out the department's core missions of weapons dismantling, environmental cleanup, technology development, and scientific research. That acreage is part of the Oak Ridge Reservation in Tennessee, the Hanford Site in Washington, and the Idaho National Engineering Laboratory. Additional real property that may be excess but was not evaluated in the IG report exists at such DOE facilities as the Nevada Test Site, the Los Alamos National Laboratory in New Mexico, the Fermi National Accelerator Laboratory in Illinois, and the Savannah River Site in South Carolina.

To demonstrate the potential savings from disposing of those properties, this option would require DOE to sell at market value 16,000 acres at the Oak Ridge Reservation that the IG has identified as excess. (The IG proposed transferring other excess property to the Department of the Interior for management as a natural resource.) That sale—conducted over four years to minimize the effect on local land values—could bring in $17 million during the 2000-2009 period. That sum excludes any savings associated with reducing DOE's liabilities for payments to local governments in lieu of taxes or the costs of cleaning up future accidents. The estimate also assumes that the sale would be exempted from requirements of the Federal Property Administrative Services Act to first offer surplus property to state and local governments.

Proponents of keeping that land argue that DOE's mission is changing to include the stewardship of land as a valuable national resource. Most of the acreage in question was used as buffer lands and has been little touched in the past 50 years. In line with that land's unique qualities, DOE has established environmental research parks at seven of its properties to protect various species and cultural sites and to provide a natural laboratory for research and environmental monitoring. It has also made agreements with the Fish and Wildlife Service and the Bureau of Reclamation to manage certain areas. Moreover, some of the land (excluding the acres at Oak Ridge to be sold in this option) may be contaminated by hazardous materials or unexploded ordnance, which would have to be disposed of before transfer could occur. (Such disposal would diminish the savings from this option.) In addition, DOE still needs buffer lands to control the future spread of contaminants from its nuclear sites.

On the positive side, selling unneeded property would not only save money but also make the land available for more uses, including agriculture, recreation, and residential or commercial development. According to the IG, cleanup will be necessary at only a small part of the acreage. Moreover, the government would still have to pay cleanup costs if it kept or transferred the property rather than selling it.

050-29 ELIMINATE CARGO PREFERENCE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	166	123
2001	179	170
2002	192	185
2003	205	199
2004	218	212
2005	218	216
2006	218	216
2007	218	217
2008	218	217
2009	218	217
Cumulative		
2000-2004	960	889
2000-2009	2,050	1,972

SPENDING CATEGORY:

Discretionary

The Cargo Preference Act of 1904 and other laws require that U.S.-flag vessels be used to carry certain government-owned or government-financed cargo that is shipped internationally. Eliminating cargo preference would lower federal transportation costs by allowing the government to ship its cargo at the lowest available rates. That would reduce the government's costs by $166 million in 2000 and a total of $2 billion over the next decade.

Four federal agencies—the Department of Defense (DoD), the Department of Agriculture (USDA), the Agency for International Development (AID), and the Department of Energy (DOE)—account for about 97 percent (by weight) of the government shipments subject to cargo preference laws. The preference applies to nearly all DoD freight, three-quarters of the USDA's shipments of food aid, foreign assistance associated with AID, and oil shipments for DOE's Strategic Petroleum Reserve. Roughly 70 percent of the savings from eliminating cargo preference would come from defense discretionary spending, with the other 30 percent from nondefense discretionary spending.

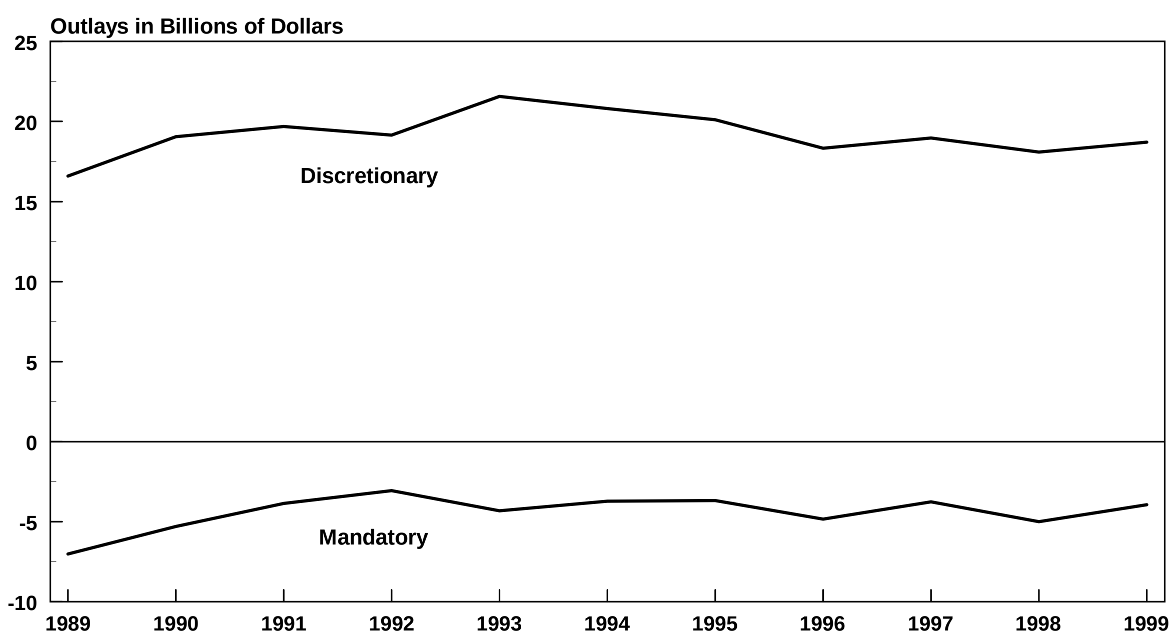
Supporters of cargo preference argue that it promotes the economic viability of the nation's maritime industry. That industry has suffered at the hands of foreign competition in recent decades. Under federal law, U.S. mariners must crew U.S. vessels, and in general, U.S. shipyards must build them. Because U.S.-flag ships face higher labor costs and greater regulatory responsibilities than foreign-flag ships, they generally charge higher rates. Without guaranteed business from cargo preference, up to two-thirds (by tonnage) of the roughly 130 U.S.-flag vessels still engaged in international trade would leave the fleet. They would do so either by reflagging in a foreign country to save money or by decommissioning if they could not operate competitively. Supporters also argue that cargo preference helps bolster national security by ensuring that U.S.-flag vessels and U.S. crews are available during wartime. Finally, eliminating cargo preference could cause U.S. ship operators and shipbuilders to default on loans guaranteed by the government. Such defaults could increase mandatory spending by about $10 million over the next several years.

Critics of cargo preference say it represents a subsidy of private industry by taxpayers, which simply helps a handful of carriers preserve their market share and market power. That subsidy equals about $1.5 million per ship per year. Opponents also point out that even DoD officials question the national security importance of the Merchant Marine fleet. DoD has invested in a fleet of its own specifically for transporting military equipment. It also contracts with foreign-flag ships when needed. In addition, critics of cargo preference argue that the U.S. government is at a competitive disadvantage in selling surplus agricultural commodities abroad because it must pay higher costs to transport them.

150

International Affairs

Budget function 150 covers all spending on international programs by various departments and agencies whose missions concern international affairs. The category includes spending by the Department of State to conduct foreign policy and exchange programs, funds controlled directly by the President to give other nations economic and military aid, and U.S. contributions to international organizations such as the United Nations, multilateral development banks, and the International Monetary Fund. Function 150 also includes financing for exports through the Export-Import Bank. CBO estimates that discretionary outlays for the function will total $18.7 billion in 1999; discretionary budget authority provided for international affairs this year is $39 billion. Repayments of loans and interest income in the Exchange Stabilization Fund account for the negative balances in mandatory spending for this function. Over the past 10 years, discretionary outlays for function 150 have declined from 1.5 percent of federal outlays to 1.1 percent.



150-01 ELIMINATE OVERSEAS BROADCASTING BY THE U.S. GOVERNMENT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	155	196
2001	234	230
2002	385	360
2003	395	385
2004	397	390
2005	397	394
2006	397	395
2007	397	395
2008	397	395
2009	397	395
Cumulative		
2000-2004	1,566	1,561
2000-2009	3,551	3,535

SPENDING CATEGORY:

Discretionary

Several entities provide U.S. overseas broadcasting. Radio Free Europe (RFE) and Radio Liberty (RL) broadcast country-specific news to Eastern Europe and the former Soviet Union, respectively. The Voice of America (VOA) oversees radio broadcasts that provide news and U.S.-related information to audiences worldwide. The United States Information Agency (USIA) oversees television broadcasting services similar to VOA's radio broadcasts and also manages a broadcasting service to Cuba. In 1996, the Congress consolidated the appropriations for VOA, RFE/RL, and USIA's television and film service into the international broadcasting operations account. Funding for radio and television broadcasting to Cuba and for construction of broadcast facilities was provided in separate appropriations.

This option would eliminate VOA and RFE/RL and end broadcasting services to Cuba, all overseas construction of broadcast facilities, and U.S. overseas television broadcasting. Compared with the 1999 funding level, those cuts would save more than $3.5 billion over 10 years—$3.2 billion from terminating the international broadcasting operations account, $208 million from ending broadcasts to Cuba, and $98 million from terminating construction of broadcast facilities. (Those savings are net of the near-term costs of termination, such as severance pay for employees.)

Proponents of ending overseas broadcasting by the U.S. government claim that RFE/RL and VOA are Cold War relics that are no longer necessary. RFE and RL continue to broadcast to former Communist countries in Europe even though those countries now have ready access to world news. With the advent of satellite television broadcasting, most nations can receive news about the United States and the world from private broadcasters, such as the Cable News Network (CNN). Some proponents of termination also argue that the primary technology used by VOA and RFE/RL—shortwave radio—limits the audiences and thus the effectiveness of U.S. overseas broadcasting. Finally, proponents say, foreigners may distrust the accuracy of broadcasts sponsored by the U.S. government.

Critics of this option would argue that the current level of broadcasting should continue or even increase. The process of change in Eastern Europe and the former Soviet Union needs nurturing, they say, and U.S. broadcasting can help in that process. In addition, many countries in other parts of the world remain closed to outside information. Supporters of VOA and RFE/RL argue that shortwave radio is the best way to reach audiences in closed countries because very few people there own satellite dishes, which are needed to receive television broadcasts such as those of CNN. Moreover, they note, VOA and RFE/RL are broadcasting more programs over AM and FM frequencies. Supporters of U.S. government broadcasting also argue that it should be sharply increased to some countries, such as China and North Korea. Further, they maintain, television is a powerful communications tool, and private television networks cannot adequately communicate U.S. policy and viewpoints.

150-02 REDUCE ASSISTANCE TO ISRAEL AND EGYPT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	220	183
2001	380	318
2002	540	463
2003	700	614
2004	860	769
2005	1,020	925
2006	1,180	1,083
2007	1,340	1,241
2008	1,500	1,400
2009	1,500	1,436
Cumulative		
2000-2004	2,700	2,347
2000-2009	9,240	8,433

SPENDING CATEGORY:

Discretionary

RELATED CBO PUBLICATIONS:

The Role of Foreign Aid in Development (Study), May 1997.

Enhancing U.S. Security Through Foreign Aid (Study), April 1994.

Limiting Conventional Arms Exports to the Middle East (Study), September 1992.

As part of the 1979 Camp David peace accords, the United States agreed to provide substantial amounts of aid to Israel and Egypt to promote economic, political, and military security. That aid, which totaled $5.1 billion for the two countries last year, is paid through the Economic Support Fund (ESF) and the Foreign Military Financing (FMF) program. Of that total, Israel received $3 billion ($1.2 billion in ESF payments and $1.8 billion from the FMF program), and Egypt received $2.1 billion ($815 million from the ESF and $1.3 billion from the FMF program). This year, U.S. aid to the two nations will total $5 billion ($100 million less than in 1998)—an amount that represents more than four-fifths of discretionary spending for U.S. security assistance and more than one-third of the foreign operations budget for 1999 (excluding appropriated funds for the International Monetary Fund).

In January 1998, Israel proposed phasing out its $1.2 billion a year in ESF payments while increasing its FMF assistance by $600 million a year. The conference report for the 1999 Foreign Operations Appropriations Act endorsed that proposal with a 10-year phase-in. As a result, it cut ESF aid to Israel by $120 million and increased FMF aid by $60 million. The conference report also reduced economic assistance to Egypt from $815 million in 1998 to $775 million in 1999—and proposed cutting it to $415 million by 2008—while keeping military aid constant.

This option would forgo the proposed increase in military funding for Israel (maintaining that aid at its 1998 level) while continuing to cut economic assistance to both Israel and Egypt each year through 2008. The reductions in Israeli aid would save $180 million in 2000, compared with this year's funding level, and a total of $2.1 billion over five years and almost $7.1 billion over 10 years. Adding in the cuts to Egyptian aid would bring total savings in outlays to $183 million in 2000, $2.3 billion over five years, and $8.4 billion over 10 years.

The conference report asserted that increased military assistance to Israel was necessary because "the [country's] security situation, particularly with respect to weapons of mass destruction, has worsened." But despite reports of weapons technology being transferred to Iran, critics could argue that Israel's security situation has improved. Iraq's arsenal of weapons of mass destruction has been reduced, though not eliminated, by U.N. inspections; Israel has concluded a peace treaty with Jordan; and peace talks with the Palestinians have made progress. In addition to those developments, Israel's per capita income (in excess of $17,000) approaches that of the United States' European allies, who have long been prodded by the Congress to assume greater responsibility for their own defense.

As for Egypt, some analysts say U.S. assistance to that country is not being spent wisely or efficiently. Critics note that high levels of appropriations have exceeded Egypt's ability to spend the funds, leading to the accumulation of large undisbursed balances, inefficient use of assistance, and delays in making the reforms needed to foster self-sustaining growth. Furthermore, many other countries and organizations contribute substantial amounts of money to Egypt, which could make reducing U.S. assistance more feasible.

150-03 ELIMINATE THE EXPORT-IMPORT BANK, OVERSEAS PRIVATE INVESTMENT CORPORATION, AND TRADE AND DEVELOPMENT AGENCY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	850	94
2001	856	242
2002	866	394
2003	876	536
2004	881	655
2005	881	750
2006	881	799
2007	881	827
2008	881	840
2009	881	843
Cumulative		
2000-2004	4,329	1,921
2000-2009	8,734	5,980

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

350-02, 350-08, and 350-09

RELATED CBO PUBLICATIONS:

The Domestic Costs of Sanctions on Foreign Commerce (Study), March 1999.

The Role of Foreign Aid in Development (Study), May 1997.

The Export-Import Bank (Eximbank), the Overseas Private Investment Corporation (OPIC), and the Trade and Development Agency (TDA) promote U.S. exports and overseas investment by providing a range of services to U.S. companies wishing to do business abroad. Eximbank offers subsidized direct loans, guarantees of private lending, and export credit insurance; OPIC provides investment financing and insurance against political risks; and TDA funds feasibility studies, orientation visits, training grants, and other forms of technical assistance. Appropriations in 1999 for Eximbank, OPIC, and TDA are $815 million, $85 million, and $44 million, respectively.

Those organizations are only three of the various U.S. government agencies (some of which are part of the Department of Agriculture) that promote trade and exports. Moreover, their impact on exports may be limited. According to the annual reports of OPIC, Eximbank, and TDA, those three agencies supported about 2 percent of total U.S. exports in 1995.

This option would eliminate TDA and the subsidy appropriations for Eximbank and OPIC. The latter two agencies could not make any new finance or insurance commitments but would continue to service their existing portfolios. Those changes would save $94 million in outlays in 2000, $1.9 billion through 2004, and almost $6 billion over 10 years compared with the 1999 funding level.

Supporters of promoting exports argue that those agencies play an important role in helping U.S. businesses, especially small businesses, understand and penetrate overseas markets. They level the playing field for U.S. exporters by offsetting the subsidies that foreign governments provide to their exporters, thereby creating jobs and promoting sales of U.S. goods. By encouraging U.S. investment in areas such as Russia and the states of the former Soviet Union, those agencies may also serve a foreign policy objective.

Critics dispute the claim that promoting exports creates U.S. jobs. They assert that by subsidizing exports, the government distorts business decisions that are best left to free markets. OPIC and Eximbank finance programs that have trouble raising funds on their own merit. Similarly, those agencies' insurance programs may encourage moral hazard—the practice of companies investing in riskier projects than they would if more of their own funds were at stake. Finally, critics argue, those agencies encourage highly risky projects in vulnerable areas. Although emerging countries like South Korea, Mexico, and Poland are important markets for U.S. exports, they can also be dangerous: firms operating there may face considerable political, currency, and business risks.

150-04 CEASE ADDITIONAL FUNDING OF MULTILATERAL DEVELOPMENT BANKS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,148	66
2001	1,293	497
2002	1,441	790
2003	1,441	983
2004	1,441	1,147
2005	1,441	1,237
2006	1,477	1,350
2007	1,477	1,415
2008	1,477	1,456
2009	1,477	1,466
Cumulative		
2000-2004	6,764	3,483
2000-2009	14,113	10,408

SPENDING CATEGORY:

Discretionary

Established to finance the reconstruction of Europe after World War II, the World Bank and its regional counterparts (the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development) are now important sources of financing for developing nations. Those multilateral development banks are owned by member countries, which purchase the banks' stock, promise to back their debts, or directly contribute funds—all of which enable the banks to make loans to developing nations on highly concessional terms.

Under this option, the United States would continue to be a member of the multilateral development banks but would not make new stock purchases or contributions. Ceasing to do so would save $66 million in outlays in 2000, $3.5 billion over the next five years, and $10.4 billion over 10 years compared with the 1999 funding level.

Critics claim that the multilateral banks are more interested in generating loans than in determining whether the loans are invested well. The banks' incentive systems, they argue, create a preoccupation with getting loans approved. After years of internal reforms, the World Bank still reports that between one-quarter and one-third of the projects that it funds are unsatisfactory at completion. Limiting U.S. participation in new lending might cause the banks to pay more attention to the success of their lending activities.

Some critics also claim that the banks' lending harms the economies of developing countries. Large amounts of aid can overvalue a recipient country's exchange rate, opponents say, thereby increasing the relative costs of its domestic products and reducing their competitiveness in world markets. In addition, a constant infusion of concessional lending can weaken financial discipline and depress domestic saving and private investment, which destroys the incentives that foster sound business practices. Besides economic harm, environmental groups charge that the large-scale projects funded by the banks too often damage the environment and marginalize indigenous peoples.

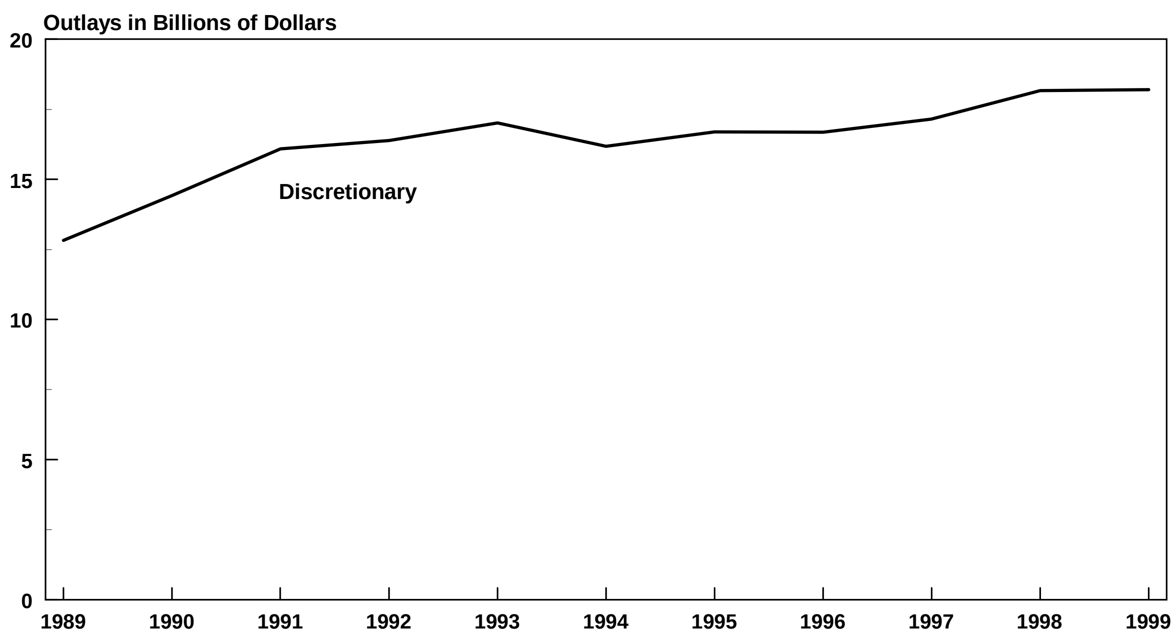
Supporters, by contrast, argue that the banks are the most effective instrument in promoting policy reform in developing nations and in countries undergoing the transformation to a free-market democracy. Supporters might also note that harmful effects on indigenous peoples, the environment, and the economy were common to all past development efforts, not just the banks' projects, and that the banks have adopted policies to reduce the adverse environmental and social impact of their projects. Furthermore, supporters argue, the poor performance of the banks' portfolios is exaggerated: development is a risky business, and if the banks were making only safe loans, they would not be serving their main function of taking risks that profit-oriented investors shun.

The banks' advocates also note that developing countries constitute the most rapidly expanding market for exports, and the financing that the banks provide is an important source of support in expanding U.S. exports to those countries. The banks promote U.S. interests around the world on a scale that the United States, acting alone, could not afford. If the United States stopped contributing to the banks, its ability to shape their policies would be weakened.

250

General Science, Space and Technology

Budget function 250 includes funding for the National Science Foundation, more than 90 percent of the spending of the National Aeronautics and Space Administration, and general science research by the Department of Energy. In 1999, CBO estimates, discretionary outlays for function 250 will total about $18 billion. Discretionary budget authority provided for the function in 1999 is nearly $19 billion. Mandatory spending for function 250 is estimated to be about $30 million this year—too small an amount to be visible in the figure below. For the past 10 years, spending under this function has represented about 1 percent of federal outlays.



250-01 CANCEL THE INTERNATIONAL SPACE STATION PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,305	900
2001	2,305	1,969
2002	2,305	2,285
2003	2,305	2,305
2004	2,305	2,305
2005	2,305	2,305
2006	2,305	2,305
2007	2,305	2,305
2008	2,305	2,305
2009	2,305	2,305
Cumulative		
2000-2004	10,525	9,764
2000-2009	22,050	21,289

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

400-04

RELATED CBO PUBLICATION:

Reinventing NASA (Study), March 1994.

The first two elements of the international space station were launched and joined in late 1998. Under current plans, the facility will be completed in 2005. By that time, an estimated $25 billion will have been spent to develop, build, and assemble the space station. The General Accounting Office (GAO) estimates that the life-cycle cost of the entire project, including operation, maintenance, and transportation to and from orbit, will be over $95 billion. The Congress's yearly decision about whether to continue funding the program hinges not on the money already spent but on whether the program's benefits are sufficient to justify spending an additional $70 billion through 2013.

People who would cancel the international space station program assert that its benefits are unlikely to justify additional spending and that costs are likely to increase above those estimated by GAO. To support their position, critics cite the general lack of enthusiasm for the space station among individual scientists and scientific societies. The program's opponents also note that the costs of the program have continually increased, although its capabilities and scope have decreased. Moreover, opponents hold that under current budgetary conditions, any cost overruns would be paid for through additional cuts in the National Aeronautics and Space Administration's (NASA's) science, technology, and aeronautical activities. Critics point to the uncertainty surrounding the costs of operating and supporting the facility once it has been developed and launched. Regarding that issue, opponents are skeptical of NASA's assurance that the station's operating costs will be low, noting that the agency made similar claims about the space shuttle that proved overly optimistic. Finally, Russia's failure to meet its obligation to provide parts of the space station will require that the United States pay those costs.

Advocates of continued spending for the space station reject critics' claim that the program's benefits do not sufficiently justify its costs. Supporters place a high value on the role of the station as a stepping stone to future human exploration of the solar system. They also contend that the program will deliver both scientific advances and perhaps even commercial benefits. Supporters also argue that Russia's participation has strengthened the foreign policy reason for continuing the program. They assert that drawing Russia, and particularly its aerospace industry, into a cooperative venture will help to stabilize the Russian economy and provide incentives for Russia to adhere to international agreements on the spread of missile technology. Advocates also point out that the project's cancellation would force the United States to renege on agreements signed with European nations, Japan, and Canada. That could hurt the prospects for future international cooperative agreements on space, science, and other areas of mutual interest.

250-02 ELIMINATE THE EXPERIMENTAL PROGRAM TO STIMULATE COMPETITIVE RESEARCH

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	90	23
2001	113	71
2002	113	98
2003	113	107
2004	113	111
2005	113	112
2006	113	113
2007	113	113
2008	113	113
2009	113	113
Cumulative		
2000-2004	542	410
2000-2009	1,107	974

SPENDING CATEGORY:

Discretionary

The Experimental Program to Stimulate Competitive Research (EPSCoR), a partnership between states and several research-oriented federal agencies, was designed to encourage more investment by states in science and technology. EPSCoR was created in response to a concentrated distribution among the states of federal research and development (R&D) funding: a large number of states receive little funding. Currently, federal agencies spend about $113 million on EPSCoR.

Eighteen states and the Commonwealth of Puerto Rico currently take part in EPSCoR. Between 1980 and 1998, the National Science Foundation provided roughly $270 million to more than 60 colleges, universities, and laboratories that had not received significant federal R&D funding in the past. State governments, local industry, and other nonfederal sources provided an additional $300 million to those institutions. The entire effort has supported 2,000 scientists and engineers.

Opponents of EPSCoR contend that the nation must make optimal use of its limited research dollars. That principle would argue for supporting researchers whose proposals are judged superior through a process of peer review, without regard to geographical distribution. Furthermore, critics doubt whether newcomers to the research enterprise can sustain a top-level effort, which requires substantial ongoing investments by the states and regional institutions. Even with matching funds from the states and other nonfederal organizations, novice research institutions might find it difficult to succeed.

Critics also argue that EPSCoR was supposed to be an experimental program, not a permanent source of R&D support for selected states. They note that after nearly 15 years of EPSCoR support, the program's recipients continue to attract only about 7 percent of the federal funding for academic R&D. Opponents point to the corresponding lack of improvement in state shares of such funding: participating states that began the 1980s in the bottom half of the national rankings were still in the bottom half in 1993.

Advocates maintain that EPSCoR promotes a more equitable geographic distribution of the nation's science and technology base. They assert that state policymakers invest more in R&D than they would without EPSCoR's incentives, and those investments promote equity in higher education by giving students in those states the research experience and training necessary for careers in scientific fields. Proponents also contend that the program fosters technology-related industries in the states by involving local firms in selecting research topics. Supporters note that 15 of the EPSCoR states experienced above-average growth in federal funding for academic R&D over the 1980-1993 period. They claim that the EPSCoR states have improved their rankings in their chosen "niche" fields, even if such changes are not apparent in the overall statistics. They argue as well that the quality of EPSCoR-funded research is equivalent to other federally funded R&D because awards are based on merit reviews.

250-03 REDUCE NSF FUNDING FOR SOCIAL, BEHAVIORAL, AND ECONOMIC SCIENCE RESEARCH

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	48	12
2001	60	38
2002	60	51
2003	60	55
2004	60	57
2005	60	57
2006	60	57
2007	60	57
2008	60	57
2009	60	57
Cumulative		
2000-2004	288	213
2000-2009	588	498

SPENDING CATEGORY:

Discretionary

Clarifying the mission of the National Science Foundation (NSF) is an important task, since the Congress is moving toward increasing research and development (R&D) spending in general. Otherwise, the federal government might be increasing the funding for a broader range of programs than it intends. To this end, the NSF could reduce its funding of social, behavioral, and economic science research. Currently, the NSF spends $137 million per year on such research. Only 55 percent of the research at the NSF Division of Social, Behavioral, and Economic Research (SBER) is for archaeology, physical anthropology, primate studies, and the like; the rest is research on economics, management, and political science.

Critics of the NSF's spending on social and economic science research argue that such research does not belong in an agency devoted to funding and promoting an understanding of the physical sciences. Eliminating NSF research in social and economic sciences would leave NSF funding for simian studies and the like intact. It would also leave intact the Science Resources Studies program, which gathers and produces federal science statistics, including the widely used *Science and Engineering Indicators*.

Opponents of the spending believe that research in economic and related fields is more appropriately funded by the agencies devoted to studies of the economy—for example, the Federal Reserve Board, which has published working papers on the contribution of R&D to the economy. In addition, regulatory agencies with responsibility for financial markets might be more appropriate for studying issues of risk-taking behavior, which the NSF has funded. Furthermore, research agencies governmentwide regularly study economic and other social science phenomena to prove the worth of their individual programs. Reducing NSF's funding for such research would lessen duplication.

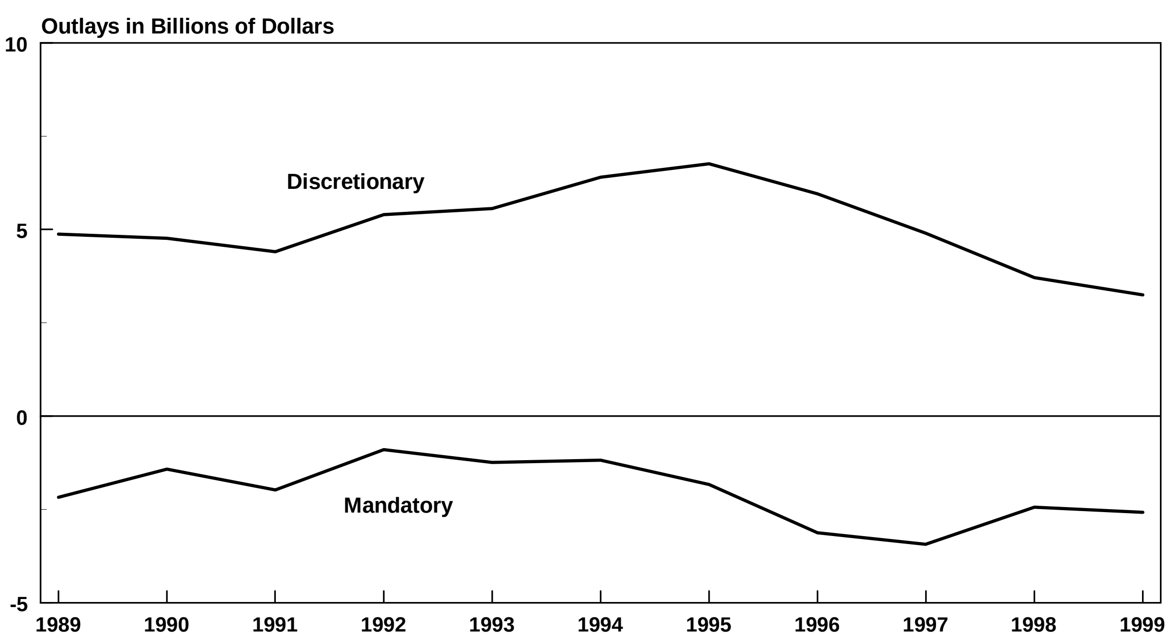
A recent study found that NSF funding of economists did little to increase the number of publications written by them. The study accounted for both the number of academic articles published and the reputation of the journals that featured the articles. Applicants who received NSF grants published no more new articles, taking into account the reputation of the journal, than their peers who did not receive NSF funding. (The major exception was investigators early in their careers, whose productivity seemed to increase with the receipt of an NSF grant.) The study suggests that most of the economic research funded by NSF would have been performed without NSF funding.

Supporters of NSF's research on social, behavorial, and economic science argue that the research has value in its own right. They cite as evidence the fact that at least one of the researchers funded by the programs has won a Nobel prize for his work. In addition, the focus and approach taken by NSF-funded research is designed to bring a scientific approach to topics, such as law and law-like systems, not usually considered from that perspective.

270

Energy

Budget function 270 includes funding for the nondefense programs of the Department of Energy as well as for the Tennessee Valley Authority, rural electrification loans, and the Nuclear Regulatory Commission. The programs supported by this function are intended to increase the supply of energy, encourage energy conservation, provide an emergency supply of energy, and regulate energy production. CBO estimates that discretionary outlays for function 270 will be $3.2 billion in 1999; discretionary budget authority provided for this year totals about $3 billion. Negative balances in mandatory spending for the function result from repayment of loans, receipts from the sale of electricity produced by federal entities, and charges for the disposal of nuclear waste.



270-01 ELIMINATE THE DEPARTMENT OF ENERGY'S APPLIED RESEARCH PROGRAMS FOR FOSSIL FUELS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	307	123
2001	384	276
2002	384	369
2003	384	384
2004	384	384
2005	384	384
2006	384	384
2007	384	384
2008	384	384
2009	384	384
Cumulative		
2000-2004	1,843	1,536
2000-2009	3,763	3,456

SPENDING CATEGORY:

Discretionary

The Department of Energy (DOE) currently spends over $350 million to improve the applied technologies for finding and using fossil fuels (petroleum, coal, and natural gas). With the deregulation of first the petroleum market then the natural gas and electricity markets, the appropriateness of federal government funding for such research and development (R&D) is questionable.

One reason for deregulating prices in energy markets is to provide suppliers with incentives to develop newer and better technology and bring it to market. The recent deregulation of electrical generation markets, for example, has already brought a great deal of low-cost generating capacity on line, displacing higher-cost power plants.

In addition, private entities are more attuned to which new technology has commercial promise than are federal officials. Federal programs in the fossil fuel area have a long history of funding technologies that, while interesting technically, had little chance of commercial feasibility, even after years of federal investment. As a result, much of the federal spending has been irrelevant to solving the nation's energy problems.

Critics of the programs argue that DOE should concentrate on basic energy research and reduce the department's involvement in applied technology development. They contend the federal government has a comparative advantage in developing the basic science for a new energy source but has a comparative disadvantage in developing and demonstrating the costly technology. Because of general agreement on the benefits of the basic energy research, the Congress appropriated $2.7 billion for DOE's basic energy science program for 1999, up from $2.5 billion in 1998. That program allows university researchers and scientists at the national laboratories to better understand the materials and other sciences underlying energy use.

Finally, because energy prices are low, potential users of such technology have little incentive to invest in implementing it. Consequently, the technology developed by the program may well sit on the shelf until it becomes obsolete.

Defenders of the programs argue that federal R&D in those areas helps offset several existing failures in energy markets and that the programs therefore represent a sound investment for the nation. Current energy prices, they argue, do not reflect the environmental damage done by excessive reliance on fossil fuels, including the potential for global warming. In addition, current energy prices do not reflect the military and economic risks posed by reliance on Middle East oil. Although the DOE R&D programs cannot correct market failures in the short term, they may moderate the consequences of such failures over the long term.

270-02 ELIMINATE THE DEPARTMENT OF ENERGY'S APPLIED RESEARCH FOR ENERGY CONSERVATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	382	95
2001	477	329
2002	477	439
2003	477	472
2004	477	477
2005	477	477
2006	477	477
2007	477	477
2008	477	477
2009	477	477
Cumulative		
2000-2004	2,290	1,812
2000-2009	4,675	4,197

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-03, 270-04, and 270-08

In 1999, the Department of Energy (DOE) will spend $477 million on programs to develop energy conservation technology. Those efforts include the Partnership for the Next Generation Vehicles (discussed in option 270-08) for automobile research as well as industrial and residential energy-efficiency research on, for example, more efficient lighting. (DOE separately provides grants to state and local agencies for energy conservation. Those grants are discussed in option 270-04.) Phasing out such research and development (R&D) would save $1.8 billion over the next five years.

Opponents of federal spending for energy conservation R&D make several arguments. Generally, they argue that the federal government should stay out of applied energy technology development and concentrate on basic research in the science underlying those areas. Specifically, they note that many projects funded through this research effort are small and discrete enough—and, in many cases, have a clear enough market—to warrant private investment. In such instances, DOE may be crowding out or preempting private-sector firms. In other instances, such programs conduct R&D that the intended recipients are likely to ignore—often because it is too expensive or esoteric to implement.

Critics of the programs also note that other federal policies encourage the introduction of some of the technologies. Utilities, for instance, are encouraged to subsidize consumers' purchases of conservation technologies by underwriting the purchase of efficient home appliances. In addition, the tax code favors investments in conservation technology. Thus, federal government R&D programs may be duplicative given such other avenues of support.

Defenders of the programs argue that federal R&D in the energy conservation area helps offset several existing failures in energy markets. Current energy prices, they argue, do not reflect the environmental damage done by excessive reliance on fossil fuels, including the potential for global warming. In addition, current energy prices do not reflect the military and economic risks posed by reliance on Middle East oil. Although those DOE R&D programs cannot correct market failures in the short term, they can moderate the consequences of the market failures over the long term.

One advantage such programs have had over other DOE R&D efforts in the energy technology area is that many of the individual programs are small. Over the years, many of the best outcomes of the research efforts, such as thin films to make windows more energy efficient, have come from small research investments. Defenders also note that the rapid growth of such research that occurred in the early 1990s has ceased. Appropriations for 1999 are only 5 percent higher than appropriations for 1995.

(Because energy conservation R&D and the Partnership for the New Generation Vehicles overlap, the savings from eliminating both of them would be less than the sum of the two options.)

270-03 ELIMINATE THE DEPARTMENT OF ENERGY'S APPLIED RESEARCH FOR SOLAR AND RENEWABLE ENERGY RESOURCES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	269	202
2001	336	319
2002	336	336
2003	336	336
2004	336	336
2005	336	336
2006	336	336
2007	336	336
2008	336	336
2009	336	336
Cumulative		
2000-2004	1,613	1,529
2000-2009	3,293	3,209

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-02 and REV-34

In 1999, the Department of Energy (DOE) will spend $336 million on research and development (R&D) for solar and other renewable energy sources. The largest technology development efforts by far are those for developing alternative liquid fuels from biomass and electricity from photovoltaic cells. Smaller efforts involve electric energy storage and wind energy systems. Phasing out the research would save $1.5 billion over the 2000-2004 time frame.

Opponents of federal support for such research argue that the federal government should stay out of applied energy technology development and concentrate on basic research in the science underlying those areas. Federally sponsored researchers lack the complex market feedback that helps researchers in private companies realize when their technologies become too esoteric or expensive for the market.

Another criticism shared by the conservation R&D programs (discussed in option 270-02) is that many of the research projects funded by the program are sufficiently small and discrete and have a clearly enough defined market to attract private funding. (Of course, with oil at its currently low price, many of those alternative energies are simply not economical.)

The biggest single solar energy program—photovoltaics—has largely succeeded, and program opponents might argue that it may now be time for an orderly withdrawal of federal support. Several large factories are producing photovoltaic cells, mainly for the export market, or are under construction. After nearly three decades of federal support, the market may well be becoming a purely private concern, and the government may wish to withdraw its support. Foreign firms, critics note, are likely to dominate the market because of their countries' higher domestic energy prices and consequent higher likely demand for alternative energy sources. U.S. consumers may let foreign companies and governments bear the cost of developing the energy sources and then buy the technology when it is cheap and perfected.

For liquid fuels derived from renewable resources (such as biomass), especially, the federal tax code already provides incentives for developing the technology. Ethanol fuels receive special treatment under the federal highway tax (see option REV-34). Furthermore, federal regulations authorized by many different statutes favor alcohol fuels, which now usually mean corn-based fuels. Such fuels could be derived from other biomass sources, however, with the right technology.

Defenders of the programs argue that energy markets are still far from perfect. The energy prices consumers pay fail to incorporate both the environmental and national security risks posed by the nation's dependence on fossil fuels. Furthermore, the United States also plays the role of international R&D laboratory for less developed countries, which often have much higher energy costs. Program defenders also note that funding has been constant since 1995.

270-04 ELIMINATE ENERGY CONSERVATION GRANT PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	121	30
2001	151	104
2002	151	139
2003	151	149
2004	151	151
2005	151	151
2006	151	151
2007	151	151
2008	151	151
2009	151	151
Cumulative		
2000-2004	725	573
2000-2009	1,480	1,328

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-01, 270-02, and 270-03

RELATED CBO PUBLICATIONS:

Should the Federal Government Sell Electricity? (Study), November 1997.

Electric Utilities: Deregulation and Stranded Costs (Paper), October 1998.

Weatherization assistance grants supported by the Department of Energy's (DOE's) Office of State and Community Programs help low-income households reduce their energy bills by funding such activities as installing weather stripping, storm windows, and insulation. Institutional conservation grants supported by the office help reduce the use of energy in educational and health care facilities by adding federal funds to private and local public spending to encourage local investment in building improvements. The Office of State and Community Programs also supports the energy conservation programs of states and municipal governments that, for example, establish energy-efficiency standards for buildings and promote public transportation and carpooling. The DOE programs are independent of a similar block grant activity, the Low Income Home Energy Assistance Program, administered by the Department of Housing and Urban Development.

This option would halt new appropriations for the block grant programs that support energy conservation activities by the states. It would save $1.3 billion in outlays from 2000 through 2009.

Federal grants to promote less energy consumption reflect the widespread concerns about energy-supply security—for all sources, including oil, natural gas, and coal—prevalent in the mid-1970s. Today, those concerns are more correctly focused on imported oil supplies. State grant programs that help reduce residential and institutional demand for natural gas and coal-generated electricity have little benefit for the cause of oil-supply security. And although the government has urged the reduction of energy use for environmental reasons, federal support for reducing the use of gas and coal through conservation grants for security or environmental needs conflicts with other federal policies that promote the production and use of those fuels.

Discontinuing the grant programs could impose hardships on states that wish to continue their energy conservation efforts but are financially stressed. Many states still rely heavily on such grants to help low-income households and public institutions. In addition, the voluntary energy savings those programs effect are an important part of the President's Climate Change Action Plan for reducing greenhouse gas emissions. Such considerations may result in continued federal support for the energy conservation grants.

270-05 ELIMINATE ELECTRIFICATION AND TELEPHONE CREDIT SUBSIDIES PROVIDED BY THE RURAL UTILITIES SERVICE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	43	1
2001	43	8
2002	43	19
2003	43	30
2004	43	37
2005	43	39
2006	43	42
2007	43	42
2008	43	42
2009	43	42
Cumulative		
2000-2004	215	95
2000-2009	430	302

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-06, 270-07, 450-01, and REV-41

RELATED CBO PUBLICATIONS:

Should the Federal Government Sell Electricity? (Study), November 1997.

Electric Utilities: Deregulation and Stranded Costs (Paper), October 1998.

The Rural Utilities Service (RUS) is an agency within the Department of Agriculture that, among other activities, offers financial assistance in subsidized loans and grants to electric and telephone companies serving primarily rural areas. This option addresses only the credit subsidies provided through loans for electrification and telephone service that were previously administered by the Rural Electrification Administration (REA). The former REA programs were combined with other loan and grant programs in 1994 to form the RUS. (Additional potential savings from cutting other RUS programs are described in option 450-01.)

For 1999, RUS subsidies to electric and telephone companies total about $43 million. In addition, the agency spends nearly $30 million per year administering those programs. Eliminating the credit subsidies for loans made or guaranteed by the RUS would reduce outlays by an estimated $302 million between 2000 and 2009.

The savings shown in the table could result from either of two scenarios: discontinue lending and require RUS borrowers to use private sources of capital for all of their loan needs, or continue a federal loan program but eliminate subsidies. A loan program with no subsidy costs would require raising the interest rates on loans to rural electric and telephone companies to the level of the Treasury's cost of borrowing; it would also mean charging small loan origination fees to cover the cost of defaults for certain classes of loans. In addition to savings in subsidy costs, some savings in administrative costs could result if all such lending was discontinued. Some of the nearly $30 million per year in current salaries and expenses would be required to administer existing loans, but those costs could be gradually reduced under a no-new-lending option. Additional administrative savings over the 2000-2009 period could be achieved by eliminating the program, but those additional savings are not counted in this option.

The loan program for rural electrification and telephone service has largely fulfilled its original goal of making those services available in rural communities. Most of the communities that the RUS subsidizes are now much larger than the original service area requirement of no more than 1,500 inhabitants. RUS borrowers serve about 10 percent of U.S. electricity customers and 4 percent of telephone customers. In addition, more than 95 percent of rural America has electric service. Moreover, most RUS borrowers already use some private financing. Because the cost of interest accounts for only a small percentage of the typical customer's bill, eliminating the remaining federal subsidy would have little effect on the utility rates that most borrowers charge their customers.

Proponents of the RUS claim that many borrowers still depend on federal loans to maintain and expand those utilities. Increasing the interest rates or charging origination fees on some loans would raise the rates that such borrowers charged their customers, especially in the rural regions that are most affected. Borrowers argue that they need some level of subsidization to keep their service and utility rates comparable with those in urban areas.

270-06 RESTRUCTURE THE POWER MARKETING ADMINISTRATIONS TO CHARGE HIGHER RATES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	130	130
2002	130	130
2003	130	130
2004	130	130
2005	130	130
2006	130	130
2007	130	130
2008	130	130
2009	130	130
Cumulative		
2000-2004	520	520
2000-2009	1,170	1,170

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

270-05, 270-07, and REV-41

RELATED CBO PUBLICATION:

Should the Federal Government Sell Electricity? (Study), November 1997.

The three smallest power marketing administrations (PMAs) of the Department of Energy sell about 1 percent of the nation's electricity: the Western Area Power Administration, the Southwestern Power Administration, and the Southeastern Power Administration. That power comes largely from hydropower facilities that the Army Corps of Engineers and the Bureau of Reclamation have built and continue to operate. Current law requires that those sales be made at cost—a situation intended to ultimately reimburse taxpayers for a share of the costs of construction, costs of current operations, and interest on the portion of total costs that has not been repaid. Interest charges are generally below the government's cost of borrowing, which, along with the low cost of generating electricity from hydropower, result in power rates for federal customers that are significantly below the rates that other utilities charge. The process results in average revenues that are about 40 percent below what nonfederal utilities receive from their sales to wholesale distributors across the country, according to a General Accounting Office analysis of Energy Information Administration data. Current law also requires that PMAs first offer that power to rural electric cooperatives, municipal utilities, and other publicly owned utilities.

Restructuring would require that those three PMAs sell electricity at market rates to any wholesale buyer. Implementing higher rate charges would bring in about $130 million in 2001 and increase total receipts by about $500 million through 2004 relative to the 1999 level.

The current beneficiaries of the federal power program argue that restructuring could greatly increase the electric utility rates for the many small and rural communities served by PMAs. They also argue that continuing low-cost federal power is necessary to counter the uncompetitive practices of investor-owned utilities and to support the economies of certain regions of the country.

The rationale for federal power subsidies is not as strong as it once was. The market power of private utilities is checked by federal and state regulation of the power supply, by federal antitrust laws, and, increasingly, by competition from independent power sources. In addition, the disparity of incomes in different regions of the country has diminished. In many cases, neighboring communities—some receiving federal power and some not—have no discernible differences. Except for households in the Northwest, federal sales of power reduce electric bills only slightly; therefore, the impact of increased federal rates on average costs is small. In addition, the prospect of significant future costs of producing electricity from hydropower further supports the case for increasing power rates now. Such costs are for long-deferred maintenance and upgrades and for addressing the environmental needs of threatened species. The opportunity to earn additional revenues from federal power sales may be short lived: new power sources are becoming increasingly competitive with federal power.

270-07 SELL THE SOUTHEASTERN POWER ADMINISTRATION AND RELATED POWER GENERATION EQUIPMENT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	1,600	1,600
2003	-161	-161
2004	-164	-164
2005	-168	-168
2006	-171	-171
2007	-175	-175
2008	-178	-178
2009	-182	-182
Cumulative		
2000-2004	1,275	1,275
2000-2009	401	401

SPENDING CATEGORY:

Mandatory (excludes discretionary savings for operations)

RELATED OPTIONS:

270-05, 270-06, and REV-41

RELATED CBO PUBLICATIONS:

Should the Federal Government Sell Electricity? (Study), November 1997.

Electric Utilities: Deregulation and Stranded Costs (Paper), October 1998.

The Southeastern Power Administration (SEPA) of the Department of Energy sells electricity that comes from hydropower facilities that the Army Corps of Engineers has constructed and operates. SEPA pays private transmission companies to deliver that power to over 300 wholesale customers: rural cooperatives, municipal utilities, and other publicly owned utilities. In 1997, SEPA sales met about 1 percent of the total power needs in the 11 states where it operates. Its biggest customer, the Tennessee Valley Authority (TVA), purchased 37 percent of SEPA power that year. Power rates are designed to recover for taxpayers a share of the costs of construction, costs of current operations, and a nominal interest charge on the portion of total costs that have not yet been recovered. The average revenues from SEPA power (for sales other than to the TVA) are about 2.7 cents per kilowatt-hour (kWh), compared with average revenues in the region of 4.7 cents per kWh.

Selling assets that directly support the production of electricity would save about $1.3 billion over the 2000-2004 period. That estimate reflects sale proceeds of about $1.6 billion minus a loss of budgetary receipts for that period of about $170 million annually. Those figures do not include discretionary budgetary savings of about $75 million annually from ending appropriations to SEPA and the Corps for operations. The estimate of sale proceeds is based on recent sales of hydroelectric assets in the United States. Corps assets to be transferred would include equipment, such as turbines and generators, but not the dams, reservoirs, or waterside property. The sale would also include rights of access to that equipment and to the water flows necessary for power generation, subject to the constraints of competing uses of water.

The original reasons for establishing SEPA—marketing low-cost power to promote competition and fostering economic development—are no longer compelling to many because of the small amount of power SEPA sells and because of competitive and regulatory constraints on power rates. The Congress has considered legislation to sell SEPA, and the President has included its sale in past budget proposals. The details involved in such a sale may be somewhat tricky, however. Many Corps facilities serve multiple purposes, for example, managing water resources for navigation, flood control, or recreation as well as for power generation. Proponents of maintaining federal ownership believe that nonfederal entities lack the proper incentives to perform all those functions. They also argue that increased power rates could accompany selling SEPA.

But selling federal facilities does not mean transferring all water resource functions. The Corps could retain direct responsibility for managing water flows for all uses, including the upkeep of basic physical structures and surrounding properties. Or, as with other nonfederal dams, the terms of the federal license to operate the facility (issued by the Federal Energy Regulatory Commission) could dictate the management of water flows for competing purposes. The General Accounting Office has estimated that the impact of the sale on the power bills of consumers would be negligible.

270-08 ELIMINATE FEDERAL FUNDING FOR THE PARTNERSHIP FOR NEW GENERATION VEHICLES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	191	54
2001	240	161
2002	240	214
2003	240	232
2004	240	235
2005	240	235
2006	240	236
2007	240	236
2008	240	236
2009	240	236
Cumulative		
2000-2004	1,151	896
2000-2009	2,351	2,075

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

270-02

The Partnership for New Generation Vehicles (PNGV) is a joint federal/private research effort that performs cooperative, precompetitive automotive research, mainly focusing on energy-efficient vehicles. The partnership draws on the resources of five federal agencies, most notably the Department of Energy (DOE). Within DOE, the partnership primarily falls under energy conservation, where it received $129 million for 1999. Total federal funding is $240 million. Eliminating the program would save $896 million over the 2000-2004 time frame. (Because the PGNV and the energy conservation programs—option 270-02—are related, the savings from eliminating both of them would be less than the sum of the two options.)

Critics of the program argue that the federal government benefits little from conducting such applied research. Accordingly, society would be better served, they argue, if the federal government focused on basic research and did not try to develop technologies intended to be commercialized in the next few years. Critics also point out that the partnership has not succeeded in its stated goal of using federal dollars to attract more research funds to the area. The intent of the joint federal/private partnership was to leverage federal dollars into increasing such research. A recent National Academy of Sciences evaluation of the program "found no evidence that the PNGV program has stimulated an increase in resources for the development of these alternative systems and devices for automotive applications . . ." except for some work in the area of fuel cells. U.S. automakers—all industrial giants—have adequate access to capital; they could easily fund research into new generation vehicles, if they so desired. Their annual advertising budgets are 15 times the size of the program.

Finally, opponents of the program note that both Honda and Toyota have announced their intention to sell a next generation vehicle in the United States beginning this year or next. (The Toyota vehicle is already sold in Japan.) Both vehicles are powered by hybrid power systems, including both a gasoline engine and an electric motor. The companies claim that the vehicles will deliver fuel efficiency in excess of 65 miles per gallon and that emissions will be substantially reduced.

If those models succeed in the U.S. market, U.S. automakers will have every incentive to rapidly develop such cars, even without federal funding. If the hybrid cars do not succeed in the U.S. marketplace, additional federal dollars would not necessarily succeed in revoking the judgment of the market.

Supporters of the program argue that continuing imperfections in energy markets and environmental considerations make the development of the technology a public policy matter. Moreover, the National Academy of Sciences report, even after noting that the partnership may not have stimulated the development of higher-risk PNGV technologies, calls for expanded federal support for developing long-term PNGV technologies.

270-09 SELL OIL FROM THE STRATEGIC PETROLEUM RESERVE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	143	143
2001	175	175
2002	180	180
2003	185	185
2004	190	190
2005	33	33
2006	0	0
2007	0	0
2008	0	0
2009	0	0
Cumulative		
2000-2004	873	873
2000-2009	906	906

SPENDING CATEGORY:

Mandatory

RELATED CBO PUBLICATION:

Rethinking Emergency Energy Policy (Study), December 1994.

The Strategic Petroleum Reserve (SPR) is a government-owned stock of crude oil that was first authorized in 1975 to help safeguard the nation against the threat of a severe disruption of oil supplies. The SPR consists of four underground sites along the Gulf of Mexico that together have the capacity to store 680 million barrels of oil. The SPR currently holds about 560 million barrels of oil. The Department of Energy (DOE) can sustain a maximum drawdown of about 4 million barrels per day (20 percent of the nation's current petroleum use) for 90 days. The department has released oil from the SPR in emergency circumstances only once—17 million barrels during the Persian Gulf War. The government's net investment in the SPR is about $16 billion for oil and about $4 billion for storage and transportation facilities. The current value of that oil is about $7 billion.

This option would require DOE to reduce the size and excess capacity of the SPR by closing the smallest storage site, Bayou Choctaw, and selling the site's 68 million barrels of oil over a five-year period. It would place at least 10 million but no more than 20 million barrels on the market each year to minimize the impact of reducing the SPR on world oil prices. The Congressional Budget Office estimates that receipts from the oil sales would total $873 million over the 2000-2004 period and appropriations for operating the reserve could be reduced after the site is decommissioned toward the end of the decade. The option conforms with past Congressional actions: in 1996 and 1997, the Congress directed DOE to sell SPR oil to offset spending on the SPR and other programs and has authorized DOE to reduce its excess capacity by leasing it to foreign governments or private entities. Thus far, however, efforts to lease excess capacity have not succeeded.

The argument for reducing the SPR is supported by changes in program benefits and costs since 1975. Structural changes in energy markets and the economy at large have reduced the potential cost of disrupting oil supplies and consequently the benefits from releasing oil in a crisis. The increasing diversity of world oil supplies and the growing integration of the economies of oil-producing and oil-consuming nations lessen the risk of such disruptions. Moreover, the experience of DOE in its Persian Gulf War sale and in recent sales indicates that the process of deciding to release oil and the sales mechanism can contribute to market uncertainty, further diminishing the benefits of release. The rising costs of maintaining the SPR also strengthen the case for reducing it: many of the SPR's facilities are aging and have required unanticipated spending for repairs to maintain drawdown capabilities.

Arguments against closing the site and selling the oil stress logistical and pricing concerns. Closing Bayou Choctaw could reduce DOE's flexibility in distributing oil if a drawdown occurred, especially in the Mississippi Valley region. With oil prices currently at 12-year lows, selling the oil now would significantly lessen its value relative to its average acquisition cost of about $27 per barrel. Another argument against this option concerns the effect of selling SPR oil on domestic oil producers, which prompted the Congress to repeal legislation in 1998 requiring oil to be sold.

270-10 ELIMINATE THE ANALYSIS FUNCTION OF THE ENERGY INFORMATION ADMINISTRATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	16	10
2001	16	16
2002	16	16
2003	16	16
2004	16	16
2005	16	16
2006	16	16
2007	16	16
2008	16	16
2009	16	16
Cumulative		
2000-2004	80	74
2000-2009	160	154

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

350-01

The Energy Information Administration (EIA), created by the Congress in 1977, is a statistical agency of the Department of Energy. EIA's mission is to develop data and analyses on energy resources and reserves, production, demand, and technologies as well as related financial and statistical information on the adequacy of energy resources necessary to meet U.S. energy demand. Eliminating the analysis function would save $16 million in 2000 and reduce outlays by $154 million through 2009 relative to the 1999 funding level.

The Congress created EIA when many people thought that the United States would deplete its reserve of fossil fuels. Because that concern has been alleviated, some argue that eliminating EIA's analysis function is appropriate. Furthermore, some critics of EIA assert that independent analysis is already done by academicians, the Department of Energy's Policy Office, the Congressional Research Service, and the General Accounting Office. In addition, some critics note that industry's willingness to fund specific research activities through trade associations, such as the American Petroleum Institute and the Edison Electric Institute, suggests that EIA is providing a service that the private sector would perform on its own.

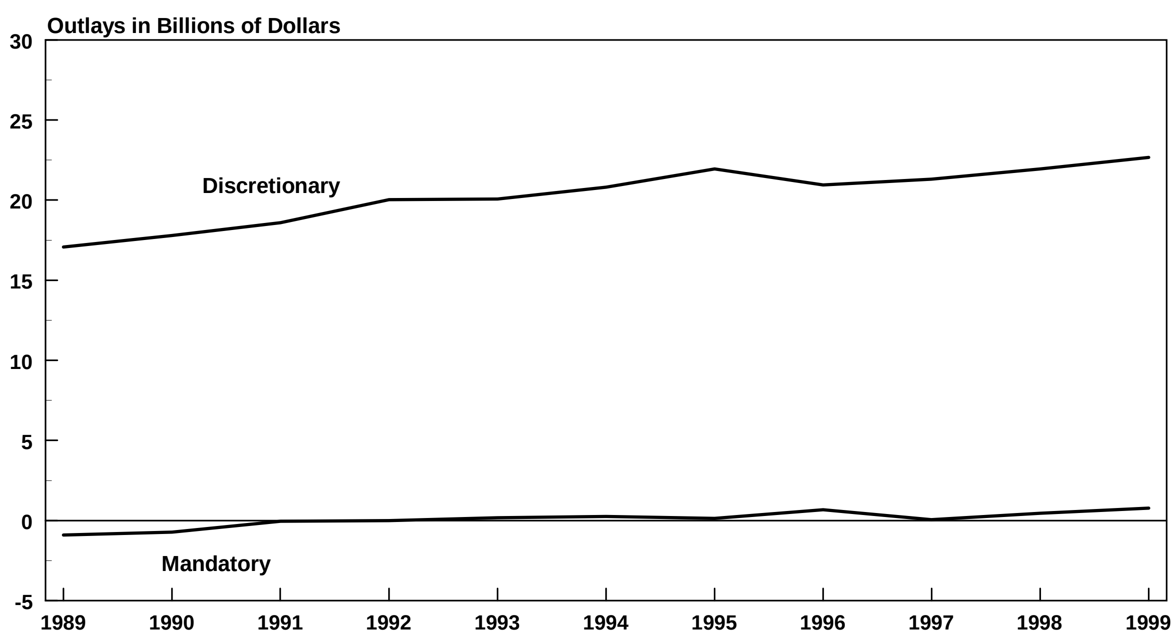
EIA supporters claim that information collection, analysis, and dissemination should be done by an independent party. They claim that access to information is important to a competitive market. Although concerns about energy supplies have been alleviated, the Congress is now addressing such issues as global warming. Without independent analysis, the Congress would have to choose between analysis done by environmental groups and analysis done by industry sources.

Additional savings could be obtained by eliminating some of EIA's data collection or moving EIA's data collection responsibilities to other agencies such as the Federal Energy Regulatory Commision. Much of the information collected and distributed by the EIA is available through newspapers and trade sources. Natural gas and electricity futures prices are traded on the New York Mercantile Exchange, among others, and published daily in the *Wall Street Journal*. Although EIA conducts its own statistical surveys, it also develops reports based on information collected by the Federal Energy Regulatory Commission.

300

Natural Resources and Environment

Budget function 300 supports programs administered by the Army Corps of Engineers, the Department of Agriculture, the Department of the Interior, the Environmental Protection Agency, and the Department of Commerce's National Oceanic and Atmospheric Administration. Those programs involve water resources, conservation, land management, pollution control, and natural resources. CBO estimates that discretionary outlays for function 300 will total almost $23 billion in 1999; discretionary budget authority provided for this year totals $23.5 billion. Over the past 10 years, spending under this function has stayed constant at about 1.4 percent of federal outlays.



300-01 INCREASE NET RECEIPTS FROM NATIONAL TIMBER SALES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	30	20
2001	45	40
2002	60	55
2003	75	70
2004	100	90
2005	120	110
2006	120	120
2007	125	125
2008	130	130
2009	135	130
Cumulative		
2000-2004	310	275
2000-2009	940	890

SPENDING CATEGORY:

The net of reduced discretionary outlays and forgone mandatory receipts.

RELATED OPTION:

300-07

The Forest Service (FS) manages federal timber sales from 119 national forests. In fiscal year 1997, the FS sold roughly 3.7 billion board feet of public timber. Purchasers may harvest the timber over several years and pay the FS upon harvest. The total fiscal year 1997 harvest, approximately 3.3 billion board feet, represented a continuing decline in volume from previous years. According to *Timber Sales Program Annual Reports* published by the FS, in fiscal years 1996 and 1997, the FS spent more on the timber program than it collected from companies harvesting the timber. In 1997, the timber expenses reported by the FS exceeded timber receipts by about $90 million. The annual reports exclude receipt-sharing payments to states from the calculation of timber expenses. When such payments are included, timber expenses exceeded receipts by more than $160 million (or almost 30 percent) in fiscal year 1997.

The FS does not maintain the data needed to estimate annual timber receipts and the expenditures associated with each individual timber sale. Therefore, it is hard to determine precisely the possible budgetary savings from phasing out all timber sales in the National Forest System for which expenditures are likely to exceed receipts. To illustrate the potential savings, however, this option estimates the reduction in net outlays in the federal budget from eliminating all future timber sales in five National Forest System regions for which imbalances between cash receipts and expenditures were prominent in fiscal years 1996 and 1997.

In those five regions (the Northern, Rocky Mountain, Southwestern, Intermountain, and Alaska regions), cash expenditures exceeded cash receipts by at least 30 percent in 1996 and 1997. Eliminating all future timber sales from those regions would reduce the FS's discretionary outlays for the 2000-2009 period by about $1,495 million; timber receipts (which are categorized as mandatory) would fall by about $600 million after subtracting payments to states, producing net savings of $890 million. (Hence, the savings estimates are the net effect of changes in both discretionary and mandatory budgets.)

Timber sales for which spending exceeds receipts have several potential drawbacks. They may lead to reductions in the federal surplus, excessive depletion of federal timber resources, and destruction of roadless forests that have recreational value.

Potential advantages of the sales include community stability in areas dependent on federal timber for logging and other related jobs. Timber sales also improve access to the land—as a result of road construction—for fire protection and recreation.

300-02 IMPOSE A FIVE-YEAR MORATORIUM ON LAND PURCHASES BY THE DEPARTMENTS OF AGRICULTURE AND THE INTERIOR

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	319	109
2001	319	224
2002	319	296
2003	319	319
2004	319	319
2005	319	319
2006	319	319
2007	319	319
2008	319	319
2009	319	319
Cumulative		
2000-2004	1,595	1,267
2000-2009	3,190	2,862

SPENDING CATEGORY:

Discretionary

For 1999, the Departments of Agriculture and the Interior have received appropriations of about $329 million to buy land that is generally used to create or expand designated recreation and conservation areas, including national parks, national forests, wilderness areas, and national wildlife refuges. This option proposes placing a 10-year moratorium on future appropriations for land acquisition by those departments. It would provide for a small annual appropriation ($10 million) to cover emergency acquisition of important tracts that became available on short notice, compensation to "inholders" (landholders whose property lies wholly within the boundaries of an area set aside for public purposes, such as a national park), and ongoing administrative expenses.

Proponents of this option argue that land management agencies should improve their stewardship of the lands they already own before taking on additional management responsibilities. In many instances, the National Park Service, the Forest Service, and the Bureau of Land Management find it difficult to maintain and finance operations on their existing landholdings. Furthermore, given the limited operating funds of those agencies, environmental objectives such as habitat protection and access to recreation might be best met by improving management in currently held areas rather than providing minimal management over a larger domain. Supporters of this option also argue that the federal government already owns enough land. Currently, about 650 million acres—approximately 30 percent of the United States' land mass—belong to the government, according to the General Services Administration. The sentiment that that amount is sufficient is particularly strong in the West, where the government owns about 62 percent of the land area in 11 states.

Opponents of this option argue that future land purchases are necessary to achieve ecosystem management objectives and fulfill existing obligations for national parks. Much of the land targeted by the Congress for new and expanded federal reserves is privately held, and acquiring it will require purchases. Furthermore, encroaching urban development and related activities outside the boundaries of national parks and other federal landholdings may be damaging the federal resources. Land acquisition is an important tool for mitigating that problem. Acquisitions that consolidate landholdings may also help improve the efficiency of public land management.

300-03 ELIMINATE FEDERAL GRANTS FOR WATER INFRASTRUCTURE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	2,527	127
2001	2,527	505
2002	2,527	1,263
2003	2,527	2,022
2004	2,527	2,401
2005	2,527	2,401
2006	2,527	2,401
2007	2,527	2,401
2008	2,527	2,401
2009	2,527	2,401
Cumulative		
2000-2004	12,635	6,318
2000-2009	25,270	18,323

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

450-01

RELATED CBO PUBLICATION:

The Economic Effects of Federal Spending on Infrastructure and Other Investments (Paper), June 1998.

The Clean Water Act (CWA) and the Safe Drinking Water Act (SDWA) require municipal wastewater and drinking water systems to meet certain performance standards to protect the quality of the nation's waters and the safety of its drinking water supply. The CWA provides financial assistance so communities can construct wastewater treatment plants that comply with the act's provisions. The 1996 amendments to the SDWA authorized a state revolving loan program for drinking water infrastructure. For 1999, the Congress appropriated about $2.5 billion for water infrastructure programs, including funds for wastewater programs and the new program for drinking water facilities. Ending all funding of new water infrastructure projects after 1999 would save $18.3 billion through 2009 measured against the 1999 funding level.

Title II of CWA provides for grants to states and municipalities for constructing wastewater treatment facilities. As amended in 1987, the CWA phased out title II grants and authorized a new grant program under title VI to support state revolving funds (SRFs) for water pollution control. Under the new system, states continue to receive federal grants, but now they are responsible for developing and operating their own programs. For each dollar of title VI grant money a state receives, it must contribute 20 cents to its SRF. States use the combined funds to make low-interest loans to communities for building or upgrading municipal wastewater treatment facilities. Although authorization for the SRF program under CWA has expired, the Congress continues to provide annual grant appropriations.

As amended in 1996, the SDWA authorizes the Environmental Protection Agency to make grants to states for capitalizing revolving loan funds for treating drinking water. As with CWA's wastewater SRF program, states may use those funds to make low-cost financing available to public water systems for constructing facilities to treat drinking water. In 1999, the Congress appropriated $775 million for capitalization grants for drinking water SRFs.

Proponents of eliminating federal grants to water-related SRFs say such grants may encourage inefficient decisions about water treatment by allowing states to loan money at below-market interest rates. Below-market loan rates could reduce incentives for local governments to find less costly alternatives for controlling water pollution and treating drinking water. In addition, federal contributions to wastewater SRFs were intended to help move toward full state and local financing of the funds by 1995. Thus, proponents of ending federal grants to those SRFs argue that the program was intended to be temporary and may have replaced, rather than supplemented, state and local spending.

Opponents of such cuts argue that states and localities could have trouble meeting the federal treatment deadlines without continued federal support—both because repayments to the SRFs would be too small to fund new projects and because states would be unable to handle the additional cost of offsetting decreased federal contributions.

Opponents of the cuts also have concerns about helping small and economically disadvantaged communities that have had the most difficulty complying with CWA and SDWA requirements. Some people who oppose eliminating the federal grants maintain that doing so would increase the burden of unfunded federal mandates on state and local governments.

300-04 SPEND THE REMAINING BALANCE OF THE SUPERFUND TRUST FUND AND TERMINATE THE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	1,500	375
2002	1,500	900
2003	1,500	1,200
2004	1,500	1,350
2005	1,500	1,425
2006	1,500	1,425
2007	1,500	1,425
2008	1,500	1,425
2009	1,500	1,425
Cumulative		
2000-2004	6,000	3,825
2000-2009	13,500	10,950

SPENDING CATEGORY:

Discretionary

Since 1981, the Superfund program of the Environmental Protection Agency (EPA) has been charged with cleaning up the nation's worst hazardous waste sites, particularly those on the National Priorities List (NPL). The program made progress in the 1990s, especially in increasing the number of sites in the final phase of the cleanup process, but more work remains. As of the end of fiscal year 1998, EPA had identified 585 of 1,361 current and former NPL sites as "construction complete," meaning that all physical construction work required for the cleanup effort (capping a landfill, installing a groundwater treatment system, and the like) was done. Conversely, remedy construction had begun but had not been completed at 457 current NPL sites and had not yet started at 319 sites. In addition, EPA has proposed that another 66 sites be added to the list, and hundreds more sites with NPL-caliber problems probably remain to be identified.

Although the Congress could choose to end the program at any time, one notable occasion to do so might be the forthcoming depletion of the Hazardous Substance Superfund, the trust fund that has been the main source of the program's appropriations. The trust fund balance has declined since Superfund's "environmental income tax" on corporations and excise taxes on oil, petroleum products, and certain chemicals expired in 1995. The trust fund is projected to end fiscal year 1999 with an unappropriated balance of roughly $1.5 billion, more than enough for fiscal year 2000 given current levels of spending and appropriations from the general fund. If the end of 2000 is too close at hand to allow a safe and orderly program shutdown, the Congress could reduce annual spending to stretch the same total funding for additional months or years.

The argument for spending the trust fund balance and terminating the program proposes that Superfund efforts are not worthwhile, at least not at the federal level. Superfund's critics argue that the program's cost is disproportionate to the threat represented by hazardous waste sites and that its system of retroactive, joint-and-several liability is irremediably inefficient and unfair. They also argue that waste sites are local problems that are more appropriately handled by the states, almost all of which have their own hazardous waste cleanup programs for sites not addressed under federal law. In addition, although depleting the trust fund has no budgetary significance, it provides a near-term opportunity to shut the program down—unlike, for example, merely closing the NPL to new sites, which would require maintaining some federal program for most or all of the next decade.

Superfund's defenders point to evidence linking Superfund sites to human health problems, including birth defects, leukemia, cardiovascular abnormalities, respiratory illnesses, and immune disorders, and note that the public places a high priority on waste cleanup. They argue further that Superfund has reduced costs and completed more cleanups in recent years and that modest legislative reforms can improve the program. Finally, they note that states vary widely in their capacity to handle NPL-caliber problems.

300-05 CHARGE MARKET RATES FOR INFORMATION PROVIDED BY THE NATIONAL WEATHER SERVICE

	Added Receipts (Millions of dollars)
Annual	
2000	2
2001	2
2002	2
2003	2
2004	2
2005	2
2006	2
2007	2
2008	2
2009	2
Cumulative	
2000-2004	10
2000-2009	20

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

300-06

The National Weather Service (NWS) provides weather and flood warnings, public forecasts, and severe-weather advisories to protect lives and reduce property damage from those hazards. The annual budget for such services, including operating weather satellites, is about $1 billion.

Currently, the NWS allows open access to all of its weather data and information services. Access to that information has contributed substantially to the growth of the weather service information industry, which transforms NWS data and general forecasts for large areas into marketable specific forecasts. Estimates suggest that the private weather information industry has revenues ranging from $300 million to $400 million a year. Commercial users—such as the Weather Channel and Accu-Weather—pay fees only for the costs of computer hookups and transmission of NWS data. Such fees are a small fraction of the fair market value of those services. Moreover, the NWS charges nothing for information received from its satellite broadcasts or Internet site.

Charging fees that are based on the fair market value of access to that information, except for severe-weather warnings, could raise $2 million in 2000, $10 million over five years, and $20 million over 10 years. Charging market value for general weather information would lessen its dissemination but encourage the production and presentation of more useful information than is now available. Supporters of this option contend that charging market-based fees would not substantially reduce the public's access to weather reports. For example, as long as the news media will pay for private forecasts, the market will demand NWS products. In addition, because the fees would not apply to severe-weather warnings, the safety of the general public would not be compromised. Many European nations routinely charge users for weather information provided by their satellites. For example, the British Meteorological Office raises over $30 million a year from commercial customers.

In the past, the NWS viewed charging fair market fees as a significant barrier to the public's access to its information. The Omnibus Budget Reconciliation Act of 1990 attempted to set fees based on the fair market value of NWS data and information, except for information related to warnings and watches, information provided under international agreements, and data for nonprofit institutions. However, the NWS received approval from the Office of Management and Budget to reset the user fee to recover only the cost of disseminating the information.

300-06 ELIMINATE THE NOAA WEATHER RADIO NETWORK

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	12	8
2001	12	11
2002	12	11
2003	12	12
2004	12	12
2005	12	12
2006	12	12
2007	12	12
2008	12	12
2009	12	12
Cumulative		
2000-2004	60	54
2000-2009	120	114

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

300-05

The National Weather Service (NWS) uses the National Oceanic and Atmospheric Administration's (NOAA's) Weather Radio Network to sound the alarm when it broadcasts emergency messages. The Weather Radio Network broadcasts official warnings and hazard information, as well as local forecasts, 24 hours a day using a national network of over 480 transmitters. Weather radios, which cost from $25 to $100, have a special signal receptor and automatically turn on when the NWS issues a warning. The radio signals also alert weather spotters, who provide supplemental information that enables forecasters to issue more accurate and more timely warnings and advisories to the public regarding hazardous weather.

A 1983 Booz-Allen & Hamilton study recommended eliminating the Weather Radio Network, which would lower discretionary outlays by $8 million in 2000, $54 million over the 2000-2004 period, and $114 million over 10 years. The study argued that the private media were widely disseminating weather forecasts and NWS products and that less than 5 percent of the population relied on the network as their main source of information. Because transmitters' signals extend only a distance of 40 miles, many rural areas do not receive broadcasts of NWS weather and flood warnings. Moreover, because most of the advance tornado warnings issued are false alarms, many owners of weather radios have disengaged the warning beeps.

Eliminating the Weather Radio Network, however, could lead to more deaths from severe weather. The Administration believes that the NOAA network performs an essential public safety role that cannot be easily assumed by commercial radio and wants to make the weather radios as common in the home as smoke detectors. The President's 1997 budget proposed replacing and modernizing the NOAA Weather Radio Network transmitters to strengthen the system after a tornado killed 20 people in a rural Alabama church despite a 12-minute warning issued by the Birmingham weather office. The NWS is increasing coverage to 95 percent of the population from the current 70 percent to 80 percent and now issues warnings for about 60 percent of tornadoes, a sharp increase in the last 10 years. In fact, warnings issued in 1998 with as much as a 15-minute lead time saved lives in three states.

300-07 CHANGE THE REVENUE-SHARING FORMULA FROM A GROSS-RECEIPT TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	185	185
2001	185	185
2002	185	185
2003	185	185
2004	190	190
2005	190	190
2006	190	190
2007	195	195
2008	195	195
2009	200	200
Cumulative		
2000-2004	930	930
2000-2009	1,900	1,900

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

300-01 and 300-09

The federal government owns about 650 million acres of public lands—nearly one-third of the United States' land mass. Those lands contain a rich supply of natural resources: timber, coal, forage for livestock, oil and natural gas, and many nonfuel minerals. Private interests have access to much of the federal land to develop its resources and generally pay fees to the federal government depending on the commercial returns realized. In many cases, the federal government allots a percentage of those receipts to the states and counties containing the resources, as compensation for tax revenues they did not receive from the federal lands within their boundaries. The federal government typically calculates those allotments on a gross-receipt basis before accounting for its program costs. The practice sometimes causes the federal government's costs to exceed its share of receipts. Shifting payments to a net basis would reduce federal outlays.

In most cases, the Forest Service is required to allot 25 percent of its gross receipts from commercial activities in the national forests to the respective states and counties. The Department of the Interior allots 4 percent of its timber receipts, an average of 18 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the department's Minerals Management Service (MMS) allots 50 percent of its adjusted onshore oil, gas, and other mineral receipts to the states. The MMS deducts 50 percent of its administrative costs from the gross-receipt calculation before distributing those payments. In effect, the states share 25 percent of the burden of those administrative costs. On certain federal lands—specifically, national forests affected by protection of the spotted owl and the Oregon and California grant lands—payments to states and counties are guaranteed on the basis of an average of past payments. (Such guaranteed payments expire after 2003. This option assumes that administrative costs would be deducted from the guaranteed payments on the basis of past receipts and from other state payments on the basis of current receipts.)

Federal savings would be substantial if the Congress required those agencies to deduct their full program costs from gross receipts before paying the states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and accrue receipt shares totaling about $645 million in 2000. The projected savings do not include potential federal cost increases under the Payment in Lieu of Taxes (PILT) program, which was established to offset the effects of nontaxable federal lands on local governments' budgets. Payments in lieu of taxes are partially reduced by the amount of revenue-sharing payments from federal agencies. Payments under the PILT program would increase by about $30 million a year beginning in fiscal year 2000 if net program receipts were shared and the Congress appropriated such an increase.

Changing the revenue-sharing formula to a net-receipt basis would probably cause economic hardship to the respective states and counties, greatly reducing their revenue. That might lead to severe cuts in state and county spending. To help alleviate that hardship, the formula could switch gradually to the net-receipt basis over several years.

300-08 CHARGE ROYALTIES AND HOLDING FEES FOR HARDROCK MINING ON FEDERAL LANDS

	Added Receipts (Millions of dollars)
Annual	
2000	36
2001	44
2002	41
2003	41
2004	41
2005	41
2006	41
2007	41
2008	41
2009	41
Cumulative	
2000-2004	203
2000-2009	408

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTIONS:

300-01, 300-07, 300-09, and 300-12

RELATED CBO PUBLICATIONS:

Review of the American Mining Congress Study of Changes to the Mining Law of 1872 (Memorandum), April 1992.

Alternative Proposals for Royalties on Hardrock Minerals (Testimony), May 1993.

The General Mining Law of 1872 governs access to hardrock minerals—including gold, silver, copper, and uranium—on public lands. Any holder of more than 10 mining claims on public lands must pay an annual holding fee of $100 per claim, and all claimholders must pay a $25 location fee when recording a claim. But unlike producers of fossil fuels and other minerals from public lands, miners do not pay royalties to the government on the value of the hardrock minerals. In addition, authorization to collect the holding and location fees expires in 2000. Estimates place the current gross value of hardrock minerals production at about $650 million annually (excluding claims with so-called first-half patents). That sum has diminished greatly in recent years because of patenting activity. (In patenting, miners gain title to public lands by paying a one-time fee of $2.50 or $5.00 an acre.) The Congress has debated reforming the General Mining Law for the past several years. Legislation calling for royalties was introduced in the 105th Congress and passed (but not enacted) in the 104th Congress (H.R. 2491) and the 103rd Congress (H.R. 322). The royalty rate and the basis for royalties varied in that legislation.

This option considers an 8 percent royalty that the Congress could impose on the production of hardrock minerals from public lands. The royalty would be on net proceeds as defined in H.R. 2491 (that is, sales revenues minus costs that include mining, separation, transportation, and other items). The option would also reauthorize the current holding fee and location fee and assumes such fees would be recorded as offsetting receipts to the Treasury. (They currently are counted as offsetting collections to appropriations.) Total budgetary savings from those actions would be $408 million over the 2000-2009 period. Of that total, royalty collections account for about $78 million, and reauthorization of holding and location fees, about $330 million. Those estimates assume that states in which the mining takes place receive 25 percent of the gross royalty receipts. They also assume that no further patenting of public lands takes place. (In comparison, royalties based on gross proceeds would raise more. In general, the costs of administering any net proceeds royalty would exceed those for a gross proceeds royalty.)

People in favor of reforming mining law—including many in the environmental community—argue that low holding fees and zero royalties make it less costly to produce on federal lands than on private lands (where payment of royalties is the rule). That policy encourages overdevelopment of public lands, which may cause severe environmental damage. Reforming the law could promote other uses of those lands, such as recreation and wilderness conservation.

Opponents of reform argue that without free access to public resources, exploration for hardrock minerals in this country—especially by small miners—would decline. They also argue that royalties would diminish the profitability of many mines, leading to scaled-back operations or closure and adverse economic consequences for mining communities in the West. Because many mineral prices are set in world markets, miners would be unable to pass along new royalty costs to consumers.

300-09 RAISE GRAZING FEES ON PUBLIC LANDS

	Added Receipts (Millions of dollars)
Annual	
2000	2
2001	4
2002	6
2003	8
2004	10
2005	11
2006	13
2007	14
2008	15
2009	16
Cumulative	
2000-2004	30
2000-2009	100

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTION:

300-07 and 300-08

The federal government owns and manages about 650 million acres of U.S. land. The land has many purposes, including grazing of privately owned livestock. Cattle owners compensate the government for using the land by paying grazing fees; the fees, however, may not give the public a fair return.

The Forest Service and the Bureau of Land Management (BLM) administer livestock grazing on public rangelands in the West. In 1997, ranchers were authorized to use about 17 million animal unit months (AUMs)—a standard measure of forage—for grazing on those lands. In 1990, the appraised value of public rangeland in six Western states varied between $5 and $10 per AUM. A 1993 study indicated that the Forest Service and BLM spent $4.60 per AUM in that year to manage their rangelands for grazing. The 1993 permit fee, however, was $1.86 per AUM. Thus, the current fee structure may subsidize ranchers. (The 1999 fee is $1.35 per AUM under the current fee formula.)

The Public Rangelands Improvement Act of 1978 established the current formula for grazing fees. It uses a 1966 base value of $1.23 per AUM and makes adjustments to account for changes in beef cattle markets and production input markets. The Congress has considered various proposals to increase grazing fees. The increase in federal receipts resulting from any such proposal depends on the degree to which ranchers reduce their use of AUMs in response to higher fees. One proposal is to allocate grazing rights through a bidding process as long as competition is not too limited. Another option is to follow the states' lead. The federal government would determine grazing fees for federal lands in each state the same way the particular state determines grazing fees on state-owned lands. The government would implement this proposal over 10 years as existing permits expired. The savings estimate is net of additional payments to states of about $28 million. It does not include any additional appropriations for range improvements that could result from added receipts.

Proponents of this option believe that low fees that subsidize ranching contribute to overgrazing and deteriorated range conditions. They support the approach of following decisions made at the state level and reject the one-size-fits-all nature of the current federal fee. State grazing fees and the means of calculating them vary widely by state and sometimes even within a state. Supporters of this approach also point out that states' interest in the revenue received from both state and federal fees lessens any incentive to manipulate state fees to lower federal fees.

Opponents of this approach note that state rangelands may be more valuable than federal lands for grazing purposes. Some systems used by states to establish fees may not reflect those differences in land quality and conditions of use when applied to federal lands. For example, that concern does not exist in states using auction or appraisal systems for fee setting. People in states using fee formulas, however, have that concern. Opponents also point out that the administrative costs of using different procedures to establish federal grazing fees in each state will be higher than those incurred under the current uniform federal fee structure. (This option does not consider possible differences in administrative costs.)

300-10 RECOVER COSTS ASSOCIATED WITH ADMINISTERING THE U.S. ARMY CORPS OF ENGINEERS PERMITTING PROGRAMS

	Added Receipts (Millions of dollars)
Annual	
2000	7
2001	14
2002	14
2003	14
2004	14
2005	14
2006	14
2007	14
2008	14
2009	14
Cumulative	
2000-2004	63
2000-2009	133

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTION:

300-13

RELATED CBO PUBLICATION:

Regulatory Takings and Proposals for Change (Study), December 1998.

The Department of Army, through the U.S. Army Corps of Engineers, administers laws pertaining to the regulation of U.S. navigable waters, including wetlands. Section 404 of the Clean Water Act (CWA) requires that any private, commercial, or government actor desiring to dredge or place fill material in U.S. waters or wetlands must obtain a permit from the Corps. By increasing permit fees, the Corps could recover a portion of its annual regulatory costs. Imposing one type of fee structure for section 404 permitting—a cost-of-service fee on commercial applicants—would generate $7 million in 2000 and $14 million in 2001 and each of the following years.

From rather inauspicious beginnings, section 404 of CWA has grown to become the core of the nation's effort to protect wetlands. As legally interpreted, the terms "dredge" and "fill" encompass virtually any activity on a wetland in which dirt is moved, effectively granting the Corps permitting jurisdiction over all wetlands, including those not associated with traditionally navigable waterways. In fiscal year 1999, the Corps's regulatory program budget is $106 million, which mainly funds permitting activities. In fiscal year 1996 (the most recent year for which data are available), the Corps received about 65,000 applications for section 404 permits for discharging dredged or fill materials. Under section 404, the Corps is required to evaluate each permit application and grant approval or denial on the basis of expert opinion and statutory guidelines. The bulk of the permits are quickly approved through outstanding general or regional permits, which grant authority for many low-impact activities. Evaluation of permits not covered by outstanding permits may require the Corps to conduct detailed, lengthy, and costly reviews.

Currently, fees levied for commercial and private permits are $100 and $10, respectively. Government applicants do not pay a fee. The fee structure has not changed since 1977. Total fee collections fall far short of covering the costs of administering the permitting program, particularly for applications requiring detailed review. The Administration has proposed changing the permit fee structure: its Wetland Plan would increase permit fees for commercial projects and eliminate the fees for private, noncommercial projects.

Proponents of higher fees argue that parties pursuing a permit should bear the cost of the permit—not the general taxpaying public. Since permit seekers are advancing a private interest whose benefits accrue to a private party, the costs should be borne by that party. Taxpayers should not have to pay for something that advances the interests of a comparative few.

Permit seekers oppose such fees because they do not want to fund something that may ultimately deny them the right to use their land in the way they choose. The goal of the section 404 permitting program is to advance a public interest by protecting wetlands. Since society benefits from wetlands protection, often at the perceived expense of property owners, society should pay. Furthermore, the regulatory process that property owners must navigate is already onerous, and raising the permit fees would add yet another cost, further infringing on property owners' rights.

300-11 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Added Receipts (Millions of dollars)
Annual	
2000	170
2001	450
2002	470
2003	470
2004	470
2005	470
2006	470
2007	470
2008	470
2009	470
Cumulative	
2000-2004	2,030
2000-2009	4,380

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTION:

300-13

RELATED CBO PUBLICATION:

Paying for Highways, Airways, and Waterways: How Can Users Be Charged? (Study), May 1992.

The Congressional Budget Office estimates that the Congress annually appropriates about $650 million for the nation's inland waterway system. Of that total, about $475 million is for operation and maintenance (O&M) and about $175 million is for construction. Current law allows up to 50 percent of inland waterway construction to be funded by revenues from the inland waterway fuel tax, a levy on the fuel consumed by barges using most segments of the inland waterway system. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover fully both O&M and construction outlays for inland waterways would reduce the federal deficit by $170 million in 2000 and $2.0 billion during the 2000-2004 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. Receipts could be increased by raising fuel taxes, imposing charges for lockage, or imposing fees based on the weight of shipments and distance traveled. The estimates do not take into account any resulting reductions in income tax revenues.

Imposing higher fees on users of the inland waterway system could improve the efficiency of its use by forcing shippers to choose the most efficient transportation route rather than the most heavily subsidized one. Moreover, user fees would encourage more efficient use of existing waterways, reducing the need for new construction to alleviate congestion. Finally, user fees send market signals that identify the additional projects likely to provide the greatest net benefits to society.

The effects of user fees on efficiency would depend largely on whether the fees were set at the same rate for all segments of a waterway or on the basis of the cost of each segment. Since costs vary dramatically by segment, systemwide fees would offer weaker incentives for cost-effective spending because they would cause users of low-cost segments to subsidize users of high-cost segments. Fees based on the cost of each segment, by contrast, could cause users to abandon high-cost segments of the waterways.

One argument against user fees is that they may repress regional economic development. Imposing higher user fees would also lower the income of barge operators and grain producers in some regions, but those losses would be small in the context of overall regional economies.

300-12 OPEN THE COASTAL PLAIN OF THE ARCTIC NATIONAL WILDLIFE REFUGE TO LEASING

	Added Receipts (Millions of dollars)
Annual	
2000	0
2001	0
2002	0
2003	0
2004	1,150
2005	1
2006	1
2007	1
2008	1
2009	1
Cumulative	
2000-2004	1,150
2000-2009	1,155

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

300-08

The Arctic National Wildlife Refuge (ANWR) consists of 19 million acres in northeastern Alaska, of which 1.5 million acres are coastal plain. The coastal plain is the yet-to-be-explored onshore area with perhaps the country's most promising oil production potential. It is also the least disturbed Arctic coastal region—valued for species conservation and subsistence use.

ANWR was established by the Alaska National Interest Lands Conservation Act of 1980. The refuge serves to conserve fish and wildlife habitats, fulfill related international treaty obligations, provide opportunities to continue indigenous lifestyles, and protect water quality. The act prohibits industry activity in ANWR unless specifically authorized by the Congress.

This option would open ANWR's coastal plain to leasing and development. Leasing would be likely to result in bonus bid payments, ongoing rental payments, and (once production begins up to 10 or more years after leasing) royalties. As in recent proposals, the Congressional Budget Office assumes the federal government would receive one-half of the offsetting receipts from those sources; the state of Alaska would receive the other half.

The Department of the Interior's most recent assessment of the area's economically recoverable undiscovered petroleum resources is expressed in probabilities and assumptions about the price of oil at the time of production. For this estimate, CBO assumed an average price of $18 per barrel (in 1996 dollars) during the 2010-2030 period, partly on the basis of the Energy Information Administration's price forecast for 2020. At $18 per barrel (delivered to the West Coast), the Department of the Interior estimates a 50 percent probability that at least 2.4 billion barrels of oil will be produced. Using that mean resource assessment and assuming ANWR lease sales are held within the next 10 years, CBO estimates that leasing ANWR would generate about $2.3 billion from bonus bids over the 2000-2009 period (with half of that amount going to Alaska). Conversely, if oil prices were to grow only at the rate of inflation after 2010, the Department of the Interior's mean resource assessment indicates that no oil would be economically recoverable from ANWR. At an expected price of $15 per barrel, leasing might not generate any significant proceeds for the government.

Arguments in favor of this option include the national security advantages of reducing dependence on imported oil. Most of ANWR would remain closed to development, and the part of the coastal plain that would be directly affected by oil drilling and production represents less than 1 percent of ANWR. Moreover, technological changes in the industry have improved its ability to safeguard the environment.

Arguments against this option include the short-term nature of the still uncertain gain from extracting a nonrenewable resource: it will not provide lasting energy security. The coastal plain is ANWR's most biologically productive area and sustains the biological productivity of the entire refuge. Industrial activity poses a threat to wildlife and the environment despite efforts to mitigate its impact.

300-13 IMPOSE A NEW HARBOR MAINTENANCE FEE

	Added Receipts (Millions of dollars)
Annual	
2000	180
2001	312
2002	260
2003	244
2004	205
2005	145
2006	79
2007	9
2008	-66
2009	-147
Cumulative	
2000-2004	1,201
2000-2009	1,221

NOTE: Figures are net of revenues lost from repealing the existing harbor tax.

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTIONS:

300-10, 300-11, 400-06, and 400-07

On March 31, 1998, the Supreme Court found that the harbor maintenance tax (as it applied to exports) violated the constitutional restriction that "No tax or duty shall be laid on articles exported from any State." Collection of the tax as applied to exports ceased on April 25, 1998. One way to replace the revenue formerly generated by the harbor maintenance tax is to develop a new system of harbor fees that is constitutional. Under such a system, the commercial users of U.S. ports would pay a fee based on port use rather than a payment based on cargo value. Such fees would apply to imports, exports, and domestic shipments. Taxes currently levied on imports and domestic shipments would be rescinded. Moneys generated by the fee would help support harbor operation, construction, and maintenance. The Administration has proposed such a program.

The Army Corps of Engineers now spends about $875 million annually for costs associated with operating, constructing, and maintaining commercial ports nationwide. A major part of those activities is maintaining adequate channel depths. Replacing what remains of the harbor maintenance tax with a more comprehensive fee on commercial port users would generate $180 million in 2000, $312 million in 2001, and $1.2 billion over the 2000-2004 period.

Two arguments can be made for imposing a harbor maintenance fee program. First, harbor maintenance activities, such as dredging by the Corps of Engineers, provide a commercial service to identifiable beneficiaries. Modern and well-maintained ports save shippers money through lower unit costs of shipping on larger vessels and by minimizing inland transport costs. Exporters currently make no payments directly associated with their use of port facilities. Second, imposing a harbor fee program would have little effect on port use because the fees would result in charges on users similar to the ones users recently paid under the rescinded tax.

Whether the imposition of a harbor fee system will pass constitutional muster is uncertain. The establishment of such a system might be viewed by the Supreme Court as an unconstitutional export tax disguised by another name. A second legal concern with a fee program is whether it would violate international trade agreements, as several international trading partners allege of the harbor maintenance tax. Another drawback of the proposed fee system is that after several years, the cash it would generate would not keep pace with the revenue that the rescinded taxes would have generated. That is because tax collections based on the value of the goods shipped are projected to increase more quickly than the proposed fees, which would be tied to the costs of operating, constructing, and maintaining harbors.

300-14 TERMINATE ECONOMIC SUPPORT FUND PAYMENTS UNDER THE SOUTH PACIFIC FISHERIES TREATY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	14	14
2004	14	14
2005	14	14
2006	14	14
2007	14	14
2008	14	14
2009	14	14
Cumulative		
2000-2004	28	28
2000-2009	98	98

SPENDING CATEGORY:

Discretionary

The South Pacific Fisheries Treaty is formally known as the Treaty on Fisheries Between the Governments of Certain Pacific Island States and the Government of the United States of America. Signed in April 1987, it lays out terms and conditions under which up to 55 U.S. flag commercial fishing vessels may use purse seine methods to catch tuna in territorial waters of 16 Pacific Island states, including Kiribati, Micronesia, and Papua New Guinea. Japan, Korea, and Taiwan have similar treaties providing access to the waters for their tuna fleets.

Associated with the treaty is an agreement on annual economic assistance paid by the United States to the South Pacific Forum Fisheries Agency. The agreement provides for amending, extending, or terminating that arrangement by written agreement. In addition, either party may terminate the agreement by giving the other party one year's written advance notice. An amended agreement went into effect in 1993 providing for $14 million annually from June 1993 to June 2002. This option would terminate the U.S. government's payments to the South Pacific Forum Fisheries Agency at the end of the current agreement in 2003.

Currently, the treaty also provides for an annual industry payment that covers license fees for up to 55 vessels as well as technical assistance to the Pacific Island parties. In addition, the treaty calls for the U.S. tuna industry to cover the cost of the observer program. From June 1993 to June 1998, industry payments for licenses and technical assistance under the treaty were $4 million annually. For that same period, on average, 40 U.S. flag vessels had access to tuna in the territorial waters of the South Pacific Island states each year. Thus, industry payments per vessel, excluding the cost of the observer program, averaged nearly $100,000 annually.

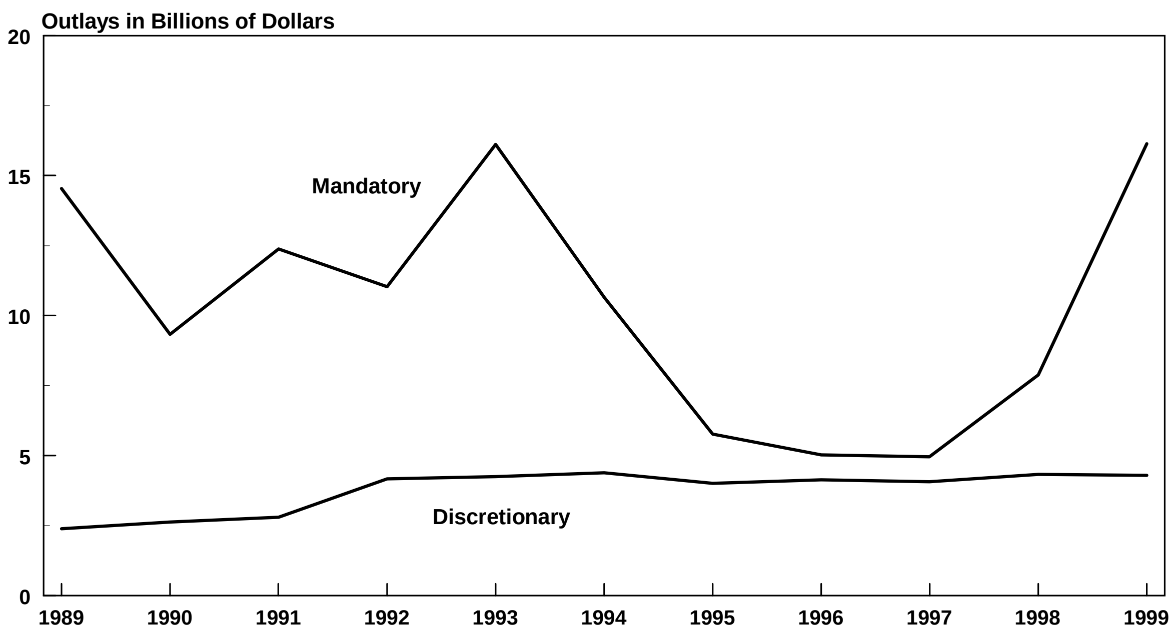
People in favor of terminating the economic support fund payments under the treaty believe that taxpayers are supporting the access of private vessels to the territorial waters of the party states at an annual rate of over $340,000 per vessel. If those payments accurately reflect part of the value of that access to the fisheries, such subsidization may encourage the overexploitation of fisheries.

People who oppose this option believe that the treaty is merely an expeditious vehicle, and the only vehicle, through which the United States provides financial assistance in keeping with its foreign policy interests to the nations in the South Pacific Forum Fisheries Agency. They argue that it is not a subsidy—the fishing industry's own payments under the treaty are comparable with those made by non-U.S. fleets. Those fleets obtain yearly licenses on a bilateral basis with any Pacific Island state of interest at a cost of 5 percent of the value of the previous year's catch.

350

Agriculture

Budget function 350 funds programs administered by the Department of Agriculture. It covers such activities as agricultural research and stabilization of farm incomes through loans, subsidies, and other payments to farmers. CBO estimates that discretionary outlays for function 350 will total more than $4 billion in 1999; discretionary budget authority of roughly the same amount was provided for agriculture this year. CBO estimates that mandatory outlays for the function will increase from just under $8 billion in 1998 to over $16 billion in 1999 because of provisions of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1998 and depressed commodity prices. Over the past 10 years, spending under this function has fluctuated between 0.5 percent and 1.5 percent of federal outlays.



350-01 REDUCE FEDERAL SUPPORT FOR AGRICULTURAL RESEARCH AND EXTENSION ACTIVITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	186	121
2001	186	166
2002	186	181
2003	186	183
2004	186	183
2005	186	183
2006	186	183
2007	186	183
2008	186	183
2009	186	183
Cumulative		
2000-2004	930	834
2000-2009	1,860	1,749

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-10 and 350-04

The Department of Agriculture (USDA) conducts and supports agricultural research and education. In particular, the Agricultural Research Service, the department's internal research arm, focuses on maintaining and increasing the productivity of the nation's land and water resources, improving the quality of agricultural products and finding new uses for them, and improving human health and nutrition. The Cooperative State Research, Education, and Extension Service (CSREES) participates in a nationwide system of agricultural research and educational program planning and coordination between state institutions and USDA. CSREES also takes part in the Cooperative Extension System, a national educational network that combines the expertise and resources of federal, state, and local partners. The Economic Research Service carries out economic and other social science research and analysis for public and private decisions about agriculture, food, natural resources, and rural America.

The 1999 appropriations for those three USDA units total $1.9 billion. Reducing the funding by 10 percent would save $834 million in outlays from 2000 to 2004 and $1.75 billion in outlays from 2000 to 2009.

Federal funding for agricultural research may, in some cases, replace private funding. If federal funding was eliminated in those instances, the private sector would finance more of its own research. Moreover, federal funding for some extension activities under CSREES could be reduced without undercutting its basic services to farmers. For example, funding for the Nutrition and Family Education and Youth at Risk Programs totaled $68 million under the Omnibus Consolidated and Emergency Supplemental Appropriations for Fiscal Year 1999.

Opponents of reducing funding for research and extension activities argue that the programs play important roles in developing an efficient farm sector. Reducing federal funding could compromise the sector's future development and its competitiveness in world markets. If the private sector assumed the burden of funding, agricultural research, which contributes to an abundant, diverse, and relatively inexpensive food supply for U.S. consumers, could decline. Moreover, some federal grants are used to improve the health of humans, animals, and plants by funding research that promotes better nutrition or more environmentally sound farming practices. If federal funding was cut back, the public might have to bear some of that cost in higher prices, forgone innovations, and environmental degradation.

350-02 REDUCE DEPARTMENT OF AGRICULTURE SPENDING FOR EXPORT MARKETING AND INTERNATIONAL ACTIVITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	31	21
2001	31	28
2002	31	31
2003	31	31
2004	31	31
2005	31	31
2006	31	31
2007	31	31
2008	31	31
2009	31	31
Cumulative		
2000-2004	155	142
2000-2009	310	297

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

150-03, 350-06, and 350-09

The Department of Agriculture (USDA) promotes exports and international activities through the programs of the Foreign Agricultural Service (FAS). For example, in the Foreign Market Development Cooperator Program, FAS acts as a partner in joint ventures with "cooperators," such as agricultural trade associations and commodity groups, to develop markets for U.S. exports. FAS also collaborates on other ventures, one of which, the Cochran Fellowship Program, provides training to foreign nationals with the objective of improving commercial relationships that will benefit U.S. agriculture. Eliminating funding for those two programs would reduce outlays by $142 million over the 2000-2004 period and $297 million over the 2000-2009 period.

The Foreign Market Development Cooperator Program, also known as the Cooperator Program, typically promotes generic products and basic commodities, such as grains and oilseeds, but the program also covers some high-value products, such as meat and poultry. Some critics of the program argue that cooperators should bear the full cost of foreign promotions because the cooperators benefit from them directly. (How much return, in terms of market development, the Cooperator Program actually generates or the extent to which it replaces private expenditures with public funds is uncertain.) Some observers also cite the possibility of duplicative services because the USDA provides funding for marketing through its Market Access Program and other activities.

Eliminating the Cooperator Program, however, could place U.S. exporters at a disadvantage in international markets, depending in part on the amount of support other countries provide to their exporters. Regarding the issue of duplicative services, some advocates note that the Cooperator Program is distinct from other programs in part because it focuses on services to trade organizations and technical assistance. People concerned about U.S. exports of generic products and basic commodities consider the program useful for developing markets that could benefit the overall economy.

The Cochran Fellowship Program brings foreign midlevel managers to the United States for training in agriculture and agribusiness. Although the program is popular among recipients and their sponsors, its direct benefits to U.S. agriculture are unknown; thus, it may be marginally valuable to taxpayers. However, eliminating the Cochran Fellowship Program could hurt U.S. agriculture to the extent that the program builds commercial relationships, introduces foreign professionals to U.S. products, and creates new opportunities for U.S. exports.

350-03 REINSTATE ASSESSMENTS ON GROWERS, BUYERS, AND IMPORTERS OF TOBACCO

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	8	8
2001	29	29
2002	29	29
2003	30	30
2004	30	30
2005	30	30
2006	30	30
2007	30	30
2008	30	30
2009	30	30
Cumulative		
2000-2004	126	126
2000-2009	276	276

SPENDING CATEGORY:

Mandatory

The federal government aids tobacco producers by supporting domestic tobacco prices above world-market levels. That support involves a combination of marketing quotas, price-supporting loans, and restrictions on imports. The support program benefits about 125,000 growers and 300,000 holders of marketing quotas and allotments. Some quota holders actually raise tobacco, and some rent their quota to others. For producers, tobacco is an important source of income, particularly in some states. The value of the 1997 tobacco crop was estimated at $3.1 billion. The crop is produced in 16 states, and nearly two-thirds of its acreage lies in North Carolina and Kentucky.

Tobacco is a controversial crop because of the health hazards of smoking, and federal support for producers has also been controversial. The price support program has been modified over time to reduce its costs to the taxpayer, even though it does nothing to encourage tobacco use. In fact, it raises the price of tobacco products to U.S. consumers but by a small amount. The Department of Agriculture estimates that the program may increase the price of a pack of cigarettes by less than 2 cents.

The cost of the tobacco price support program varies from year to year. The program may have substantial outlays in a given year, but if it functions as intended, it should have no net cost to the government over time. The reason is that growers and purchasers of tobacco contribute to "no-net-cost accounts" that are used to reimburse the government for costs (excluding administrative costs) of the price support program. Starting with the 1991 crop, growers and purchasers each paid an additional assessment of 0.5 percent of the value of sales (for a total collection of 1 percent of sales). Those assessments, which were introduced to reduce federal farm program costs and cut net federal outlays, are set to expire with the 1998 tobacco crop. A related assessment on imported tobacco expired at the end of calendar year 1998. This option would reinstate those assessments beginning with the 2000 crop. Doing so would bring in receipts of $126 million over the 2000-2004 period.

The main benefit of reinstating the assessments is reducing net federal outlays. Proponents argue that the price support program gives tobacco producers substantial benefits and that the assessment recoups a portion of those benefits for the taxpayer. Opponents would argue that since the tobacco program costs the government little, assessments are unfair.

350-04 ELIMINATE MANDATORY SPENDING FOR THE AGRICULTURAL RESEARCH ACTIVITIES OF THE FUND FOR RURAL AMERICA AND THE INITIATIVE FOR FUTURE AGRICULTURE AND FOOD SYSTEMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	150	15
2001	150	60
2002	150	105
2003	150	135
2004	0	135
2005	0	90
2006	0	45
2007	0	15
2008	0	0
2009	0	0
Cumulative		
2000-2004	600	450
2000-2009	600	600

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

350-01

The Federal Agriculture Improvement and Reform Act of 1996 (FAIR) established the Fund for Rural America as a mandatory program to support rural communities nationwide. FAIR provided the fund with $100 million in fiscal years 1997, 1999, and 2000—one-third of which is dedicated to research, education, and extension grants administered by the Department of Agriculture's (USDA's) Cooperative State Research, Education, and Extension Service (CSREES). The Agricultural Research, Extension, and Education Reform Act of 1998 (Public Law 105-185) provided the fund with an additional $100 million, so $60 million will be provided annually for fiscal years 2000 through 2003.

In addition, the Agricultural Research, Extension, and Education Reform Act of 1998 created and provided mandatory funding for the Initiative for Future Agriculture and Food Systems as a competitive grants program supporting research, extension, and education activities in critical emerging areas. Administered by CSREES, the initiative is mandated to receive $120 million annually for fiscal years 2000 to 2003 to target food genome research, food safety, human nutrition, alternative uses for agricultural commodities, biotechnology, and precision agriculture. Eliminating those activities would reduce direct spending by $600 million from 2000-2009.

Mandatory funding is usually reserved for entitlement programs, for which funding needs may be too immediate or undisputed to warrant annual review by the Congress in the appropriation process. Supporters of this option argue that the programs should hardly be grouped with other entitlements and should be left where they have always been: as part of USDA's discretionary funding budget. Because providing the programs with mandatory funds may avoid the spending jurisdiction and annual review of the appropriations committees, supporters of the option argue that the programs do not necessarily provide funding for intended activities. In addition, they argue, existing discretionary programs can meet the agricultural research program goals. Furthermore, they contend that federal funding for agricultural research may, in some cases, replace private funding. If federal funding was eliminated in those instances, the private sector would finance more of its own research.

Opponents of this option argue that if producers gradually receive less federal support under FAIR's new commodity policies, then the federal government should provide them with a steady flow of new technologies to improve productivity and profitability. Opponents of the option argue that the program is necessary to address future food productivity, environmental quality, and farm income. They also contend that reducing federal funding could compromise U.S. agriculture's future development and its competitiveness in world markets.

350-05 LIMIT FUTURE ENROLLMENT OF LAND IN THE DEPARTMENT OF AGRICULTURE'S CONSERVATION RESERVE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	27	27
2001	162	162
2002	253	253
2003	347	347
2004	429	429
2005	452	452
2006	484	484
2007	533	533
2008	568	568
2009	1,750	1,750
Cumulative		
2000-2004	1,218	1,218
2000-2009	5,005	5,005

SPENDING CATEGORY:

Mandatory

The Conservation Reserve Program promotes soil conservation, improves water quality, and provides wildlife habitat by removing land from active agricultural production. Landowners contract with the program to keep land out of production, usually for a 10-year period, in exchange for annual rental payments. Such land is referred to as "enrolled" in the program. The federal government also pays part of what farmers spend to establish approved cover crops on the land. The Department of Agriculture's (USDA's) Commodity Credit Corporation funds the program and spends about $1.5 billion per year on it. The program now has roughly 31 million acres enrolled; the law limits enrollment to a total of 36.4 million acres. The Congressional Budget Office baseline assumes that future net enrollments of land will reach the limit by 2009. Stopping new enrollments beginning October 1, 1999, would reduce outlays by $1.2 billion over the 2000-2004 period and by $5 billion over the 2000-2009 period.

Some critics of the conservation reserve program see it as corporate welfare—unnecessarily and inefficiently supporting farm income. Others see it as an expensive and poorly focused conservation program and believe that other uses of the money would yield greater environmental benefits. Still other critics worry about the loss of economic activity in areas where much crop land is retired. Demand for seed, fertilizer, and other farm supplies drops in such areas, hurting rural communities.

The Conservation Reserve Program enjoys widespread support, however. Landowners appreciate the payments, which often exceed profits from continued agricultural production and are more certain. Conservationists and environmentalists recognize the program's benefits and note USDA's plans to accept the most environmentally sensitive land in future enrollments. Those plans involve special provisions for enrolling land devoted to the most effective conserving practices such as the use of filter strips, grass waterways, and riparian buffers. Those and several other practices yield high returns per dollar spent in enhanced wildlife habitat, water quality improvement, and reduced soil erosion. In fact, even most critics of the program recognize the need to take at least some environmentally sensitive land out of production for some time.

350-06 ELIMINATE ATTACHÉ POSITIONS IN THE FOREIGN AGRICULTURAL SERVICE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	29	20
2001	39	33
2002	39	38
2003	39	39
2004	39	39
2005	39	39
2006	39	39
2007	39	39
2008	39	39
2009	39	39
Cumulative		
2000-2004	185	169
2000-2009	380	364

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

350-02 and 370-02

U.S. agricultural attachés, located at about 60 posts worldwide, provide U.S. agricultural producers and traders with information on foreign government policies, supply and demand conditions, commercial trade relationships, and market opportunities. That information is an integral part of the market forecasting and analysis system of the U.S. Department of Agriculture (USDA). The attachés, employed by the Foreign Agricultural Service of the USDA, also represent that department in disputes and negotiations with foreign governments on agricultural issues. The attaché positions were developed to promote U.S. commodities and to help U.S. farmers, processors, distributors, and exporters adjust their operations and practices to meet world conditions. This option would eliminate the attaché positions and reduce outlays by $169 million from 2000 to 2004 and $364 million from 2000 to 2009.

Proponents of eliminating the attaché positions argue that the federal government should not be collecting and distributing information that directly aids large private traders of agricultural commodities and products. Instead, they argue, private firms could collect such information. In addition, Department of State or Commerce personnel could assume the attachés' other functions. Although trade is vitally important to U.S. agriculture, according to that argument the industry no longer warrants the special treatment it receives.

Opponents of eliminating the agricultural attaché positions contend, however, that because attachés represent the U.S. government, they have more access to information than representatives of private firms would have. Opponents also maintain that if agricultural producers and traders do not receive quality agricultural information in a timely manner, the sector's responsiveness to changes in world demand for U.S. products could be compromised. Finally, USDA uses information collected by attachés in conducting its analyses. If the attachés no longer provided such information, USDA might have to purchase it; without it, USDA would have difficulty conducting policy analyses.

350-07 REDUCE THE REIMBURSEMENT RATE PAID TO PRIVATE INSURANCE COMPANIES IN THE DEPARTMENT OF AGRICULTURE'S CROP INSURANCE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	25	23
2001	26	26
2002	28	28
2003	29	29
2004	30	31
2005	31	31
2006	32	32
2007	34	34
2008	35	35
2009	37	37
Cumulative		
2000-2004	138	137
2000-2009	307	306

SPENDING CATEGORY:

Mandatory

The Federal Crop Insurance Program protects farmers from losses caused by drought, floods, pests, and other natural disasters. Insurance policies that farmers buy through the program are sold and serviced by private insurance firms, which receive an administrative cost reimbursement according to the total amount of insurance premiums they handle. Firms also share underwriting risk with the federal government and can gain or lose depending on the value of crop losses relative to claims made. Overall, the companies typically gain.

The General Accounting Office (GAO) has widely studied the crop insurance program and, in particular, the amount paid to the firms that service and sell the insurance policies. In a 1997 study, GAO concluded that the amount the program has paid the firms has historically exceeded the reasonable expenses of selling and servicing the crop insurance. Partly on the basis of that information, the 105th Congress cut the reimbursement rate from 27 percent of premiums to 24.5 percent. This option would reduce that rate to 22.5 percent, resulting in savings of $306 million over the 2000-2009 period.

Arguments for cutting the reimbursement rate hinge on the belief that the 105th Congress could have cut the reimbursement rate more deeply without substantially affecting the quantity or quality of services provided to farmers. In addition to relying on GAO's analysis, proponents of further cuts point to the dramatic expansion in business that followed enactment of the Federal Crop Insurance Reform Act of 1994. Total insurance now in force totals more than $24 billion, which is about twice that of the early 1990s. Total premiums grew correspondingly, but because of economies of scale, the costs of selling and servicing the policies probably grew by less. Thus, proponents argue, the program could tolerate further cuts. Finally, even if cuts caused firms to curtail some services to farmers, proponents claim that the results would not be catastrophic or irreversible.

The industry argues, however, that the cuts enacted last year will impair its ability to sell and service insurance and will threaten farmers' access to insurance. If farmers lack insurance, the industry argues, the Congress would more likely resort to expensive, special-purpose disaster relief programs when disaster strikes, negating any apparent savings from cutting the reimbursement rate. That argument—perhaps made more forcefully—applies to any further program cuts. Moreover, falling crop prices reduce total premiums (and reimbursements) but hardly affect companies' costs. Cutting reimbursement rates would further reduce company profits, making it harder for them to maintain the services now provided to farmers.

350-08 ELIMINATE PUBLIC LAW 480 TITLE I SALES AND TITLE III GRANTS AND LIMIT THE SECRETARY OF AGRICULTURE'S AUTHORITY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	219	115
2001	219	200
2002	219	212
2003	219	212
2004	219	212
2005	219	212
2006	219	212
2007	219	212
2008	219	212
2009	219	212
Cumulative		
2000-2004	1,095	951
2000-2009	2,190	2,013

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

150-03

The U.S. Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) was enacted to promote commercial exports of surplus agricultural commodities, foster foreign markets, and aid developing countries. The law included commodity sales for foreign currencies, concessional credit, and grants.

In the 45 years since the law was passed, the program may have become obsolete and inefficient. This option would eliminate sales under title I of the act and grants under title III beginning in 2000. It would also constrain authority provided by the Commodity Credit Corporation Charter Act of 1948 and other acts that allow the Secretary of Agriculture to use Commodity Credit Corporation or other funds to purchase and ship U.S. commodities abroad. Such constraints are necessary, some analysts believe, because without them, the Secretary of Agriculture could offset the effects of a cut in the program (a discretionary one) by using Commodity Credit Corporation or other funds (mandatory spending) to purchase and ship agricultural commodities. In fact, the Secretary is using such authority in 1999 to provide about $2 billion of food aid to Russia and other countries.

This option would reduce outlays by $950 million over the 2000-2004 period and by $2 billion over the 2000-2009 period. Title II of the act and section 416 of the Agricultural Act of 1949, which fund humanitarian and emergency feeding programs, would not be affected by this option.

The program's effectiveness in promoting agricultural exports is questionable for two reasons: exports under titles I and III are a small portion of total U.S. agricultural exports, and the countries currently receiving those commodities are unlikely to become commercial customers. In fact, countries that receive commodities under titles I and III are typically those in which the United States has a security or foreign policy interest rather than those likely to become commercial customers in the near term.

Providing assistance to developing countries is also a goal of the programs but may not always be an efficient use of U.S. resources. Many commodities that foreign countries buy with P.L. 480 assistance are resold to generate local currency. Those funds are used in turn to support local budgets and local development. But the inexpensive food may discourage local investment in agriculture, lower rural employment and income, and discourage the development of local stockpiles.

Supporters of titles I and III argue that the programs are a flexible, fast means of providing assistance to friendly countries. They also note that the programs reduce the likelihood that agricultural surpluses will depress prices in the United States, and they stress the programs' humanitarian benefits: U.S. agricultural products are exported, and hungry people are fed.

350-09 ELIMINATE THE MARKET ACCESS PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	5	5
2001	76	76
2002	90	90
2003	90	90
2004	90	90
2005	90	90
2006	90	90
2007	90	90
2008	90	90
2009	90	90
Cumulative		
2000-2004	351	351
2000-2009	801	801

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

150-03 and 350-02

The Market Access Program (MAP), formerly known as the Market Promotion Program, was authorized under the 1990 Food, Agriculture, Conservation, and Trade Act to assist U.S. exporters of agricultural products. The program has been used to counter the effects of unfair trading practices abroad, but the Uruguay Round Agreements Act of 1994 eliminated the requirement that it be used for such purposes. Payments are made to partially offset the costs of market building and product promotion conducted by trade associations, commodity groups, and some profit-making firms. On the basis of current law, the Congressional Budget Office assumes that $90 million will be allocated annually for the program. Eliminating MAP would reduce outlays by $351 million over the next five years.

The program has been used to promote a wide range of mostly high-value products, including fruit, tree nuts, vegetables, meat, poultry, eggs, seafood, and wine. About 40 percent of MAP funding goes to promote brand-name products. The 1996 farm bill prohibits direct MAP assistance for brand promotions to foreign companies for foreign-produced products or to companies not recognized as small businesses under the Small Business Act, except for cooperatives and nonprofit trade associations.

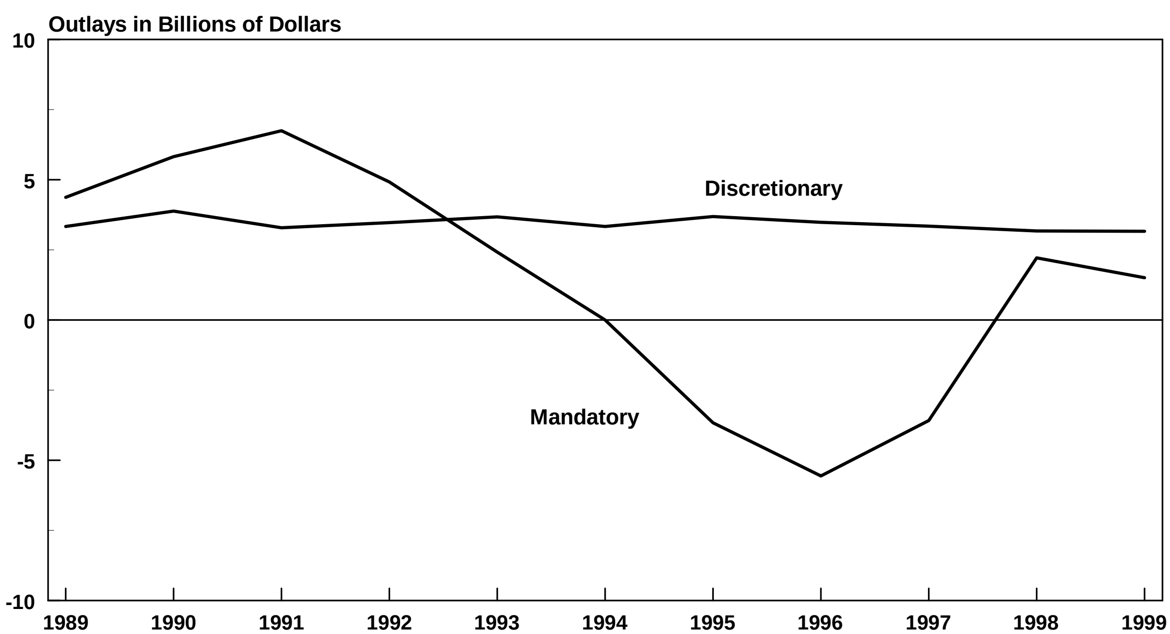
Some critics of the program argue that participants should bear the full cost of foreign promotions because they benefit directly from them. (The extent to which the program has developed markets or replaced private expenditures with public funds is uncertain.) In addition, some critics note the possibility of duplication because the Department of Agriculture provides marketing funds through the Foreign Market Development Cooperator Program of the Foreign Agricultural Service and other activities. Many people also object to spending the taxpayers' money on advertising brand-name products.

Eliminating MAP, however, could place U.S. exporters at a disadvantage in international markets, depending in part on the amount of support provided by other countries. Responding to concerns about duplication, some MAP advocates note that the program differs from other programs partly because it focuses on foreign retailers and consumer promotions. People concerned about U.S. exports of high-value products consider the program useful for developing markets and benefiting the overall economy.

370

Commerce and Housing Credit

Budget function 370 funds programs administered by the Department of Commerce, the Federal Housing Administration, and the Small Business Administration, among others. They include programs to regulate and promote commerce and provide housing credit and deposit insurance. (The figure below excludes spending for deposit insurance.) Also included in this category are outlays for loans and other aid to small businesses and support for the government's effort to gather and disseminate economic and demographic data. CBO estimates that discretionary outlays for function 370 will total about $3 billion in 1999. Discretionary budget authority of $3.6 billion was provided for the function for 1999.



370-01 END THE CREDIT SUBSIDY FOR MAJOR SMALL BUSINESS ADMINISTRATION BUSINESS LOAN GUARANTEE PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	132	84
2001	132	124
2002	132	127
2003	132	127
2004	132	127
2005	132	127
2006	132	127
2007	132	127
2008	132	127
2009	132	127
Cumulative		
2000-2004	660	589
2000-2009	1,320	1,224

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-05

The Small Business Administration (SBA) operates several loan guarantee programs to increase small businesses' access to capital and credit. Under the Federal Credit Reform Act of 1990, the credit subsidy for those programs is the estimated net present value cost of projected defaults (excluding administrative costs) to the SBA of guaranteeing loans over their lives. SBA's largest business credit programs are the general business loan guarantee, or 7(a) program; the certified development company, or 504 program; and the small business investment company (SBIC) equity capital programs. One of the programs, the certified development company loan program, now operates with a zero subsidy rate. Equalizing the subsidy rate of all major SBA business loan guarantee programs at zero would reduce outlays by $1.2 billion for the 2000-2009 period measured against the 1999 funding level.

Under the 7(a) loan guarantee program, the federal government guarantees 80 percent of the principal for business loans up to $100,000 and 75 percent of the principal for larger ones. Small business investment companies in the SBIC program are private investment firms licensed by the SBA. They make equity investments and long-term loans to small firms, using their own capital supplemented with SBA-guaranteed debentures.

In 1996, the Congress amended both the Small Business Act and the Small Business Investment Act to reduce subsidy rates and improve the performance of the SBA's business loan programs. One of the most significant changes the Congress made was to increase the fees paid by loan recipients for most business loans. Those increases help to reduce program costs because the revenues from the fees cover some of the expenses if a borrower defaults. The Congress also cut the percentage of each loan amount that the government guarantees under the SBA's largest loan program—the 7(a) program—from about 90 percent to about 80 percent. Reducing the guarantee rate should induce banks to more carefully evaluate loan applications because the banks will share more responsibility for any losses from defaults. If banks use more care in approving SBA loans, the default rate should decline, and the program's cost to the government should decrease. Adjusting fees (and changing loan guarantee levels) to cover potential default losses could make the major SBA business loan programs financially sound. As the subsidy rate declined to zero, the Congress would no longer have to appropriate funds to cover the government's expected losses.

Critics of this option believe SBA assistance aids small businesses by filling a gap in financing when banks and other traditional sources do not provide loans for the purposes, in the amounts, and with the terms required by small business borrowers. Some critics argue against increasing program fees or reducing guarantee rates because such changes would reduce access to credit for small businesses. Others argue that subsidies are not necessary because the loan programs provide the mechanism to pool risk so that the private sector will make financing available. Some supporters of this option argue, however, that SBA assistance serves only a tiny fraction of the nation's small businesses and that most of the program's borrowers could obtain financing without the SBA's help.

370-02 REDUCE COSTS OF THE ITA BY ELIMINATING TRADE PROMOTION ACTIVITIES OR CHARGING THE BENEFICIARIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	58	40
2001	231	173
2002	231	213
2003	231	231
2004	231	231
2005	231	231
2006	231	231
2007	231	231
2008	231	231
2009	231	231
Cumulative		
2000-2004	982	888
2000-2009	2,137	2,043

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

350-06

RELATED CBO PUBLICATIONS:

Antidumping Action in the United States and Around the World: An Analysis of International Data (Paper), June 1998.

How the GATT Affects U.S. Antidumping and Countervailing-Duty Policy (Study), September 1994.

The International Trade Administration (ITA) of the Department of Commerce has four major program activities: the Import Administration, which investigates antidumping and countervailing-duty cases; the trade development program, which assesses the competitiveness of U.S. industries and runs export promotion programs; the market access and compliance (MAC) unit, which works to unlock foreign markets for U.S. goods and services; and the U.S. and foreign commercial services, which counsel U.S. businesses on exporting. The MAC unit, and perhaps the countervailing-duty program against foreign subsidies, may be necessary to maintain public support for free-trade policies, and in some cases, they can be defended on economic grounds. The ITA's export promotion, marketing, and counseling activities could be eliminated, however, or the beneficiaries could be charged fees to cover more of the programs' costs. The ITA already charges some fees for some services, but those fees do not cover the cost of all such activities.

Some people argue that such activities are better left to the firms and industries involved rather than to the ITA. Others argue that those activities might have some economies of scale, especially for small firms. If so, having one entity (the federal government) counsel exporters on foreign legal and other requirements, disseminate knowledge of foreign markets, and promote U.S. products abroad might make sense. In that case, net federal spending could be reduced by charging the beneficiaries of those programs their full cost.

Fully funding the ITA's trade promotion activities through charges that are voluntary for all beneficiaries may not be possible, however. For example, in many cases, promoting the products of selected firms in a given industry that want and pay for such promotion may be impossible without also encouraging demand for the products of all other firms in that industry. In those circumstances, all the firms have an incentive not to purchase the services because they know that they are likely to receive the benefits whether they pay for them or not. Consequently, if the federal government wanted to charge beneficiaries for the ITA's services, it might have to require that all firms in an industry (or the industry's national trade group) decide together whether to purchase the ITA's services. If the firms decided to purchase them, all firms in the industry would be required to pay according to some equitable formula.

When beneficiaries do not pay the full cost of services, the ITA's activities effectively subsidize the industries involved. Those implicit subsidies are an inefficient means of helping the industries because they are partially passed on to foreigners in the form of lower prices for U.S. exports. Because the current-account balance is determined by total saving and investment in the U.S. economy, over which the ITA has no influence, the agency's activities do not improve the current-account balance. As a result of the changes they cause in exchange rates and other variables, some combination of reduced exports in other industries and increased imports completely offsets all increases in exports resulting from ITA activities. Thus, the ITA's export promotion activities hurt other U.S. firms.

370-03 ELIMINATE THE ADVANCED TECHNOLOGY PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	158	16
2001	197	59
2002	197	132
2003	197	187
2004	197	197
2005	197	197
2006	197	197
2007	197	197
2008	197	197
2009	197	197
Cumulative		
2000-2004	946	591
2000-2009	1,931	1,576

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-04

The Omnibus Trade and Competitiveness Act of 1988 established the Advanced Technology Program (ATP) within the Commerce Department's National Institute of Standards and Technology. This option would eliminate the ATP, whose objective is to further the competitiveness of U.S. industry by helping convert discoveries in basic research more quickly into technological advances with commercial potential. The program awards research and development (R&D) grants on the basis of merit to individual companies, independent research institutes, and joint ventures. The grants support research in generic technologies that have applications for a broad range of products as well as precompetitive research (preceding product development).

The ATP's grants are limited to $2 million over a three-year period when awarded to a single firm, but they have no dollar limit when awarded to a joint venture over a period of up to five years. Joint ventures must pay at least half of the R&D costs of each project, however, which helps ensure a project's commercial viability.

The ATP has awarded 352 grants from its inception through 1997, including awards to 100 joint ventures. Roughly two-thirds of the firms participating in awards are small or medium-sized firms, with large firms accounting for only 20 percent of grant recipients. Universities and other nonprofit organizations account for about 10 percent. Total funding committed to the research projects was $2.3 billion, of which the ATP paid roughly half.

Starting in 1998, the ATP explicitly required applicants to disclose their prior efforts to secure private financing. ATP officials also made consideration of spillover benefits part of the selection criteria. The ATP was responding to earlier research done by the General Accounting Office (GAO), which found that almost two-thirds of applicants had not even sought private capital before applying to the ATP and that half of the proposals the ATP rejected were subsequently funded privately. GAO found that the changes in the selection process, although positive, are insufficient, rely on the self-interested applicants for crucial information, or are difficult to operationalize.

Opponents of the program argue that private investors, not the federal government, are better able to decide which research efforts should be funded. Furthermore, citing the GAO survey, critics argue that even when the federal government chooses "a winner," it is just as likely as not to be displacing private capital. The U.S. venture capital markets are the best developed in the world and do an effective job of funding new ideas.

Program supporters argue that surveys of the ATP's award recipients indicate that the awards have accelerated the development and commercialization of advanced technology by two years or more in the majority of planned commercial applications. In addition, those surveys reveal that recipients are more willing to tackle high-risk technology development projects as a result of their grants, presumably increasing both the amount and the breadth of the R&D funded.

370-04 ELIMINATE THE MANUFACTURING EXTENSION PARTNERSHIP AND THE NATIONAL QUALITY PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	88	11
2001	110	35
2002	110	75
2003	110	105
2004	110	110
2005	110	110
2006	110	110
2007	110	110
2008	110	110
2009	110	110
Cumulative		
2000-2004	528	336
2000-2009	1,078	886

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-03

The Manufacturing Extension Partnership (MEP) and the National Quality Program reside in the National Institute of Standards and Technology. MEP consists primarily of a network of manufacturing extension centers that assist small and midsize firms with expertise in the latest management practices, manufacturing techniques, and other knowledge. The nonprofit centers are not owned by the federal government but are partly funded by it. The National Quality Program consists mainly of the Malcolm Baldridge National Quality Award, which is given to firms for achievements in quality. This option would eliminate the MEP.

Proponents of MEP point to the economic importance of small and midsize firms, which produce more than half of U.S. output and employ two-thirds of U.S. manufacturing workers. Small firms, they argue, often face limited budgets, lack of expertise, and other barriers to obtaining the information that MEP provides. Those circumstances and the substantial reliance of larger firms on small and midsize companies for supplies and intermediate goods lead proponents to contend that MEP is needed for U.S. productivity and international competitiveness.

Opponents may question the need for government to provide such technical assistance. Small firms thrived long before MEP began in 1989, in part because other sources of expertise were available. Many professors of business, science, and engineering are also consultants to private industry, and other ties between universities and private firms facilitate the transfer of knowledge. In fact, some of the centers MEP subsidizes predate MEP.

Furthermore, MEP cannot improve the competitiveness of the economy as a whole. The competitiveness of particular firms helped by MEP may improve, resulting in more exports or fewer competing imports. However, those changes in trade cause the dollar to rise in foreign exchange markets, decreasing the competitiveness of other U.S. firms. Overall, the balance of trade is not affected.

Finally, one may question MEP's positive effect on the economy's productivity. Federal spending for MEP is a subsidy for the firms MEP helps. In most cases, subsidies promote inefficiency by allowing inefficient firms to remain in business, tying up capital, labor, and other resources that would otherwise be used more productively elsewhere. In the case of businesses that increase their exports, part of the subsidy is likely to be passed on to foreign customers in the form of lower prices.

Like MEP advocates, defenders of the National Quality Program argue that it promotes U.S. competitiveness. The same counterargument used for MEP also applies to the National Quality Program. Opponents may argue that businesses need no government incentive to maintain quality—the threat of lost sales is sufficient. Furthermore, winners of the Baldridge Award often mention it in their advertising, which means they value it. If so, they should be willing to pay contest entry fees large enough to eliminate the need for federal funding.

370-05 ELIMINATE THE MINORITY BUSINESS DEVELOPMENT AGENCY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	22	6
2001	27	25
2002	27	27
2003	27	27
2004	27	27
2005	27	27
2006	27	27
2007	27	27
2008	27	27
2009	27	27
Cumulative		
2000-2004	130	112
2000-2009	265	247

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-01

The Minority Business Development Agency (MBDA) of the Department of Commerce plays the lead coordinating role in all federal programs for minority business development. Through public/private partnerships, the MBDA provides a variety of direct and indirect business services. It provides management and technical assistance, expands domestic and international marketing opportunities, and collects and disseminates business information. The agency also provides support for advocacy, research, and technology to reduce information barriers. This option would eliminate the MBDA, saving $2.5 billion over the 2000-2009 period.

The arguments for and against the MBDA mirror in part those of the larger debate over affirmative action. Proponents contend that minority groups, especially African Americans, have historically been, and continue to be, hindered by pervasive discrimination. They argue that such discrimination leads to financial and educational disadvantage and lack of experience, which means that members of minority groups are less competitive relative to (non-Hispanic) whites in the business world. Discrimination also hinders minority businesses in their task of developing business relationships with suppliers and customers. Minorities, according to the program's advocates, need a helping hand to compensate for those unfair handicaps.

Opponents maintain that discrimination has substantially declined and that which remains is best fought by enforcing civil rights laws in the courts. Although, on average, African Americans and certain other minority groups are economically and educationally disadvantaged in comparison with whites, in many individual instances the reverse is true: individual African Americans or members of other minorities may be quite wealthy and educated and are competing with individual whites who are not. In such cases, opponents point out, a desire to help the disadvantaged would argue for helping the white person—not the minority group member. It is unfair, according to that argument, to help current-generation minority individuals at the expense of current-generation whites simply because previous generations of whites benefited from discrimination against previous generations of minorities. Opponents contend that such help should be limited to remedies for specific acts of illegal discrimination that have been proved in court or to general help for anyone who is disadvantaged, regardless of race. If the MBDA was eliminated, the Small Business Administration would continue to provide assistance to small businesses in general.

370-06 ELIMINATE NEW FUNDING FOR THE RURAL RENTAL HOUSING ASSISTANCE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	55	3
2001	55	28
2002	55	42
2003	55	53
2004	55	54
2005	55	54
2006	55	54
2007	55	54
2008	55	54
2009	55	54
Cumulative		
2000-2004	275	180
2000-2009	550	450

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

600-02, 600-05, and REV-29

The Section 515 housing program, administered by the Rural Housing Service (RHS), provides low-interest mortgage loans to developers of multifamily rental projects in rural areas. Those mortgages typically have credits that reduce the effective interest rate to 1 percent and, in turn, lower rental costs for Section 515 tenants.

Under current rules, assisted tenants pay rent equal to the greater of 30 percent of their adjusted income or the minimum project rent. (The minimum project rent for each unit consists of a proportionate share of the amortization costs of the 1 percent mortgage and the project's operating expenses.) The owner of the housing project keeps the minimum rent, and the RHS collects any payments above it. Many of the poorest tenants receive additional federal subsidies through the Rural Rental Assistance Payments program that reduce their rent payments to 30 percent of their income.

Eliminating all new commitments for assistance under the Section 515 program would reduce federal outlays by about $450 million over the 2000-2009 period.

Support for this option is based on the view that expanding rural rental assistance is inappropriate when other federal programs are being cut. In addition, turnover among current project residents would ensure that the program would help some new income-eligible families each year.

Critics of this option point out that it would reduce the proportion of rural families the program can help as the number of eligible families continues to grow. Moreover, eliminating new funding for the program would slow the growth in the supply of standard-quality, low-income rental units in rural areas.

370-07 CHARGE A USER FEE ON COMMODITY FUTURES AND OPTIONS CONTRACT TRANSACTIONS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	15	15
2001	60	60
2002	60	60
2003	60	60
2004	60	60
2005	60	60
2006	60	60
2007	60	60
2008	60	60
2009	60	60
Cumulative		
2000-2004	255	255
2000-2009	555	555

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection, a mandatory offsetting receipt, or a revenue depending on the specific language of the legislation establishing the fee.

The Commodity Futures Trading Commission (CFTC) administers the amended Commodity Exchange Act of 1936. The purpose of the commission is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting participants from abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's operating costs. Such a fee would be similar to one now imposed on securities exchanges to cover the operating costs of the Securities and Exchange Commission (SEC).

A per-contract transaction fee could be imposed and remitted quarterly and adjusted periodically so that the money collected equals the CFTC's cost of operation. On the basis of the number of contracts traded in 1998, a fee of 10 cents per contract would generate enough money to cover the CFTC's operating expenses—$555 million over the 2000-2009 period. The CFTC would collect the fee. The Congressional Budget Office envisions that authorizing legislation would establish the fee, but only appropriation language would trigger the collection of the fee. The fee would then be classified as an offsetting collection.

The main arguments for the fee are based on the principle that users of government services should pay for those services. Participants in transactions that the CFTC regulates, rather than general taxpayers, are seen as the main beneficiaries of the agency's operations and therefore should pay a fee, according to proponents of the fee. Furthermore, the precedent for charging user fees has already been established by the SEC and other federal financial regulators, such as the Office of Thrift Supervision and the Office of the Comptroller of the Currency. Considerations of equity and fairness suggest that not charging a comparable fee to support CFTC operations could give futures traders an unfair advantage over securities traders.

People who argue against the fee maintain that such charges tend to encourage evasion by those who have to pay them. Users might try to avoid fees by limiting or shifting transactions to activities that are exempt from charges, which could conceivably cause some market participants to desert U.S. exchanges for foreign exchanges. Major competing foreign exchanges, however, already charge transaction fees. Even with the proposed 10-cent fee, U.S. futures exchanges may still have a cost advantage over their major foreign competitors.

CBO expects a fee of 10 cents to cause a negligible decrease in transactions because that fee is small compared with fees already imposed by the exchanges and the industry's self-regulatory organization, the National Futures Association.

370-08 ELIMINATE FHA MORTGAGE INSURANCE REBATES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	158	158
2001	158	158
2002	158	158
2003	158	158
2004	158	158
2005	158	158
2006	158	158
2007	158	158
2008	158	158
2009	158	158
Cumulative		
2000-2004	790	790
2000-2009	1,580	1,580

SPENDING CATEGORY:

Mandatory

The Federal Housing Administration (FHA) insures home mortgages made by private lenders. It assumes the default risk on loans to eligible home buyers, who usually make down payments of 5 percent or less and often have debt payment burdens that are high relative to their income. The agency charges both up-front and annual insurance premiums to cover its default losses. The up-front premium equals 2.25 percentage points of the mortgage amount; the annual premium equals 0.5 percentage point of the outstanding loan balance. The FHA partially refunds the up-front premium if the borrower pays off the mortgage in full during the first seven years. If the borrower takes out a new loan that the FHA insures, the refund is credited toward the up-front premium on the new loan. If the rebate and the equivalent credit were eliminated for newly insured loans, the government would save $158 million in 2000 and $790 million over five years. Over 10 years, the savings would total $1.6 billion.

Eliminating the rebate would raise the cost of FHA insurance, which could lead some borrowers to take their business to the private mortgage insurance industry rather than to the FHA. Borrowers who pose less default risk than the average ones served by the FHA would be most likely to do that because they are most likely to exercise their prepayment option. The increase in the cost of insurance would be fairly small for the average FHA borrower, however, who prepays within seven years only about 20 percent of the time. For the average FHA borrower, eliminating the rebate would be equivalent to increasing the up-front premium by about $1.70 for every $1,000 borrowed (17 basis points). Many borrowers probably do not place a high value on the rebate when deciding whether to use FHA or private insurance.

Eliminating the rebate of the FHA's up-front premium would make it easier for prospective FHA borrowers to evaluate the cost of the agency's insurance. It would also have the advantage of better directing FHA insurance to borrowers in need of government assistance. But the resulting increase in the relative cost of FHA insurance could hamper the agency's ability to attract low-risk borrowers, whose presence helps to maintain an actuarially sound insurance program. Because eliminating the rebate would probably not cause many low-risk borrowers to take their business elsewhere, however, it would probably have little effect on the soundness of the program. (The most effective way to ensure the program's soundness would be to introduce greater variation in FHA premiums based on a borrower's default risk.) In addition, raising the cost of FHA insurance by eliminating the rebate could cause some higher-risk borrowers to delay their home purchases or buy smaller homes. Because the FHA has a strong market presence among younger borrowers and low- and moderate-income and minority borrowers and neighborhoods, those home buyers and areas would most likely be affected. Whether higher-risk FHA borrowers account for the value of the rebate in deciding on the size and timing of their home purchases is unclear, however.

370-09 INCREASE THE GINNIE MAE GUARANTEE FEE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	40	40
2001	40	40
2002	40	40
2003	40	40
2004	40	40
2005	0	0
2006	0	0
2007	0	0
2008	0	0
2009	0	0
Cumulative		
2000-2004	200	200
2000-2009	200	200

SPENDING CATEGORY:

Discretionary

The Government National Mortgage Association, or Ginnie Mae, is a government corporation that facilitates the financing of federally insured and guaranteed home mortgages. Ginnie Mae guarantees mortgage-backed securities (MBSs) collateralized by home mortgages that are insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs or the Department of Agriculture's Rural Housing Service. Ginnie Mae now charges issuers an annual fee of 6 cents for every $100 (6 basis points) of guaranteed MBSs backed by single-family loans. Under current law, a fee increase to 9 basis points is scheduled to take effect in 2005. Moving the fee hike up to 2000 would save $40 million in 2000 and $200 million over five years.

The cost of the fee increase would be shared by two groups: the firms that issue and service the mortgages backing MBSs guaranteed by Ginnie Mae and borrowers who take out such loans. Ginnie Mae issuers would lose income from a reduction in their servicing fee from the current maximum of 44 basis points to 41 basis points (federal law limits the sum of the Ginnie Mae guarantee and servicing fees to 50 basis points). A Ginnie Mae servicing fee of 41 basis points would probably still surpass competitive levels, which has the benefit of inducing issuers to service loans well. Some issuers with low profit margins would leave the market as a result, but other firms in this highly competitive industry would increase their business. Issuers leaving the business would prefer to sell their portfolios rather than default, so Ginnie Mae's default costs would probably be unaffected.

Alternatively, some issuers of Ginnie Mae MBSs might try to maintain their profit margins by raising the interest rates on new federally insured or guaranteed mortgages they made. Fully passing on to borrowers the cost of an increase of 3 basis points in the guarantee fee would raise the monthly payments on a $100,000 loan by $2.50. An increase of that size would probably have little effect on the demand for federally insured and guaranteed mortgages or the volume of Ginnie Mae MBSs issued. Borrowers take out such loans mainly because the government accepts lower down payments and has less stringent underwriting guidelines than do private mortgage insurers.

Proponents of raising the Ginnie Mae guarantee fee by 3 basis points argue that the hike would result, at most, in a modest increase in the cost of using FHA mortgage insurance that would lead few, if any, borrowers to switch to private mortgage insurance. In addition, proponents argue that a modest reduction in the profitability of issuers of Ginnie Mae MBSs would not adversely affect the policy objective of ensuring a steady supply of credit to housing. Opponents of moving up the fee hike argue that any increase in the cost of using FHA mortgage insurance is unwarranted. They are also concerned about the precedent of raising the fee, which could open the door to later increases that could jeopardize the viability of many Ginnie Mae issuers or hasten the consolidation of the mortgage banking industry.

370-10 REQUIRE ALL GSEs TO REGISTER WITH THE SEC

	Added Receipts (Millions of dollars)
Annual	
2000	259
2001	257
2002	258
2003	258
2004	249
2005	256
2006	262
2007	92
2008	97
2009	102
Cumulative	
2000-2004	1,282
2000-2009	2,091

NOTE: Most of the additional receipts would be revenues; a portion of the fees would be offsetting collections credited against discretionary spending.

RELATED OPTION:

920-04

RELATED CBO PUBLICATIONS:

Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac (Report), May 1996.

Controlling the Risks of Government-Sponsored Enterprises (Report), April 1991.

Government-sponsored enterprises (GSEs) are private financial institutions chartered by the federal government to support the flow of funds to agriculture, housing, and higher education. GSEs achieve their public purposes by borrowing on the strength of an implicit federal guarantee of their debt obligations. The implicit guarantee lowers GSEs' cost of borrowing, conveying subsidies that give them a competitive advantage in financial markets. The federal government also explicitly subsidizes five GSEs—Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, the Farm Credit System, and Sallie Mae—by exempting them from the registration requirements of the Securities Act of 1933. That statute requires all corporations issuing stock or debt securities with maturities of more than nine months to register such offerings with the Securities and Exchange Commission (SEC), disclose uniform information about the securities, and pay registration fees. A sixth enterprise, Farmer Mac, is not exempt from SEC registration. In 1992, the Department of the Treasury, the Federal Reserve, and the SEC advocated requiring the five GSEs that are now exempt to register their securities with the SEC, which would save $259 million in 2000, $1.3 billion over five years, and $2.1 billion by 2009.

Requiring issuers to register their securities with the SEC protects investors by ensuring that all offerings are accompanied by disclosures of uniform information. GSEs were originally exempted from the requirement in part to relieve them of the costs of registering until they became accepted names in the marketplace. That rationale no longer applies: the five exempt GSEs are well known in financial markets. Repealing the exemption would not impose significant additional regulatory burdens on those GSEs because they now disclose most of the required information voluntarily. Moreover, it would reduce the competitive advantage that the enterprises have over other firms that finance loans by issuing debt or mortgage-backed securities. A more level playing field would likely lead to a more efficient allocation of credit.

To register with the SEC, each of the five GSEs would pay about 26 cents for every $1,000 (about 3 basis points) in securities it issued in 2000. SEC registration fees are scheduled to decline gradually under current law and will be less than 1 basis point in 2007 and later years. Competition from wholly private firms and between the enterprises would limit the GSEs' ability to recoup the cost of paying registration fees by raising the interest rates on the loans they finance. Fully absorbing the costs of registration would have little effect on either the enterprises' profits or the interest rates paid by the borrowers they serve. If Fannie Mae absorbed the full cost of registering its securities, for example, that GSE's after-tax return on equity would probably decline by less than 1 percentage point. But if Fannie Mae and Freddie Mac raised the rates on the home mortgages they buy so that the rate would cover the full cost of registering securities issued to finance such loans, the payments of homeowners with 30-year, fixed-rate loans with an initial balance of $150,000 would rise by less than 30 cents per month.

370-11 IMPOSE A LEASE FEE ON ANALOG TELEVISION LICENSEES

	Added Receipts (Millions of dollars)
Annual	
2000	200
2001	200
2002	200
2003	200
2004	200
2005	200
2006	200
2007	150
2008	134
2009	100
Cumulative	
2000-2004	1,000
2000-2009	1,784

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED CBO PUBLICATION:

Two Approaches for Increasing Spectrum Fees (Memorandum), November 1998.

In the next several years, new digital television service will be introduced, and the current analog television service will be turned off once the new service is well established. Analog television broadcasts are tentatively scheduled to end in 2006 but most likely will continue in many markets for awhile. After 2006, the analog licensees have the option of requesting an extension of their licenses in markets where digital television can be used by 85 percent of the households.

This option, also proposed in the President's budget, would impose a fee totaling $200 million per year on analog broadcasters, beginning in fiscal year 2000. (Television broadcasters now pay a fee of about $10 million per year that covers the cost to the Federal Communications Commission of regulating the television industry.) The proposed fee would continue for as long as a broadcaster held a license to broadcast analog television. After 2006, the number of analog broadcasters would decline, on a market-by-market basis, as the transition to digital television is completed. CBO estimates that this option would raise $200 million in 2000 and almost $1.8 billion over the 2000-2009 period.

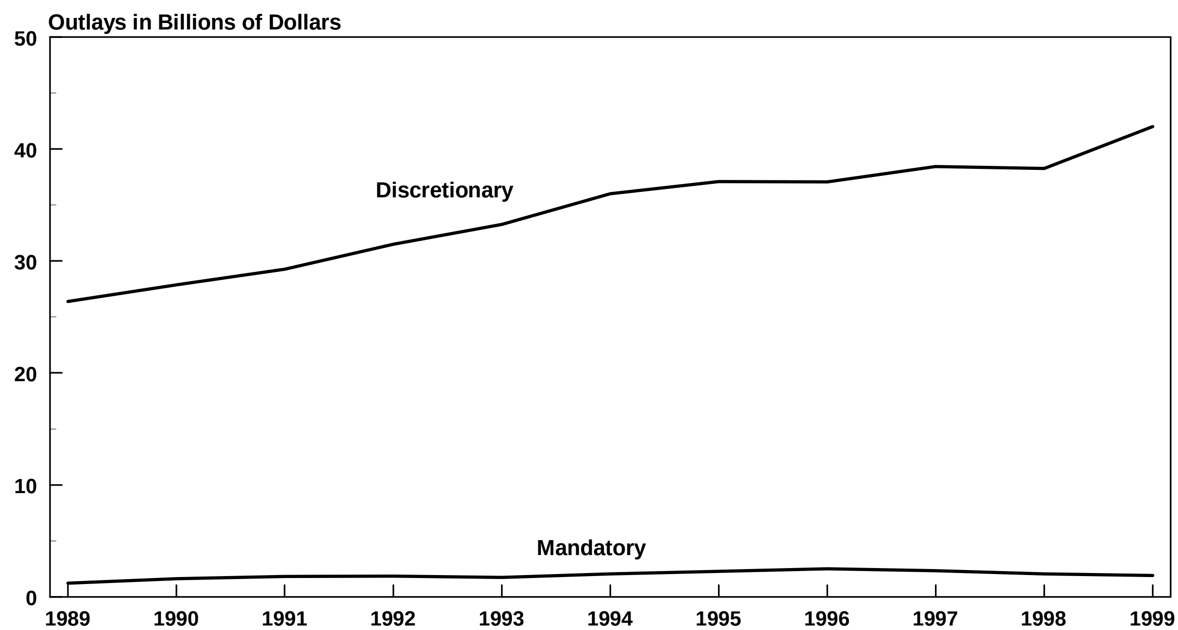
Proponents of the fee argue that broadcasters receive the right to use valuable publicly owned airwaves and should compensate the public for that right. In addition, the public has an interest in completing the transition to digital television by the end of 2006. The fee, which is approximately 20 times the current fee paid by broadcasters, would create a significant financial incentive for broadcasters not to extend their analog licenses after 2006.

Opponents of the fee argue that it places an undue burden on broadcasters and the television-viewing public and that the collection level set in the Administration's proposal is not supported by an economic rationale. Although the broadcast industry should be able to absorb the cost of the fee, the burden on some individual broadcasters could be significant, depending on how the fee is distributed among television licensees. Broadcasters may argue that the fee would consume revenues that would otherwise be used to support the transition to digital television, thus possibly delaying the introduction of the new service. Finally, broadcasters may cease broadcasting analog television in 2006 to avoid paying the fee even if the market they are in has not sufficiently converted to digital television. (Sufficient conversion means that 85 percent of households in a market would be able to receive the new signal). Consequently, many households may not be able to receive on-air television.

400

Transportation

Budget function 400 funds most programs of the Department of Transportation as well as aeronautical research by the National Aeronautics and Space Administration. It covers programs that aid and regulate ground, air, and water transportation, including grants to states for highways and airports and federal subsidies for Amtrak. CBO estimates that in 1999, discretionary outlays for function 400 will total over $42 billion. Discretionary budget authority provided for the function in 1999 is more than $14 billion. (Funding for some transportation programs is provided by mandatory contract authority.) Over the past 10 years, spending under function 400 has accounted for about 2.5 percent of federal outlays.



400-01 ELIMINATE FEDERAL SUBSIDIES FOR AMTRAK

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	609	244
2004	609	609
2005	609	609
2006	609	609
2007	609	609
2008	609	609
2009	609	609
Cumulative		
2000-2004	1,218	853
2000-2009	4,263	3,898

SPENDING CATEGORY:

Discretionary

This option would eliminate all federal subsidies for the National Railroad Passenger Corporation, commonly known as Amtrak, by the end of 2002. The Congress has appropriated $609 million for Amtrak in 1999; however, according to Amtrak's strategic business plan, Amtrak should be self-supporting on an operational basis by the end of 2002. By requiring Amtrak to finance its capital investments without federal assistance, the government would save $3.9 billion over the 2000-2009 period.

When the Congress established Amtrak in 1970, it anticipated providing subsidies for a limited time only, until Amtrak could become self-supporting. By the late 1970s, however, annual federal subsidies had risen to more than $1 billion. In fact, Amtrak has consumed more than $20 billion in federal subsidies since its creation.

In 1981, the Administration proposed substantial cuts in federal funding. Amtrak subsequently raised fares and reduced costs, and subsidies declined to about $600 million a year in the late 1980s. In the early 1990s, federal subsidies rose again, to about $950 million in appropriations in 1995, before declining to the current level. In addition to appropriations, Amtrak received $2.2 billion (in credits for tax refunds) under the Taxpayer Relief Act of 1997 for capital improvements and maintenance. This option would require Amtrak to continue on the path of cutting costs and increasing revenues.

Proponents of eliminating federal subsidies contend that the time has come for Amtrak to be self-supporting, as initially envisioned. Without federal subsidies, Amtrak would have to focus on service that has the greatest potential for financial success, such as the Metroliner's high-speed service along the congested corridor between Washington and New York City, where passengers are willing and able to pay the full cost of the service. Without subsidies, proponents argue, Amtrak would improve efficiency and equity in its operations and investments. Regarding equity, people who favor eliminating subsidies claim that it is unfair for the federal government to subsidize business travelers, who make up a substantial share of Amtrak passengers in congested corridors, and vacationers with high incomes. Under this option, states or local governments that want to keep Amtrak service in their areas could provide subsidies.

Opponents of ending subsidies say that reducing federal support would cause Amtrak to cancel service on lightly traveled routes, possibly leaving passengers in those areas without alternative transportation. They also note that subsidizing rail service in congested areas may be justified as a way of offsetting the congestion costs imposed on and by users of highways, airports, and airways. Retaining federal subsidies for Amtrak, especially for serving congested corridors, may help balance those costs. Moreover, improving service on some corridors could strengthen the national passenger rail system by providing linkages to better-performing routes.

400-02 ELIMINATE GRANTS TO LARGE AND MEDIUM-SIZED HUB AIRPORTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	858	146
2001	858	506
2002	858	695
2003	858	781
2004	858	824
2005	858	858
2006	858	858
2007	858	858
2008	858	858
2009	858	858
Cumulative		
2000-2004	4,290	2,952
2000-2009	8,580	7,242

SPENDING CATEGORY:

Budget authority is mandatory.
Outlays are discretionary.

Under the Airport Improvement Program (AIP), the Federal Aviation Administration (FAA) provides grants to airports for expanding runways, improving safety and security, and meeting other capital needs. From 1982 to 1997, nearly 44 percent of AIP funding went to large and medium-sized hub airports—the 70 or so airports that together account for nearly 90 percent of passenger boardings. This option would eliminate AIP funding for those airports but continue funding for smaller airports at levels consistent with those of 1999, assuming that the smaller airports will receive about 56 percent of the $1.95 billion made available in 1999, or about $1.1 billion.

Budget authority for the AIP is provided in authorization acts as contract authority, which is a mandatory form of budget authority. Spending of contract authority is subject to obligation limitations, which are contained in appropriation acts. Therefore, outlays from AIP contract authority are categorized as discretionary. Contract authority and obligation limitations allow an agency to enter into financial obligations that will result in future outlays. This option assumes that both budget authority and obligation limitations are reduced, saving $7.2 billion over the 2000-2009 period.

People who want to end the grants maintain that larger airports do not need federal funding and that federal grants simply substitute for funds that airports could raise from private sources. Because of their large volume of traffic, those airports generally have been able to finance investments through bond issues, passenger facility charges, and other user fees. In contrast, smaller airports may have more difficulty raising funds for capital improvements, although some have succeeded in tapping the same funding sources as their large counterparts. Supporters of this option argue that it would focus federal spending on airports that most need federal aid.

Proponents of continuing federal grants to larger airports argue that the controls exerted by the FAA as conditions of receiving aid ensure that the airports will continue to make investment and operating decisions that are consistent with the national interest of providing a safe and efficient aviation system.

400-03 ELIMINATE THE ESSENTIAL AIR SERVICE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	50	30
2001	50	50
2002	50	50
2003	50	50
2004	50	50
2005	50	50
2006	50	50
2007	50	50
2008	50	50
2009	50	50
Cumulative		
2000-2004	250	230
2000-2009	500	480

SPENDING CATEGORY:

Mandatory

The Essential Air Service (EAS) program was created by the Airline Deregulation Act of 1978 to continue air service to communities that had received federally mandated air service before deregulation. The program provides subsidies to air carriers serving small communities that meet certain criteria. Subsidies currently support air service to 114 U.S. communities, including 26 in Alaska (for which separate rules apply). The number of passengers served annually has fluctuated in recent years, as has the subsidy per passenger, which has ranged from $4 to $400. The Congress has directed that such subsidies not exceed $200 per passenger unless the community is more than 210 miles from the nearest large or medium-sized hub airport.

This option would eliminate the EAS program, thus providing savings in mandatory outlays of $480 million from 2000 to 2009. To adopt this option, the Congress would have to modify the provision of the Federal Aviation Reauthorization Act of 1996 that authorized $50 million a year in direct spending for the EAS program. That law also authorized the Federal Aviation Administration (FAA) to collect up to $100 million in fees for specified air traffic control services (for certain aircraft flying over the United States but not taking off or landing at a U.S. airport), of which $50 million was to be made available for the EAS subsidies. The law further provided that even if the FAA did not collect $50 million in fees, it still had to provide that amount for the EAS program. The FAA's initial fee structure was overturned in court, however. While the agency is developing a new fee structure, it is collecting no fees. This option would not affect fee collection, but it would sever the link between fees and EAS subsidies. Phasing out the program over several years would mitigate disruptions.

Critics of the EAS program contend that the subsidies are excessive, providing air transportation at a high cost per passenger. They also maintain that the program was intended to be transitional and that the time has come to phase it out. If states or communities derive benefits from service to small communities, the states or communities could provide the subsidies themselves.

Supporters of the subsidy program claim that it prevents the isolation of rural communities that would not otherwise receive air service. Subsidies are not available for service to communities located less than 70 miles from a large or medium-sized hub airport (except in Alaska). The availability of airline transportation is an important ingredient in the economic development of small communities. Without continued air service, according to some proponents, some towns might lose a sizable portion of their economic base.

400-04 ELIMINATE NASA's SUPPORT FOR PRODUCERS AND USERS OF COMMERCIAL AIRLINERS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	216	102
2001	270	224
2002	270	259
2003	270	269
2004	270	270
2005	270	270
2006	270	270
2007	270	270
2008	270	270
2009	270	270
Cumulative		
2000-2004	1,296	1,124
2000-2009	2,646	2,474

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

250-01

The National Aeronautics and Space Administration (NASA) funds two programs that develop technology and systems intended for use in commercial airliners to preserve the U.S. share of the current and future world airliner market. The first, the Advanced Subsonic Technology program, explores technologies that would create safer, more fuel-efficient, less polluting, and cheaper airliners than today's models. The program also supports the development of technologies that could extend the life of existing aircraft. The second program, the High-Speed Research program, involves a cooperative venture with U.S. industry for developing an economically viable commercial supersonic airliner. This option would eliminate both programs, saving $2.5 billion over 10 years.

The case for eliminating the programs is that the research and development (R&D) necessary to maintain U.S. market share is a private rather than a public responsibility. Aircraft company owners and employees benefit from success in the world market; therefore, they should pay for the R&D necessary to produce better aircraft, according to that argument. Sizable investments are needed to develop, produce, and market a new commercial aircraft—$8 billion to $10 billion by some estimates—and developing new aircraft requires many years. Neither of those facts, however, should affect whether the public or private sector pays for producing the necessary technologies. Moreover, the Boeing Company's recent decision to withdraw its participation from the High-Speed Research program indicates a lack of private-sector interest.

The case for continuing the programs is based largely on the unique competitive features of the market for large commercial aircraft. The United States and the European Union have a bilateral agreement permitting public support for developing commercial airliners. If the federal government failed to grant U.S. aircraft companies support comparable with that provided by the governments of European competitors, advocates of ending the programs argue, U.S. producers would face a severe disadvantage in the global market.

A second argument for continuing NASA's expenditures on the programs is that limitations on noise levels and atmospheric pollutants impose an unfunded federal mandate on aircraft producers and airlines. Federal funds spent for research on noise and pollution abatement, compared with funds spent for enhancing the economic viability of commercial aircraft, might be justified because those funds cover a cost that federal law imposes on the industry. The extent to which noise and atmospheric pollutants generated by jet air travel constitute unpaid "costs" that air travelers impose on the public at large, however, diminishes that argument. From that point of view, it is appropriate that aircraft producers, airlines, and, ultimately, air travelers pay the full social cost of their activities—including the cost of R&D for current and future jet aircraft.

400-05 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Added Receipts (Millions of dollars)
Annual	
2000	500
2001	500
2002	500
2003	500
2004	500
2005	500
2006	500
2007	500
2008	500
2009	500
Cumulative	
2000-2004	2,500
2000-2009	5,000

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED CBO PUBLICATION:

Paying for Highways, Airways, and Waterways: How Can Users Be Charged? (Study), May 1992.

The Federal Aviation Administration (FAA) has established controls on airport takeoff and landing slots at four airports: Kennedy International and La Guardia in New York, O'Hare in Chicago, and Ronald Reagan Washington National Airport. Under this option, the FAA would charge annual fees for slots at those airports.

The FAA instituted limits on takeoff and landing slots in 1968 and allocated them to airlines without charge. FAA-controlled airports have about 3,500 air carrier slots and 1,000 commuter and general aviation slots. Airlines are allowed to buy and sell slots from and to each other, with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules for using them at any time.

Estimating the revenue from slot charges is difficult. Slot values vary by airport, time of day and season they are available, and other factors. Moreover, both legislative and administrative actions may reduce slot values substantially. Legislation under consideration in the 106th Congress would eliminate slot restrictions at Kennedy, La Guardia, and O'Hare and would increase the number at Ronald Reagan Washington National. Those provisions would eliminate or greatly reduce the value of existing slots. In addition, in recent years, the Secretary of Transportation has approved several exemptions to the slot rules to permit new service to rural areas or to increase competition. The effect of those exemptions on slot values is unclear. On the one hand, the increase in the supply of slots could diminish the value of each slot. On the other hand, exemptions for rural service could add to the value of some air carriers' slots by providing feeder traffic for their main routes. The amount of revenue that the government would obtain from annual charges would depend on similar factors. For those reasons, the Congressional Budget Office's revenue estimates are somewhat equivocal. CBO estimates receipts to be about $500 million annually, but they could be higher or lower depending on the structure of the slots' leasing arrangements—such as length, whether slots could be subleased, and usage requirements—as well as market conditions affecting the airline industry.

The main argument for establishing charges for slots is that public airspace is scarce and private firms and individuals should pay for the benefits that result from that scarcity. Furthermore, the charges would provide an incentive for using those scarce resources most efficiently.

The main argument against charging for slots is that the scarcity of slots at the four airports mentioned arises mainly from a lack of land and runway space; the fees are not intended to provide more capacity. Furthermore, if the current prices that airlines already pay in the private sale of slots accurately reflect their value, the proposal might not produce more efficient use of those scarce resources; the result would only redistribute the benefits from their use between the private and public sectors.

400-06 INCREASE USER FEES FOR FAA CERTIFICATES AND REGISTRATIONS

	Added Receipts (Millions of dollars)
Annual	
2000	4
2001	4
2002	4
2003	4
2004	4
2005	4
2006	4
2007	4
2008	4
2009	4
Cumulative	
2000-2004	20
2000-2009	40

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTION:

300-13

The Federal Aviation Administration (FAA) oversees a large regulatory program to ensure safe operation of aircraft within the United States. It oversees and regulates the registration of aircraft, licensing of pilots, issuance of medical certificates, and other similar activities. The FAA issues most licenses and certificates free of charge or at a price well below its cost of providing such regulatory approvals. For example, the current fee for registering aircraft is $5, but the FAA's cost of providing the service is closer to $30. The FAA estimates the cost of issuing a pilot's certificate to be $10 to $15, but the agency does not charge for the certificates. Imposing fees to cover the costs of the FAA's regulatory services could increase receipts by an estimated $20 million over the 2000-2004 period. Net savings could be somewhat smaller than those shown if the FAA needed additional resources to develop and administer fees.

The Drug Enforcement Assistance Act of 1988 authorizes the FAA to impose several registration fees as long as they do not exceed the agency's cost of providing that service. For general aviation, the act allows fees of up to $25 for aircraft registration and up to $12 for pilots' certificates (plus adjustments for inflation). Setting higher fees would require additional legislation. The Congress could provide for them in the legislation currently under consideration that would reauthorize the FAA.

Increasing regulatory fees might burden some aircraft owners and operators. That effect could be mitigated by setting registration fees according to the size or value of the aircraft rather than to the FAA's cost. FAA fees based on the cost of service, however, would be comparable with automobile registration fees and operators' licenses and thus likely to be affordable, especially when compared with the total cost of owning an airplane.

400-07 ESTABLISH MARGINAL COST-BASED FEES FOR AIR TRAFFIC CONTROL SERVICES

	Added Receipts (Millions of dollars)
Annual	
2000	2,000
2001	2,000
2002	2,000
2003	2,000
2004	2,000
2005	2,000
2006	2,000
2007	2,000
2008	2,000
2009	2,000
Cumulative	
2000-2004	10,000
2000-2009	20,000

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

RELATED OPTION:

300-13

RELATED CBO PUBLICATION:

Paying for Highways, Airways, and Waterways: How Can Users Be Charged? (Study), May 1992.

The Federal Aviation Administration (FAA) operates the air traffic control (ATC) system, which serves commercial air carriers, military aircraft, and such smaller users as air taxis and private corporate and recreational aircraft. Traffic controllers in airport towers, terminal radar approach control facilities (TRACONs), and air route traffic control centers (ARTCCs) help guide aircraft safely as they taxi to the runway, take off, fly through designated airspace, land, and taxi to the airport gate. Other ATC services include flight service stations that provide weather data and other information useful to small-aircraft operators.

This option would impose fees for ATC services that reflect the FAA's marginal costs of providing the services. The marginal cost of a flight equals the costs of each ATC service (or contact) provided for that flight. For example, a commercial flight from New York to San Francisco entails contacts with two airport towers, two TRACONs, and seven ARTCCs. Under this option, the airline would pay the sum of the marginal costs of each of those contacts. A 1997 FAA study estimated total marginal costs to be about $2 billion a year.

The amount of the government's total collections in fees based on marginal costs plus revenues from aviation user taxes could equal either more or less than the FAA's total expenditures. Currently, appropriations from the general fund finance part of the operational cost of the ATC system. The Airport and Airway Trust Fund, comprising revenues from user taxes (such as the airline passenger ticket tax), finances the rest of the costs. In recent years, the general fund's share of costs has averaged about $2 billion (or about half of total ATC costs). The amount provided from the general fund dropped to about $1 billion (or about one-quarter of ATC costs) in 1999. If charging users their marginal costs yielded larger federal collections than needed to cover future general fund contributions, the fees could be lowered or excise taxes reduced accordingly.

Fees based on marginal costs would affect different types of airline operations differently. Carriers mainly using hub-and-spoke networks would probably face higher fees than those providing nonstop origin-destination flights because of differences in the number of contacts with towers and TRACONs.

Imposing fees for marginal costs would encourage users to use the ATC system efficiently. Noncommercial users might reduce their consumption of ATC services, freeing controllers for other tasks and increasing the system's overall capacity. By analyzing the pattern of revenues from user fees, FAA planners could better decide on the amount and location of additional ATC investment, which would improve system efficiency.

The main argument against this option is that it would raise the cost of ATC services to users. Such a move could weaken the financial condition of some commercial air carriers.

400-08 DISCONTINUE FUNDING FROM THE GENERAL FUND FOR HIGHWAY PROJECTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	132	36
2001	132	91
2002	132	114
2003	132	121
2004	132	127
2005	132	129
2006	132	132
2007	132	132
2008	132	132
2009	132	132
Cumulative		
2000-2004	660	488
2000-2009	1,320	1,146

SPENDING CATEGORY:

Discretionary

The Transportation Equity Act for the 21st Century (TEA-21) authorized spending of about $175 billion from the Highway Trust Fund, which provides the appropriations for construction and maintenance of interstate highways and bridges and a variety of other federal efforts related to highways. That funding level represents an increase from previous authorizations. In 1999, the Congress appropriated from the general fund additional funding for highway programs above the level authorized by TEA-21. This option would discontinue making appropriations from the general fund for highway programs, saving $1.1 billion over the 2000-2009 period.

The Appalachian Development Highway Program (ADHP) exemplifies one program that would not receive additional funding under this option. It also serves as the basis for estimating the amount of money that this option could save. The Congress has appropriated $132 million from the general fund for roads in the ADHP. That amount was in addition to TEA-21's authorization of $450 million annually (subject to contract authority to be appropriated from the Highway Trust Fund) for the ADHP. Before 1998, ADHP received about $100 million annually. This option assumes that no additional outlays would be provided from the general fund after 1999.

People who favor discontinuing the use of the general fund for funding highway projects contend that TEA-21 was the appropriate authorizing legislation for the Congress to use in deciding how much to spend on highways and how to set priorities for road projects. They argue that the additional $132 million from the general fund was not scrutinized as much as the funds authorized by TEA-21. In addition, proponents of this option maintain that highway funding under TEA-21 has increased significantly compared with previous years, currently providing much more funding for ADHP than in recent years. Opponents of this option argue that the funding is needed to promote economic development in areas that have lagged behind the rest of the country and that the Appalachian region has been short-changed for many years.

400-09 IMPOSE A USER FEE TO COVER THE COST OF THE FEDERAL RAILROAD ADMINISTRATION'S RAIL SAFETY ACTIVITIES

	Added Receipts (Millions of dollars)
Annual	
2000	61
2001	61
2002	61
2003	61
2004	61
2005	61
2006	61
2007	61
2008	61
2009	61
Cumulative	
2000-2004	305
2000-2009	610

SPENDING CATEGORY:

This fee could be classified as a discretionary offsetting collection or a mandatory offsetting receipt depending on the specific language of the legislation establishing the fee.

The function of the Railroad Safety Program is to protect railroad employees and the public by ensuring the safe operation of passenger and freight trains. Field safety inspectors are responsible for enforcing federal safety regulations and standards. Other functions include issuing standards, procedures, and regulations; administering postaccident and random drug testing of railroad employees; providing technical training; and managing highway grade-crossing projects.

Railroad safety fees, which had been authorized in the Omnibus Budget Reconciliation Act of 1990, expired in 1995. Before 1995, railroads were subject to the Federal Railroad Administration's (FRA's) safety oversight user fees that covered the safety enforcement and administrative costs of carrying out FRA's mandated safety responsibilities. Those fees offset a portion of federal spending on safety programs. As of 1995, the FRA does not receive any funding from user charges for operating its safety program.

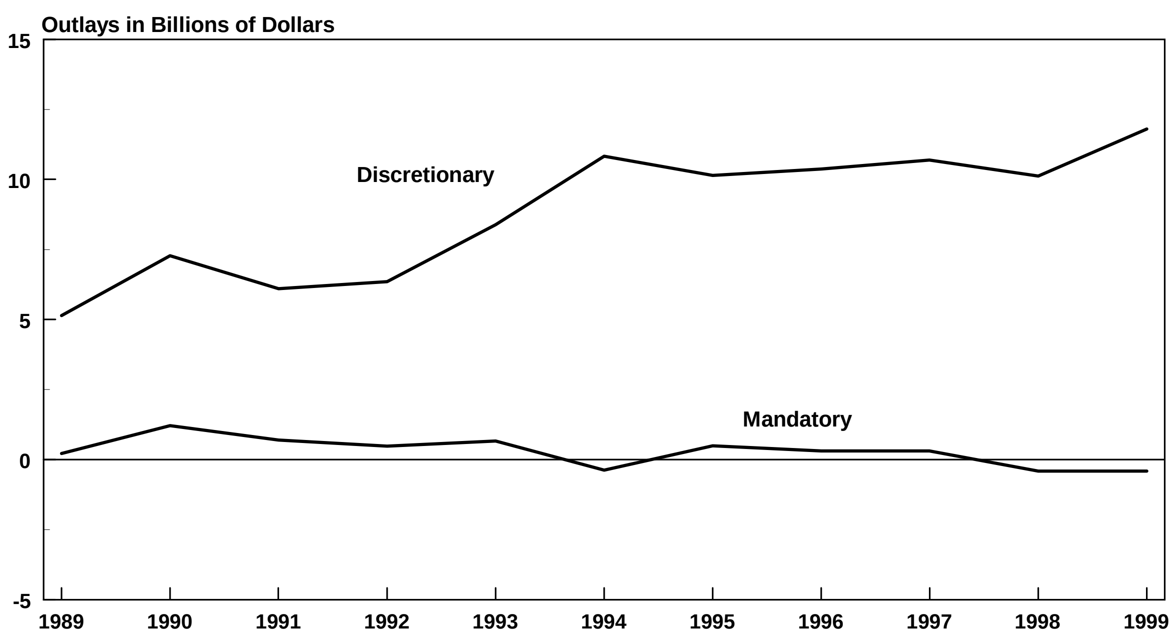
This option would impose new user fees to offset 100 percent of the costs of the Railroad Safety Program—$600 million over 10 years. Those in favor of user fees contend that the specific recipients of government services should bear the cost of those services. The user fees would relieve the general taxpayer of the burden of supporting the Railroad Safety Program.

People who oppose having users pay for the service contend that the general public is the main beneficiary of the Railroad Safety Program. Critics of this option also note that other than businesses in the pipeline industry, no other freight or transportation businesses pay safety user fees.

450

Community and Regional Development

Budget function 450 funds programs that support the development of physical and financial infrastructure intended to promote viable community economies, including activities of the Department of Commerce and the Department of Housing and Urban Development. This function also includes spending to help communities and families recover from natural disasters and spending for the rural development activities of the Department of Agriculture, the Bureau of Indian Affairs, and other agencies. CBO estimates that in 1999, discretionary outlays for function 450 will be almost $12 billion; discretionary budget authority of more than $10 billion was provided this year. During the past 10 years, spending under function 450 has fluctuated between just under 0.6 percent and just over 0.7 percent of federal outlays.



450-01 CONVERT THE RURAL COMMUNITY ADVANCEMENT PROGRAM TO STATE REVOLVING LOAN FUNDS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	0	0
2004	0	0
2005	723	22
2006	723	152
2007	723	347
2008	723	528
2009	723	643
Cumulative		
2000-2004	0	0
2000-2009	3,615	1,692

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

270-05 and 300-03

The Department of Agriculture's Rural Community Advancement Program (RCAP) assists rural communities by providing loans, loan guarantees, and grants for rural water and waste disposal projects, community facilities, economic development, and fire protection. Funds are generally allocated among the states on the basis of their rural populations and the number of rural families with income below the poverty threshold. Within each state's allocation, the department awards funds competitively to eligible applicants, including state and local agencies, nonprofit organizations, and (in the case of loan guarantees for business and industry) for-profit firms.

The terms of a particular recipient's assistance depend on the purpose of the aid and, in some cases, the economic condition of the recipient's area. For example, aid for water and waste-disposal projects can take the form of loans with interest rates ranging from 4.5 percent to market rates, depending on the area's median household income; areas that are particularly needy may receive grants or a mix of grants and loans.

For 1999, the Congress appropriated $723 million for RCAP's grants and the budgetary cost of its loans and loan guarantees, which is defined under credit reform as the present value of the interest rate subsidies and expected defaults. The Congress could reduce future spending by capitalizing state revolving loan funds (SRLFs) for rural development and then ending federal RCAP assistance. The amount of federal savings would depend on the level and timing of the contribution to capitalize the SRLFs. Under one illustrative option, the federal government would provide steady funding of $723 million annually for five more years to capitalize the funds, then cut off assistance in 2005. The option would yield savings of $1.7 billion from 2005 to 2009. That level of capitalization alone would not support the volume of loans and grants now provided annually by RCAP. Accordingly, the Congress could choose to allow the SRLFs to use the capitalization funds as collateral with which to leverage additional capital from the private sector, as has been allowed with the SRLFs established under the Clean Water Act and Safe Drinking Water Act.

The main argument for replacing RCAP with a system of SRLFs is that the federal government should not bear continuing responsibility for local development; rather, programs that benefit localities, whether urban or rural, should be funded at the state or local level. On the basis of that argument, a few more years of federal funding to capitalize SRLFs would provide a reasonable transition to the desired policy.

One argument against converting RCAP is that without annual infusions of new federal money, states will feel a need to stretch their rural development funds by reducing the number of grants and interest rate subsidies, making it harder for needier communities to find affordable assistance. In addition, precedent suggests that the estimated federal savings may not materialize: the Congress continues to appropriate additional grants to the state funds for wastewater treatment systems, long past the point at which those funds were originally designed to be independent of federal support.

450-02 ELIMINATE THE ECONOMIC DEVELOPMENT ADMINISTRATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	374	23
2001	380	111
2002	386	198
2003	390	305
2004	391	380
2005	392	392
2006	392	392
2007	392	392
2008	392	392
2009	392	392
Cumulative		
2000-2004	1,921	1,017
2000-2009	3,881	2,977

SPENDING CATEGORY:

Discretionary

The Economic Development Administration (EDA), an agency within the Commerce Department, provides grants to state and local governments for public works, technical assistance, defense conversion activities, and job programs, as well as loan guarantees to firms for business development. For 1999, appropriations for EDA programs total $392 million. Eliminating EDA would reduce federal outlays by $23 million in 2000 and $3 billion over the 2000-2009 period.

The main argument for eliminating EDA—and all federal efforts in local economic development—is that money for activities that mainly benefit localities should be provided by state or local governments, not the federal government. Even if one accepts a federal role in local development, however, EDA's effectiveness in accomplishing that mission is questionable. The 1993 National Performance Review found, for example, that the agency had not adequately adapted to increased development activity by state and local governments, that it had an outdated emphasis on public works and infrastructure development, and that the many federal development programs resulted in "fragmentation, poor quality, and excessive bureaucracy." Nonetheless, five years later, public works remains the single largest category of EDA assistance, and several federal departments and agencies continue to operate large, distinct development programs. Critics also argue that EDA's broad eligibility criteria, which cover areas containing an estimated 80 percent to 90 percent of the U.S. population, allow the agency to approve grants to communities that are not economically distressed. In two examples from 1995, EDA gave Cheyenne, Wyoming, and Rapid City, South Dakota, grants totaling $980,000, although the cities' unemployment rates were below their states' averages—3.3 percent and 2.6 percent, respectively, compared with 4.5 percent and 2.9 percent statewide.

Supporters of continued funding for EDA argue that the federal government has a legitimate role to play in local development, not only in providing needy areas with more funding than they would receive from their state governments or could raise locally but also in helping communities adjust to such federal policies as military base closures and free-trade agreements. EDA's supporters also note that the agency has reduced staff from early-1990s' levels, eliminated many regulations, and established performance measures for its grant programs. Supporters also cite evidence that agency grants generally do target needier areas: a 1997 Rutgers University study of the 203 public works program grants receiving their final payment in 1990 found that poverty and unemployment rates were roughly 40 percent higher and per capita income was about 40 percent lower in the median recipient county than nationwide.

450-03 ELIMINATE THE APPALACHIAN REGIONAL COMMISSION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	66	7
2001	66	20
2002	66	40
2003	66	50
2004	66	59
2005	66	66
2006	66	66
2007	66	66
2008	66	66
2009	66	66
Cumulative		
2000-2004	330	176
2000-2009	660	506

SPENDING CATEGORY:

Discretionary

The federal government provides annual funding to the Appalachian Regional Commission (ARC) for activities that promote economic growth in the Appalachian counties of 13 states. For 1999, the Congress appropriated $66 million for ARC. The states are responsible for filing development plans and recommending specific projects for federal funding. The commission distributes the funds competitively according to such factors as the area's growth potential, per capita income, and unemployment rate; the financial resources of the state and locality; the project's prospective long-term effectiveness; and the degree of private-sector involvement.

ARC supports a variety of programs, including the Community Development Program, mainly to create jobs; the Human Development Program, to improve rural education and health; and the Local Development District Programs, to provide planning and technical assistance to multicounty organizations. (In 1998, the Congress transferred the responsibility for the Appalachian Development Highway System, previously another main ARC program, to the general Transportation Trust Fund.) Federal funds also support 50 percent of the salaries and expenses of ARC staff. Discontinuing the programs funded through ARC would reduce federal outlays by $7 million in 2000 and by $506 million over the 2000-2009 period.

The debate over eliminating ARC focuses on two main points. First, ARC's critics argue that the responsibility for supporting local or regional development basically lies with the state and local governments whose citizens will benefit from the development, not with the federal government. ARC's supporters believe that the federal government has a legitimate role to play in redistributing funds among states to support development in the neediest areas and that reducing federal funding would reduce local progress in job creation, education, and health care. Second, the agency's critics note that all parts of the country have needy areas and argue that those areas in Appalachia have no special claim to federal dollars. According to such critics, needy Appalachian areas should, like other areas, get federal development aid through national programs, such as those of the Economic Development Administration. ARC's defenders respond that Appalachia's size, physical isolation, and severe poverty have created a unique situation requiring special attention.

450-04 DROP WEALTHIER COMMUNITIES FROM THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	591	12
2001	591	201
2002	591	449
2003	591	532
2004	591	561
2005	591	585
2006	591	591
2007	591	591
2008	591	591
2009	591	591
Cumulative		
2000-2004	2,955	1,755
2000-2009	5,910	4,704

SPENDING CATEGORY:

Discretionary

The Community Development Block Grant (CDBG) program provides annual grants, by formula, to metropolitan cities and urban counties through what is referred to as its entitlement component. The program also allocates funds, by formula, to each state. Those funds are distributed among the states' smaller and more rural communities, called nonentitlement areas, typically through a competitive process.

In general, CDBG funds must be used to aid low- and moderate-income households, eliminate slums and blight, or meet emergency needs. Specific eligible uses include housing rehabilitation, infrastructure improvement, and economic development. Funds from the entitlement component may also be used to repay bonds that are issued by local governments (for acquiring public property, for example) and guaranteed by the federal government under the Section 108 program. For 1999, the CDBG program received a regular appropriation of $4.75 billion, including $2.95 billion for entitlement communities, plus supplemental appropriations totaling $380 million.

Under current law, all urban counties, metropolitan cities, and other cities of 50,000 or more are eligible for the CDBG entitlement program. The formula for allocating entitlement funds includes the following factors: population, the number of residents with income below the poverty level, the number of housing units with more than one person per room, the number of housing units built before 1940, and the extent to which an area's population growth since 1960 is less than the average for all metropolitan cities. The formula neither requires a threshold percentage of residents living in poverty nor excludes communities with high average income.

Federal spending for the program could be reduced by focusing entitlement grants on more needy jurisdictions and lowering funding accordingly. Several alternative changes to the current formula could yield similar results; one simple approach, however, would be to exclude communities whose per capita income exceeds the national average by more than a certain percentage. Data from the Department of Housing and Urban Development on the 1993 grants to entitlement cities (but not counties) suggest that restricting the grants to communities whose per capita income is less than 112 percent of the national average, for example, would save 26 percent of the entitlement funds, in part by cutting the large grants to New York City and Los Angeles. To illustrate the general idea, the Congressional Budget Office has assumed a somewhat smaller cut of 20 percent of entitlement funding, which would save an estimated $12 million in 2000 and $4.7 billion from 2000 to 2009.

Proponents of that change argue that if the CDBG program can be justified at all—some argue that using federal funds for local development is generally inappropriate—its primary rationale is redistribution and that redistributing money to less needy communities serves no pressing interest. Opponents argue that such a change would reduce efforts to aid low- and moderate-income households in poverty pockets within those communities because local governments would not sufficiently redirect their own funds to completely offset the lost grants.

450-05 ELIMINATE THE NEIGHBORHOOD REINVESTMENT CORPORATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	90	90
2001	90	90
2002	90	90
2003	90	90
2004	90	90
2005	90	90
2006	90	90
2007	90	90
2008	90	90
2009	90	90
Cumulative		
2000-2004	450	450
2000-2009	900	900

SPENDING CATEGORY:

Discretionary

The Neighborhood Reinvestment Corporation (NRC) is a public, nonprofit organization charged with revitalizing distressed neighborhoods. The NRC oversees a network of locally initiated and operated groups called Neighbor Works® organizations, or NWOs, which engage in a variety of housing, neighborhood revitalization, and community-building activities. The corporation provides technical and financial assistance to begin new NWOs; it also monitors and assists current network members. As of 1998, the NeighborWorks® network had 181 NWO members operating in 825 communities nationwide.

For 1999, the NRC's appropriation of $90 million represents 94 percent of its annual income. With those funds, the corporation provides grants, conducts training programs and educational forums, and produces publications in support of member NWOs. The bulk of the grant money goes to NWOs, which use the funds to cover operating costs; conduct projects; purchase, construct, and rehabilitate properties; and capitalize their revolving loan funds. NWO revolving loan funds make home ownership and home improvement loans to individuals or loans to owners of mixed-use properties who provide long-term rental housing for low- and moderate-income households. In addition, the NRC awards grants to Neighborhood Housing Services of America to provide a secondary market for the loans from NWOs. Eliminating the NRC would save $900 million over 10 years.

One argument for eliminating the NRC is that the federal government should not fund programs whose benefits are local rather than national. A second argument is that the NeighborWorks® approach duplicates the efforts of programs from other federal agencies (particularly the Department of Housing and Urban Development, or HUD) and government-sponsored enterprises (such as the Federal Home Loan Bank System and the Federal Home Loan Mortgage Corporation) that also rehabilitate low-income housing and promote home ownership and community development. Third, critics of the corporation argue that even within the NeighborWorks® approach, the NRC is a redundant funding channel. In 1997, NRC grants accounted for about one-quarter of the NWOs' governmental funding and roughly 6 percent of their total funding. Larger shares came from private lenders, foundations, corporations, and HUD.

The NRC's defenders argue that the large number of federal programs to assist local development is evidence of widespread support for a federal role—particularly in areas where state and local governments may lack adequate resources of their own. They further argue that NWOs focus on whole neighborhoods rather than individual housing properties, and with their nonhousing activities—such as community organization building, neighborhood cleanup and beautification, and leadership development—provide economic and social benefits that other federal programs do not. Finally, defenders say that the NRC is a valuable part of the approach because of its flexibility in making grants, which allows it to fund valuable NWO efforts that do not fit within the narrow criteria of larger federal grantors, and the services it provides to the NWOs, such as training, program evaluation, and technical assistance.

450-06 ELIMINATE FUNDING FOR NEW EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	60	1
2001	60	20
2002	60	46
2003	60	55
2004	60	57
2005	60	60
2006	60	60
2007	60	60
2008	60	60
2009	60	60
Cumulative		
2000-2004	300	179
2000-2009	600	479

SPENDING CATEGORY:

Discretionary

The Omnibus Budget Reconciliation Act of 1993 authorized a new program under which 104 economically distressed communities could be designated as "empowerment zones" or "enterprise communities." The EZ/EC communities, as they are known, must satisfy certain eligibility criteria and are selected in a competitive review of strategic plans for implementing the program. Designated communities receive federal funding—up to $100 million over 10 years for each urban EZ, $40 million for each rural EZ, and just under $3 million for each EC—for a broad range of economic and social development activities consistent with their strategic plans, plus access to certain tax preferences for businesses locating or expanding in an EZ or EC area.

The Congress authorized the designation of 20 new EZs in 1997—15 in urban areas and five in rural areas. The first funding for those second-round EZs appeared in the omnibus appropriation bill for 1999, which provided $55 million in grant money—less than the $170 million requested by the Administration as part of a proposed 10-year mandatory budget item. The bill also appropriated $5 million for 20 additional rural ECs but did not grant them the tax preferences provided to previous ECs. If the Congress chose to provide the second-round EZs and ECs with the same grant funding as the first-round communities, the initial $60 million would effectively be a down payment toward total spending of $1.759 billion.

CBO estimates that eliminating grant funding for the second round of EZs and ECs would save $1 million in 2000 and about $480 million over the 2000-2009 period, assuming that the alternative is continued funding at the 1999 level. One argument for eliminating the funding is that local economic development is an inappropriate use of federal dollars and should be left to state and local governments. Another is that the federal government already has duplicative programs promoting economic development—including Community Development Block Grants, programs of the Economic Development Administration, and various regional commissions and authorities (see other options under budget function 450)—and that the relatively new EZ/EC program should be stopped before developing its own entrenched constituency.

Supporters of continued funding for the second round of EZs and ECs argue that early evidence from the first-round communities indicates that the program is working well—developing local capacities through its strategic planning requirements and building public/private partnerships that leverage federal dollars with private investments. Supporters also note that EZ/EC communities are by definition high-poverty areas and require more public resources than local and state governments are willing and able to provide. Furthermore, they argue that the new EZs and ECs applied for the designations expecting that multiyear funding would be available.

450-07 DROP FLOOD INSURANCE FOR CERTAIN REPEATEDLY FLOODED PROPERTIES

Savings (Millions of dollars)

	Budget Authority	Outlays
Annual		
2000	0	71
2001	0	75
2002	0	79
2003	0	84
2004	0	88
2005	0	94
2006	0	99
2007	0	105
2008	0	112
2009	0	119
Cumulative		
2000-2004	0	397
2000-2009	0	926

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

450-08

Data from the National Flood Insurance Program (NFIP) show that a relatively small number of properties subject to repeated flooding account for a large share of the losses incurred by the program. The Federal Emergency Management Agency (FEMA), which administers the NFIP, has focused its attention on properties that have incurred two or more losses of at least $1,000 each in any 10-year period since 1978 (the earliest year for which data are available). The more than 83,000 properties fitting that definition account for about one-third of all claims since 1978 and close to 40 percent of the cost of such claims. Many of those properties no longer have flood insurance: in some cases, the property has been destroyed or moved; in other cases, the owner dropped the policy—for example, after FEMA limited coverage under the NFIP for basement losses in 1983. The NFIP currently insures roughly 41,000 repeatedly flooded properties, representing about 1 percent of all policies in force but a much larger share of annual flood losses.

The issue of repeatedly flooded properties raises concern in part because they generally are covered at premium rates that do not adequately reflect their risk of flood losses. FEMA data show that 96 percent of such properties were built before the development of the Flood Insurance Rate Map (FIRM) for their respective communities—which is not surprising, given the flood mitigation requirements imposed on post-FIRM construction. Thus, almost all repeatedly flooded properties are covered under the pre-FIRM premium rates that the government explicitly subsidizes. (See the related discussion for option 450-08.) In addition, although some properties may incur losses twice in 10 years because of a bad "draw" of storms or other random events, others have flooded four, five, or even 10 or 20 times since 1978, demonstrating that the gap between the pre-FIRM rates and their true actuarial risk of flood loss is particularly large.

One way to reduce federal costs for the flood insurance program would be to deny coverage after the fourth loss of at least $1,000 in any 20-year period. FEMA data indicate that the option would immediately affect 8,300 properties, and the Congressional Budget Office estimates that it would reduce federal outlays by $71 million in 2000 and $926 million over the 2000-2009 period. The main argument for the option is that neither taxpayers nor other policyholders should be required to provide an unlimited subsidy for properties known to be at high risk for frequent flood damage. The loss or threat of losing NFIP protection would encourage owners of such properties to take appropriate mitigation measures, such as elevating their structures or rebuilding elsewhere.

Opponents of dropping the flood insurance argue that it would be unfair to the property owners to suddenly withdraw their protection from flood risk—especially owners who have occupied their properties since before the local FIRM was developed and cannot readily afford relocation or other costly mitigation measures. Some opponents might prefer a more moderate change from current policy, such as adding a repetitive-loss surcharge to insurance premiums or denying coverage only to policyholders who reject offers of mitigation assistance.

450-08 ELIMINATE THE FLOOD INSURANCE SUBSIDY ON PRE-FIRM STRUCTURES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	120
2001	0	386
2002	0	537
2003	0	575
2004	0	617
2005	0	660
2006	0	706
2007	0	751
2008	0	790
2009	0	815
Cumulative		
2000-2004	0	2,235
2000-2009	0	5,957

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

450-07

The National Flood Insurance Program (NFIP) offers insurance at heavily subsidized rates for buildings constructed before 1975 or before the completion of a participating community's Flood Insurance Rate Map (FIRM). Owners of post-FIRM construction pay actuarial rates for their insurance. Currently, about one-sixth of all flood insurance coverage is subsidized.

The Federal Emergency Management Agency (FEMA), which administers the flood insurance program, estimates that 32 percent of policyholders are paying subsidized rates for some or all of their coverage. The program subsidizes only the first $35,000 of coverage for a single-family or two- to four-family dwelling and the first $100,000 of a larger residential, nonresidential, or small business building; various levels of additional coverage are available at actuarially neutral rates. As a result of an April 1996 rate increase, coverage in the subsidized tier is priced at an estimated 38 percent of its actuarial value. The program also offers insurance for buildings' contents; again, policyholders in pre-FIRM buildings pay subsidized prices for a first tier of coverage.

The Congressional Budget Office estimates that eliminating the subsidy would yield about $120 million in new receipts in 2000 and $6 billion over the 2000-2009 period, accounting for the likelihood that many current policyholders would drop their coverage. Purchase of flood insurance is voluntary, except for properties in special flood hazard areas carrying mortgages from federally insured lenders. Only 20 percent of properties in the nine states affected by the 1993 midwestern flood are estimated to have had coverage, reflecting both lax enforcement of the mandatory requirements and spotty participation of properties not subject to the requirements. Although enforcement of the requirement has reportedly improved under new rules legislated in 1994, CBO expects that some mandatory and many voluntary purchasers would leave the program if confronted with unsubsidized premiums.

Proponents of eliminating the subsidy argue that actuarially correct prices would make all property owners in flood-prone areas pay their fair share for insurance protection and would give them economic incentives to relocate or take preventive measures.

Supporters of the subsidy argue that it should be maintained to help increase the low rates of participation by property owners who are not subject to the mandatory purchase requirement. Another argument is that people who built or purchased property before FEMA documented the extent of the flood hazards should not face the same costs as those who made decisions after such information became available. Defenders of the current rates also question the accuracy of the maps on which FEMA bases its estimate that current prices cover only 38 percent of long-term costs. For most pre-FIRM properties except a relatively few repeatedly flooded structures, premiums now roughly equal average losses incurred to date. Finally, defenders argue that some of the projected gains will be offset by increased spending by FEMA and the Small Business Administration on disaster grants and loans to people who drop or fail to purchase insurance coverage at the higher rates.

450-09 ELIMINATE FEDERAL SUPPORT FOR TENNESSEE VALLEY AUTHORITY ACTIVITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	32	26
2001	43	39
2002	43	42
2003	43	43
2004	43	43
2005	43	43
2006	43	43
2007	43	43
2008	43	43
2009	43	43
Cumulative		
2000-2004	204	193
2000-2009	419	408

SPENDING CATEGORY:

Discretionary

RELATED PUBLICATION:

Should the Federal Government Sell Electricity? (Study), November 1997.

The Tennessee Valley Authority (TVA) is a federal agency that operates an electric utility with billions of dollars in annual sales. It is also charged with "planning for the proper use, conservation, and development of the natural resources of the Tennessee River drainage basin." The annual federal appropriation for TVA supports its water and land management activities (including maintaining a system of dams and reservoirs), environmental research center, recreational and educational programs, and efforts to assist local economic development.

In 1997, TVA Chairman Craven H. Crandall Jr. proposed eliminating the federal appropriation in exchange for allowing TVA to sell electricity outside its current service area. Subsequently, the Congress appropriated $70 million for TVA's nonpower activities for 1998 but included language indicating that the agency was to support those activities without additional federal funds—instead drawing on user fees, charges to electricity purchasers, investment returns, and internal cost savings—beginning in 1999. However, the Congress included another $50 million—described as "final" in the accompanying report—for TVA in the omnibus appropriation bill for 1999. That bill also directed TVA to transfer the Land Between the Lakes Recreation Area (LBL) to the Forest Service on October 1 of the first fiscal year for which the Congress gives TVA less than $6 million for LBL. Accounting for the transfer and associated shift in costs to the Forest Service, eliminating TVA's federal funding as of fiscal year 2000 would reduce federal outlays by $26 million then and by $408 million over 10 years.

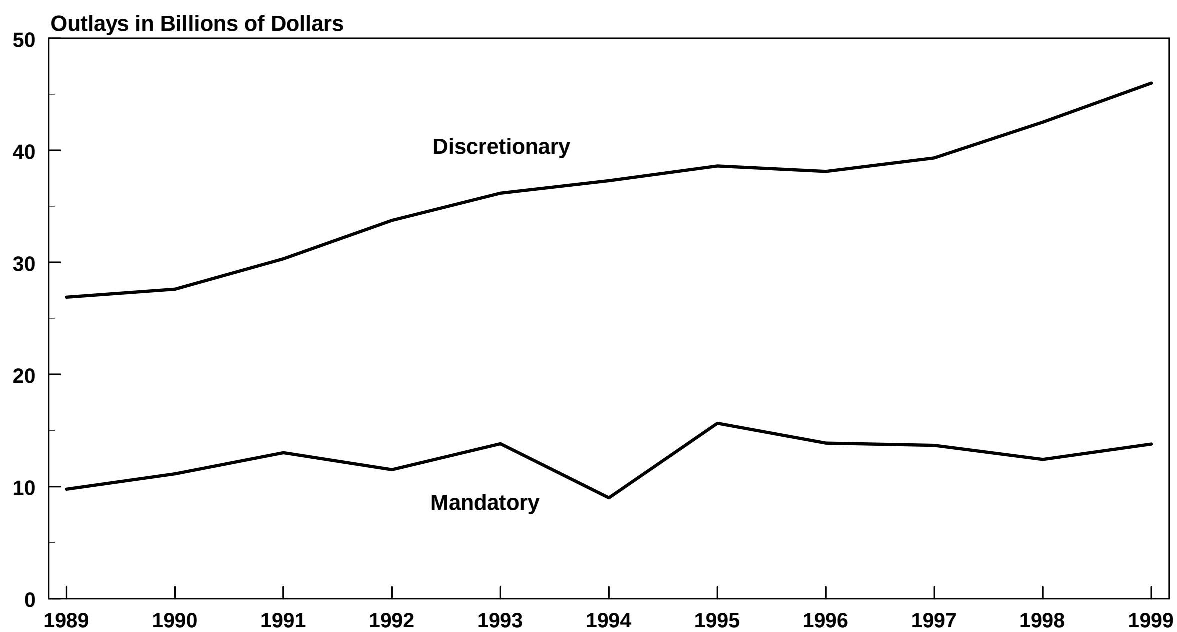
Critics of the funding for TVA's activities argue that the programs provide local or regional benefits and should therefore be financed by state and local governments or by charges to beneficiaries—or be discontinued if they are insufficiently valuable. Proponents of continued funding argue that TVA has few practical alternatives to federal support if it is to continue promoting proper use, conservation, and development of the region's natural resources. Charging user fees may be appropriate for some of TVA's nonpower activities, such as maintaining navigation locks and recreation facilities, but perhaps not for others. For example, because the benefits of reducing flood crests and improving ecological stability are spread over time and broad geographic areas, affected state and local governments may find it difficult to divide the burden of making up lost federal funding for such causes.

In addition, a small and declining share of TVA's federal appropriation supports its Environmental Research Center in Muscle Shoals, Alabama. The center's research involves ozone mitigation, pollution-free agriculture, utility waste management, and biotechnology for cleaning up hazardous wastes. Critics of the center argue that many of its research projects benefit the private sector and that other projects should be consolidated with research being conducted by the Department of Agriculture or the Environmental Protection Agency. The center has diversified its funding sources and is in the last year of a four-year phaseout of federal support.

500

Education, Training, Employment, and Social Services

Budget function 500 primarily includes federal spending within the Departments of Education, Labor, and Health and Human Services for programs that either directly provide, or assist states and localities in providing, services to young people and adults. The activities that it covers include providing developmental services to low-income children, helping disadvantaged and other elementary and secondary school students, offering grants and loans to postsecondary students, and funding job-training and employment services for people of all ages. CBO estimates that in 1999, discretionary outlays for function 500 will total about $46 billion—roughly the same amount as discretionary budget authority provided for 1999. Over the past 10 years, spending under function 500 has remained relatively constant as a share of federal outlays at just over 3 percent.



500-01 REDUCE FUNDING FOR TITLE I, EDUCATION FOR THE DISADVANTAGED

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	329	16
2001	329	230
2002	329	312
2003	329	329
2004	329	329
2005	329	329
2006	329	329
2007	329	329
2008	329	329
2009	329	329
Cumulative		
2000-2004	1,645	1,216
2000-2009	3,290	2,861

SPENDING CATEGORY:

Discretionary

Title I of the Elementary and Secondary Education Act of 1965 provides two kinds of grants to school districts to fund supplementary educational services for educationally disadvantaged children. Basic grants allocate federal funds on the basis of the number of children who live in families with income below the poverty level in a particular geographic area. Concentration grants provide additional funds to school districts in counties in which the number of poor children exceeds 6,500 or 15 percent of the school-age population. Although title I distributes funds on the basis of the number of poor students in a district, schools that receive the money may use it to provide services to any students who are performing well below their grade level.

Title I funds reached about 50,000 schools in 1998 and served approximately 10 million children. About 15,000 schools operated schoolwide programs (which benefit all of the children in a specific school), and another 35,000 participated in targeted assistance programs (which must focus the grants on the children most in need of title I services).

This option would reduce funding for basic grants to local educational agencies by 5 percent, saving $16 million in federal outlays in 2000 and $2.9 billion over the 2000-2009 period. To direct cuts toward the schools with the least need for title I services, the eligibility criteria for receiving funding could be altered. Currently, the law restricts title I basic grant funds to school districts that have 2 percent of their children living in families with income below the poverty level and at least 10 poor children. If the Congress raised the lower bound on the criterion for the percentage of children living in poverty (for example, to 5 percent or 10 percent), funding could be maintained at its current level for the school districts that satisfied the more restrictive eligibility criteria.

Some proponents of eliminating federal funding for elementary and secondary education argue that such support represents federal intervention into matters that are primarily of state and local concern. Opponents, however, insist that federal funding augments state and local efforts and ultimately makes them more successful.

The primary argument for reducing title I funding in particular is that there is little evidence that it improves the long-term academic performance of students who receive its services. Many studies have compared students receiving title I services with groups of students that are similar by grade and poverty status. Such studies show that program participants do not improve their academic achievement relative to other students. However, supporters of the program maintain that title I funds help underachieving students in schools that serve many poor children. Advocates also note that such funding is a major federal instrument for fostering school reform because states applying for the grants must develop standards specifying what public school children should know and be able to do at various points in their education.

500-02 ELIMINATE FUNDING FOR BILINGUAL AND IMMIGRANT EDUCATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	380	46
2001	380	304
2002	380	372
2003	380	380
2004	380	380
2005	380	380
2006	380	380
2007	380	380
2008	380	380
2009	380	380
Cumulative		
2000-2004	1,900	1,482
2000-2009	3,800	3,382

SPENDING CATEGORY:

Discretionary

Federal bilingual education programs authorized under title VII of the Elementary and Secondary Education Act provide grants to school districts for instructing students who have limited proficiency in English (so-called LEP students). School districts use the funds primarily to support bilingual instructional services, to disseminate information on ways to serve students whose English is limited, and to train instructors to teach in bilingual classrooms.

Bilingual education projects funded through title VII provide a range of services to LEP students. Most schools use English as a Second Language projects to meet those students' needs. In the projects, teachers instruct children jointly in English and their native language but stress a rapid grasp of English. No more than 25 percent of federal funding for bilingual education programs may be used to support instruction conducted only in English.

Eliminating federal funding for bilingual education programs would reduce federal outlays by $46 million in 2000 and by $3.4 billion over the 2000-2009 period.

Supporters of this option contend that bilingual education programs under title VII do not effectively advance literacy in the English language and slow the integration of LEP students into regular classrooms. They maintain that the federal government should not fund programs requiring the use of a student's native language but should encourage school districts to move LEP students into regular classrooms as quickly as possible. Many supporters of this option argue that "immersion" programs, in which LEP students are instructed solely in English, are the most effective means to teach English to such students.

Defenders of bilingual education assert that it serves a valuable purpose. By introducing students to the English language while continuing instruction in their native language, the program helps students acquire knowledge in a variety of academic subjects as they develop their English literacy skills. As a result, supporters argue, students do not fall behind their schoolmates in other subjects during their transition to English-only instruction.

500-03 REDUCE FUNDING TO SCHOOL DISTRICTS FOR IMPACT AID

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	78	64
2001	78	76
2002	78	78
2003	78	78
2004	78	78
2005	78	78
2006	78	78
2007	78	78
2008	78	78
2009	78	78
Cumulative		
2000-2004	390	374
2000-2009	780	764

SPENDING CATEGORY:

Discretionary

The Impact Aid program, authorized under title VIII of the Elementary and Secondary Education Act, provides funds to school districts affected by activities of the federal government. The program pays districts for federally connected pupils and for school construction in areas where the federal government has acquired a significant portion of the real property tax base, thereby depriving the school district of a source of revenue.

For a school district to be eligible for Impact Aid, a minimum of 3 percent (or at least 400) of its pupils must be associated with activities of the federal government—for example, pupils whose parents both live and work on federal property (including Indian lands), pupils whose parents are in the uniformed services but live on private property, and pupils who live in federally subsidized low-rent housing. In addition, aid goes to a few districts enrolling at least 1,000 pupils (and 10 percent of enrollment) whose parents work on federal property. In 1998, approximately 1,700 local education agencies received Impact Aid.

This option would restrict Impact Aid to the school districts that are most affected by federal activities—districts with children who live on federal property and have a parent on active duty in the uniformed services and districts with children who live on Indian lands. The restriction would reduce federal outlays by $764 million during the 2000-2009 period. The Administration's budget for fiscal year 2000 included this option in its list of recommendations.

Proponents of this alternative argue that restricting Impact Aid payments to students whose presence puts the greatest burden on school districts is appropriate, given the limited funding available for federal discretionary programs. Opponents argue that eliminating payments for other types of children associated with federal activities could significantly affect certain districts—for example, those in which large numbers of military families live off-base but shop at military exchanges, which do not collect state and local sales taxes.

500-04 LIMIT FEDERAL FUNDING FOR STATE EDUCATION REFORM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	130	6
2001	130	91
2002	130	123
2003	130	130
2004	130	130
2005	130	130
2006	130	130
2007	130	130
2008	130	130
2009	130	130
Cumulative		
2000-2004	650	480
2000-2009	1,300	1,130

SPENDING CATEGORY:

Discretionary

The federal government currently supports education reform at the state and local levels through two programs that have related purposes but quite different structures. The first program, the Innovative Education Program Strategies state grants (authorized under title VI of the Elementary and Secondary Education Act) provides relatively untargeted funding in the form of block grants to supplement state and local funding for elementary and secondary education reform. Recipients may use funds from the grants to carry out programs in a number of broad categories, but those activities need not be tied to any specific reform plan or set of standards.

The second program, Goals 2000, requires recipients to pursue a systemic model of reform, which involves setting goals and standards for reform, developing benchmarks to promote progress toward the goals, and pursuing reform at all levels of the education system. Goals 2000 funds may only be used for activities that are consistent with that model, such as developing state standards for reform, aligning local curricula with those standards, paying for professional development activities for teachers and other staff, and purchasing technology.

Reducing combined federal funding for the two programs by 15 percent would cut federal outlays by $6 million in 2000 and by $1.1 billion over the 2000-2009 period. Lawmakers could retain the current relative distribution of funding between the two programs or shift funding to favor one approach or the other. Proponents of decreasing federal funding for both types of education reform argue that state and local governments are already carrying out school reforms on their own and do not need additional federal support. Federal funding for education reform is unnecessary, say those proponents, and constitutes needless federal intervention into matters that are primarily of state and local concern. Opponents of limiting federal support insist that federal funds augment ongoing state and local reform efforts and contribute to their faster and more complete implementation.

Among supporters of some federal role in state and local education reform, opinions differ about which program should receive the larger share of federal funding. Fiscal year 1999 funding for title VI block grants was $375 million; funding for the Goals 2000 program totaled $491 million. On the one hand, proponents of more funding for the Goals 2000 program argue that it is better designed to foster systemic reform, which they contend is highly effective in improving teaching and learning. Because Goals 2000 links funding to a state reform plan, supporters maintain that the funds are better directed and have a greater impact on the quality of schools within a state. On the other hand, supporters of the title VI block grants insist that those grants are a better tool for supplementing state education reform. By offering greater flexibility, supporters say, block grants allow states to fund the local reforms that are best suited to particular communities—even if those reforms are not tied to a larger state effort.

500-05 ELIMINATE FUNDING FOR FEDERAL INITIATIVES TO REDUCE CLASS SIZE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,200	60
2001	1,200	600
2002	1,200	1,080
2003	1,200	1,260
2004	1,200	1,320
2005	1,200	1,260
2006	1,200	1,200
2007	1,200	1,200
2008	1,200	1,200
2009	1,200	1,200
Cumulative		
2000-2004	6,000	4,320
2000-2009	12,000	10,380

SPENDING CATEGORY:

Discretionary

The Department of Education's fiscal year 1999 budget included $1.2 billion to reduce class sizes in elementary schools nationwide. With those funds, the department estimates that school districts will be able to hire as many as 30,000 teachers for the 1999-2000 school year. By eliminating funding for the program, the federal government could save $10.4 billion in outlays during the 2000-2009 period.

In recent reviews of the scientific evidence for the benefits of small classes, the results of one study, Tennessee's Project STAR, are prominent because of the study's rigorous experimental design. Children entering kindergarten were randomly assigned either to special small classes of between 13 and 17 students or to "regular" classes of between 22 and 26 students. With only few exceptions, students remained in the same size class to which they were initially assigned through the end of the third grade.

Testing showed that students in the small classes outperformed students in the regular classes on both standardized and curriculum-based tests. In the early grades, the positive effect of small classes on achievement among minority students was twice that for nonminority students; later, it was about the same. Beginning in fourth grade, all of the students attended regular classes. Nevertheless, through eighth grade, students who had been in the small classes showed a decreasing but still significantly higher level of academic achievement than students in the regular classes.

Proponents of eliminating federal funding for class-size initiatives see limitations to Project STAR's success. If education is cumulative, with each year building on what was learned the year before, children assigned to a small class would be expected to pull further away from their counterparts in a regular class for each year they remained in the small class. In fact, the evidence shows such advances for youngsters in small classes only at the end of kindergarten and, to a lesser extent, at the end of first grade. Critics of a policy advocating small class sizes also point to other evidence suggesting that class size must fall to about 15 students before it has an effect. Reducing class sizes to those levels would be quite expensive, and the costs would increase over time. More classrooms would have to be built; new teachers would require services such as staff training; and as they gained experience, those teachers' salaries would increase. Finally, the critics note that strategies such as providing one-on-one or peer tutoring as well as cooperative learning achieve results similar to those gained from reducing class size—but at a fraction of the cost.

Supporters of funding for initiatives to decrease class sizes find that approach attractive because it moves resources directly to the classroom and to students. Furthermore, many analysts have concluded that enrollment in the early grades in small classes of about 18 or fewer students can have positive effects on a student's academic achievement, compared with enrollment in classes of between 25 and 30 students. Minority students in particular seem to benefit from small classes. In addition, most of the benefits students gain from being in a small class appear to persist into later grades.

500-06 CONSOLIDATE AND REDUCE FUNDING FOR SEVERAL ELEMENTARY AND SECONDARY EDUCATION PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	280	14
2001	280	196
2002	280	266
2003	280	280
2004	280	280
2005	280	280
2006	280	280
2007	280	280
2008	280	280
2009	280	280
Cumulative		
2000-2004	1,400	1,036
2000-2009	2,800	2,436

SPENDING CATEGORY:

Discretionary

Current federal programs to aid elementary and secondary education are generally categorical—that is, they focus on specific populations of students with special needs (for example, disabled students or educationally disadvantaged students), on subject areas of high priority to policymakers (such as mathematics or science), or on specific approaches to improving education (for instance, charter schools). The Congress adopted categorical forms of federal aid in certain cases because of a belief that many states would be unable or unwilling to commit funds to those priorities. The alternative to categorical programs is broad block grants. For example, H.R. 3248, the Dollars to the Classroom Act introduced in the 105th Congress, would have consolidated several federal categorical programs for elementary and secondary education into a single block grant. The grant would have allowed funds to be used for any of the purposes previously authorized for the categorical programs. The appropriations for the programs that the block grant would have replaced totaled $2.8 billion for 1999.

To reduce federal outlays, the federal government could trim the consolidated block grant proposed in H.R. 3248 by, for example, 10 percent, or $280 million. Despite the cut in funding, states might prefer the block grant to categorical funding because the block grant would give them and local education agencies added flexibility in allocating federal funds among different purposes. In addition, states would probably find savings under the block grant as a result of fewer administrative duties and reporting responsibilities compared with categorical aid.

Proponents of block grants for education funding point out that they give states and local education agencies the flexibility to direct federal aid toward the schools' greatest needs. Block grants can circumvent the administrative requirements accompanying categorical aid programs, which may unintentionally limit a school's ability to implement comprehensive reforms. Block grants also avoid the problems created within a school by a proliferation of categorical programs that often aid the same children. Poor coordination among such programs may lead to fragmentation of a child's instructional program in some areas and duplication in others. Moreover, by requiring that funds be clearly associated with the intended beneficiaries, categorical grants may encourage schools to partially segregate children with special needs, track students by achievement level, or perpetuate lower expectations of their performance.

Opponents of education block grants argue that they dilute the effect of federal funding on national educational priorities and provide less assurance than categorical funding that federal aid will be used to meet national objectives. Block grants virtually ensure more variation in how federal funds are used. In principle, accountability for the results of that use could substitute for the targeting requirements that are traditionally a part of categorical aid programs, but measuring the appropriate outcomes is often difficult. Furthermore, as opponents point out, alternative means, such as waivers, are now available to give state and local education agencies increased flexibility in using funds from categorical programs without sacrificing federal priorities.

500-07-A RESTRICT INTEREST SUBSIDIES ON LOANS TO UNDERGRADUATES

	Outlay Savings (Millions of dollars)
Annual	
2000	325
2001	485
2002	495
2003	510
2004	540
2005	560
2006	580
2007	600
2008	615
2009	635
Cumulative	
2000-2004	2,355
2000-2009	5,345

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

500-07-B and 500-07-C

Federal student loan programs afford students and their parents the opportunity to borrow funds to attend postsecondary schools. Those programs offer three types of loans: "subsidized" loans to students who are defined as having financial need, "unsubsidized" loans to students regardless of need, and loans to parents of students. Two programs provide all three types of loans; they are the Federal Family Education Loan Program, in which loans made by private lenders are guaranteed by the federal government, and the Ford Federal Direct Loan Program, in which the government makes the loans through schools. With all of the loans, borrowers benefit because the interest rate charged is lower than the rates most of them could secure from alternative sources. With subsidized loans, borrowers benefit further because the federal government pays the interest on the loans while students are in school and during a six-month grace period after they leave.

Federal costs could be reduced by limiting eligibility for subsidized loans to undergraduate students. Graduate students could substitute unsubsidized loans for the subsidized loans they had received previously. That change would reduce federal outlays by $325 million in 2000 and $5.3 billion during the 2000-2009 period.

Restricting subsidized loans to undergraduate students would direct funds toward achieving the federal goal of universal access to an undergraduate education. Because graduate students have completed their undergraduate work, they are outside the group of students that constitutes the federal government's particular focus. Under this option, graduate students who took unsubsidized loans to replace the subsidized loans they had lost would ultimately be responsible for somewhat higher loan payments. However, the federal student loan programs have several options for making repayment manageable for students who have high loan balances or difficult financial circumstances.

Nevertheless, graduate students often amass large student loan debts because of the number of years of schooling required for their degrees. Without the benefit of interest forgiveness while they were enrolled in school, their debt would be substantially larger when they entered the repayment period because the interest on the amounts they had borrowed over the years would be added to their loan balance.

500-07-B INCREASE ORIGINATION FEES FOR UNSUBSIDIZED LOANS TO STUDENTS AND PARENTS

	Outlay Savings (Millions of dollars)
Annual	
2000	120
2001	185
2002	200
2003	215
2004	230
2005	240
2006	255
2007	265
2008	280
2009	295
Cumulative	
2000-2004	950
2000-2009	2,285

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

500-07-A and 500-07-C

The government and guaranty agencies recoup part of the cost of insuring student loans by collecting 4 percent of the face value of each loan from students and their parents as an origination and insurance fee. (In some instances, guaranty agencies pay that fee themselves.) The fee is charged on subsidized, unsubsidized, and PLUS loans (Parent Loans to Undergraduate Students). Increasing the loan origination fee on unsubsidized and PLUS loans by 1 percentage point would reduce program outlays by $120 million in 2000 and $2.3 billion over the 2000-2009 period.

An argument for the change is that even with the higher origination fee, many students would still benefit substantially from the loans, in part because the government guarantees them. The guarantee means that lenders are willing to make loans to students who do not have a credit history and to make them at interest rates below those available on most private loans. Furthermore, during the first five years of repayment, many borrowers can subtract the interest on the loans from their income for the purpose of calculating federal income taxes. And because the change in the origination fee would affect only unsubsidized and PLUS loans, it would produce savings without affecting the value of subsidized loans received by the neediest students.

Increasing the origination fee, however, would reduce the net proceeds from any given loan. As a result, students would need to secure larger loans to finance the same amount of education. That could pose a problem for many students who were already borrowing the maximum allowed by law and would not be able to borrow more.

500-07-C RESTRICT ELIGIBILITY FOR SUBSIDIZED STUDENT LOANS BY INCLUDING HOME EQUITY IN THE DETERMINATION OF FINANCIAL NEED

	Outlay Savings (Millions of dollars)
Annual	
2000	55
2001	80
2002	80
2003	85
2004	85
2005	85
2006	85
2007	85
2008	85
2009	85
Cumulative	
2000-2004	385
2000-2009	815

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

500-07-A and 500-07-B

The Higher Education Amendments of 1992 eliminated house and farm assets from consideration in determining how much a student's family is expected to contribute to cover educational expenses—a change that has made it easier for many students to obtain subsidized student loans. The amount a family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, federal calculations "tax" family incomes and assets above the amounts assumed to be required for a basic standard of living. Since 1992, the definition of assets has excluded house and farm equity for all families and excluded all assets for applicants whose income is below $50,000.

Under this option, house and farm equity would be included in calculating a family's need for financial aid for postsecondary education. In addition, the income threshold under which most families are not asked to report their assets would be lowered from $50,000 to its previous level of $15,000. House and farm equity would be "taxed," as other assets are now, at rates of up to about 5.6 percent after a deduction for allowable assets. The change would result in fewer students qualifying for subsidized loans or more students qualifying for subsidized loans of smaller amounts. Overall, by including house and farm equity, outlays could be reduced by about $55 million in 2000 and $815 million during the 2000-2009 period.

Not counting home equity gives families who own a house an advantage over those who do not. In today's economy, borrowing against home equity at an affordable interest rate is relatively simple. To the extent that families would not take out home equity loans, students could take unsubsidized loans to finance the family's expected contribution. That approach would cause relatively little difficulty for families' budgets because the interest payments on unsubsidized loans can be postponed while the student is in school. The interest is then simply added to the accumulated loan balance when the student leaves school and begins repayment.

However, because increases in incomes have not always kept pace with increases in housing prices, some families might have difficulty repaying their mortgage if they borrow against home equity to finance their children's education. In addition, having to value their home and other assets would complicate the loan application process for many families.

500-08 REDUCE SPECIAL ALLOWANCE PAYMENTS TO LENDERS IN THE STUDENT LOAN PROGRAM

	Outlay Savings (Millions of dollars)
Annual	
2000	340
2001	540
2002	565
2003	500
2004	0
2005	0
2006	0
2007	0
2008	0
2009	0
Cumulative	
2000-2004	1,945
2000-2009	1,945

SPENDING CATEGORY:

Mandatory

The largest federal student loan program is the Federal Family Education Loan Program, which guarantees 98 percent reimbursement on defaulted loans made by private lenders to eligible students. Under the program, students and the federal government together pay lenders an interest rate each year based on changes in a reference rate determined in the financial markets. The federal payments are called special allowance payments; their purpose is to approximate a fair market return to lenders while subsidizing the cost to students of financing their education. One such payment, which was added by the Higher Education Amendments of 1998, applies to subsidized and unsubsidized loans made after October 1, 1998, and before July 1, 2003. Under that provision, the federal government makes a payment equivalent to 0.5 percentage points above the interest rate paid by students.

This option would eliminate the 0.5 percentage-point payment on all new subsidized and unsubsidized loans. It would produce savings of $340 million in 2000 and $1.9 billion over the 2000-2009 period.

An argument for eliminating the 0.5 percentage-point payment is that lenders do not need it to achieve a fair market rate of return on their loans. Nearly the entire loan amount is guaranteed by the federal government. Moreover, a 1998 study by the Department of the Treasury concluded that even without the additional 0.5 percentage-point payment, lenders would earn returns on loans made under the program that on average would be sufficient to make the business attractive.

The argument for retaining the payment is that without it, some lenders would, indeed, receive unacceptably low rates of return and leave the program. Such pruning of the lender ranks could create difficulties for financial aid officers who administer student financial aid at postsecondary institutions and for students who seek loans. In general, student loans are quite small compared with, for example, mortgage loans, but the costs of servicing them are not proportionately lower. As a result, the interest rate necessary to yield sufficient income to cover the costs of servicing needs to be higher. Furthermore, servicing costs vary by the size of the loan and the characteristics of the student, so reducing the profit margin for lenders might induce them to stop making loans to some students. Another risk of paying lenders less than a fair market rate of return is that they might substantially reduce their investments in improving the quality of loan servicing or stop adapting their package of loan services to the particular needs of the institutions that participate in the loan program.

500-09 ELIMINATE ADMINISTRATIVE FEES PAID TO SCHOOLS IN THE CAMPUS-BASED STUDENT AID AND PELL GRANT PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	158	18
2001	158	153
2002	158	158
2003	158	158
2004	158	158
2005	158	158
2006	158	158
2007	158	158
2008	158	158
2009	158	158
Cumulative		
2000-2004	790	645
2000-2009	1,580	1,435

SPENDING CATEGORY:

Discretionary

In two types of federal student aid programs, the government pays schools to administer the programs or to distribute the funds, or both. In campus-based aid programs, which include Federal Supplemental Educational Opportunity Grants, Federal Perkins loans, and Federal Work-Study Programs, the government distributes funds to institutions that in turn award grants, loans, and jobs to qualified students. Under a statutory formula, institutions may use up to 5 percent of program funds for administrative costs. Similarly, in the Federal Pell Grant Program, the schools distribute the funds, although eligibility is determined solely by federal law. The Higher Education Act provides for a federal payment of $5 per Pell grant to reimburse schools for a share of their costs of administering the program.

The federal government could save about $138 million a year if schools were not allowed to use federal funds from the campus-based aid programs to pay for administrative costs. The government could save another $20 million if the $5 payment to schools in the Pell Grant program was eliminated. Together, those options would produce savings of $18 million in 2000 and $1.4 billion over the 2000-2009 period.

Arguments can be made both for eliminating the administrative payments and for retaining them. On the one hand, institutions benefit significantly from participating in federal student aid programs even without the payments because the aid makes attendance at the schools more affordable. In 1999, students will receive an estimated $10.3 billion in federal funds under the Pell Grant and campus-based aid programs.

On the other hand, the institutions do, indeed, incur costs for administering the programs. Furthermore, if the federal government does not pay those expenses, schools will simply pass along the costs to students in the form of higher tuition or fees.

500-10 ELIMINATE THE LEVERAGING EDUCATIONAL ASSISTANCE PARTNERSHIP PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	25	5
2001	25	25
2002	25	25
2003	25	25
2004	25	25
2005	25	25
2006	25	25
2007	25	25
2008	25	25
2009	25	25
Cumulative		
2000-2004	125	105
2000-2009	250	230

SPENDING CATEGORY:

Discretionary

The Leveraging Educational Assistance Partnership (LEAP) program, formerly the State Student Incentive Grant program, helps states provide financially needy postsecondary students with grant and work-study assistance while they attend either academic institutions or schools that teach occupational skills. States must match federal funds at least dollar for dollar and also meet maintenance-of-effort criteria. Unless excluded by state law, all public and private nonprofit postsecondary institutions in a state are eligible to participate in the LEAP program.

Eliminating the program would save $5 million in 2000 and $230 million over the 2000-2009 period. The extent of the actual reduction in student assistance would depend on the responses of states, some of which would probably make up at least part of the lost federal funds.

Proponents of eliminating this program argue that it is no longer needed to encourage states to provide more student aid. When the LEAP program was first authorized in 1972, only 28 states had student grant programs; now, all 50 states provide such grants.

An argument against eliminating the LEAP program is that not all states would increase their student aid appropriations to make up for the lost federal funding and some might even reduce them. In that case, some students receiving less aid might not be able to enroll in college or might have to attend a less expensive school.

500-11 END NEW FUNDING FOR PERKINS LOANS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	100	10
2001	100	97
2002	100	100
2003	100	100
2004	100	100
2005	100	100
2006	100	100
2007	100	100
2008	100	100
2009	100	100
Cumulative		
2000-2004	500	407
2000-2009	1,000	907

SPENDING CATEGORY:

Discretionary

The federal government provides student loans through three programs: Federal Family Education Loans, Ford Federal Direct Loans, and Federal Perkins Loans (formerly National Defense Student Loans). The Perkins Loan program is the smallest, with allocations made directly to approximately 2,000 post-secondary institutions. Financial aid administrators at those schools then determine which eligible students receive Perkins loans. During the 1998-1999 academic year, approximately 700,000 students will receive such loans.

The money for Perkins loans comes from an institutional revolving fund, totaling approximately $1.1 billion in 1999, that has four sources: collections by the schools of payments on prior year student loans ($980 million in 1999), federal payments for loan cancellations granted in exchange for teaching in high-need areas or for military or public service ($30 million in 1999), federal contributions from new appropriations ($100 million in 1999), and institutional matching contributions that for each school must equal at least one-third of the federal contribution.

Eliminating new appropriations for federal contributions would lower outlays by $907 million during the 2000-2009 period. The extent of the reduction in funds for student loans would depend on the responses of postsecondary institutions, some of which would make up part or all of the lost federal money. If institutions made up none of the lost federal funds but continued to contribute to the program at the level of their previous matching share, approximately 66,000 fewer Perkins loans would be made.

Reflecting the view that the main goal of federal student aid is to provide access to postsecondary education for needy students, the primary justification for this option is that the program may be failing to provide equal access to equally needy students. Federal contributions are allocated, first, on the basis of an institution's 1985 allocation and, second, on the basis of the financial need of its students. Because campus-based aid is tied to specific institutions, students with greater need at poorly funded schools may receive less than those with less need at well-funded institutions.

Eliminating new funds for Perkins loans, however, would reduce the discretion of postsecondary institutions in packaging aid to address the special situations of some students. It would also reduce total available aid. Moreover, Perkins loans disproportionately help students at private nonprofit institutions (whose students get almost half of the aid, compared with about 20 percent of Pell Grant aid). Thus, cutting Perkins loans would make that type of school less accessible to needy students.

500-12 REDUCE FUNDING FOR THE ARTS AND HUMANITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	110	72
2001	110	100
2002	161	157
2003	161	160
2004	161	161
2005	161	161
2006	161	161
2007	161	161
2008	161	161
2009	161	161
Cumulative		
2000-2004	703	651
2000-2009	1,508	1,455

SPENDING CATEGORY:

Discretionary

The federal government subsidizes various activities related to the arts and humanities. In 1999, combined funding for several programs totaled almost $1 billion; it included federal appropriations for the Smithsonian Institution ($413 million), the Corporation for Public Broadcasting ($250 million), the National Endowment for the Humanities ($111 million), the National Endowment for the Arts ($98 million), the National Gallery of Art ($64 million), the John F. Kennedy Center for the Performing Arts ($32 million), and the Institute of Museum Services ($23 million).

Cutting funding for those programs by 15 percent would reduce federal outlays over the 2000-2009 period by over $1.4 billion. (Savings from a reduction in funding for the Corporation for Public Broadcasting would not be realized until 2002 because the program receives its appropriations two years in advance.) The actual effect on arts and humanities activities would depend in large part on the extent to which other funding sources—states, localities, individuals, firms, and foundations—increased their contributions.

Some proponents of reducing or eliminating funding for the arts and humanities argue that support of such activities is not an appropriate role for the federal government. Other advocates of cuts suggest that the expenditures are particularly unacceptable when programs addressing central federal concerns are not being funded fully. Some federal grants for the arts and humanities already require nonfederal matching contributions, and over half of all museums charge or suggest that patrons pay an entrance fee. Those practices could be expanded to accommodate a reduction in federal funding.

However, critics of cuts in funding contend that alternative sources would be unlikely to fully offset the drop in federal subsidies. Subsidized projects and organizations in rural or low-income areas might find it especially difficult to garner increased private backing or sponsorship. Thus, a decline in government support, opponents argue, would reduce activities that preserve and advance the nation's culture and that introduce the arts and humanities to people who might not otherwise have access to them.

500-13 ELIMINATE FUNDING FOR THE SENIOR COMMUNITY SERVICE EMPLOYMENT PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	440	80
2001	440	400
2002	440	440
2003	440	440
2004	440	440
2005	440	440
2006	440	440
2007	440	440
2008	440	440
2009	440	440
Cumulative		
2000-2004	2,200	1,800
2000-2009	4,400	4,000

SPENDING CATEGORY:

Discretionary

The Senior Community Service Employment Program (SCSEP) funds part-time jobs for people age 55 and older who are unemployed and who meet income eligibility guidelines. To be eligible to participate in the program in 1998, an individual's annual income had to be below roughly $10,000, which was 125 percent of the federal poverty guideline for a person living alone. Through SCSEP, which is authorized under title V of the Older Americans Act, grants are awarded to several nonprofit organizations, the U.S. Forest Service, and state agencies. The sponsoring organizations and agencies pay participants to work in part-time community service jobs, up to a maximum of 1,300 hours per year.

SCSEP participants work in schools, hospitals, and senior citizen centers and on beautification and conservation projects. They are paid the higher of the federal or state minimum wage or the local prevailing rate of pay for similar employment. Participants also receive annual physical examinations, training, personal and job-related counseling, and assistance to move into private-sector jobs when they complete their projects.

Eliminating SCSEP would reduce outlays over the 2000-2009 period by about $4 billion. Opponents of the program maintain that it offers few benefits aside from income support and that the presumed value of the work experience gained by SCSEP participants would generally be greater if the experience was provided to equally disadvantaged young people, who have longer careers over which to benefit. In addition, the costs of producing the services now provided by SCSEP participants could be borne by the organizations that benefit from their work; under current law, those organizations bear only 10 percent of such costs. That shift would ensure that only those services that were most highly valued would be provided.

SCSEP, however, is the major federal jobs program aimed at low-income older workers, providing jobs for nearly 100,000 of them in 1998. Eliminating the program could cause hardship for older workers who were unable to find comparable unsubsidized jobs. In general, older workers are less likely than younger workers to be unemployed, but those who are take longer to find work. Moreover, without SCSEP, community services might be reduced if nonprofit organizations and states were unwilling or unable to increase expenditures to offset the loss of federal funds.

500-14 ELIMINATE FUNDING FOR THE NATIONAL AND COMMUNITY SERVICE ACT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	415	40
2001	430	225
2002	430	350
2003	435	395
2004	435	410
2005	435	420
2006	435	435
2007	435	445
2008	435	450
2009	435	450
Cumulative		
2000-2004	2,145	1,420
2000-2009	4,320	3,620

SPENDING CATEGORY:

Discretionary

As a reward for providing community service, students may receive aid from the federal government to attend postsecondary schools through the National and Community Service Act. The act funds the AmeriCorps Grants Program, the National Civilian Community Corps (NCCC), Learn and Serve America, and the Points of Light Foundation, with AmeriCorps receiving the majority of the total appropriation. Those programs provide assistance for education, public safety, the environment, and health care, among other services. In many cases, the programs build on existing federal, state, and local programs. The AmeriCorps Grants Program and NCCC provide participants with an educational allowance, a stipend for living expenses, and, if they need them, health insurance and child care. Learn and Serve America participants generally do not receive stipends or education awards but may receive academic credit toward their degrees. Much of the total financial resources available for the AmeriCorps Grants Program comes from state and local governments and from private enterprises.

Eliminating federal funding for those programs would save $3.6 billion over the 2000-2009 period. (The estimate includes costs associated with terminating the program.) Alternatively, some of the savings from eliminating the programs could be redirected to the Federal Pell Grant Program, which is more closely targeted toward low-income students.

Some critics who favor eliminating the programs maintain that community service should be voluntary rather than an activity for which a person is paid. An additional justification for this option is based on the view that the main goal of federal aid to students should be to provide access to postsecondary education for people with low income. Because participation in the programs is not based on family income or assets, funds do not necessarily go to the poorest students.

Supporters of the programs argue, however, that in addition to providing valuable services, the programs enable many students to attend postsecondary schools. Moreover, they believe that opportunities to engage in national service can promote a sense of idealism among young people and should be supported.

Redirecting some of the savings from eliminating the programs to Pell grants would mitigate the effects of this option on lower-income students. The appropriations committees could use redirected funds from the national service programs to increase the maximum Pell grant.

500-15 REDUCE FUNDING FOR HEAD START

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	1,091	401
2001	1,091	997
2002	1,091	1,074
2003	1,091	1,074
2004	1,091	1,074
2005	1,091	1,074
2006	1,091	1,074
2007	1,091	1,074
2008	1,091	1,074
2009	1,091	1,074
Cumulative		
2000-2004	5,455	4,620
2000-2009	10,910	9,990

SPENDING CATEGORY:

Discretionary

Since 1965, Head Start has funded grants to local agencies to provide comprehensive services to foster the development of preschool children from low-income families. The services supported by Head Start address the health, education, and nutrition of the children as well as their social behavior. Funds are awarded to about 1,630 grantees at the discretion of the Secretary of Health and Human Services, using state allocations determined by formula. Grantees must contribute 20 percent of program costs from nonfederal funds unless they obtain a waiver. In 1997, the program served about 800,000 children, approximately 60 percent of whom were 4 years old. The average cost per child in Head Start that year was about $4,900 (compared with $6,800 per pupil spent by public elementary and secondary schools).

Reducing the appropriation for Head Start in 2000 and subsequent years to its level for 1996 would reduce federal costs by about $400 million in 2000 and nearly $10 billion over the 2000-2009 period. If grantees maintained the current level of services but were unable to replace federal funding with nonfederal resources, the reduction in federal funding would require the program to cut enrollment from its 1999 level by about 22,000 children.

The primary argument for reducing funding for Head Start is that there is little evidence of its long-term effectiveness. The evidence that does exist suggests that Head Start does not improve the prospects of participants over the long run. Although the program produces gains in children's intellectual, emotional, and social development after they have been in the program a year, those gains diminish and disappear as participants move through elementary school. Some model early-childhood education efforts have provided evidence of long-term improvement in the lives of participants, but those projects were much more intensive—and expensive—than Head Start and were initiated several decades ago, when the social environment of the country, especially in urban areas, was different. Furthermore, Head Start enrollment and funding have expanded rapidly during the 1990s, and some people question the ability of the program to effectively absorb the additional funds and students. Concerns have been raised as well about the quality of the program's services, including the limited qualifications of some staff.

The main argument against reducing the appropriation for Head Start is that it appears to modestly lessen the probability that participants will be placed in special education programs and to increase the likelihood that students will be promoted to higher grades. Proponents also argue that Head Start enrolls the most severely disadvantaged children and consequently should be credited with preventing participants from falling even further behind in their cognitive, social, and emotional development before they enter elementary school. An additional argument for not cutting Head Start funding is that the program has taken several steps to improve the quality of services that its grantees provide. For example, 60 percent of new appropriations for 1999 must be used for quality improvement activities. A new data collection system is also being developed to produce longitudinal data on a nationally representative sample of participants.

500-16 REDUCE THE 50 PERCENT FLOOR ON THE FEDERAL SHARE OF FOSTER CARE AND ADOPTION ASSISTANCE PAYMENTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	120	100
2001	130	130
2002	140	140
2003	150	150
2004	160	160
2005	180	170
2006	190	190
2007	200	200
2008	220	220
2009	240	230
Cumulative		
2000-2004	700	680
2000-2009	1,730	1,690

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

500-17

The Foster Care and Adoption Assistance programs provide benefits and services to children who are in need. Foster Care supports eligible low-income children who must reside in foster homes; Adoption Assistance subsidizes families that adopt eligible low-income children with special needs.

The federal government and the states jointly pay for the benefits provided by the two programs. The state and federal shares are based on the federal matching rate for medical assistance programs, which depends on a state's per capita income. Higher-income states pay for a larger share of program benefits than do lower-income states. Currently, the federal share for the Foster Care and Adoption Assistance programs can vary between 50 percent and 83 percent. The federal government now pays a 50 percent share in 11 jurisdictions: Colorado, Connecticut, Delaware, the District of Columbia, Illinois, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, and New York.

This option would lower the floor on the federal share of benefits from 50 percent to 45 percent. The Congressional Budget Office estimates that this option would save $100 million in 2000 and about $1.7 billion through 2009. Those amounts assume, however, that states would partially offset their higher costs by reducing benefits.

With the 45 percent floor on the federal share of benefits, a state's contribution would relate more directly to its per capital income. As a result, higher-income states that chose to be relatively generous would pay a larger share of their higher benefits. Nevertheless, seven of the 11 jurisdictions would be paying less than the formula alone would require.

In part, however, higher incomes and benefits in the affected jurisdictions reflect higher costs of living and not simply greater wealth and generosity. To accommodate the drop in funding, the jurisdictions would have to reduce Foster Care and Adoption Assistance benefits, cut spending for other services, or raise taxes. If, as CBO's estimates assume, states chose to compensate for their higher costs by partially reducing benefits, the programs' beneficiaries would be adversely affected.

Under the Unfunded Mandates Reform Act of 1995, reductions in federal funding for certain entitlement grant programs—including Foster Care and Adoption Assistance—are considered mandates on state governments if the states lack authority to amend their programmatic or financial responsibilities to offset the loss of funding. Because some states may not have sufficient flexibility within the Foster Care and Adoption Assistance programs to make such changes, this option could constitute an unfunded federal mandate on those jurisdictions under the law.

500-17 REDUCE THE FEDERAL MATCHING RATE FOR ADMINISTRATIVE AND TRAINING COSTS IN THE FOSTER CARE AND ADOPTION ASSISTANCE PROGRAMS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	135	110
2001	145	145
2002	160	155
2003	175	170
2004	190	190
2005	210	205
2006	225	220
2007	245	240
2008	265	265
2009	290	285
Cumulative		
2000-2004	805	770
2000-2009	2,040	1,985

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

500-16

The Foster Care and Adoption Assistance programs provide benefits and services to eligible low-income children and families. The federal government pays 50 percent of most administrative costs for the programs, including those for child placement services, and states and local governments pay the remaining share. However, the costs of certain activities are matched at higher rates to induce local administrators to undertake more of them than they would if costs were matched at the 50 percent rate. For example, the federal government pays 75 percent of the costs of training administrators and participating parents.

Reducing the matching rates for all administrative and training expenses to 50 percent would decrease federal outlays by $110 million in 2000 and by almost $2.0 billion over the 2000-2009 period.

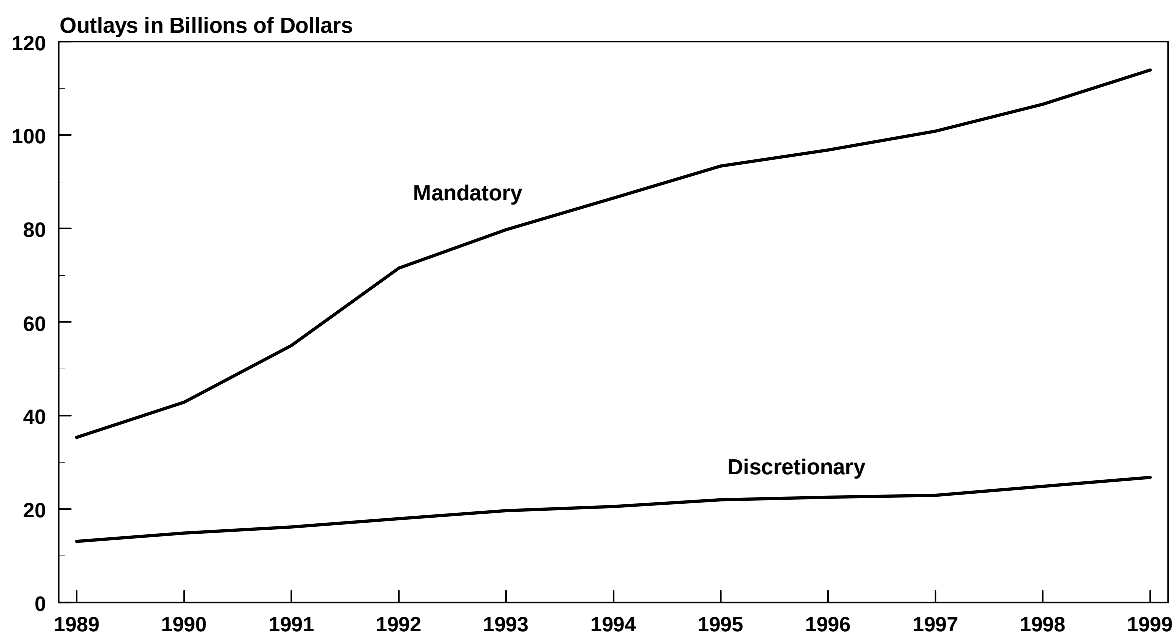
Cutting the higher matching rates to 50 percent would be appropriate if the need for special incentives for activities such as training no longer existed. However, states might respond to this option by reducing their administrative efforts, which could raise program costs and offset some of the federal savings. Specifically, states might make less of an effort to eliminate waste and abuse in payments to providers. Alternatively, this proposal might encourage states to provide less training for administrators and prospective foster and adoptive parents or to reduce the payments and other services that the programs offer.

Under the Unfunded Mandates Reform Act of 1995, reductions in federal funding for certain entitlement grant programs—including Foster Care and Adoption Assistance—are considered mandates on state governments if the states lack authority to amend their programmatic or financial responsibilities to offset the loss of funding. Because some states may not have sufficient flexibility within the Foster Care and Adoption Assistance programs to make such changes, this option could constitute an unfunded federal mandate on those jurisdictions under this law.

550

Health

Budget function 550 includes federal spending for health care services, disease prevention, consumer and occupational safety, health-related research, and similar activities. The largest component of spending is the federal/state Medicaid program, which pays for health services for some low-income women, children, and elderly people as well as people with disabilities. CBO estimates that in 1999, the federal government will spend $107 billion on Medicaid and a total of $141 billion on function 550, of which $27 billion will be discretionary. Discretionary budget authority of over $30 billion was provided for the function in 1999. Over the past 10 years, outlays under function 550 have increased from about 4 percent of federal spending to more than 8 percent.



550-01 REDUCE FUNDING FOR THE NATIONAL HEALTH SERVICE CORPS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	29	9
2001	29	21
2002	29	26
2003	29	28
2004	29	28
2005	29	28
2006	29	28
2007	29	28
2008	29	28
2009	29	28
Cumulative		
2000-2004	144	113
2000-2009	289	254

SPENDING CATEGORY:

Discretionary

The National Health Service Corps (NHSC), which is administered by the Health Resources and Services Administration, attempts to increase access to primary care services for people who live in designated Health Professional Shortage Areas. The Corps provides scholarships or loan repayment for health professionals in exchange for the recipients' agreeing to serve in a shortage area for a specified period. In recent years, over 2,200 health professionals have been serving with the NHSC—most of them in underserved rural areas but about a third in inner cities. Over half of the participants are doctors, but a substantial fraction of Corps practitioners are dentists, nurse-practitioners, or physician assistants.

This option would reduce budget authority for the NHSC by 25 percent, producing savings in outlays of $9 million in 2000. Five-year savings would total $113 million; savings over the 2000-2009 period would reach $254 million.

Although some people living in underserved areas receive greater access to health services because of the Corps, critics of the program may question whether it distributes health professionals efficiently. Concerns center on whether the services that an NHSC professional provides in an underserved area outweigh the value of the services that he or she would have provided in some other location by enough to justify the public expense of a scholarship or loan repayment. Moreover, some NHSC participants may displace other health professionals. For example, certain of the more desirable shortage areas might have been able to attract health professionals if a number of the potential patients were not already being served by Corps professionals. In addition, some observers might question whether NHSC funding represents a good return on investment. Although retention rates have increased substantially, almost half of the recruits do not remain in their underserved location beyond their obligation.

Reducing funding for the NHSC would lessen access in some underserved areas to the services provided by health professionals, although the Corps might be able to mitigate the effects of budget cuts by spending more of its resources on relatively inexpensive nonphysician providers. But even if the Corps refocused its remaining funds on nonphysician practitioners, the services of those professionals would not fully substitute for the skills and services offered by physicians. In the event of a cut in funding, community health centers, which obtain about a quarter of their physicians from the NHSC, would probably reduce their services. Moreover, lower levels of funding would probably have a disproportionate impact on people from minority groups, who constitute the majority of patients served by Corps professionals.

550-02 REDUCE THE FLOOR ON THE FEDERAL MATCHING RATE IN MEDICAID

	Outlay Savings (Millions of dollars)
Annual	
2000	3,660
2001	3,940
2002	4,260
2003	4,610
2004	5,020
2005	5,450
2006	5,940
2007	6,460
2008	7,050
2009	7,680
Cumulative	
2000-2004	21,480
2000-2009	54,050

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

550-03

The Medicaid program pays for medical assistance for certain low-income families, for low-income people who receive Supplemental Security Income, and for other low-income individuals—mostly children and pregnant women. The federal government and the states pay for the program jointly, with the federal government's share generally varying according to a formula that depends on a state's per capita income. High-income states pay for a larger share of benefits than low-income states, but by law, the federal share can be no less than 50 percent and no more than 83 percent. In 2000, the 50 percent floor will apply to 10 states: Colorado, Connecticut, Delaware, Illinois, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, and New York. (The floor would also apply to the District of Columbia, but the Balanced Budget Act of 1997 established a permanent special exception for that jurisdiction.)

Under this option, the 50 percent floor would be reduced to 45 percent, generating savings of about $3.7 billion in 2000 and $21.5 billion through 2004. (The option assumes that matching rates for other programs that are jointly funded by the federal and state governments would be unaffected, even though some programs have matching rates that are tied to the rate for Medicaid. Savings would be greater if matching rates in those programs also changed.)

Proponents of this change argue that the allocation formula does not adequately address differences in the tax base of the states and that high-income states should bear a larger share of the cost of their programs. If the floor was reduced to 45 percent, federal contributions would be more closely related to the state's per capita income, and six of the 10 jurisdictions would still be paying less than the formula alone would require.

Opponents of reducing the 50 percent floor believe that higher incomes in the affected states partly reflect higher costs of living. If the option was adopted, those states would have to compensate for the lower matching rates by either reducing Medicaid benefits, reducing expenditures for other services, or raising taxes.

550-03 REDUCE THE ENHANCED FEDERAL MATCHING RATES FOR CERTAIN ADMINISTRATIVE FUNCTIONS IN MEDICAID

	Outlay Savings (Millions of dollars)
Annual	
2000	610
2001	760
2002	980
2003	1,060
2004	1,160
2005	1,260
2006	1,370
2007	1,490
2008	1,620
2009	1,760
Cumulative	
2000-2004	4,570
2000-2009	12,070

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

550-02, 550-04-A, and 550-04-B

Under current law, the federal government pays part of the costs that states incur in administering their Medicaid programs. For most administrative activities, the federal matching rate is 50 percent, but that rate is higher for certain activities. For example, the federal government pays 75 percent of the costs of skilled medical professionals who are employed in Medicaid administration, 75 percent of the costs of utilization review, 90 percent of the development costs of systems for claims processing and management information, and 75 percent of the costs of operating such systems.

The purpose of enhanced matching rates is to give states incentives to develop and support particular administrative activities that the federal government considers important for the Medicaid program. But once the administrative systems are operational, there may be less reason to continue to pay higher rates. If the federal share of all Medicaid administrative costs was 50 percent, savings would be $610 million in 2000, $4.6 billion over the 2000-2004 period, and $12.1 billion over the 2000-2009 period.

Opponents of the reduction might argue, however, that without high matching rates, states would be inclined to cut back on some activities, with adverse consequences for the quality of care and for program management. States might, for example, hire fewer nurses to conduct utilization review and oversee care in nursing homes, or they might undertake fewer improvements to their management information systems. If the Congress wished to protect certain administrative functions, however, it could maintain the higher matching rates for some administrative activities and reduce them for others.

550-04-A RESTRICT THE ALLOCATION OF COMMON ADMINISTRATIVE COSTS TO MEDICAID

	Outlay Savings (Millions of dollars)
Annual	
2000	300
2001	340
2002	410
2003	410
2004	410
2005	410
2006	410
2007	410
2008	410
2009	410
Cumulative	
2000-2004	1,870
2000-2009	3,920

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

550-03 and 550-04-B

Public assistance programs have certain administrative requirements that are common to the enrollment process, such as the collection of information on a family's income, assets, and other characteristics. Before the 1996 welfare reform law, the three major public assistance programs—Aid to Families with Dependent Children (AFDC), Food Stamps, and Medicaid—all reimbursed states for 50 percent of most of their administrative costs. But states usually charged the common administrative costs of those programs to AFDC.

The welfare reform law replaced AFDC and some related programs with the Temporary Assistance for Needy Families (TANF) block-grant program. The block grants that states receive are based on historical federal welfare expenditures, including administrative costs. Thus, insofar as states had previously paid for the common administrative costs of public assistance programs out of AFDC funds, those amounts are now included in their block grants. Although the welfare reform act is silent about the cost allocation process, the Department of Health and Human Services now requires states to charge part of the common administrative costs of Medicaid and TANF to Medicaid, even if those costs are already included in the states' TANF block grants.

This option would reduce federal reimbursement for Medicaid administrative costs to reflect the share of those costs that are assumed to be covered by the TANF block grant; it would also prohibit states from using TANF funds to pay for those costs. The amount of the reduction would be about one-third of the common costs of administering the Medicaid, AFDC, and Food Stamp programs that were charged to AFDC during the base period used for determining the amount of the TANF block grant. (A similar adjustment has already been made in the amount the federal government pays the states for the administrative costs of the Food Stamp program.) Savings would be $300 million in 2000, $1.9 billion over the 2000-2004 period, and $3.9 billion over the 2000-2009 period. (If, however, the policy permitted the states to use TANF funds to pay for those costs, savings would be $70 million in 2000, $510 million over the 2000-2004 period, and $1.3 billion over the 2000-2009 period.)

The reductions would come at a time when states are attempting to expand their outreach activities to enroll more eligible children in Medicaid and the State Children's Health Insurance Program (S-CHIP). Because the share of S-CHIP spending that can be devoted to administration is capped, states may seek to increase the share of the administrative burden that Medicaid bears. But states would be less likely to pursue that strategy if Medicaid administrative payments were reduced.

550-04-B REDUCE SPENDING FOR MEDICAID ADMINISTRATION

	Outlay Savings (Millions of dollars)
Annual	
2000	1,390
2001	1,400
2002	1,540
2003	1,720
2004	1,960
2005	2,220
2006	2,520
2007	2,860
2008	3,250
2009	3,680
Cumulative	
2000-2004	8,000
2000-2009	22,540

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

550-03 and 550-04-A

An alternative strategy to limit federal payments for Medicaid's common administrative costs would base those payments to the states on matching payments for administrative costs in the period before the Temporary Assistance to Needy Families (TANF) block-grant program was established. Under this option, the federal government would cap the amount per enrollee that it paid the states for Medicaid administration. The per capita limit would grow at 5 percent a year from the base-year amount, which would be the administrative costs per enrollee for which the states claimed matching payments in 1996. Savings would be $1.4 billion in 2000, $8.0 billion over the 2000-2004 period, and $22.5 billion over the 2000-2009 period.

Using this approach, states that before TANF allocated Medicaid's common administrative costs to AFDC would not have those costs included in their projected Medicaid administrative costs. But states that claimed those costs through the Medicaid program would have them built into their Medicaid administrative cost base. The option would generate large savings because the actual average rate of growth of administrative costs was more than 5 percent a year in the 1996-1998 period and is also projected to exceed 5 percent in 1999 and later years.

550-05 CONVERT MEDICAID AND MEDICARE DSH PAYMENTS INTO A BLOCK GRANT

	Outlay Savings (Millions of dollars)
Annual	
2000	650
2001	440
2002	340
2003	510
2004	730
2005	830
2006	920
2007	1,010
2008	1,150
2009	1,310
Cumulative	
2000-2004	2,660
2000-2009	7,870

SPENDING CATEGORY:

Mandatory

Under current law, states are required to adjust Medicaid payments to hospitals that treat large numbers of low-income and Medicaid patients, which are known as disproportionate share (DSH) hospitals. In the early 1990s, some states used creative financing mechanisms to generate large federal matching payments through the DSH program, and federal DSH costs soared. To curb that growth, the Congress enacted a series of restrictions on DSH payments, culminating in those of the Balanced Budget Act of 1997 (BBA). Federal outlays for Medicaid DSH payments were $9.0 billion in 1997 and are projected to decline to $8.4 billion by 2002, when they will start to rise with inflation.

In addition to Medicaid DSH payments, hospitals that serve a disproportionately large share of low-income patients may also receive higher payment rates under Medicare's prospective payment system (PPS). Implemented in 1986, the Medicare disproportionate share adjustment was intended to account for the presumably higher costs of treating Medicare patients in such hospitals. Recently, however, the adjustment has been seen more as a means to protect access to care for Medicare and low-income populations by providing financial support to hospitals serving large numbers of indigent patients. Outlays for Medicare DSH payments rose rapidly between 1989 and 1997, reaching $4.5 billion in that year. Under the BBA, a temporary 5 percent reduction in Medicare DSH adjustments is being phased in over five years. As a result, payments in 2002 will be $5.0 billion.

An alternative approach to providing federal financial support for health care institutions that serve the poor and uninsured would be to convert the current Medicaid and Medicare disproportionate share programs into block grants to the states. The grants could be constrained to grow more slowly than DSH payments would grow under current law. In exchange for slower growth, states could be given flexibility to use the funds to meet the needs of their low-income uninsured populations in the most cost-effective ways.

Under this illustrative option, which assumes a maintenance-of-effort requirement for states, the aggregate block grant in 2000 would be the sum of Medicare DSH payments and Medicaid DSH allotments for 1999, reduced by 10 percent. In subsequent years the block grant would be indexed to the increase in the consumer price index for urban consumers less 1 percentage point. Total savings would be $650 million in 2000, $2.7 billion for the 2000-2004 period, and $7.9 billion for the 2000-2009 period.

Giving the states more discretion in the allocation of DSH payments could result in those funds being targeted more appropriately and equitably to facilities and providers that serve low-income populations. But allowing the states to allocate the payments could cause some large urban safety-net hospitals to receive considerably less public funding than they do now, possibly threatening their future survival. In addition, determining how to allocate the block grant funds among the states would be difficult and controversial.

550-06 REDUCE SUBSIDIES FOR HEALTH PROFESSIONS EDUCATION

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	209	63
2001	209	152
2002	209	190
2003	209	204
2004	209	204
2005	209	204
2006	209	204
2007	209	204
2008	209	204
2009	209	204
Cumulative		
2000-2004	1,043	814
2000-2009	2,086	1,836

SPENDING CATEGORY:

Discretionary

The Congress provided about $209 million to the Public Health Service in 1999 to fund subsidies to institutions for educating physicians, nurses, and public health professionals. Those funds primarily furnish support through grants and contracts to schools and hospitals for designated training programs in the health professions. The programs promote primary care and community-based training for physicians and other health professionals as well as nursing education:

- *Primary care and community-based training*. Several programs provide federal grants to medical schools, teaching hospitals, and other training centers to develop, expand, or improve graduate medical education in primary care specialties and other allied health fields and to encourage practice in rural and low-income urban areas. Funding for 1999 is $143 million.

- *Nursing education*. The subsidies to nursing schools are meant to promote nursing education, including graduate training for nurse administrators, educators, and nursing specialists such as nurse-midwives and nurse-practitioners. Funding for 1999 is $66 million.

Eliminating those grants and subsidies would save about $800 million over the 2000-2004 period. Savings over the 2000-2009 period would be $1.8 billion.

The principal justification for this option is that market forces provide strong incentives for people to seek training and jobs in the health professions. Over the past several decades, the number of physicians—the principal health profession targeted by the subsidies—has rapidly increased, rising from 142 physicians in all fields for every 100,000 people in 1960 to 274 in 1995. In the case of nurses, if a shortage indeed existed, higher wages and better working conditions would attract more people to the profession and more trained nurses to nursing jobs, and would encourage more of them to seek advanced training.

The major disadvantage of eliminating the subsidies is that the incentives supplied by market forces may not be strong enough to entirely meet the goals of the health professions programs. For example, third-party reimbursement rates for primary care may not encourage enough physicians to enter those specialties and may not include sufficient financial inducements to increase access to care in rural and inner-city areas. In addition, fewer people might choose advanced training in nursing, which could limit the opportunities for the use of relatively inexpensive physician substitutes.

550-07 COMBINE AND REDUCE PUBLIC HEALTH SERVICE BLOCK GRANTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	383	138
2001	383	332
2002	383	359
2003	383	375
2004	383	376
2005	383	376
2006	383	376
2007	383	376
2008	383	376
2009	383	376
Cumulative		
2000-2004	1,915	1,579
2000-2009	3,831	3,458

SPENDING CATEGORY:

Discretionary

In its appropriations for 1999, the Congress provided about $3.8 billion for nine block-grant programs administered by the Health Resources and Services Administration (HRSA), the Centers for Disease Control and Prevention (CDC), and the Substance Abuse and Mental Health Services Administration (SAMHSA).

Four of the nine programs—the Maternal and Child Health Care Block Grant, HIV Care Grants to States, the Family Planning Block Grant, and the Healthy Start Initiative—are administered by HRSA. Those grants support programs that provide child health services, including immunizations, well-child examinations, and services for children with special health care needs; medical care and social support services for people who have been diagnosed with the human immunodeficiency virus; family planning services; and infant mortality efforts. CDC administers the Preventive Health and Health Services Block Grant, which is distributed to the states for programs that support Healthy People 2000, the nation's overall health objectives.

The remaining four block grants—the Substance Abuse Performance Partnership Block Grant, the Mental Health Performance Partnership Block Grant, the Projects for Assistance in Transition from Homelessness (PATH) program, and the Protection and Advocacy Program—are administered by SAMHSA. The grants fund substance abuse prevention programs, community-based mental health services for adults with serious mental illnesses and children with severe emotional disturbances, services for mentally ill people with substance abuse disorders who are also either homeless or at risk of becoming homeless, and programs that investigate allegations of abuse and neglect in facilities that provide care for people with mental illness.

This option would combine all of the block grants into two large grants and reduce funding to 90 percent of the 1999 level. The block grants currently administered by HRSA and the CDC would be combined and administered by HRSA, and the block grants currently administered by SAMHSA would be combined and administered by that agency.

The principal justification for this option is that each state would be given added flexibility to direct the grant funds toward programs that the state considers likely to have the most favorable impact. Conditions vary substantially by state, yet grant requirements often compel states to invest resources in programs that may or may not meet a given state's needs. By reducing funds for lower-priority programs, states could allocate additional resources to programs that they considered more important.

The option's major disadvantage is that improved flexibility might not entirely make up for the 10 percent cut in federal funds for state programs. The states would have to make difficult decisions to trim programs that benefited vulnerable population groups. Alternatively, if reducing resources was not feasible, they might have to raise state taxes or cut other state programs.

550-08 ADOPT A VOUCHER PLAN FOR THE FEHB PROGRAM

	Savings[a] (Millions of dollars) Discretionary[b]	Mandatory
Annual		
2000	0	0
2001	150	150
2002	370	370
2003	610	610
2004	860	880
2005	1,140	1,180
2006	1,450	1,520
2007	1,780	1,880
2008	2,130	2,280
2009	2,520	2,710
Cumulative		
2000-2004	1,990	2,010
2000-2009	11,010	11,580

a. Estimates do not include any savings realized by the U.S. Postal Service.

b. Savings measured from the 1999 funding level adjusted for premium increases and changes in employment.

SPENDING CATEGORIES:

Discretionary and mandatory

RELATED OPTION:

550-09

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

The Federal Employees Health Benefits (FEHB) program provides health insurance coverage for over 4 million active federal employees and annuitants, as well as for their 4.6 million dependents and survivors, at a cost to the government of about $12 billion in 1999. The cost-sharing structure of the FEHB program encourages federal employees to switch from high-cost to lower-cost plans to blunt the effects of rising premiums; cost sharing also intensifies competitive pressures on all participating plans to hold down premiums. The Balanced Budget Act of 1997 set the federal government's share of premiums for employees and annuitants (including family coverage) at 72 percent of the average weighted premium of all plans beginning January 1, 1999. (The employer's costs are higher under the U.S. Postal Service's collective bargaining agreement.) The act, which made largely technical changes to the FEHB formula for determining the government's contribution, did not significantly change the government's average share of those premiums. Moreover, the government still requires policyholders to pay at least 25 percent of the premium of any particular plan.

To reduce expenditures, the government could offer a flat voucher for health insurance premiums. It could pay the first $1,900 of premiums for employees and retirees ($4,350 for family coverage). Those amounts are based on the government's average expected contribution for nonpostal employees in 2000 and would increase annually by the rate of inflation rather than by the average weighted rate of change for premiums in the FEHB program. Budgetary savings would come from indexing the premiums to inflation rather than to the growth of premiums, which the Congressional Budget Office expects will rise at a rate more than twice that of inflation. Savings in discretionary spending from lower payments for current employees and their dependents would be zero in 2000, $2 billion over five years, and $11 billion over 10 years. Savings in mandatory spending from reduced payments for retirees would be zero in 2000, $2.0 billion over five years, and $11.6 billion over 10 years.

The option would strengthen price competition among health plans in the FEHB program because almost all current enrollees would be faced with paying all of the incremental premiums above the voucher amount. In addition, removing the requirement that enrollees pay at least 25 percent of the premiums should increase price competition among low-cost plans to attract participants.

On the downside, participants would pay an ever-increasing share of their premiums—possibly just under 40 percent by 2004—if premiums rose as expected. The added cost to enrollees could exceed $600 per worker in 2004 and more in later years. Currently, large private-sector plans provide better health benefits for their employees—although not for their retirees—which might make it harder for the government to attract and retain high-quality workers. In addition, for current retirees and long-time federal workers, the option would cut benefits that have already been earned.

550-09 BASE RETIREE HEALTH BENEFITS ON LENGTH OF SERVICE

	Savings[a] (Millions of dollars) Budget Authority	Outlays
Annual		
2000	50	50
2001	100	100
2002	150	150
2003	200	200
2004	250	250
2005	300	300
2006	400	400
2007	500	500
2008	600	600
2009	700	700
Cumulative		
2000-2004	750	750
2000-2009	3,250	3,250

a. Estimates do not include any savings realized by the U.S. Postal Service.

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

550-08

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

The Federal Employees Health Benefits (FEHB) program provides health insurance to federal retirees and active employees through participating fee-for-service plans and managed care plans. Participants and the government share the cost of premiums. The government's share for annuitants and employees is 72 percent of the weighted average premium of all participating plans (up to a cap of 75 percent of the total premium). Retirees are generally eligible to continue receiving benefits from the FEHB program if they have been participants during their last five years of service and are eligible to receive an immediate annuity. About 80 percent of eligible new retirees elect to receive retiree health benefits. After age 65, FEHB program benefits are coordinated with Medicare; the program pays amounts not covered by Medicare (but no more than the amount it would have paid in the absence of Medicare). Consequently, many retirees receive benefits superior to those they received while employed. In 1998, the government paid $4.3 billion in premiums for 1.9 million annuitants and their dependents and survivors.

In contrast to federal pensions, retiree health benefits are not based on length of service. Moreover, federal retiree health benefits are significantly more generous than those offered by most large private firms, which have been aggressively paring and, in some cases, eliminating retiree health benefits in recent years. A survey of all U.S. employers found that fewer than half provide medical benefits to retirees.

Federal retiree health benefits could be reduced for those with relatively short federal careers while preserving the right of retirees to participate in the FEHB program. For new retirees only, the government's share of the premium could be cut by 2 percentage points for every year of service under 30. For example, the government's contribution would fall to 52 percent of the average premium for a retiree with 20 years of service. In 1998, about 55 percent of the roughly 60,000 new retirees who continued in the FEHB program had less than 30 years of service. The average new nonpostal retiree affected by the proposal would pay 47 percent of the premium rather than 28 percent, an annual increase of $750 in 2000. The estimated savings to the government in mandatory spending would total $50 million in 2000 and $750 million over five years. Ten-year savings would rise to $3.3 billion.

The option might make the government's compensation mix fairer and more efficient by improving the link between service and deferred compensation. And even with this change, federal retiree health benefits would remain comparable with those offered by firms that continued to provide retiree benefits.

A negative aspect of the option is that it would mean a substantial cut in benefits whose effects would be felt most strongly by the roughly 20 percent of new retirees with less than 20 years of service. The option could also encourage some employees with short service careers to delay retirement, whereas others might accelerate retirement plans to avoid the new rules.

550-10 ESTABLISH NEW USER FEES FOR MEDICAL DEVICES REGULATED BY THE FDA

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	12	9
2001	28	23
2002	32	30
2003	31	31
2004	31	31
2005	31	31
2006	31	31
2007	31	31
2008	31	31
2009	31	30
Cumulative		
2000-2004	134	124
2000-2009	289	277

SPENDING CATEGORY:

Discretionary

The Prescription Drug User Fee Act of 1992 (PDUFA) authorized the Food and Drug Administration (FDA) to collect fees from pharmaceutical manufacturers to help speed up the review of applications for marketing and approval of new drugs. The Food and Drug Administration Modernization Act of 1997 (FDAMA) reauthorized the PDUFA user fee program but did not address user fees for medical devices. The Congress considered but did not pass legislation authorizing user fees for medical devices in 1994. The Administration's 2000 budget includes a proposal to impose user fees on medical devices as well as on other products regulated by the FDA.

Manufacturers must notify the FDA before they market any new medical device, and for certain products, they must obtain approval before marketing them. Imposing fees of $7,000 for each new medical device requiring premarket notification, $3,500 for those devices qualifying for abbreviated or special notification processes, and $60,000 for each new medical device needing premarket approval would raise $9 million in 2000 and $277 million during the 2000-2009 period. Taken together, those fees would ultimately constitute about 21 percent of the cost of regulating medical devices. The estimates assume that only a few exemptions would be granted for small businesses or devices with very small markets.

Establishing new user fees for medical devices would require new authorizing legislation. To generate budgetary savings, that legislation would have to permit user fee collections to offset other FDA appropriations for salaries and expenses. PDUFA does not permit that offset for prescription drug user fees.

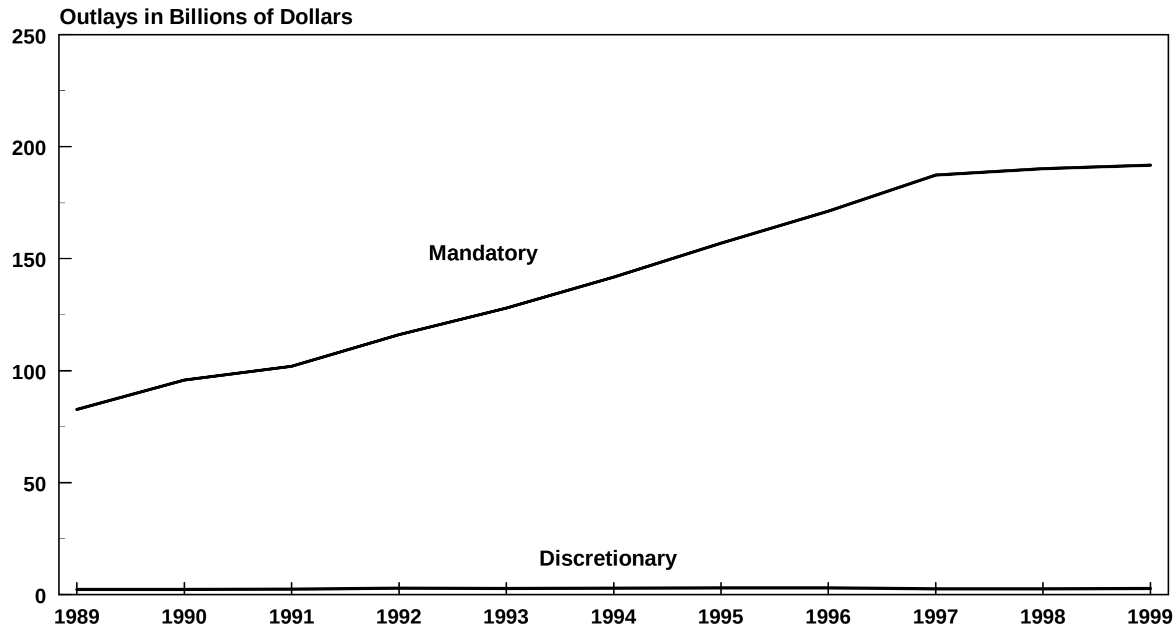
Proponents of user fees for medical devices argue that regulatory activities benefit both consumers and industry. The FDA's primary function is to ensure public safety by monitoring the quality of pharmaceutical products, medical devices, and food. Firms benefit from the public confidence that results from the FDA's regulation, those proponents maintain, and should therefore bear a share of the costs of those activities.

People who oppose levying new user fees on medical devices might argue that the agency's current oversight of medical devices is excessive and unnecessary. Rather than adding user fees, those opponents might contend that the FDA could cut costs by scaling back its regulatory requirements.

570

Medicare

Budget function 570 comprises spending for Medicare, the federal health insurance program for elderly and eligible disabled people. Medicare consists of two parts, each tied to a trust fund. Hospital Insurance (Part A) reimburses providers for inpatient care that beneficiaries receive in hospitals, as well as care at skilled nursing facilities, home health care related to a hospital stay, and hospice services. Supplementary Medical Insurance (Part B) pays for physicians' services, outpatient hospital services, home health care, and other services. CBO estimates that Medicare outlays (net of premiums paid by beneficiaries) will total $195 billion in 1999, including discretionary outlays of $3 billion. Discretionary budget authority provided for function 570 in 1999 also totals $3 billion. Over the past 10 years, Medicare outlays have risen from about 7.5 percent of federal spending to nearly 12 percent.



570-01 REDUCE MEDICARE'S PAYMENTS FOR THE INDIRECT COSTS OF PATIENT CARE THAT ARE RELATED TO HOSPITALS' TEACHING PROGRAMS

	Outlay Savings (Millions of dollars)
Annual	
2000	1,200
2001	1,000
2002	1,200
2003	1,300
2004	1,400
2005	1,600
2006	1,700
2007	1,900
2008	2,100
2009	2,400
Cumulative	
2000-2004	6,200
2000-2009	15,800

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-02, 570-03, and 570-04

RELATED CBO PUBLICATION:

Medicare and Graduate Medical Education (Study), September 1995.

The Social Security Amendments of 1983 established the prospective payment system (PPS) under which Medicare pays hospitals for inpatient services provided to beneficiaries. Higher rates are paid to hospitals with teaching programs to cover their higher costs of caring for Medicare patients. The additional percentage paid to those hospitals under current law in 2000 will be approximately 6 percent for each 0.1 increase in a hospital's ratio of full-time interns and residents to its number of beds. For 2001 and later, the addition to Medicare's payments will be 5.5 percent for each 0.1 increase in the resident-to-bed ratio. Those adjustments were enacted to compensate hospitals for indirect teaching costs—such as the greater number of tests and procedures thought to be prescribed by interns and residents—and to cover higher costs caused by factors that are not otherwise accounted for in setting the PPS rates. Such factors might include more severely ill patients, location in inner cities, and a more costly mix of staffing and facilities—all of which are associated with large teaching programs.

The Prospective Payment Assessment Commission has estimated that a 4.1 percent adjustment to Medicare's payments would more closely match the increase in operating costs associated with teaching. If the teaching adjustment was lowered accordingly, outlays would fall by about $6.2 billion from current-law spending over the 2000-2004 period and by about $15.8 billion over the 2000-2009 period.

This option would better align payments with the actual costs incurred by teaching institutions. Furthermore, since the training that medical residents receive will result in a significant increase in their future income and since hospitals benefit from using residents' labor, it is reasonable for some or all of a hospital's indirect training costs to be borne by both residents and the hospital. Some of those costs are now passed on in the form of stipends that are lower than the value of the residents' services to the hospital. A lower teaching adjustment would probably lead to even lower stipends as well as smaller residency programs. Although some people seeking residency positions might consider smaller programs to be a disadvantage of this option, several health policy groups, including the Council on Graduate Medical Education, believe that a decline in the number of residency positions is desirable. An additional consideration is that if the teaching hospitals now use some payments to fund such activities as charity care, people without health insurance could have less access to health services.

570-02 REDUCE MEDICARE'S DIRECT PAYMENTS FOR MEDICAL EDUCATION

	Outlay Savings (Millions of dollars)
Annual	
2000	800
2001	900
2002	900
2003	1,000
2004	1,000
2005	1,000
2006	1,100
2007	1,200
2008	1,200
2009	1,200
Cumulative	
2000-2004	4,600
2000-2009	10,300

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-01, 570-03, and 570-04

RELATED CBO PUBLICATION:

Medicare and Graduate Medical Education (Study), September 1995.

Medicare's prospective payment system does not include payments to hospitals for the direct costs they incur in providing graduate medical education (GME)—namely, residents' salaries and fringe benefits, teaching costs, and institutional overhead. Instead, Medicare makes those payments separately on the basis of its share of a hospital's 1984 cost per resident indexed for increases in the level of consumer prices. Medicare's direct GME payments, which are received by about one-fifth of all U.S. hospitals, totaled about $2.1 billion for 1998.

In effect, this option would reduce teaching and overhead payments for residents but continue to pay their salaries and fringe benefits. Hospitals' direct GME payments would be based on the national average of salaries paid to residents in 1987, updated annually by the consumer price index for all urban consumers. Reimbursement would be based on 120 percent of the national average salary. Unlike the current system, under which GME payments vary considerably from hospital to hospital, this option would pay every hospital the same amount for the same type of resident. The option would also continue the current-law practice of reducing payments for residents who have gone beyond their initial residency period. The savings from current-law spending would total about $4.6 billion over the 2000-2004 period and about $10.3 billion over the 2000-2009 period.

The overall reduction in the level of subsidies might be warranted since market incentives appear to be sufficient to encourage a continuing flow of new physicians. Moreover, since hospitals use resident physicians to care for patients and since residency training helps young physicians earn higher incomes in the future, both hospitals and residents might reasonably contribute more to those training costs. Residents would contribute more to those costs if hospitals responded to the changes in reimbursements by cutting residents' salaries or fringe benefits.

If hospitals lowered residents' salaries or benefits, the costs of longer residencies—in terms of forgone practice income—could exert greater influence on the young physicians' decisions about pursuing a specialty. More residents might choose to begin primary care practice rather than specialize further. That outcome could be negative for the individual resident; by contrast, the Council on Graduate Medical Education and other groups believe that a relative increase in the number of primary care practitioners would be desirable. Finally, decreasing GME reimbursement could force some hospitals to reduce the resources they commit to training, possibly jeopardizing the quality of their medical education programs.

570-03 ELIMINATE ADDITIONAL CAPITAL-RELATED PAYMENTS FOR HOSPITALS WITH RESIDENCY PROGRAMS

	Outlay Savings (Millions of dollars)
Annual	
2000	300
2001	300
2002	300
2003	300
2004	300
2005	300
2006	300
2007	300
2008	300
2009	300
Cumulative	
2000-2004	1,400
2000-2009	3,000

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-01, 570-02, and 570-04

Under the prospective payment system for inpatient hospital services, Medicare pays hospitals an amount for each discharge that is intended to compensate the hospital for capital-related costs. Currently, teaching hospitals receive additional capital-related payments that are based on teaching intensity, measured as a hospital's ratio of residents to its average daily number of inpatients. Specifically, an increase of 0.1 in that ratio raises the hospital's capital-related payment by 2.8 percent.

Eliminating those extra payments would save the Medicare program about $0.3 billion in 2000. Five-year savings would equal about $1.4 billion, and savings over the 2000-2009 period would be $3.0 billion.

In contrast to higher operating costs, which analyses indicate are indeed associated with teaching intensity, a hospital's capital costs per case appear to be unrelated to intensity. Furthermore, paying teaching hospitals more than nonteaching hospitals for otherwise similar patients may discourage efficient decisionmaking by hospitals. In addition, Medicare's payment adjustments for teaching intensity may distort the market for residency training by artificially increasing the value (or decreasing the cost) of residents to hospitals. If residents' training raises the costs of patient care for a hospital, arguably the hospital should bear those costs in order to encourage an efficient amount of training. Hospitals are likely to shift such costs to residents in the form of lower stipends or greater workloads. Residents will engage in such training if they perceive that their future productivity, as reflected in their future incomes, will be great enough to outweigh those costs.

Eliminating the special capital-related payments would reduce revenues to teaching hospitals at a time when those hospitals already face pressures to reduce costs to remain competitive in the growing managed care environment. Teaching hospitals would probably have to reduce some services in response to the decline in their revenues. Those reductions in services could include less provision of public goods, such as research or providing medical care to the indigent.

570-04 CONVERT MEDICARE PAYMENTS FOR GRADUATE MEDICAL EDUCATION TO A BLOCK GRANT AND SLOW THEIR RATE OF GROWTH

	Outlay Savings (Millions of dollars)
Annual	
2000	0
2001	a
2002	300
2003	500
2004	700
2005	900
2006	1,100
2007	1,400
2008	1,700
2009	2,000
Cumulative	
2000-2004	1,600
2000-2009	8,600

a. Outlay decrease of less than $50 million.

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-01, 570-02, and 570-03

RELATED CBO PUBLICATION:

Medicare and Graduate Medical Education (Study), September 1995.

Three types of Medicare graduate medical education (GME) payments are tied to the size or intensity of a teaching hospital's residency program: direct graduate medical education payments, the indirect medical education adjustment for inpatient operating costs, and the indirect medical education adjustment for inpatient capital-related costs. Under provisions in the Balanced Budget Act of 1997, teaching hospitals have begun to receive GME payments for participants in Medicare+Choice health plans in addition to the payments that they have traditionally received for fee-for-service Medicare patients. Several variables determine the total amount of GME payments that a hospital receives, including the number and diagnoses of Medicare discharges and numerical factors used for annually updating payments for inpatient operating costs and capital-related costs. Because of changes in those variables over time, the Congressional Budget Office expects GME payments under current law to grow at an average annual rate of 5.1 percent between 2000 and 2009.

This option would replace the current system with a consolidated block grant to fund the special activities of teaching hospitals. Under the current system, a hospital receives GME payments based on regulatory formulas, and total Medicare GME spending is the resulting sum of what Medicare owes each hospital. The option considered here assumes that a budget-neutral switch to the block-grant program would occur in 2000 and that the program's future growth would be limited to the rate of overall inflation. Compared with projected spending under current law, federal outlays would be reduced by $1.6 billion over the first five years and $8.6 billion over the 2000-2009 period.

Establishing a block grant for the three types of GME payments would allow the Congress to better monitor and adjust that funding. Another feature of the option is that Medicare would no longer pay different rates to hospitals for inpatient services merely because of differences in the size or presence of residency programs.

However, because this option would reduce total payments to teaching hospitals below the amounts expected under current law, such hospitals would, on average, receive less revenue than they would otherwise. In response, teaching hospitals might reduce the amount or quality of some of their services or their provision of some public goods, such as medical research or care for indigent people.

570-05 ELIMINATE MEDICARE'S ADDITIONAL PAYMENTS TO SOLE COMMUNITY HOSPITALS

	Outlay Savings (Millions of dollars)
Annual	
2000	70
2001	80
2002	80
2003	90
2004	100
2005	100
2006	110
2007	110
2008	120
2009	130
Cumulative	
2000-2004	420
2000-2009	990

SPENDING CATEGORY:

Mandatory

Under Medicare's prospective payment system (PPS) for inpatient hospital services, special rules apply to providers designated as sole community hospitals (SCHs). At present, there are more than 600 SCHs, almost all of which are located in rural areas. Thus, more than one-fourth of rural hospitals qualify for SCH status. Under the current rules, a hospital may be designated as an SCH if it meets specific criteria that define a sole provider of inpatient, acute care hospital services in a geographic area. In addition, some SCHs have been permitted to retain that status regardless of whether they meet the current sole-provider criteria.

Payments to SCHs are equal to the highest of three amounts: the regular PPS payment that would otherwise apply, an amount based on the hospital's costs in 1982 updated to the current year, or an amount based on the hospital's costs in 1987 updated to the current year. Hospitals that choose to receive the regular PPS payment—about half of all SCHs—are eligible to receive higher payment adjustments than other rural hospitals for disproportionate share status. Hospitals that receive payments based on their updated costs are ineligible for those higher adjustments.

If all sole community hospitals received the regular PPS payment rather than their updated costs, total PPS payments would be about $70 million less in 2000 and $420 billion less for the 2000-2004 period. Those savings assume that SCHs would continue to be eligible for higher disproportionate share adjustments.

A primary objective of the SCH rules is to assist hospitals in locations where closings would threaten access to hospital care, but the federal support is not particularly well aimed at such essential providers. Moreover, whether an SCH actually receives higher payments under the special rules that permit payments to be based on a hospital-specific amount depends on whether its costs in either of the specified base years (1982 or 1987) were relatively high, not on its current financial condition.

If the special payment rules were eliminated, however, revenues of many sole community hospitals would be lower, which might cause financial distress for some of them. Because many SCHs are the sole providers of hospital services in their geographic areas, access to health care or the quality of care might be reduced in some rural locations.

570-06 INSTITUTE A SINGLE GLOBAL PAYMENT FOR HOSPITALS' AND PHYSICIANS' SERVICES PROVIDED DURING AN INPATIENT STAY

	Outlay Savings (Millions of dollars)
Annual	
2000	50
2001	60
2002	60
2003	60
2004	60
2005	70
2006	70
2007	80
2008	80
2009	80
Cumulative	
2000-2004	290
2000-2009	670

SPENDING CATEGORY:

Mandatory

Hospitals receive payments under Medicare's prospective payment system (PPS) for the operating costs of providing inpatient services to the program's beneficiaries. The payments are determined on a per-case basis; payment rates vary with the patient's diagnosis, which Medicare classifies within a system of diagnosis-related groups (DRGs), and the characteristics of the hospital. Those rates take into account reasonable variations in the treatment of patients with a given DRG and offer an incentive to the hospital to reduce the cost of treatment. PPS payments do not cover all services rendered to patients during the hospital stay. In particular, Medicare pays separately for physicians' services provided on an inpatient basis.

The Health Care Financing Administration (HCFA) has explored the feasibility of making a single global payment for high-cost, high-volume inpatient procedures. That payment would be lower than the separate payments that are now made for hospitals' operating costs and physicians' services. In a recent demonstration project involving heart bypass surgery, discounted payment rates were established through negotiations with participating hospitals in conjunction with teams of physicians. With a global payment, hospitals and physicians alike have an incentive to reduce operating costs while maintaining a satisfactory standard of care. The institutions hoped to offset the discounts in their Medicare payments by two means: improvements in efficiency (and their resultant cost savings) and increases (using new marketing efforts) in the volume of heart bypass patients. During the five-year project, Medicare outlays to the seven hospitals participating in the demonstration averaged about 14 percent less than would have been spent otherwise.

HCFA has also investigated ways to extend the global payment concept. One approach, similar to the heart bypass demonstration, identified other high-cost, high-volume inpatient procedures that might yield negotiated savings. (They included cataract surgery, coronary angioplasty, heart valve replacement, and joint replacement surgery.) That option might be attractive to hospitals, which could market themselves as "centers of excellence." However, such terminology would be controversial because it might be construed as suggesting that other hospitals did not offer high-quality care. Another disadvantage would be that only a modest number of institutions and high-cost procedures might become eligible for global payments.

A further approach developed by HCFA would provide global payments for nearly all DRGs, with an average discount of 5 percent that would not be subject to negotiation. Expanding the use of global payments through such a discount would yield savings of $50 million in 2000 and $670 million for the 2000-2009 period. That approach has the advantage of being available to all hospitals across the country, but it could also be unpopular because it would lower payments without giving the institutions much opportunity to expand their marketing efforts. In addition, its lack of focus on specific clinical conditions might dilute the incentive to find cost-saving innovations.

570-07 INCREASE AND EXTEND THE REDUCTIONS IN THE MEDICARE PPS MARKET BASKET

	Outlay Savings (Millions of dollars)
Annual	
2000	60
2001	690
2002	1,350
2003	3,040
2004	4,920
2005	7,120
2006	9,130
2007	11,850
2008	14,770
2009	18,000
Cumulative	
2000-2004	10,050
2000-2009	70,930

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-08

Under Medicare's prospective payment system (PPS), payments for hospitals' operating costs for inpatient services provided to beneficiaries are determined on a per-case basis, according to preset rates that vary with the patient's diagnosis and the characteristics of the hospital. Payment rates are adjusted each year using an update factor that is determined, in part, by the projected increase in the hospital market-basket index (MBI), which reflects increases in hospital costs.

The Balanced Budget Act of 1997 reduced hospital update factors for 1998 through 2002. Specifically, the act froze the basic payment in 1998 and reduced the update by 1.9 percentage points in 1999, 1.8 percentage points in 2000, and 1.1 percentage points in 2001 and 2002. Without those reductions, the updates would have been 2.1 percent in 1998, 2.4 percent in 1999, 2.9 percent in 2000, and more than 3 percent each year in 2001 and 2002. (In several states, however, certain hospitals with negative PPS margins received a 0.5 percentage-point adjustment in 1998 and a 0.3 percentage-point adjustment in 1999.) After 2002, the update factor reverts to the full value of the MBI. If the factor was reduced to the MBI minus 1.9 percentage points in 2000 and stayed at that level throughout the 2000-2009 period, total savings during that time would be $70.9 billion.

In 1997, average profit margins for hospitals on Medicare inpatient services were about 16 percent. Moreover, MedPAC (the Medicare Payment Advisory Commission) projects that despite the payment freeze in 1998 and the large reduction in the update factor for 1999, average Medicare inpatient margins will exceed 15 percent in both years. Thus, further reductions in update factors could be justified. The American Hospital Association, however, maintains that high inpatient margins reflect major efforts by hospitals to cut costs, which cannot continue indefinitely. Moreover, almost one-quarter of all hospitals have negative profit margins on Medicare inpatient services, so further reductions in payment update factors could cause considerable hardship for those facilities, especially as some hospitals are only now beginning to feel the effects of past payment reductions.

570-08 REDUCE MEDICARE'S PAYMENTS FOR HOSPITALS' INPATIENT CAPITAL-RELATED COSTS

	Outlay Savings (Millions of dollars)
Annual	
2000	260
2001	360
2002	360
2003	390
2004	410
2005	430
2006	440
2007	460
2008	490
2009	520
Cumulative	
2000-2004	1,780
2000-2009	4,120

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-07

In 1992, Medicare revised its method of paying hospitals for their inpatient capital-related costs by replacing cost-based reimbursement with a prospective payment method. Under the prospective system, hospitals receive a predetermined amount for each Medicare patient to pay for capital-related costs, which include depreciation, interest, taxes, insurance, and similar expenses for buildings and fixed and movable equipment. The prospective system applies to about 5,000 hospitals paid under Medicare's prospective payment system (PPS) for operating costs.

A fully prospective federal payment rate for capital costs is being phased in over 10 years. During the transition period, payments are determined by a complicated method based on a number of factors, including federal and hospital-specific payment rates. The federal and hospital-specific rates are increased annually. By 2001, all hospitals will receive the federal rate, adjusted for the hospital's mix of patients and certain other characteristics.

Analyses conducted by the Health Care Financing Administration (HCFA) suggest that the initial federal and hospital-specific rates were too high. The 1992 rates were based on actual 1989 and 1990 data (for the federal rate and hospital-specific rates, respectively) projected to 1992, but more recent data indicate that the rate of growth of capital costs between 1989 and 1992 was slower than expected. Moreover, the initial level of capital costs per case in 1989 was probably higher than would be optimal in an efficient market because of incentives provided by the Medicare payments. Factors such as changes in capital prices, the mix of patients treated by hospitals, and the "intensity" of hospital services contributed to the overestimate. On the basis of HCFA's analysis, the estimated 1992 capital costs would have been reduced by about 22 percent if those factors had been taken into account.

The federal rate was reduced by 7.4 percent in the Omnibus Budget Reconciliation Act of 1993 in a provision that expired in 1996. The Balanced Budget Act of 1997 reduced the federal rate by 17.8 percent for capital payments made to hospitals for patient discharges occurring in 1998 through 2002. A small part of that reduction will be restored beginning in 2003. A further reduction of 5 percent (bringing the total reduction in capital payments to about the level estimated by HCFA) would yield savings of $260 million in 2000 and $4.1 billion for the 2000-2009 period.

Most hospitals would probably be able to adjust to the reductions by lowering their capital costs or partially covering them with other sources of revenue because Medicare's payments for capital costs are a small share of hospitals' revenues—less than 5 percent of their total revenues from all sources. Hospitals that are in poor financial condition, however, might have difficulty absorbing the reductions. As a result, the quality of the care they offer might decline, and they might provide fewer services to people without insurance.

570-09 ELIMINATE MEDICARE'S PAYMENTS TO HOSPITALS FOR ENROLLEES' BAD DEBTS

	Outlay Savings (Millions of dollars)
Annual	
2000	450
2001	580
2002	610
2003	670
2004	730
2005	800
2006	840
2007	920
2008	1,000
2009	1,070
Cumulative	
2000-2004	3,030
2000-2009	7,670

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-10

Medicare beneficiaries are responsible for certain deductible and coinsurance amounts when they receive hospital services. In calendar year 1999, the deductible amount is $768 per spell of illness, and beneficiaries must make coinsurance payments for inpatient care in excess of 60 days and for services furnished on an outpatient basis. Before enactment of the Balanced Budget Act of 1997 (BBA), if the hospital made a reasonable effort to collect the cost-sharing amounts from patients, Medicare would reimburse it for any remaining unpaid amounts. The BBA phased in a reduction in those bad-debt payments to 55 percent of the amount that hospitals did not collect from beneficiaries. Eliminating all reimbursement for enrollees' bad debts would reduce Medicare's payments by $450 million in 2000 and $3.0 billion over the 2000-2004 period.

This option would give hospitals incentives to improve their collection efforts, but they would not be able to collect all of the money that their Medicare patients owed. In particular, low-income enrollees who were not covered by Medicaid might not be able to pay their hospital bills. As a result, this option would reduce revenues the most for those hospitals that were most likely to serve low-income Medicare patients. Moreover, a drop in their Medicare payments might lead some hospitals to cut back on the quality of their services or the amount of uncompensated care that they provide or to raise the rates that they charge for the care of other patients.

570-10 ELIMINATE MEDICARE'S PAYMENTS TO NONHOSPITAL PROVIDERS FOR ENROLLEES' BAD DEBTS

	Outlay Savings (Millions of dollars)
Annual	
2000	520
2001	690
2002	730
2003	790
2004	860
2005	950
2006	990
2007	1,100
2008	1,190
2009	1,290
Cumulative	
2000-2004	3,600
2000-2009	9,130

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-09

The Medicare program pays a variety of providers, in addition to hospitals, for the bad debts of their Medicare patients. Providers incur such debts when Medicare patients do not pay the cost-sharing amounts that the program requires. Patients in skilled nursing facilities (SNFs), for example, must pay a daily coinsurance amount of $96 in calendar year 1999 for care received from the 21st through the 100th day following discharge from a hospital. Providers that are eligible for bad-debt payments include SNFs, rural health clinics, and comprehensive outpatient rehabilitation facilities. The Balanced Budget Act of 1997 reduced Medicare's payments for hospitals' bad debts but did not affect bad-debt payments for nonhospital providers. This option would eliminate such payments for nonhospital providers, saving $520 million in 2000 and $3.6 billion over the 2000-2004 period.

As with hospitals, eliminating bad-debt payments would increase providers' incentives to improve their collection efforts, but some bad debts would remain. The policy could, therefore, cause financial problems for providers that serve a large number of low-income Medicare beneficiaries. Faced with unpaid bad debts, such providers might reduce the quality of their care or the amount of uncompensated care that they provide.

570-11 REDUCE MEDICARE EXPENDITURES FOR PRESCRIPTION DRUGS

	Outlay Savings (Millions of dollars)
Annual	
2000	260
2001	440
2002	490
2003	650
2004	850
2005	1,110
2006	1,360
2007	1,710
2008	2,100
2009	2,540
Cumulative	
2000-2004	2,690
2000-2009	11,510

SPENDING CATEGORY:

Mandatory

Medicare Supplementary Medical Insurance (Part B) paid providers over $2.5 billion in 1998 for certain outpatient drugs. Prescription drugs are covered under Part B when they must be administered under a physician's supervision, as is the case with many drugs requiring injection or infusion. Medicare also pays for drugs that must be delivered by durable medical equipment covered under the program. In addition, some oral chemotherapy and antinausea drugs for cancer patients as well as immunosuppressive drugs for organ transplant recipients are covered, as are certain vaccines.

Medicare payment policies for prescription drugs have evolved in recent years. Before the Balanced Budget Act of 1997 (BBA), the amount that Medicare allowed as a reasonable charge was based on the average wholesale price, or AWP, which is a published list price set by the manufacturer. For single-source drugs, the allowed charge was the AWP; for multisource drugs, the allowed charge was the median AWP among all generic suppliers of multisource drugs. The BBA, however, set the allowed charge for each covered single-source drug at 95 percent of the AWP. For multisource drugs, the allowed charge is 95 percent of either the median AWP among generic suppliers or the lowest brand-name AWP when that price is less than the median generic AWP for the product.

Because the AWP is a list price and not the actual price providers pay for drugs, pegging Medicare's payment to the AWP has meant that providers and suppliers could profit from administering or dispensing Medicare-covered drugs. The Inspector General of the Department of Health and Human Services has reported that actual wholesale drug prices available to physicians were about 30 percent less than the AWP in 1997. The BBA changes may reduce those mark-ups by 5 percentage points in the near term, but manufacturers can restore pre-BBA profit margins for physicians by raising list prices.

This option would limit Medicare's reimbursements for prescription drugs by decreasing the allowed charge from 95 percent to 85 percent of the AWP and by limiting increases in the allowed charge for covered drugs to changes in the rate of inflation. (Changes in the allowed charge would track the consumer price index for all urban consumers, excluding food and energy.) As a result, Medicare Part B outlays would decrease by $11.5 billion between 2000 and 2009.

One disadvantage of the option is that it would encourage manufacturers to introduce new drugs at AWPs that were higher than they would otherwise be in order to restore the profit margins available to physicians and other suppliers. Physicians would prescribe newly introduced drugs more quickly as a result. Therefore, the option's effectiveness in limiting Part B spending growth would gradually erode as new drugs replaced older ones in the mix of covered drugs. Critics of this kind of proposal also claim that some physicians would sometimes be unable to obtain drugs at a price at or below the allowed charge, especially if actual acquisition prices were to rise faster than the rate of inflation. However, such problems should be infrequent.

570-12 INDEX MEDICARE'S DEDUCTIBLE FOR PHYSICIANS' SERVICES

	Outlay Savings (Millions of dollars)
Annual	
2000	110
2001	360
2002	550
2003	830
2004	1,140
2005	1,530
2006	1,750
2007	2,100
2008	2,530
2009	2,960
Cumulative	
2000-2004	2,990
2000-2009	13,860

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-13-A, 570-13-B, 570-14, and 570-15

One way to achieve federal savings in Medicare's Supplementary Medical Insurance (SMI) program is to increase the deductible—that is, the amount that enrollees must pay for services each year before the government shares responsibility. The deductible is now $100 a year and has been increased only three times since Medicare began in 1966, when it was set at $50. In relation to average annual per capita charges under the SMI program, the deductible has fallen from 45 percent in 1967 to about 3 percent (projected) for 1999.

Increasing the SMI deductible for 2000 and later years according to the growth in SMI charges per enrollee would save $110 million in 2000, $3.0 billion over the five-year period, and $13.9 billion over the 10-year period. In 2000, the deductible would be $107.

An increase in the amount of the deductible would enhance the economic incentives for prudent consumption of medical care while spreading the impact of an increase in cost sharing among most enrollees. No enrollee's out-of-pocket costs would rise by more than $7 in 2000.

However, the additional out-of-pocket costs under this option might discourage some low-income enrollees who are not eligible for Medicaid from seeking needed care. In addition, costs to states would increase because their Medicaid programs pay the deductibles for Medicare enrollees who also receive benefits under Medicaid.

570-13-A SIMPLIFY AND LIMIT MEDICARE'S COST-SHARING REQUIREMENTS

	Outlay Savings (Millions of dollars)
Annual	
2000	690
2001	1,110
2002	1,080
2003	580
2004	520
2005	730
2006	1,250
2007	660
2008	650
2009	910
Cumulative	
2000-2004	3,980
2000-2009	8,180

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-13-B and 570-15

RELATED CBO PUBLICATION:

Restructuring Health Insurance for Medicare Enrollees (Study), August 1991.

Medicare's cost-sharing requirements in its fee-for-service sector are varied and difficult for beneficiaries to understand. Moreover, in contrast to most private insurance plans, Medicare places no limit on the cost-sharing expenses for which enrollees may be liable. As a result, most fee-for-service enrollees seek supplementary coverage (either through their employers or by purchasing individual medigap plans) to protect them from the potentially catastrophic expenses they might be left with under Medicare. Those enrollees with the nearly first-dollar coverage that medigap plans provide no longer have financial incentives to use medical services prudently. Consequently, Medicare's costs are higher than they would be if there were no medigap supplements.

Medicare could simplify and limit cost-sharing requirements in the fee-for-service sector while also reducing federal costs. For example, the current complicated mix of cost-sharing requirements could be replaced with a single deductible, a uniform coinsurance rate of 20 percent for amounts above the deductible, and a cap on each beneficiary's total cost-sharing expenses—whether they arose from Part A or Part B of the Medicare program. If those provisions were in place beginning in January 2000 with a deductible of $750 and a cap on total cost sharing of $2000, federal savings would be $0.7 billion for 2000, $4.0 billion over five years, and $8.2 billion over 10 years. Those estimates assume that both the deductible and the cap would be indexed to growth in per capita benefits paid by Medicare.

For three reasons, such changes in Medicare's cost-sharing requirements would increase the incentives for enrollees to use medical services prudently. First, because about 40 percent of the medigap plans purchased do not now cover the deductible, more of the services used by those policyholders would be exempt from medigap coverage under Medicare's higher deductible. Second, over time, fewer enrollees would purchase medigap plans because their cost-sharing expenses would be capped under Medicare. Third, the uniform coinsurance rate on all services would encourage enrollees without supplementary coverage to consider relative costs appropriately when choosing among alternative treatments.

Although this option would generally reduce out-of-pocket costs for enrollees who had serious illnesses or were hospitalized during the year, it would increase out-of-pocket costs for most enrollees. On average, enrollees' cost-sharing expenses under Medicare would increase by about $50 a year in 2000. Expenses would fall for about 10 percent of enrollees, rise for about 70 percent, and be unchanged for all others. The option would also introduce cost-sharing requirements for services—such as home health care—that are not now subject to them, increasing administrative costs for the affected providers.

570-13-B RESTRICT MEDIGAP COVERAGE

	Outlay Savings (Millions of dollars)
Annual	
2000	2,600
2001	4,150
2002	4,330
2003	3,940
2004	4,140
2005	4,630
2006	5,510
2007	5,160
2008	5,530
2009	6,200
Cumulative	
2000-2004	19,160
2000-2009	46,190

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-12, 570-13-A, 570-15, and 570-16

RELATED CBO PUBLICATION:

Restructuring Health Insurance for Medicare Enrollees (Study), August 1991.

Savings from option 570-13-A could be substantially increased by restricting or prohibiting medigap coverage in addition to changing Medicare's cost-sharing provisions. Alternatively, some or all of the additional savings from restricting medigap coverage could be used to improve Medicare's coverage by reducing the deductible or cap.

If, for example, medigap plans were prohibited from covering any part of Medicare's new deductible (as discussed in option 570-13-A), savings would be $19.2 billion over five years and $46.2 billion over 10 years. By raising Medicare's deductible and prohibiting medigap plans from covering it, the incentives for more prudent use of health care services would be appreciably strengthened for enrollees who now have medigap plans. Those incentives would be still greater if medigap coverage was prohibited altogether. However, despite Medicare's new copayment cap, which would protect enrollees against very large cost-sharing expenses, some enrollees would object to any policy that denied them access to first-dollar coverage.

570-14 COLLECT DEDUCTIBLE AND COINSURANCE AMOUNTS ON CLINICAL LABORATORY SERVICES UNDER MEDICARE

	Outlay Savings (Millions of dollars)
Annual	
2000	590
2001	990
2002	1,050
2003	1,130
2004	1,240
2005	1,350
2006	1,510
2007	1,640
2008	1,810
2009	2,020
Cumulative	
2000-2004	5,000
2000-2009	13,330

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-12 and 570-15

Medicare currently pays 100 percent of the approved fee for clinical laboratory services provided to enrollees. Medicare's payment is set by a fee schedule, and providers must accept that fee as full payment for the service. For most other services provided under Medicare's Supplementary Medical Insurance (SMI) program, beneficiaries are subject to both a deductible and a coinsurance rate of 20 percent.

Imposing the SMI program's usual deductible and coinsurance requirements on laboratory services would yield appreciable savings. If this policy was in place beginning on January 1, 2000, federal savings would be $590 million in 2000, $5.0 billion over five years, and $13.3 billion over 10 years.

In addition to reducing Medicare's costs, this option would make cost-sharing requirements under the SMI program more uniform and therefore easier to understand. Moreover, enrollees might be somewhat less likely to undergo laboratory tests with little expected benefit if they paid part of those costs.

However, enrollees' use of laboratory services would probably not be substantially affected because decisions about what tests are appropriate are generally left to physicians, whose judgments do not appear to depend on enrollees' cost-sharing liabilities. Hence, the Congressional Budget Office assumes that a small part of the expected savings under this option would stem from more prudent use of laboratory services, but the greater part would reflect the transfer to enrollees of costs now borne by Medicare. Billing costs for some providers, such as independent laboratories, would be higher under the option because they would have to bill both Medicare and enrollees to collect their full fees. (Currently, they have no need to bill enrollees directly for clinical laboratory services.) In addition, states' Medicaid costs would increase for enrollees who also received Medicaid benefits.

570-15 IMPOSE A COPAYMENT REQUIREMENT ON HOME HEALTH VISITS UNDER MEDICARE

	Outlay Savings (Millions of dollars) With $5 Copayment	With $10 Copayment
Annual		
2000	1,130	2,000
2001	1,780	3,180
2002	1,850	3,300
2003	1,880	3,380
2004	1,970	3,600
2005	2,140	3,930
2006	2,380	4,370
2007	2,540	4,670
2008	2,780	5,120
2009	3,030	5,600
Cumulative		
2000-2004	8,610	15,460
2000-2009	21,480	39,150

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-12, 570-13-A, 570-13-B, and 570-14

The use of home health services and the resulting costs are growing rapidly under Medicare. One reason for the unrestrained growth of such costs is that the services are free to enrollees—enrollees are not currently required to pay any portion of the cost of home health services under Medicare.

If a copayment of $5 was required for each home health visit covered by Medicare beginning in January 2000, net federal savings would be $1.1 billion in 2000, $8.6 billion over five years, and $21.5 billion over 10 years. If the copayment was $10, five-year savings would be $15.5 billion and 10-year savings would be $39.2 billion. Those estimates assume that the copayment would be indexed to the consumer price index after 2000.

This option would reduce Medicare's costs for home health care not only by shifting a small part of the cost per visit to users but also by reducing enrollees' use of the service—at least among the 15 percent of fee-for-service enrollees with no supplementary coverage for their cost-sharing expenses. However, little or no drop in use would be expected among the 85 percent of enrollees who have either Medicaid, medigap, or employment-sponsored supplementary coverage. Further, the option would increase private insurance premiums for the 35 percent of enrollees with medigap supplements, and it would increase Medicaid program costs on behalf of the 15 percent of enrollees who also receive Medicaid benefits. Moreover, it would increase the risk of very large out-of-pocket costs for those with no supplementary coverage.

570-16 PROHIBIT FIRST-DOLLAR COVERAGE UNDER MEDIGAP POLICIES

	Outlay Savings (Millions of dollars)
Annual	
2000	4,210
2001	6,740
2002	7,160
2003	7,450
2004	8,080
2005	8,790
2006	9,710
2007	10,180
2008	11,120
2009	12,170
Cumulative	
2000-2004	33,639
2000-2009	85,610

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-13-B

RELATED CBO PUBLICATION:

Restructuring Health Insurance for Medicare Enrollees (Study), August 1991.

About 35 percent of Medicare's fee-for-service enrollees purchase individual supplementary private insurance (medigap coverage) that covers all or most of the cost-sharing that the Medicare program requires. On average, medigap policyholders use at least 25 percent more services than they would if they did not have first-dollar coverage. However, the federal government through Medicare and not medigap insurers pays most of the costs of those additional services.

Federal costs for Medicare could be reduced if medigap plans were prohibited from offering first-dollar coverage for Medicare's cost-sharing requirements. If, for example, medigap plans were barred from paying any portion of the first $1,500 of an enrollee's cost-sharing liabilities for calendar year 2000, use of medical services by medigap policyholders would fall and federal savings in 2000 would total $4.2 billion. Assuming that the medigap limit was linked to growth in the average value of Medicare's costs for later years, savings over the 2000-2004 period would total $33.6 billion. Over 10 years, savings would total $85.6 billion.

Only enrollees who have medigap policies would be directly affected by this option, and most of them would be financially better off under it. Because their medigap premiums would decrease more than their out-of-pocket liabilities would increase, most medigap enrollees would have lower yearly expenses under this approach. Indirectly, all enrollees might be better off because Medicare's premiums would be lower than under current law.

Medigap policyholders, however, would have to assume a higher level of financial risk for Medicare-covered services than they do now. Because they might feel more uncertain about their expenses, some policyholders might object to eliminating their option to purchase first-dollar coverage, even if in most years they would be financially better off. Moreover, in any given year, about a quarter of people with medigap policies would actually incur higher expenses under this option, and those with expensive chronic conditions might be worse off year after year. Finally, the decrease in use of services by medigap policyholders that would generate federal savings under this option might not be limited to unnecessary care, so the health of some of them might be adversely affected.

570-17 INCREASE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO 30 PERCENT OF PROGRAM COSTS

	Outlay Savings (Millions of dollars)
Annual	
2000	2,950
2001	4,310
2002	4,740
2003	5,260
2004	5,850
2005	6,450
2006	6,970
2007	7,640
2008	8,380
2009	9,170
Cumulative	
2000-2004	23,110
2000-2009	61,720

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

570-18

Benefits under Medicare's Supplementary Medical Insurance (SMI) program are partially funded by monthly premiums paid by enrollees, with the remainder funded by general revenues. Although the SMI premium was initially intended to cover 50 percent of the cost of benefits, premium receipts between 1975 and 1983 covered a declining share of SMI costs—falling from 50 percent to less than 25 percent. That drop occurred because premium increases were limited by the cost-of-living adjustment (COLA) for Social Security benefits (which is based on the consumer price index), but the per capita cost of the SMI program rose faster. Since 1984, premiums have been set to cover about 25 percent of average benefits for an aged enrollee, a provision that was made permanent in the Balanced Budget Act of 1997.

If the SMI premium was set to cover 30 percent of costs for 2000 and all years thereafter, outlay savings would be $3.0 billion in 2000, $23.1 billion over five years, and $61.7 billion over 10 years. The premium for 2000 would be $59.40 a month instead of $49.50. Those estimates assume a continuation of the current hold-harmless provision, which ensures that no enrollee's monthly Social Security benefit will fall as a result of the Social Security COLA (which is based on the whole benefit) being smaller than the SMI premium increase.

Most SMI enrollees would pay a little more under this option, in contrast to proposals—such as increasing cost-sharing requirements—that could substantially raise the out-of-pocket costs of those who become seriously ill. This option need not affect enrollees with income below 120 percent of the federal poverty threshold because all of them are eligible to have Medicaid pay their Medicare premiums. (Some people who are eligible for Medicaid do not apply for benefits, however.)

Low-income enrollees who are not eligible for Medicaid could find the increased premium burdensome. A few might drop SMI coverage and either do without care or turn to sources of free or reduced-cost care, which could increase demands on local governments. In addition, states' expenditures would rise because states would pay part of the higher premium costs for those Medicare enrollees who also receive Medicaid benefits.

570-18 TIE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO ENROLLEES' INCOME

	Outlay Savings (Millions of dollars)
Annual	
2000	400
2001	1,390
2002	1,620
2003	1,900
2004	2,230
2005	2,620
2006	3,080
2007	3,620
2008	4,230
2009	4,940
Cumulative	
2000-2004	7,540
2000-2009	26,030

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-17 and REV-16

RELATED CBO PUBLICATIONS:

The Medicare Catastrophic Coverage Act of 1988 (Staff Working Paper), October 1988.

Subsidies Under Medicare and the Potential for Disenrollment Under a Voluntary Catastrophic Program (Study), September 1989.

Instead of increasing the basic premium to 30 percent of costs for all enrollees under the Supplementary Medical Insurance (SMI) program (see option 570-17), this option would collect relatively more from higher-income people. For example, people with modified adjusted gross income of less than $50,000 and couples with income lower than $75,000 would pay only the basic premium, set at 25 percent of SMI costs per aged enrollee. Premiums would rise progressively for higher-income enrollees, however. The maximum total premium would be set to cover 50 percent of costs for people with income exceeding $100,000 and for couples with income exceeding $150,000. The income-related premiums would have to be collected through the income tax system so that rates could be aligned with income. Current premiums are deducted automatically from Social Security checks for most enrollees.

If this option was in place in calendar year 2000, savings would total $400 million in fiscal year 2000, $7.5 billion over five years, and $26.0 billion over 10 years. Those estimates assume that the current hold-harmless provisions would continue only for people subject to the basic 25 percent premium. (The hold-harmless provisions ensure that no enrollee's Social Security check will decrease because an increase in the SMI premium exceeds the cost-of-living adjustment.)

Most SMI enrollees would be unaffected by tying a portion of the program's premium to income. Roughly 88 percent of enrollees would face the basic 25 percent premium, about 3 percent would pay the maximum premium, and 9 percent would pay a premium somewhere in between.

Enrollees subject to the income-related premium would pay substantially more, however. The maximum monthly premium for 2000 would be $99.00 instead of the $49.50 premium projected under current law. That increase might lead some enrollees to drop out, although it is estimated that fewer than 0.5 percent would do so. Those with retirement health plans that do not require Medicare enrollment (mainly, retired government employees) would be most likely to drop out. Some healthy enrollees who have no other source of health insurance might do so as well, if they were not averse to the risk that they might incur large health care costs.

570-19-A INCREASE MEDICARE'S AGE OF ELIGIBILITY TO MATCH SOCIAL SECURITY'S NORMAL RETIREMENT AGE

	Outlay Savings (Millions of dollars)
Annual	
2000	0
2001	0
2002	0
2003	410
2004	1,130
2005	1,920
2006	2,870
2007	4,070
2008	5,540
2009	7,080
Cumulative	
2000-2004	1,540
2000-2009	23,020

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-19-B and REV-16

RELATED CBO PUBLICATION:

Long-Term Budgetary Pressures and Policy Options (Report), May 1998, Chapter 4.

Under current law, the normal retirement age (NRA) for Social Security will gradually increase from 65 to 67 in the first quarter of the next century. However, eligibility for Medicare based on age will remain at 65. Because the two programs affect the same population and because eligibility is based on the same work history, some people have argued that the age requirements should be the same.

If the age at which a person became eligible for Medicare was raised in step with increases in the NRA for Social Security, the first cohort to be affected would be people who turned 65 in 2003—for that group, eligibility for Medicare would be delayed by two months. The age of eligibility would be increased by an additional two months each year through 2008 and then remain at 66 for 12 years. Beginning in 2020, the age of eligibility would again increase by two months a year until it reached 67 in 2025. Under that option, federal budget savings would total $410 million in 2003, $1.5 billion through 2004, and $23.0 billion through 2009. Reduced spending for Medicare would be partially offset by increased spending under Medicaid, the Federal Employees Health Benefits program, and the Civilian Health and Medical Program of the Uniformed Services (reflected in the savings estimates). In addition, off-budget outlays for Social Security would fall by $6.8 billion over the 10-year period because some people who were affected would delay retirement. (That drop in costs is not reflected in the estimates.)

The same reasons that have been used to justify increasing the NRA for Social Security apply to this option as well. Life expectancy has increased substantially since Social Security and Medicare began, and a majority of workers now live well beyond the age of eligibility. When Social Security was established in 1935, average life expectancy at birth was less than 65 years; now average life expectancy is greater than 75 years. Unless changes are made in those programs, longer expected lifetimes, together with the population bulge of the baby-boom generation, will increase costs enormously under Social Security and Medicare after 2010. Only three general options for change are available: reduce the number of people eligible for benefits, reduce benefits per eligible person, or increase taxes. As a practical matter, it is likely that all three options will be called into play.

However, about 70 percent of Social Security beneficiaries retire before the normal retirement age—generally at Social Security's early retirement age of 62, which entitles them to benefits at a reduced level. Increasing Medicare's age of eligibility would also raise the number of years during which early retirees would be at risk of having no health insurance—just when their need for health care would be expected to increase significantly and their access to private individual insurance would be limited.

570-19-B PERMIT EARLY BUY-IN TO MEDICARE ALONG WITH AN INCREASE IN THE NORMAL AGE OF ELIGIBILITY

	Outlay Savings (Millions of dollars)
Annual	
2000	-40
2001	-340
2002	-370
2003	0
2004	640
2005	1,360
2006	2,230
2007	3,360
2008	4,770
2009	6,240
Cumulative	
2000-2004	-110
2000-2009	17,850

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

570-19-A and REV-16

RELATED CBO PUBLICATIONS:

An Analysis of the President's Budgetary Proposals for Fiscal Year 1999 (Report), March 1998, Appendix B.

Long-Term Budgetary Pressures and Policy Options (Report), May 1998, Chapter 4.

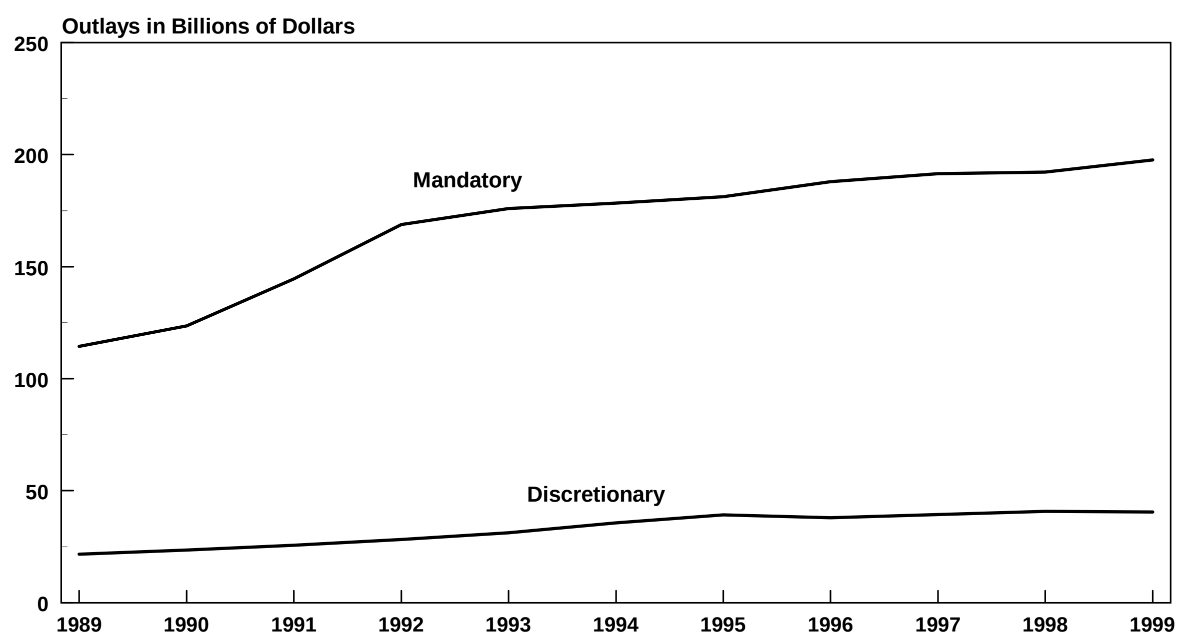
One way to alleviate the problem that early retirees may have in continuing health insurance coverage until they are eligible for Medicare would be to introduce an early age of eligibility (62) for nondisabled retirees. (Disabled people are already eligible for Medicare regardless of their age.) That change would make the conditions for age-based eligibility under Medicare wholly consistent with those for Social Security.

Allowing people to "buy in" to Medicare at age 62 beginning in January 2000, together with the gradual move to a later normal age of eligibility (67), described in option 570-19-A, would increase federal costs by $0.1 billion over the 2000-2004 period but then reduce costs by $17.8 billion through 2009. Social Security costs would also increase in the early years when only the buy-in was in place, but (off-budget) savings would occur after 2004 as delays in retirement due to the increase in the eligibility age for Medicare more than offset earlier retirement among those taking advantage of the buy-in option. Those estimates assume that people who used the early buy-in option would pay an actuarially fair premium for their age group during the buy-in years. The estimates also assume that once buy-in participants reached the normal age of eligibility, they would pay a premium surcharge to compensate for any excess costs incurred during their buy-in years. (Buy-in participants are likely to be more costly to Medicare than the average person in their age group.)

600

Income Security

Budget function 600 covers federal income-security programs that provide cash or in-kind benefits to individuals. Some of those benefits (such as food stamps, Supplemental Security Income, Temporary Assistance for Needy Families, and the earned income tax credit) are means-tested, whereas others (such as unemployment compensation and Civil Service Retirement and Disability payments) do not depend on a person's income or assets. CBO estimates that in 1999, federal outlays under function 600 will total $238 billion, including more than $40 billion in discretionary outlays. Discretionary budget authority of $33 billion was provided for the function in 1999. Over the past 10 years, outlays under function 600 have grown slightly as a share of federal spending, from just under 12 percent to just under 14 percent.



600-01 END TRADE ADJUSTMENT ASSISTANCE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	250	185
2001	305	280
2002	310	310
2003	315	315
2004	320	320
2005	330	330
2006	335	335
2007	340	340
2008	350	350
2009	360	360
Cumulative		
2000-2004	1,500	1,410
2000-2009	3,215	3,125

SPENDING CATEGORY:

Mandatory

The Trade Adjustment Assistance (TAA) program offers income-replacement benefits, training, and related services to workers who are unemployed as a result of import competition. To obtain assistance, such workers must petition the Secretary of Labor for certification and then meet other eligibility requirements. Cash benefits are available to certified workers receiving training, but only after their unemployment insurance benefits are exhausted. Authorization for the program expired on October 1, 1998, and was subsequently extended for nine months by the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1998.

Ending the TAA program would reduce federal outlays by about $200 million in 2000 and by $3.1 billion during the 2000-2009 period. Affected workers could apply for benefits under the Workforce Investment Act of 1998 (WIA), which authorizes a broad range of employment and training services for displaced workers regardless of the cause of their job loss. (Because funding for WIA is limited, however, TAA cash benefits alone could be eliminated, and the remaining TAA funds for training and related services could be shifted to WIA. Doing so would reduce the total savings by about one-quarter during the 10-year period.)

The rationale for this option is to secure under federal programs more equivalent treatment of workers who are permanently displaced as a result of changing economic conditions. Since WIA provides cash benefits only under limited circumstances, workers who lose jobs because of foreign competition are now treated more generously than workers who are displaced for other reasons.

Eliminating TAA cash benefits would, however, cause economic hardship for some of the long-term unemployed who would have received them. In addition, TAA now compensates some of the workers adversely affected by changes in trade policy. Some people argue, therefore, that eliminating TAA benefits could lessen political support for free trade, which economists generally view as beneficial to the overall economy.

600-02 END THE EXPANSION OF PROGRAMS FOR BUILDING NEW HOUSING UNITS FOR ELDERLY AND DISABLED PEOPLE

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	854	0
2001	854	10
2002	854	120
2003	854	310
2004	854	540
2005	854	710
2006	854	760
2007	854	800
2008	854	840
2009	854	850
Cumulative		
2000-2004	4,270	980
2000-2009	8,540	4,940

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-06

Since the early 1980s, federal activities to provide rental subsidies for low-income people have shifted sharply from constructing low-income housing to using less costly existing housing subsidized with vouchers and certificates. Two construction programs under which new commitments are still being made are the Section 202 and Section 811 programs for elderly and disabled people, respectively. For 1999, $854 million was appropriated to construct up to 9,900 new units and subsidize their operating costs. (The appropriation allows as much as $48 million of those funds to be used for vouchers for disabled people.)

Eliminating funding for additional new units under those programs would reduce outlays by $4.9 billion over the 2000-2009 period. Initially, savings in outlays would be substantially smaller than savings in budget authority because of the long lags involved in building new projects and thus in spending authorized funds.

Proponents of this option see little need to subsidize any new construction. The overwhelming housing problem today, they argue, is not a shortage of rental units but the inability of low-income households to afford those that exist. For example, average overall annual vacancy rates have consistently exceeded 7 percent since 1986. In any event, if elderly and disabled people need more housing assistance, it could be provided less expensively through vouchers or certificates.

Opponents of the option argue that national statistics on the supply of rental units mask local shortages of certain types of units. In particular, many households with an elderly or disabled person need housing that can provide special social and physical services that are not generally available. People who support subsidized construction of units for low-income elderly and disabled households also maintain that the high cost of producing such units requires the certainty of a guaranteed stream of income that only project-based subsidies can provide.

600-03 INCREASE PAYMENTS BY TENANTS IN FEDERALLY ASSISTED HOUSING

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	300	160
2001	610	490
2002	970	850
2003	1,350	1,220
2004	1,680	1,620
2005	1,790	1,850
2006	1,860	1,900
2007	1,920	1,960
2008	1,990	2,020
2009	2,060	2,080
Cumulative		
2000-2004	4,910	4,330
2000-2009	14,530	14,150

SPENDING CATEGORY:

Discretionary

Most lower-income renters who receive federal rental assistance are aided through various Section 8 programs or the public housing program, all of which are administered by the Department of Housing and Urban Development (HUD). Those programs usually pay the difference between 30 percent of a household's income after certain adjustments and either the actual cost of the dwelling or a payment standard. In 1998, the average federal expenditure per assisted household for all of HUD's rental housing programs combined was roughly $5,100. That amount includes both housing subsidies and fees paid to administering agencies.

This option would increase tenants' rent contributions over a five-year period from 30 percent to 35 percent of their adjusted income. Budgetary savings would total $14.2 billion over the 2000-2009 period, including $10.5 billion for Section 8 programs and $3.7 billion for public housing. (Those estimates are based on the assumption that the Congress will provide budget authority to extend the life of all commitments for housing aid that are due to expire during the 2000-2009 period.) To diminish or eliminate the impact of this change on assisted tenants, state governments—which currently contribute no funds toward the federal rental assistance programs—could be encouraged to make up some or all of the decreased federal support.

One rationale for directly involving states in housing assistance is that those programs generate substantial local benefits, such as improved quality of the housing stock. If all states paid 5 percent of the adjusted income of those tenants receiving assistance, housing costs for assisted families would not rise. Moreover, since eligibility for housing aid is determined by each area's median income, tying states' contributions to renters' incomes would ensure that lower-income states would pay less per assisted family than would higher-income states. Finally, if a state chose not to participate and consequently rent payments by its households increased to 35 percent of adjusted income, those out-of-pocket costs would still be well below the nearly 50 percent of income paid by the typical unassisted renter who is eligible for assistance.

Because not all states might make up the reduction in federal assistance, housing costs could increase for some current recipients of aid, who generally have very low incomes. This option could also cause some higher-income renters in assisted housing projects to move to unassisted housing because it might now cost less to rent. As those tenants were replaced by new ones with lower income, the concentration of families with very low income in those projects would increase. In turn, the savings from this option could decrease somewhat.

600-04 REDUCE RENT SUBSIDIES TO CERTAIN ONE-PERSON HOUSEHOLDS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	30	20
2001	70	50
2002	100	80
2003	130	110
2004	160	150
2005	200	180
2006	230	210
2007	260	240
2008	280	260
2009	270	290
Cumulative		
2000-2004	490	410
2000-2009	1,730	1,580

SPENDING CATEGORY:

Discretionary

Generally, recipients of federal housing aid live in housing units that are specifically designated for use by federally assisted tenants or rent units of their own choosing in the private rental market. Support for that second type of aid comes in the form of Section 8 certificates and vouchers, which generally reduce what recipients spend for housing to 30 percent of their income. Starting in 2000, the certificate and voucher programs will be combined into one program that will pay the difference between 30 percent of a tenant's income and the lesser of the tenant's actual housing cost or a payment standard determined by local rental levels.

The payment standard and the amount of the federal subsidy both vary according to the type of unit in which the tenant resides. One-person households may generally reside in apartments with up to one bedroom, whereas larger households may reside in larger units. Linking the rent subsidy for a newly assisted one-person household (or a currently assisted household that moves to another housing unit) to the cost of an efficiency apartment rather than a one-bedroom apartment would save $20 million in federal outlays in 2000 and nearly $1.6 billion over the 2000-2009 period. The Administration included this option in its 1999 budgetary proposals.

An argument in favor of this option is that an efficiency unit would provide adequate living space for a person who lived alone. An argument against the option is that individuals in some areas might have difficulty finding suitable housing under this new rule and as a result might have to spend more than 30 percent of their income to pay for available housing.

600-05 STOP EXPANSION OF THE NUMBER OF RENTAL ASSISTANCE COMMITMENTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	283	20
2001	570	210
2002	870	670
2003	1,170	1,080
2004	1,480	1,380
2005	1,800	1,700
2006	2,130	2,020
2007	2,460	2,360
2008	2,800	2,700
2009	3,150	3,040
Cumulative		
2000-2004	4,380	3,360
2000-2009	16,730	15,180

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

370-06

Each year between 1975 and 1995, and again in 1999, the Congress expanded the stock of Section 8 certificates and vouchers to increase the number of low-income renters who receive housing aid. Those forms of housing assistance provide subsidies that allow recipients to live in private housing of their own choosing, provided the units meet certain standards. At the end of 1998, a total of about 1.5 million commitments for rental assistance were outstanding in both programs, at a total cost of about $7.9 billion in that year. For 1999, the Congress authorized $283 million to fund an additional 50,000 vouchers, and the Congressional Budget Office's baseline assumes that this amount of funding for new units will also be appropriated for each year in the future.

Stopping expansion of the number of rental assistance commitments would reduce federal outlays by $15.2 billion over the 2000-2009 period. (That estimate is based on the additional assumption that the Congress will provide budget authority to extend the life of all vouchers and certificates that are due to expire over the 2000-2009 period.)

An argument in favor of this option is that expanding rental assistance programs is inappropriate in light of the cutbacks that have occurred in other areas of federal spending. Furthermore, existing commitments will continue to assist many new eligible households each year because of turnover among assisted renters. In addition, no current recipients would lose their housing assistance as a result of this option.

An argument against the option is that less than one-third of eligible renters actually receive housing assistance. If the number of commitments was frozen, the proportion of eligible renters receiving aid would fall because of continued growth in the number of eligible households. As a result, the number of eligible households with one or more housing problems—such as paying a relatively large share of income for rent or living in a physically inadequate or crowded dwelling—would probably increase.

600-06 REDUCE FUNDING FOR EMPLOYMENT AND TRAINING IN THE FOOD STAMP PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	116	95
2001	175	138
2002	122	147
2003	116	129
2004	115	125
2005	115	125
2006	110	110
2007	110	110
2008	110	110
2009	109	109
Cumulative		
2000-2004	644	634
2000-2009	1,198	1,198

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

600-07

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) established a new work and training requirement for certain food stamp recipients. The act limited food stamp eligibility to a maximum of three months in any 36-month period for adults not engaged in work or job training who are able-bodied, are between the ages of 18 and 50, and have no dependent children. Under PRWORA, the requirement applies unless the Secretary of Agriculture waives it for a locale because of a high level of unemployment or insufficient job opportunities.

The Balanced Budget Act of 1997 (BBA) provided certain exemptions from the PRWORA work/training requirement as well as $600 million to fund new work/training program slots. The Agricultural Research, Extension, and Education Reform Act of 1998 (P.L. 105-185) reduced work/training funds by $100 million in 1999 and $45 million in 2000.

This option would eliminate the remaining funds for work/training slots under the BBA. It would also provide additional savings in the Food Stamp program derived from not paying benefits to the people who would have occupied the canceled slots. (When the Congressional Budget Office estimated the cost of P.L. 105-185, it estimated savings of $200 million.) In total, CBO estimates that the option would reduce outlays by $95 million in 2000 and about $1.2 billion for the 2000-2009 period.

An argument for eliminating the remaining work/training funds provided under the BBA is that states have not been using all of the funds allotted to them. States receive basic federal funding for employment and training of food stamp recipients under the Food Stamps Act of 1985, and those funds can be used for able-bodied adults without dependent children. People facing the work/training requirement under PRWORA can also apply to other programs that operate independently of the Food Stamp program. States with economically distressed areas, which might have fewer alternative work/training opportunities than more prosperous locales, can also apply for waivers from the PRWORA requirement.

An argument against this option is that the unspent funds are not necessarily evidence of a lack of need. States have had little time to develop the work/training programs that the BBA authorizes. Such programs must be targeted primarily at able-bodied adults without dependent children and may not simply substitute for state-funded programs. To ensure that BBA funds are spent on new work/training efforts, the act requires states to maintain their 1996 state spending levels for work/training programs in order to collect the BBA funds. Another argument for maintaining the funds available under the BBA is that they offer some flexibility because they do not have to be spent in a particular fiscal year. The funds may be carried over and redistributed by the Secretary of Agriculture among the states on the basis of year-to-year changes in the distribution of covered individuals.

600-07 REDUCE THE EXEMPTIONS FROM EMPLOYMENT AND TRAINING REQUIREMENTS FOR FOOD STAMP RECIPIENTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	30	30
2001	30	30
2002	35	35
2003	35	35
2004	35	35
2005	35	35
2006	35	35
2007	40	40
2008	40	40
2009	40	40
Cumulative		
2000-2004	165	165
2000-2009	355	355

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

600-06

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) is intended to encourage people to work or pursue job training. Thus, the act restricts food stamp eligibility to a maximum of three months in any 36-month period for able-bodied adults not engaged in work or training who are 18 to 50 years of age and have no dependent children—unless the Secretary of Agriculture has waived the work/training requirement for their locale. Under the Balanced Budget Act of 1997 (BBA), however, states may exempt from the requirement up to 15 percent of such able-bodied food stamp recipients.

This option would eliminate the 15 percent exemption to the PRWORA work/training requirement, which the Congressional Budget Office estimates would reduce outlays by $30 million in 2000 and $355 million for the 2000-2009 period.

The BBA exemption allows states to use different food stamp eligibility rules for different childless adults. Eliminating the exemption would require states to use the same eligibility criteria for all 18- to 50-year-old able-bodied people with no dependent children who live in a particular local area. An argument against this option is that the exemption provides a safety net for a needy population that can be difficult to serve.

600-08 REDUCE THE $20 UNEARNED INCOME EXCLUSION UNDER THE SUPPLEMENTAL SECURITY INCOME PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	60	60
2001	125	125
2002	125	125
2003	125	125
2004	130	130
2005	140	140
2006	125	125
2007	115	115
2008	130	130
2009	135	135
Cumulative		
2000-2004	565	565
2000-2009	1,210	1,210

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

600-09

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments—based on uniform, nationwide eligibility rules—to low-income elderly and disabled people. In addition, most states provide supplemental payments. Because SSI is a means-tested program, recipients' outside income reduces their SSI benefits, subject to certain exclusions. For unearned income, most of which is Social Security, $20 a month is excluded; benefits are reduced dollar for dollar for unearned income above that amount. The program allows a more liberal exclusion for earned income in order to maintain work incentives.

This option would reduce the monthly $20 unearned income exclusion to $15. The Congressional Budget Office estimates that the savings from that change would be $60 million in 2000 and $1.2 billion over the 2000-2009 period.

A program that ensures a minimum living standard for its recipients need not provide a higher standard for people who happen to have unearned income. Nevertheless, reducing the monthly $20 exclusion by $5 would decrease by as much as $60 a year the incomes of the roughly 2.5 million low-income people (approximately 40 percent of all federal SSI recipients) who would benefit from the exclusion in 2000. Even with the full $20 exclusion, the incomes of most SSI recipients fall below the poverty threshold.

600-09 CREATE A SLIDING SCALE FOR CHILDREN'S SSI BENEFITS BASED ON THE NUMBER OF RECIPIENTS IN A FAMILY

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	50	50
2002	120	120
2003	120	120
2004	130	130
2005	160	160
2006	140	140
2007	140	140
2008	170	170
2009	180	180
Cumulative		
2000-2004	420	420
2000-2009	1,210	1,210

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

600-08

The Supplemental Security Income (SSI) program provides cash payments —based on uniform, nationwide eligibility rules—to elderly and disabled people with low incomes. In addition, most states provide supplemental payments to SSI recipients. In 1997, children received approximately $5 billion in federal SSI benefits, accounting for almost one-quarter of federal SSI benefits paid to disabled recipients that year.

Unlike other means-tested benefits, the amount of the SSI benefit for an additional child does not decline as the number of SSI recipients in a family increases. In 1999, a family with one child qualifying for SSI benefits could receive up to $500 a month, or $6,000 a year, if the family's income (excluding SSI benefits) was under the cap for the maximum benefit. If the family had additional eligible children, it could have received an additional $500 a month for each one. (A child's benefit is based only on the presence of a disability and the family's resources, not on the nature or severity of the qualifying disability or on participation by other family members in the SSI program.)

This option would create a sliding scale for SSI disability benefits, so that a family would receive smaller benefits per child as the number of children receiving SSI increased. The sliding scale used for this option was recommended by the National Commission on Childhood Disability in 1995. It would keep the maximum benefit for one child as it is in current law but reduce additional benefits for additional recipient children in the same family. If that sliding scale was in place in 1999, the first child in a family qualifying for the maximum benefit would receive $500, the second child would receive $312 (38 percent less), and the third would receive $267 (47 percent less). Benefits would continue to decrease for additional children. About 90 percent of child recipients would be unaffected by the new scale, and the remaining 10 percent would have their benefits reduced by about one-fourth, on average. As with current SSI benefits, the sliding scale would be adjusted each year to reflect changes in the consumer price index.

The Congressional Budget Office assumes that this option would not be implemented until 2001, because the Social Security Administration does not maintain data on multiple SSI recipients in a family and implementation of the sliding scale would therefore require significant effort. Savings from this option would total $50 million in 2001 and $1.21 billion over the 2001-2009 period.

Proponents of this option argue that the proposed reductions in benefits reflect economies of scale that generally affect the cost of living for families with more than one child. Proponents might also note that the high medical costs that disabled children often incur, which would not be subject to economies of scale, would continue to be covered because SSI participants generally are covered by Medicaid. Still, opponents could argue that children with disabilities sometimes have unique needs that may not be covered by Medicaid, including housing modifications and specialized equipment. With the proposed drop in benefits, some families might be unable to meet such needs.

600-10 REDUCE THE FEDERAL MATCHING RATE FOR ADMINISTRATIVE COSTS IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

	Savings (Millions of dollars)	
	Budget Authority	Outlays
Annual		
2000	850	850
2001	930	930
2002	1,050	1,050
2003	1,150	1,150
2004	1,250	1,250
2005	1,350	1,350
2006	1,440	1,440
2007	1,530	1,530
2008	1,640	1,640
2009	1,740	1,740
Cumulative		
2000-2004	5,230	5,230
2000-2009	12,930	12,930

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

600-11

The Child Support Enforcement (CSE) program, enacted in 1975, assists states in their effort to improve the payment of child support by noncustodial parents. The federal government pays 66 percent of the program's administrative costs, provides incentive payments, and allows states to retain some of the money they collect.

This option would reduce the federal share of administrative costs from 66 percent to 50 percent. The Congressional Budget Office estimates that lowering the federal matching rate could save $850 million in 2000 and $12.9 billion through 2009.

Several arguments can be made for shifting greater responsibility for CSE administrative costs to the states. For one thing, it would encourage states to make their CSE efforts more efficient because states would be paying a larger share of the costs of any inefficiencies. Moreover, it would bring the federal share of CSE administrative costs more in line with the share of such costs that the federal government bears in comparable programs.

Lowering the matching rate would entail some risks, however. Because caseloads for child support workers are already high, states are not likely to be able to improve the program's efficiency enough to offset the reduction in federal payments. As a result, states might cut their CSE services, and child support collections might drop. A reduction in collections could also mean higher state costs for Temporary Assistance for Needy Families (TANF) because state collections of child support partly offset states' TANF benefit payments. States might respond to their greater share of the costs by reducing their benefits and services for needy families.

Under the Unfunded Mandates Reform Act of 1995, reductions in federal funding for certain entitlement grant programs—including the Child Support Enforcement program—are considered mandates on state governments if the states lack authority to amend their programmatic or financial responsibilities to offset the loss of funding. Because some states may not have sufficient flexibility within the CSE program to make such changes, this option could constitute an unfunded mandate on those jurisdictions under the law.

600-11 REPEAL THE HOLD-HARMLESS PROVISION FOR STATE COLLECTIONS IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	50	50
2001	50	50
2002	45	45
2003	45	45
2004	40	40
2005	35	35
2006	30	30
2007	25	25
2008	20	20
2009	15	15
Cumulative		
2000-2004	230	230
2000-2009	355	355

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

600-10

Enacted in 1975, the Child Support Enforcement (CSE) program assists states' efforts to improve the payment of child support by noncustodial parents. In addition to providing funds for CSE administration and incentive payments, the federal government allows states to keep a portion of their collections. Under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), which provides block grants to states for Temporary Assistance for Needy Families (TANF), a state can retain a portion of the child support it collects for TANF recipients. The act allows the state to keep an amount equal to the state's matching rate for other federal programs or the amount that the state retained in 1995, whichever is greater.

This option would repeal the "hold-harmless" provision in PRWORA that allows a state to keep the amount of its 1995 CSE collections for TANF families, even if the state collects less than the 1995 amount. The Congressional Budget Office estimates that eliminating that provision would reduce outlays by $50 million in 2000 and by $355 million in 2000 to 2009.

Eliminating the hold-harmless provision could elicit different reactions from the states. Because it would tie the amounts retained by states from CSE collections more closely to what they actually collected, this option could induce states to expand their CSE efforts and thus raise their total collections for TANF families. But states that did not reach their 1995 CSE collection levels would have less funding available, which could cause them to reduce their benefits and services for needy families.

Under the Unfunded Mandates Reform Act of 1995, reductions in federal funding for certain entitlement grant programs—including the CSE program—are considered mandates on state governments if the states lack authority to amend their programmatic or financial responsibilities to offset the loss of funding. Because some states may not have sufficient flexibility within the CSE program to make such changes, this option could constitute an unfunded federal mandate on those jurisdictions under the law.

600-12 REDUCE TANF BLOCK GRANTS TO STATES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	819	35
2001	819	35
2002	819	85
2003	819	95
2004	814	120
2005	814	150
2006	814	160
2007	804	250
2008	804	300
2009	804	300
Cumulative		
2000-2004	4,092	370
2000-2009	8,130	1,530

SPENDING CATEGORY:

Mandatory

Under the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), the federal government provides block grants to states for Temporary Assistance for Needy Families (TANF). The amounts of the block grants are based on spending levels for three programs that PRWORA repealed and TANF replaces: Aid to Families with Dependent Children (AFDC), Emergency Assistance for Needy Families, and the Job Opportunities and Basic Skills (JOBS) training program. To receive TANF funds, a state must spend from its own funds a predetermined "maintenance-of-effort" amount based on its pre-TANF spending. In addition, the state must maintain minimum work participation rates for recipient families, require parents and caretaker recipients to engage in work activities after receiving no more than 24 months of TANF benefits (with some exemptions), and impose a five-year limit on receipt of federally funded TANF benefits. Currently, the Congress has authorized \$16.5 billion annually for TANF through 2002.

This option would reduce the TANF block grants to states by 5 percent, which the Congressional Budget Office estimates would reduce budget authority by \$819 million and outlays by \$35 million in 2000. For 2000 to 2009, CBO estimates that this option would reduce budget authority by \$8.1 billion and outlays by \$1.5 billion.

Budget authority is projected to fall by less than the full 5 percent reduction in the TANF block grant because of the increase in spending for food stamps that would occur when TANF benefits were reduced. Outlays would fall by less than the reduction in budget authority because caseloads in the AFDC and TANF programs have declined significantly over the past five years and many states have been accumulating TANF budget authority from their current annual block grants. The cut in budget authority would result in lower outlays only after a state had depleted its stored budget authority.

An argument for reducing the TANF block grants is that most states need much less money for their programs than legislators expected when PRWORA was enacted. An argument against the cut is that it would reduce federal spending immediately in several states that have been exhausting their TANF block grants, which could cause those states to cut their TANF benefits and services. In addition, reducing federal funding could be viewed as an abrogation of a prior agreement between the federal and state governments and could make future agreements on block grants more difficult.

600-13 REDUCE FUNDING FOR THE LOW INCOME HOME ENERGY ASSISTANCE PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	110	83
2001	110	108
2002	110	110
2003	110	110
2004	110	110
2005	110	110
2006	110	110
2007	110	110
2008	110	110
2009	110	110
Cumulative		
2000-2004	550	521
2000-2009	1,100	1,071

SPENDING CATEGORY:

Discretionary

The Low Income Home Energy Assistance Program (LIHEAP) helps some low-income households pay their home energy costs. Authorized by the Omnibus Budget Reconciliation Act of 1981 and distributed through block grants to the states, LIHEAP funding is $1.1 billion in 1999. States may use the grants to help eligible households pay home heating or cooling bills, provide energy "crisis intervention" for those in immediate need, and fund low-cost weatherization projects. Additionally, the LIHEAP appropriation includes $300 million for energy emergencies designated by the President.

Households may be eligible for the program if they receive assistance under certain means-tested programs or if their income is sufficiently low. Eligibility requirements are set by the states within federal guidelines. For example, the states may give preference to households with the highest energy costs (relative to income).

Cutting LIHEAP funding by 10 percent would save nearly $1.1 billion in federal outlays during the 2000-2009 period. One way of achieving that reduction in spending would be for states to forgo weatherization spending, which includes funds for new windows, doors, and furnaces that reduce future energy use. In 1995, states spent an average of just over 10 percent of their LIHEAP block grants for weatherization. Currently, states can spend up to 15 percent of their grant funds for weatherization, with the option of obtaining a waiver that allows expenditures of as much as 25 percent. Each year between 1995 and 1998, five states on average received that type of waiver.

An argument in favor of reducing LIHEAP funding is that the program was created in response to rapid increases in the price of home energy sources in the late 1970s and early 1980s. Since 1981, however, real energy prices (adjusted for inflation) have decreased by about one-quarter. In addition, the small number of waivers that states have obtained to increase weatherization spending supports the claim that most do not regard weatherization as a priority for LIHEAP funds. The federal government already provides similar assistance through the Department of Energy's (DOE's) Weatherization Assistance for Low-Income Persons, which has an appropriation of $133 million in 1999 and served over 63,000 households in 1998.

An argument against reducing LIHEAP funding is that spending for the program has already declined. In real terms, its 1999 appropriation is about half of its first appropriation. From 1981 to 1995, the percentage of eligible households receiving assistance dropped from 36 percent to 19 percent. Moreover, many communities have yearlong waiting lists for assistance from DOE's weatherization program, making it unlikely that the DOE program would be able to make up for LIHEAP's decreased coverage. In addition, it would be impossible for all of the states to limit cuts in funding to weatherization assistance. In 1995, six states did not fund any weatherization projects. To comply with this option, those six states and others that use less than 10 percent of their grant funds for weatherization would have to cut their basic LIHEAP spending.

600-14-A DEFER COST-OF-LIVING ADJUSTMENTS FOR CSRS ANNUITANTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	370	370
2001	520	520
2002	460	460
2003	560	560
2004	720	720
2005	890	890
2006	1,070	1,070
2007	1,240	1,240
2008	1,460	1,460
2009	1,670	1,670
Cumulative		
2000-2004	2,630	2,630
2000-2009	8,960	8,960

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

600-14-B, 600-14-C, 600-15, 600-16, and 600-17

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Federal civilian and military retirement programs cover about 4.2 million active employees and 4.3 million retirees and survivors. Federal pension payments totaled $75 billion in 1998. Civilian workers covered by the Civil Service Retirement System (CSRS), which covers most civilian employees hired before January 1, 1984, receive full cost-of-living-adjustments (COLAs), as do military personnel hired before August 1, 1986. Civilian employees and military personnel hired after those dates receive less generous protection from inflation. Employees covered by the post-1983 civilian plan, the Federal Employees Retirement System (FERS), receive a so-called diet-COLA, generally 1 percentage point less than inflation. Moreover, COLAs are generally paid only to FERS retirees who are age 62 and older. Military personnel covered by the post-1986 pension provisions also receive COLAs that are a percentage point less than inflation. At age 62, those military retirees will receive a one-time adjustment to their pensions, increasing them to the amount that would have been payable had full COLAs been in effect.

This option and options 600-14-B and 600-14-C illustrate three basic approaches to reducing the cost of COLAs: deferring adjustments for inflation, limiting the size of those adjustments, and reducing adjustments for middle- and high-income retirees. All three options would still leave federal retirees with better protection against inflation than most retirees with private-sector pensions. However, as with any cut in benefits, those reductions could make recruitment and retention harder for both federal civilian programs and the military services.

Deferring COLAs until age 62 for all nondisabled civilian employees who retired before that age would yield savings in direct spending of $370 million in 2000, $2.6 billion over five years, and $9 billion over 10 years. Consistent with the military retirement system, this option allows a catch-up adjustment at age 62 that reflects inflation after the date of retirement. Under the COLA-deferral approach, a CSRS-covered annuitant retiring at age 55 with an average annuity of $25,000 in 1998 would lose $18,000 over seven years. No estimate of this option is provided for the military. Extending the COLA deferral to military retirees, who are generally forced to retire after 20 to 30 years of service, would probably be too onerous.

Deferring COLAs would align COLA practices for CSRS with those under FERS and encourage federal employees to work longer. A major disadvantage of this option is that for current retirees or those nearing retirement, it could be regarded as a revocation of earned retirement benefits. In addition, although CSRS benefits are more generous than those typically offered by private employers, they fall short of those offered by many large private firms, which compete directly with the federal government in labor markets. Moreover, because CSRS benefits are already less generous than those available under FERS, this option would worsen the disparity between the government's civilian retirement plans.

600-14-B LIMIT SOME COLAs FOR FEDERAL RETIREES

	Savings (Millions of dollars) Civilian	Military
Annual		
2000	170	560
2001	390	910
2002	630	1,260
2003	880	1,640
2004	1,130	2,030
2005	1,400	2,450
2006	1,680	2,870
2007	1,970	3,320
2008	2,270	3,790
2009	2,580	4,270
Cumulative		
2000-2004	3,200	6,400
2000-2009	13,100	23,100

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

600-14-A, 600-14-C, 600-15, 600-16, and 600-17

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Another way to reduce the cost of protecting retired federal workers from inflation would be to widely apply the so-called diet-COLAs (cost-of-living adjustments) provided under the Federal Employees Retirement System, or FERS, and the post-1986 Military Retirement System, or MRS. That option would limit COLAs for pre-1986 MRS retirees to 1 percentage point below the rate of inflation. For annuitants under the Civil Service Retirement System, or CSRS, COLAs would be restricted to half a percentage point below inflation. Moreover, when inflation fell below 3 percent, FERS retirees would receive a COLA equaling the rate of inflation less a percentage point. The smaller one-half point reduction for CSRS retirees would produce a cut roughly comparable to the 1 percentage-point limit for MRS and FERS enrollees because MRS and FERS enrollees are also covered by Social Security.

Savings in direct spending for civilian pensions would amount to $170 million in 2000, $3.2 billion over five years, and $13.1 billion over 10 years. For military pensions, savings in direct spending would be $560 million in 2000, $6.4 billion over five years, and $23 billion over 10 years. (Those estimates assume that the Congress would also lower agencies' appropriations to reflect the decreased cost of funding current employees' benefits.) Over five years, the average CSRS retiree would lose $1,600; the average military retiree would lose $3,400. (Savings from this option for civilian pensions would fall by $440 million over five years if it was coupled with option 600-14-A, which would defer COLAs until age 62 for CSRS workers.) On the civilian side, the Congress could also consider limiting COLAs only for the more generous FERS plan.

The main argument for this approach, as with the other COLA options, is that COLA protection under the CSRS and pre-1986 MRS exceeds that offered by other federal and private pension plans. On average, private pension plans offset only about 30 percent of the erosion of purchasing power caused by inflation. FERS and the post-1986 MRS provide full protection less 1 percent. By contrast, CSRS and the pre-1986 MRS provide 100 percent automatic protection from inflation.

The main argument against cutting any retirement benefit is that such an action hurts both retirees and the government's ability to recruit a quality workforce. Advocates for federal workers argue that although certain provisions of federal retirement plans are generous, total compensation should be the basis of comparison between federal and private-sector employment. Annual surveys indicate that federal workers may be accepting salaries below private-sector rates for comparable jobs in exchange for better retirement provisions. In essence, workers pay for their more generous retirement benefits by accepting lower wages during their working years. This option, however, would hurt those retirees most dependent on their pensions. It would also renege on an understanding that workers covered under CSRS who passed up the chance to switch to FERS would retain their full protection against inflation. Finally, critics note that some protection from inflation for federal retirees has been restricted in the past. The General Accounting Office calculated that COLA delays and reductions during the 10-year period from 1985 through 1994 effectively reduced COLAs to about 80 percent of inflation.

600-14-C REDUCE COLAs FOR MIDDLE- AND HIGH-INCOME FEDERAL RETIREES

	Savings (Millions of dollars) Civilian	Military
Annual		
2000	260	300
2001	610	540
2002	960	800
2003	1,320	1,070
2004	1,700	1,350
2005	2,080	1,640
2006	2,480	1,950
2007	2,890	2,280
2008	3,320	2,610
2009	3,750	2,970
Cumulative		
2000-2004	4,850	4,060
2000-2009	19,370	15,510

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

600-14-A, 600-14-B, 600-15, 600-16, and 600-17

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Another alternative would tie reductions in the cost-of-living adjustment (COLA) to annuitants' benefit levels. For example, the full COLA could be awarded only on the first $680 of a retiree's monthly benefit; a half COLA could be given on the remainder. The average pension for a civilian retiree was $1,710 a month in 1998, and the average military pension was $1,450 a month. The threshold of $680 per month is about equal to the projected poverty level for an elderly person in 1999 and could be indexed to maintain its value over time. Similar proposals have been considered for Social Security.

This approach would save about $260 million in direct spending for civilian pensions in 2000, $4.9 billion over the 2000-2004 period, and $19.4 billion over 10 years. For military pensions, savings in direct spending would be $300 million in 2000, $4 billion over five years, and $15.5 billion over 10 years. (Those estimates assume that the Congress would also decrease appropriations to agencies to reflect the drop in the cost of funding benefits for current employees.) The average retiree under the Civil Service Retirement System (CSRS) who was affected by the cut would lose $2,600 over five years, and the average affected military retiree would lose $2,140. Because the full COLA would be paid only to beneficiaries with small annuities, this option would better focus COLAs on retirees who had the greatest need for protection from inflation. Retirees receiving Federal Employees Retirement System (FERS) benefits already receive a reduced COLA, so this change would affect them less than those receiving CSRS benefits. As a result, the option would widen the existing gap between benefits provided by FERS and those provided by CSRS, leaving FERS even more generous relative to CSRS than it had been in the past.

The disadvantage of the option is that it would reduce the ability of the federal government to hire and retain middle- and upper-level managers and professionals. In addition, restricting COLAs would undercut a major strength of the federal retirement system—its ability to offer indexed pensions. Fully indexed benefits provide insurance against inflation, which generally is not offered in the private sector. Furthermore, many people object to any reductions in earned retirement benefits. They also point out that federal pensions are fully taxable under the individual income tax in the same proportion that they exceed the contributions that employees made during their working years. Moreover, pension benefit levels are not always reliable indicators of total income. As a result, unrestricted COLAs might be paid to recipients who had substantial income from other sources.

600-15 MODIFY THE SALARY USED TO SET FEDERAL PENSIONS

	Savings (Millions of dollars) Civilian	Military
Annual		
2000	20	20
2001	50	40
2002	80	70
2003	120	90
2004	160	130
2005	190	180
2006	220	230
2007	250	310
2008	280	410
2009	320	540
Cumulative		
2000-2004	430	350
2000-2009	1,690	2,020

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

600-14-A, 600-14-B, 600-14-C, 600-16, and 600-17

RELATED CBO PUBLICATION:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Both of the government's major civilian employee retirement plans, the Federal Employees Retirement System (FERS) and the Civil Service Retirement System (CSRS), provide initial benefits based on an average of the employee's three highest-earning years. The Military Retirement System also uses that three-year base for personnel hired after September 1980. However, personnel hired before that date receive benefits calculated by using their salary at the date of retirement. If a four-year average was adopted for future retirees under CSRS and FERS as well as for military personnel hired after September 1980, and a 12-month average was adopted for all other military personnel, initial pensions would be about 1.5 percent to 2 percent smaller for most new civilian retirees and about 1 percent to 2 percent smaller for new military retirees. In 2000, total savings to the government in direct spending for civilian pensions would be $20 million; savings would total $430 million over five years and $1.7 billion over 10 years. Savings in direct spending for military pensions would be $20 million in 2000, $350 million over five years, and $2 billion over 10 years. (Those estimates assume that the Congress would also reduce agencies' appropriations to reflect the lower cost of funding current employees' benefits.)

This option would align federal practices more closely with those in the private sector, which commonly uses five-year averages. The change in figuring the base salary would encourage some employees to remain on the job longer in order to boost their pensions to reflect the higher salaries they receive with more years on the job. That incentive could help the government keep experienced people, but it would hinder efforts to reduce federal employment and promote younger hires. In 1995, the Congress actively considered basing military pensions on the final 12 months of pay for personnel hired before September 1980 but ultimately rejected that proposal.

The major drawback to the option is that it would cut benefits and consequently reduce the attractiveness of the government's civilian and military compensation packages. In fact, the 105th Congress considered significant increases in pension benefits for military personnel in its second session before finally dropping the proposal from the omnibus appropriation bill. Recently, the Senate passed legislation increasing military pay and pensions; the Administration's budget for 2000 also proposes increases.

Under this option, FERS benefits would remain more generous than those offered by large private firms, but CSRS benefits would fall below those received by many retirees in the private sector. The average CSRS retiree would lose $450 annually, whereas the average FERS retiree would lose $140 annually because of the smaller defined benefit under that system. Retirees participating in FERS would continue to receive their full Social Security benefits and distributions from the Thrift Savings Plan (TSP). In contrast, Social Security does not cover CSRS participants, and the government makes no contributions to TSP accounts established by CSRS participants.

600-16 RESTRICT THE GOVERNMENT'S MATCHING CONTRIBUTIONS TO THE THRIFT SAVINGS PLAN

	Savings[a] (Millions of dollars) Budget Authority	Outlays
Annual		
2000	640	640
2001	720	720
2002	800	800
2003	880	880
2004	980	980
2005	1,080	1,080
2006	1,190	1,190
2007	1,300	1,300
2008	1,430	1,430
2009	1,560	1,560
Cumulative		
2000-2004	4,020	4,020
2000-2009	10,580	10,580

a. Discretionary savings from the 1999 funding level adjusted for inflation.

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

600-14-A, 600-14-B, 600-14-C, 600-15, and 600-17

RELATED CBO PUBLICATIONS:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Comparing Federal Salaries with Those in the Private Sector (Memorandum), July 1997.

The Thrift Savings Plan (TSP) for federal civilian employees is a defined contribution pension plan similar to the 401(k) plans that many private employers offer. Federal agencies automatically contribute to the TSP an amount equal to 1 percent of an individual's earnings on behalf of each of the 1.5 million workers covered by the Federal Employees Retirement System (FERS). In addition, the employing agency matches voluntary deposits by employees dollar for dollar on the first 3 percent of their pay and 50 cents for each dollar on the next 2 percent. The total federal contribution is 5 percent of pay for employees who also put aside 5 percent. Employees covered by the Civil Service Retirement System (CSRS), which covers most civilian federal employees hired before January 1, 1984, can contribute 5 percent of their pay to the TSP, but agencies contribute nothing on behalf of those employees.

If the government limited its matching contributions to a uniform rate of 50 percent on the first 5 percent of pay, its maximum contribution would fall to 3.5 percent of pay. Savings from that proposal would total $640 million in 2000 and $4 billion over five years. Ten-year savings would reach $10.6 billion. (The estimates exclude savings realized by the Postal Service because reductions in its operating costs eventually benefit only mail users.) Assuming that agencies continued the automatic 1 percent contribution, this arrangement would remain more generous than the defined contribution pension plans that are typically offered in the private sector.

Limiting the matching contributions would reduce the disparity between the government's two major retirement systems. Benefits under FERS are currently more generous than those under the older CSRS for most participants. Yet restricting the matching contributions would have several drawbacks. Middle- and upper-income employees rely on the government's contributions to maintain their standard of living during retirement because Social Security replaces a smaller fraction of their income than it does for lower-income employees. Part of the TSP's appeal derives from its individual accounts for each participant, which enjoy some protection from cuts imposed by subsequent changes in law. The security and portability of the TSP were major factors in the decision of many employees to switch from CSRS to FERS, because the TSP compensated for a less generous defined benefit plan. Changing the TSP's provisions would be unfair to that group, whose decision to switch plans reasonably assumed that changes would not be made. Opponents of restricting the matching rate also argue that doing so would diminish employees' savings for retirement, a problem that would be intensified if the cut reduced TSP participation. Research shows, however, that private-sector employees' contributions to their 401(k) plans tend to be responsive to the offer of employer matching contributions but not to the size of the match.

600-17 INCREASE EMPLOYEE CONTRIBUTIONS FOR FEDERAL PENSIONS

	Mandatory Savings from Civilian Plans[a]	Increased Revenues from Military Plans[a]
Annual		
2000	0	20
2001	0	90
2002	0	130
2003	940	160
2004	1,140	190
2005	1,130	210
2006	1,120	230
2007	1,100	250
2008	1,080	280
2009	1,070	280
Cumulative		
2000-2004	2,080	590
2000-2009	7,580	1,840

a. In millions of dollars.

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

600-14-A, 600-14-B, 600-14-C, 600-15, and 600-16

RELATED CBO PUBLICATIONS:

Comparing Federal Employee Benefits with Those in the Private Sector (Memorandum), August 1998.

Comparing Federal Salaries with Those in the Private Sector (Memorandum), July 1997.

This option would permanently increase by 0.5 percent of pay the contributions that most federal civilian employees make to their retirement plan. The option would also require people entering the military services to contribute 2 percent of basic pay toward retirement. Before 1999, most civilian workers covered by the Civil Service Retirement System (CSRS), the older of the two major civilian retirement plans, contributed 7 percent of their salary to their retirement fund. However, as CSRS-covered workers, they pay no Social Security taxes. Employees covered by the other major civilian plan, the Federal Employees Retirement System (FERS), generally contributed 0.8 percent of pay toward a defined benefit plan and paid 6.2 percent in Social Security taxes. The Balanced Budget Act of 1997 temporarily raises federal civilian employees' contributions to the retirement funds by 0.5 percent of pay; it also raises nonpostal agencies' contributions for CSRS participants by 1.5 percent of pay. The government began phasing in those increases in January 1999—employee contributions initially rose by 0.25 percent of pay. The increases are scheduled to expire after 2002. This option would make those higher employee and agency contributions for civilian pensions permanent.

Adopting this option for civilian employees would increase savings in mandatory programs by $2.1 billion over five years and $7.6 billion over 10 years. Contributions by new military personnel would increase revenues by $20 million in 2000, $590 million over five years, and $1.8 billion over 10 years. (The estimates assume that agencies' contributions for employees under FERS and for military personnel remain unchanged.) Because the majority of military personnel leave the armed forces before retirement and receive no pension, the estimate of revenues is net of their refunded pension contributions during the 2000-2009 period.

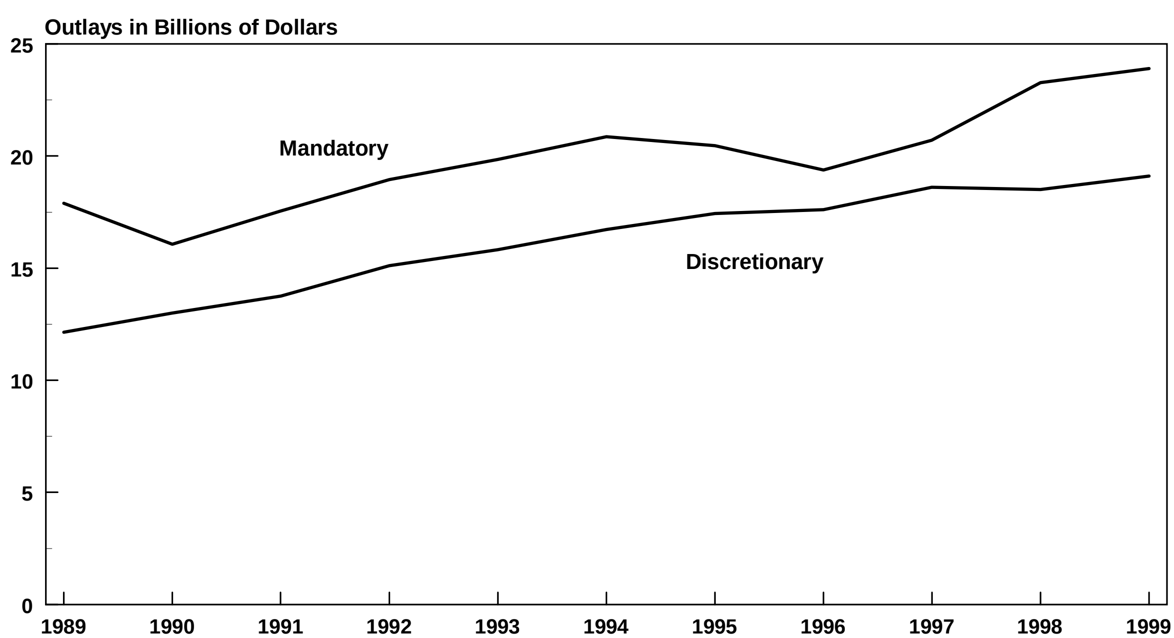
Requiring employees to contribute to their retirement funds is one way to offset the generosity of federal civilian pension benefits relative to those in the private sector, yet maintain a high level of salary replacement once people retire. Moreover, military retirement benefits, which currently require no contributions, are more generous than benefits for federal civilian retirees. Requiring contributions by military personnel would be a step toward parity.

On the downside, for most federal civilian employees and new entrants to the armed forces, the option would be roughly equivalent to a 0.5 percent and 2.0 percent pay cut, respectively, and would further diminish the federal government's compensation package relative to that of the private sector. (Private firms seldom require employees to contribute to pension plans.) Those factors would weaken the government's ability to attract new personnel. In the case of military personnel, the option would hurt retention by increasing the incentive for service members to leave the military before they became eligible for retirement after 20 years of service—in essence, the option would offer an "exit bonus" in the form of the returned contributions. The government as a result might attract a less skilled workforce or be forced to raise cash compensation for its employees.

700

Veterans Benefits

Budget function 700 funds programs that offer benefits to military veterans. Those programs, most of which are run by the Department of Veterans Affairs, provide health care, disability compensation, pensions, life insurance, education and training, and guaranteed loans. CBO estimates that outlays for function 700 will be $43 billion in 1999, including discretionary outlays of $19 billion. Discretionary budget authority provided for the function this year is also about $19 billion. Over the past 10 years, outlays for veterans' benefits have remained at about 2.5 percent of federal spending.



700-01 SUSPEND FUNDING FOR MAJOR CONSTRUCTION PROJECTS IN THE VETERANS' HEALTH CARE SYSTEM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	142	6
2001	142	45
2002	71	88
2003	71	103
2004	71	92
2007	71	79
2006	71	73
2007	71	71
2008	71	71
2009	71	71
Cumulative		
2000-2004	498	334
2000-2009	854	700

SPENDING CATEGORY:

Discretionary

The Department of Veterans Affairs (VA) operates a nationwide health care delivery system for eligible veterans that comprises 172 hospitals, 132 nursing homes, and 551 outpatient clinics. The VA spends about $500 million a year to construct and modernize those facilities. Although in 1996 the Congress gave the VA authority to purchase health care services from community providers, the department continues to receive funds to build facilities and alter existing ones in ways that would increase patient capacity.

This option would suspend funding for major construction projects for two years but leave funds for minor repair and modernization intact. Funding for major construction would then resume in fiscal year 2002 at 50 percent of projected levels. Those reductions would save $854 million over 10 years compared with the 1999 funding level.

Proponents of this option would argue that funding for major construction weakens the VA's incentive to purchase care from private-sector providers who already have facilities in place. Moreover, the VA's 22 regional health care networks are still developing ways to better plan and coordinate services among VA facilities. While that process is going on, constructing and renovating facilities may not necessarily be the most efficient way to ensure access to care. Before the VA enlarges its direct care system, the regional networks should be required to develop long-range planning models that compare the costs of capital expansion and the costs of contracting with local providers in their geographic areas.

Opponents of this option would claim that funding for new construction has already slowed down because of the VA's emphasis on building outpatient clinics rather than large hospital facilities. They would also argue that some locations are underserved by the private sector as well as by the VA, which will make the department's new contract authority ineffective in creating access to care. Without the availability of funds for construction, the VA may not be able to provide care to deserving veterans in some locations.

700-02 END FUTURE VETERANS' COMPENSATION PAYMENTS FOR CERTAIN VETERANS WITH LOW-RATED DISABILITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	21	19
2001	66	62
2002	113	109
2003	162	158
2004	214	209
2003	290	285
2006	324	324
2007	354	351
2008	445	439
2009	509	503
Cumulative		
2000-2004	576	557
2000-2009	2,498	2,459

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

700-03

Approximately 2.3 million veterans who have service-connected disabilities receive veterans' disability compensation benefits. The amount of compensation is based on a rating of the individual's impairment that is intended to reflect an average reduction in the ability to earn wages in civilian occupations. Veterans' disability ratings range from zero to 100 percent (most severe). Veterans who are unable to maintain gainful employment and who have ratings of at least 60 percent are eligible to be paid at the 100 percent disability rate. Additional allowances are paid to veterans who have disabilities rated 30 percent or higher and who have dependent spouses, children, or parents.

About 50,000 veterans with disability ratings below 30 percent are added to the rolls every year, receiving benefits of between $70 and $185 a month. Federal outlays could be reduced by almost $2.5 billion during the 2000-2009 period by ending benefits for those low-rated disabilities in future cases.

Making veterans with new disability ratings below 30 percent ineligible for compensation would concentrate spending on the most impaired veterans. Performance in civilian jobs depends less now on physical labor than when the disability ratings were originally set, and improved reconstructive and rehabilitative techniques are now available, so physical impairments rated below 30 percent may not reduce veterans' earnings. Those impairments include conditions such as mild arthritis, moderately flat feet, or amputation of part of a finger—conditions that would not affect the ability of veterans to work in many occupations today.

Veterans' compensation could be viewed, however, as career or lifetime indemnity payments owed to veterans disabled to any degree while serving in the armed forces. Moreover, some disabled veterans—especially older ones who have retired—might find it difficult to increase their working hours or otherwise make up the loss in compensation payments.

700-03 END FUTURE AWARDS OF VETERANS' DISABILITY OR DEATH COMPENSATION WHEN A DISABILITY IS UNRELATED TO MILITARY DUTIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	53	48
2001	165	155
2002	283	274
2003	409	399
2004	543	532
2005	734	730
2006	837	837
2007	917	914
2008	1,166	1,151
2009	1,343	1,329
Cumulative		
2000-2004	1,453	1,408
2000-2009	6,450	6,369

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

700-02 and 700-04

Veterans are eligible for disability compensation if they either receive or aggravate disabilities while on active-duty service. Service-connected disabilities are defined as those resulting from diseases, injuries, or other physical or mental impairments that occurred or were intensified during military service (excluding those resulting from willful misconduct). Disabilities need not be incurred or made worse while performing military duties to be considered service-connected; for example, disabilities incurred while on leave also qualify. The federal government gives death compensation awards to survivors when a service-connected disability is related to the cause of death.

As many as 50 percent of veterans receiving compensation payments may qualify on the basis of injuries or diseases that were neither incurred nor aggravated while performing military duties. Ending disability and death compensation awards in such cases in the future would reduce outlays by almost $6.4 billion over 10 years. Approximately 5 percent of those savings would come from reduced death compensation awards.

This option would make disability compensation of military personnel comparable with that of federal civilian employees under workers' compensation arrangements. However, because military personnel are assigned to places where situations may sometimes be volatile, they have less control than civilians over where they spend their off-duty hours. Therefore, in many cases it might be difficult to determine whether a veteran's disease, injury, or impairment was entirely unrelated to military duties. The formal appeals system of the Department of Veterans Affairs (VA) could be extended to cover rulings specifying that disabling conditions were unrelated to military duties.

Data collected by the VA indicate that about 200,000 veterans receive a total of $1.2 billion a year in VA compensation payments for diseases that, according to the General Accounting Office (GAO), are generally neither caused nor aggravated by military service. Those diseases include arteriosclerotic heart disease, diabetes mellitus, multiple sclerosis, Hodgkin's disease, chronic obstructive pulmonary disease (including chronic bronchitis and pulmonary emphysema), hemorrhoids, schizophrenia, osteoarthritis, and benign prostatic hypertrophy. Ending new awards only for veterans with those diseases would have a more limited impact than this option because it would not affect all veterans whose compensable disabilities are unrelated to military service. However, it could eliminate compensation for some veterans whose disabilities are not generally service-connected, according to GAO, but whose circumstances constitute an exception to that general conclusion. Such an approach would yield smaller savings than the main option—about $1.1 billion over the 2000-2009 period.

700-04 ELIMINATE "SUNSET" DATES ON CERTAIN PROVISIONS FOR VETERANS IN THE BALANCED BUDGET ACT OF 1997

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	672	672
2004	692	692
2005	748	748
2006	732	732
2007	714	714
2008	772	771
2009	794	793
Cumulative		
2000-2004	1,364	1,364
2000-2009	5,124	5,122

SPENDING CATEGORY:

Mandatory

RELATED OPTIONS:

700-03, 700-05, and 700-06

Five provisions in law that affect veterans will cease to apply on September 30, 2002—their "sunset" date. As a result, starting in 2003, outlays will be higher than if the provisions remained in effect. Those provisions:

- o Protect the monthly benefit for certain pensioners who have no dependents and are eligible for Medicaid coverage for nursing home care, thus lowering pension costs for the Department of Veterans Affairs (VA) but increasing costs for the Medicaid program, which is paid for by the federal and state governments;

- o Authorize the Internal Revenue Service to help the VA verify incomes reported by beneficiaries, for the purpose of establishing eligibility for pensions and benefits;

- o Increase the fees charged for first-time and repeated use of the veterans' home loan program and make the VA more cost-effective in securitizing loans and acquiring property:

- o Authorize the VA to collect from any health insurer that contracts to insure a veteran with service-connected disabilities the reasonable cost of medical care that the VA provides for the treatment of non-service-connected disabilities; and

- o Authorize the VA to charge copayments to certain veterans receiving inpatient and outpatient care and outpatient medication from VA facilities.

This option would make the effects of those provisions permanent by eliminating the sunset date in each case. In addition, it would eliminate the VA's current authority to spend the medical care collections. Beginning in 2003, those collections would revert back to the Treasury. If all five provisions were made permanent and medical receipts were deposited in the Treasury, savings during the 2000-2009 period, compared with the current level of spending, would total $5.1 billion.

The main advantage of this option is that it would convert the temporary savings achieved by those provisions into continuing savings. The main disadvantage is that certain veterans or their insurers would be worse off financially. States would also face higher Medicaid costs because of withdrawn federal funds for nursing home care.

700-05 EXTEND AND INCREASE COPAYMENTS FOR OUTPATIENT PRESCRIPTIONS FILLED AT VA PHARMACIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	0	0
2001	0	0
2002	0	0
2003	137	137
2004	186	186
2005	236	236
2006	239	239
2007	243	243
2008	247	247
2009	250	250
Cumulative		
2000-2004	323	323
2000-2009	1,538	1,538

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

700-04

In 1990, the Congress gave the Department of Veterans Affairs (VA) temporary authority to charge copayments for care and services at VA facilities to certain veterans—namely, those with relatively high income and no service-connected disabilities. Copayments for outpatient prescriptions filled at VA pharmacies were set at $2 for a 30-day supply of drugs. The Congress has since extended the authority to collect that copayment through 2002 but has not increased the copayment amount, even though the VA's prescription drug expenditures have risen by an average of 9 percent per year between 1991 and 1998.

This option would make three sets of changes. First, it would eliminate the provision under which the copayment will expire and would extend that payment indefinitely. It would also require the VA to collect copayments in all applicable cases and would remove the department's discretion to waive the copayment. Currently, the VA bills veterans from a central office on the basis of information forwarded by VA pharmacies. Under this option, copayments would be collected by those pharmacies as they dispensed prescriptions. Second, this option would increase the copayment amount by $1 each year until it reached $5 for a 30-day supply. Third, the option would send those collections to the Treasury rather than allowing the VA to spend them, as under current law. Those three actions would take effect in 2003 and save more than $1.5 billion through 2009.

Proponents would argue that eventually requiring a $5 copayment for prescription drugs would encourage more prudent consumption and make the VA drug benefit consistent with that of other health delivery systems, including managed care plans in the private sector.

Opponents, by contrast, would charge that some veterans with multiple chronic illnesses could be overburdened by the higher cost sharing. Even limiting the number of prescriptions subject to copayments in one month could place an undue financial burden on chronically ill veterans and their families, according to critics.

700-06 INCREASE BENEFICIARIES' COST SHARING FOR CARE AT VA-OPERATED NURSING FACILITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	195	195
2001	202	202
2002	209	209
2003	216	216
2004	220	220
2005	227	227
2006	234	234
2007	242	242
2008	250	250
2009	258	258
Cumulative		
2000-2004	1,043	1,043
2000-2009	2,255	2,255

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

700-04

Veterans may receive long-term care in nursing homes operated by the Department of Veterans Affairs (VA) depending on the availability of resources. That care is rationed primarily on the basis of service-connected disabilities and income. Under certain conditions, a veteran may receive care at the VA's expense in state-operated or privately run nursing facilities.

The VA may charge copayments to veterans with no service-connected disabilities and high enough income when they receive more than 90 days of care in VA-run nursing homes. In 1998, the copayment rate was equivalent to about $13 a day. A study by the General Accounting Office found that the copayment recovers just 0.1 percent of the costs of providing nursing home care. In contrast, state-operated nursing facilities for veterans and community long-term care facilities that treat veterans have their own copayment policies. As a result, those facilities offset a larger share of their operating expenses than the VA, recovering as much as 43 percent through copayments. (Estate recovery programs are another way they offset costs.)

This option would authorize the VA to revise its cost-sharing policies to recover more of the cost of providing care in VA nursing facilities. The department would be required to collect a minimum of 10 percent of its operating costs, but it could determine the type of copayments charged and who would be eligible to pay them. For example, it could apply the current copayment to a broader category of veterans or could require the veterans who now make copayments to pay more. Recovering 10 percent of the VA's operating costs would save $195 million in 2000 and almost $2.3 billion over 10 years. Achieving those savings would require not allowing the VA to retain and spend the receipts; instead, they would be deposited in the Treasury.

Proponents of this option would argue that veterans in VA nursing facilities are getting a far more generous benefit than similar veterans in non-VA facilities. Because VA-run nursing homes are relatively scarce, veterans lucky enough to be admitted to one receive an unfair advantage over similarly situated veterans. Recovering more of the expense at VA facilities would make that benefit more equitable among veterans and different sites of care.

Opponents of this option would argue that beneficiaries in nursing facilities may be less able to make copayments than beneficiaries receiving other types of care. They would also argue that allowing the VA to charge veterans with service-connected disabilities would be inconsistent with other medical benefits that those veterans receive. The department could continue to exempt those veterans, but it would have to charge high-income veterans without service-connected disabilities even more to achieve the 10 percent recovery level.

700-07 REVISE THE MONTGOMERY GI BILL PROGRAM

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	104	104
2001	116	116
2002	128	128
2003	140	140
2004	153	153
2005	165	165
2006	177	177
2007	191	191
2008	206	206
2009	221	221
Cumulative		
2000-2004	640	640
2000-2009	1,601	1,601

SPENDING CATEGORY:

Mandatory

The Montgomery GI Bill—which provides funds for higher education to former service members—was created as a form of military compensation and an incentive in recruiting. Recruits on active duty can participate by contributing $1,200 during their first year of service (the same amount as in 1986). Reservists can participate too, but they make no contribution. Veterans of active duty and the selected reserves receive $453 or $212 a month, respectively, for full-time enrollment in an authorized program of study. The size of those benefits is indexed to the consumer price index (CPI).

This option would limit the cost of the program in three ways. First, it would lower the cost-of-living adjustment (COLA) for benefits to half the annual change in the CPI. Second, it would raise the initial contribution of active-duty personnel from $1,200 to about $1,600 in 2000 and increase it in subsequent years by the same percentage that benefits increase. Third, the option would require reserve personnel to make contributions proportional to those of active-duty members and would subject their benefits to the lower COLA. Those three changes would save $104 million in 2000 and a total of $1.6 billion through 2009.

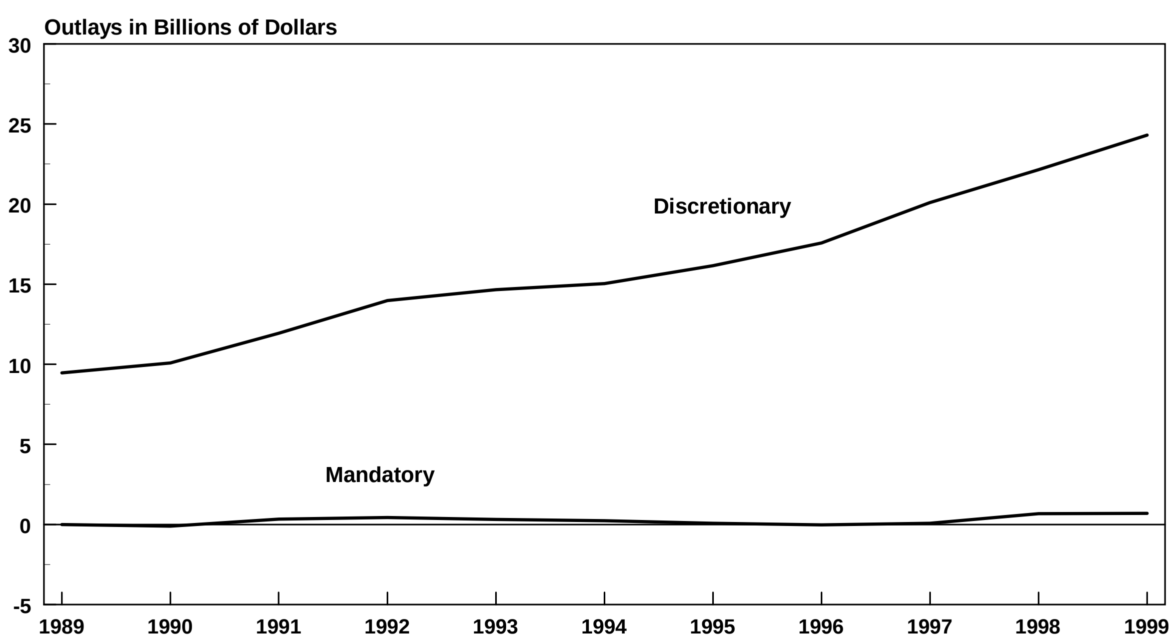
Opponents of the option would argue that the Montgomery GI Bill is an effective tool (more so than enlistment bonuses) for recruiting the kinds of people the military needs to operate high-technology weapons and other equipment. It encourages recruits to complete their initial term of enlistment and increases the probability that they will join a reserve component. Current and prospective service members could view this option as an erosion of benefits. Moreover, the option might force the Department of Defense to expand other recruiting programs, diluting the potential savings from curtailing these benefits. Opponents would also observe that college costs have continued to rise faster than the CPI. Finally, opponents would argue that the annual CPI-based adjustment is not primarily a COLA but rather a mechanism for maintaining the value of the Montgomery GI Bill as an enlistment incentive. Reducing the automatic adjustment could force the Congress to raise benefits periodically, as it did in the past.

Allowing benefits to increase with inflation while contributions remain fixed provides a richer net benefit each year. At the program's inception, benefits were nine times greater than contributions, but they are now more than 16 times greater—and the multiple will continue to grow every year under current law. Proponents of this option might argue that such a situation is unnecessary to recruit a high-quality force. In recent years, the Department of Defense has met or exceeded its goals for the percentages of recruits having high school diplomas and above-average scores on the Armed Forces Qualifying Test. Moreover, the armed forces need a smaller percentage of the targeted population now than they did in the 1980s, when the program was created and the force was 50 percent larger. Proponents of this option would argue that fine-tuning these educational benefits to the post-Cold War environment would still allow the military to maintain a highly skilled force. Finally, the program did not provide any automatic COLAs to benefits for its first seven years and provided only a half-size COLA when such adjustments were initially made.

750

Administration of Justice

Budget function 750 funds programs that provide judicial services, law enforcement, and prison operation. The Federal Bureau of Investigation, the Customs Service, the Drug Enforcement Administration, and the federal court system are all supported under this function. CBO estimates that discretionary outlays for function 750 will total almost $25 billion in 1999, and discretionary budget authority of more than $26 billion was provided for the function this year. Over the past 10 years, the share of federal outlays accounted for by this function has increased steadily, from less than 1 percent to almost 1.5 percent.



750-01 REDUCE FUNDING FOR LAW ENFORCEMENT EFFORTS TO CONTROL ILLEGAL DRUGS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	2,370	1,618
2001	2,370	2,130
2002	2,370	2,266
2003	2,370	2,328
2004	2,370	2,342
2005	2,370	2,348
2006	2,370	2,370
2007	2,370	2,370
2008	2,370	2,370
2009	2,370	2,370
Cumulative		
2000-2004	11,848	10,684
2000-2009	23,696	22,511

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

750-02 and 800-05

The federal government currently allocates nearly $18 billion a year for controlling illegal drugs. Of that amount, approximately $2.4 billion is designated for efforts to prevent drugs from entering the United States. Both domestic agencies and the Department of Defense carry out law enforcement efforts to control illegal drugs. Approximately two-fifths of the funds for interdiction and international activities are allocated under the administration of justice budget function. Another one-fourth is allocated to defense-related efforts. (The remainder is split between the transportation and international affairs budget functions.) Eliminating funds for drug interdiction and international activities, which may be relatively less effective than domestic antidrug efforts, would save $1.6 billion in the first year, $10.7 billion over five years, and $22.5 billion over 10 years.

Critics of the funding claim that interdiction and international activities are both more costly and less effective than other antidrug efforts; that no clear proof of their efficacy exists; and that the federal government could drastically reduce the resources devoted to such activities without affecting drug use over the long term. In fact, some sources show that illicit drugs are less expensive and more readily available now than they were before the federal government began trying to control them. Interdiction and international activities do not reduce the demand for drugs and have less impact on the price users pay than state and locally funded efforts. Interdiction and international activities affect producers' costs, which are only a small part of the users' charges. The bulk of those charges are added in the later stages of processing and delivery. (Of course, local and state efforts to control the supply of drugs also face several obstacles: competition among producers and distributors, the large markup from wholesale to retail prices, and the ability of distributors to dilute the drug to maintain an end price that customers can afford.)

Proponents argue that a variety of reasons exist to support interdiction and international activities. Notable successes, including the destruction of major drug trafficking organizations and the large quantities of illegal drugs seized or destroyed, contradict claims of ineffectiveness. In fact, supporters of interdiction and international activities argue that street prices would have been much lower, and the availability of drugs much greater, without extensive funding for criminal justice efforts. Moreover, if the goal of the federal government is to control, and not simply to reduce, the use of illegal drugs, some effort to reduce the flow of drugs into the country will be necessary. Proponents of antidrug activities argue that given the unacceptably high level of drug use, the government should reform allegedly ineffective programs rather than eliminate them. Finally, in cases where antidrug activities are integrated with other agency functions, cutting back funding for interdiction and international efforts would also disrupt those related activities.

750-02 REDUCE FUNDING FOR JUSTICE ASSISTANCE AND CERTAIN JUSTICE-RELATED ACTIVITIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	502	410
2001	504	476
2002	504	504
2003	504	504
2004	504	504
2005	504	504
2006	504	504
2007	504	504
2008	504	504
2009	504	504
Cumulative		
2000-2004	2,518	2,398
2000-2009	5,038	4,918

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

750-01 and 800-05

In addition to the law enforcement activities that the Department of Justice carries out directly, it and related government entities provide various types of law enforcement or legal assistance to individuals, community organizations, and state and local law enforcement agencies. That assistance, which amounted to $1.3 billion in 1999, can take the form of direct payments to individuals; financial grants to carry out projects or conduct research; information, training, or services; or in-kind grants. This option would consolidate and reform justice assistance programs and reduce the amount spent on them by 20 percent. It would also terminate the Legal Services Corporation and the State Justice Institute. Those cuts can, of course, be considered separately. Taken together, they would save $410 million in 2000, $2.4 billion over five years, and $4.9 billion by 2009.

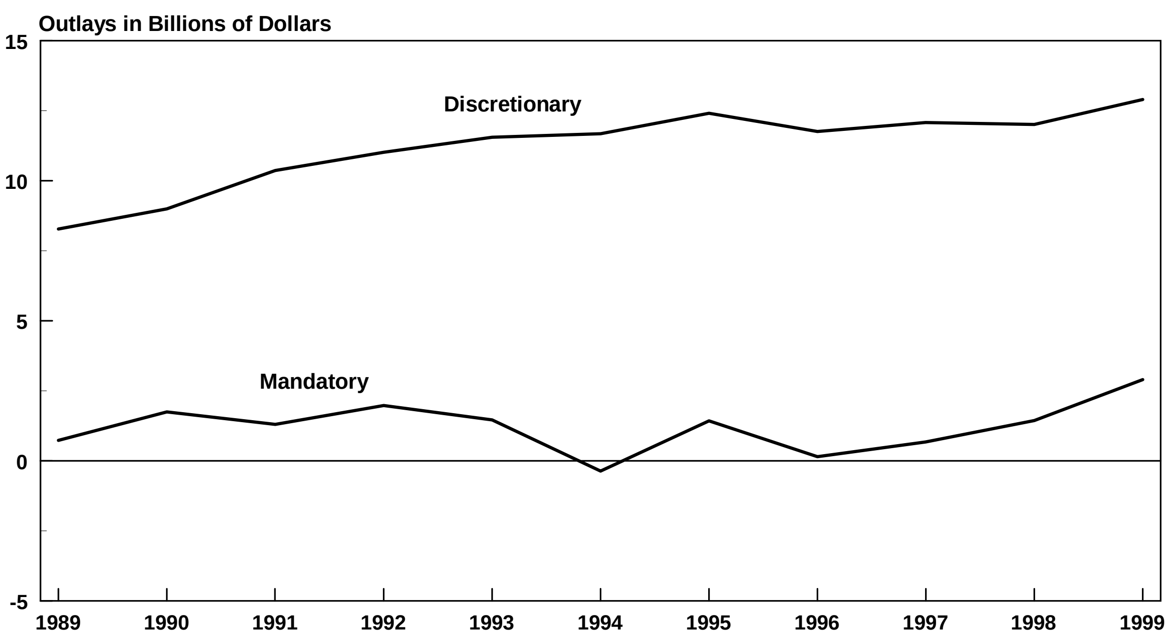
The two greatest criticisms of the justice assistance programs are that they do not respond to local concerns and priorities and that they often address problems that are not federal responsibilities. Consolidating the grant programs administered by the Bureau of Justice Assistance would yield administrative savings, and switching from categorical to block grants would allow grant recipients to focus their efforts on areas of greatest need rather than on problems that, though significant nationally, are less important locally. Similar arguments apply to the Legal Services Corporation, which provides legal assistance to the poor in civil matters. Critics contend that responsibility for such assistance more properly lies with state and local governments. Some critics also charge that the activities of Legal Service lawyers tend to focus on advancing social causes rather than on helping poor people with routine legal problems. (The Congress modified the Legal Services Corporation in 1996, restricting the types of cases and clients it could represent by, for example, prohibiting the corporation's lawyers from representing plaintiffs in class-action suits.) The State Justice Institute, which makes grants for research on criminal justice matters, likewise faces questions of responsibility and jurisdiction. The criticisms leveled against the institute are that much of the research it sponsors is similar to that conducted elsewhere and that in neglecting to publicize the research or cooperate with the courts in instituting reforms and new ideas, it does too little to affect the states' actual administration of justice.

Supporters of funding for justice assistance argue that it is merited on practical grounds. The categorical grant system, they maintain, is working as intended: in certain cases, the problems the grants address have a national scope but might be ignored by states without the incentive of federal funds. Reduced federal spending would, moreover, disproportionately affect those state-run programs that depend heavily on federal funding, such as juvenile justice. In defending the Legal Services Corporation and the State Justice Institute, opponents of this option argue that the federal government has an obligation to provide assistance in areas with scarce support from state and private sources.

800

General Government

Budget function 800 funds the central management and policy responsibilities of both the legislative and executive branches of the federal government. Among the agencies it funds are the General Services Administration and the Internal Revenue Service. CBO estimates that in 1999, discretionary outlays for function 800 will total almost $13 billion. Discretionary budget authority provided for the function in 1999 exceeds $14 billion. Over the past 10 years, spending for general government activities has made up less than 1 percent of federal outlays.



800-01 RESTRICT PUBLIC-PURPOSE TRANSFERS OF REAL PROPERTY BY GSA

	Added Receipts (Millions of dollars)
Annual	
2000	45
2001	45
2002	45
2003	45
2004	45
2005	45
2006	45
2007	45
2008	45
2009	45
Cumulative	
2000-2004	225
2000-2009	450

<u>SPENDING CATEGORY</u>:

Mandatory

The General Services Administration (GSA) makes surplus federal buildings, land, and other property available to state and local governments, nonprofit organizations, and others for use as parks, prisons, schools, and airports. The government makes the property available free or at deep discounts. In 1998, according to GSA data, the government donated 49 pieces of property valued at $90 million. For the 1994-1998 period, the value of donations totaled about $475 million. If the government discontinued the program and instead sold surplus property at market value, it could increase offsetting receipts by a total of $450 million over 10 years.

According to supporters of this option, selling surplus property, rather than giving it away, would raise revenue for government and would ensure, through open competition for assets in the market, that property is put to its most highly valued use. They note that the government already provides abundant direct and indirect assistance to states and localities to support conservation, education, and other public services. They also point out that nonprofit organizations received about $20 billion in federal support in tax deductions for charitable contributions in 1998. In addition, the program provides uneven assistance, which favors areas with a heavy federal presence, according to those who would restrict it.

Advocates of transferring surplus property argue that the program provides valuable support to localities, nonprofit organizations, and others struggling to offer useful public services in areas such as education, conservation, and transportation. During periods of fiscal restraint, such programs also offer the government a way to support causes it deems worthy, without having to make appropriations. In addition, advocates argue that transferring surplus property to communities may offset some of the local impact of closing federal installations.

800-02 ELIMINATE GENERAL FISCAL ASSISTANCE TO THE DISTRICT OF COLUMBIA

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	232	232
2001	232	232
2002	232	232
2003	232	232
2004	232	232
2005	232	232
2006	232	232
2007	232	232
2008	232	232
2009	232	232
Cumulative		
2000-2004	1,160	1,160
2000-2009	2,320	2,320

SPENDING CATEGORY:

Discretionary

Under the National Capital Revitalization and Self-Government Improvement Act (Revitalization Act) of 1997, the federal government assumed responsibility for providing certain services to the District of Columbia in exchange for eliminating the annual payment of general assistance to the District. Specifically, the federal government agreed to fund the operations of the District's criminal justice, court, and correctional systems. It also assumed responsibility for paying off more than $5 billion in unfunded liabilities owed by the city to several pension plans, increased the federal share of the city's Medicaid payments, and provided special borrowing authority to the District.

For fiscal year 1998, the Revitalization Act included slightly more than $200 million in assistance for the District that was not related to the obligations specifically assumed by the federal government. For fiscal year 1999, the Omnibus Consolidated and Emergency Supplemental Appropriations Act included $232 million in such funding. That amount includes funds for transportation projects, District of Columbia schools, and government management reforms. Eliminating such funds would save about $2.3 billion over the 2000-2009 period.

One argument for eliminating such funding is that the federal government relieved the District of Columbia government of the cost of a substantial, and increasing, portion of its budget—criminal justice, Medicaid, and pensions. The proposed trade-off for assuming responsibility for those functions was eliminating other assistance, including the annual federal payment. Eliminating assistance would be consistent with that policy. Furthermore, because the District of Columbia's financial situation has recently improved considerably, the city needs less assistance.

One argument against eliminating such funding is that the Constitution gives the Congress responsibility for overseeing the District of Columbia (which the Congress has largely delegated to the city government) and the city still has major problems with its public schools, roadways, and other essential city services. Therefore, opponents of this option argue that the need continues for funding assistance. Moreover, the Congress prevents the District of Columbia from imposing commuter taxes as other cities do. Those are taxes on nonresidents who work in a city and benefit from city services. Two of three dollars earned in the District of Columbia are earned by nonresidents. Finally, opponents note that continued assistance is justified because a large portion of city property is exempt from local taxes, including the property owned by the federal government or foreign nations that accounts for over 40 percent of property in the city.

800-03 ELIMINATE MANDATORY GRANTS TO U.S. TERRITORIES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	28	2
2001	28	8
2002	28	13
2003	28	18
2004	28	23
2005	28	28
2006	28	28
2007	28	28
2008	28	28
2009	28	28
Cumulative		
2000-2004	140	64
2000-2009	280	204

SPENDING CATEGORY:

Mandatory

As part of the Covenant to Establish a Commonwealth of the Northern Mariana Islands (CNMI), the federal government agreed to provide financial assistance to CNMI, a U.S. territory. During the 1978-1992 period, the federal government provided CNMI with $420 million for operations, economic development, and infrastructure.

After 1992, the financial assistance agreement between the United States and CNMI requires, in the absence of a new agreement, grants to the Commonwealth to continue indefinitely at the 1992 funding amount—$28 million. In 1996, Public Law 104-134 reallocated the $28 million in annual grants among CNMI; the territories of Guam, American Samoa, and the Virgin Islands; and the freely associated states of Micronesia and the Marshall Islands. The reallocation was made, in part, because the government believed that the goals of the original financial assistance agreements had been met and that other areas had a greater need for assistance. Of the $28 million, more than $11 million continues to go to CNMI.

The option and savings assume a new agreement with CNMI. Eliminating the mandatory grants to the U.S. territories and freely associated states would save about $200 million over the 2000-2009 period. Because the territories spend new grants relatively slowly, eliminating the grants would not save much money in the first several years. The Department of the Interior could include additional funding for infrastructure and other purposes as part of its annual appropriation request; however, the territories would no longer be entitled to the $28 million, and requests for additional appropriations for infrastructure grants would compete with all other appropriation requests. For instance, in fiscal year 1999, the Congress appropriated $38 million in assistance to the territories.

Aside from reducing direct spending, eliminating the grants would put assistance to the territories for capital needs on equal footing with other assistance to the territories and with similar grants to state and local governments. In addition, some people argue that the reason for providing mandatory assistance to CNMI has ended because its goals have been met. The decision to reallocate the annual funds among the insular areas would seem to support that conclusion. In addition, CNMI has had considerable difficulty developing projects, raising matching funds, and receiving approval from the Department of the Interior, all of which suggests that the goals for which the funding was designed have been met.

Those who would continue the grants argue that the insular areas still have significant needs and that the mandatory grants ensure that funding is available. In addition, CNMI has a growing economy and increasing self-sufficiency, which supporters of this option cite as proof that the federal assistance works. Others argue that any further change in CNMI's funding should be part of a new financial agreement between the United States and CNMI. Otherwise, CNMI could view the unilateral ending of the assistance as a breach of good faith on the part of the U.S. government, which could have political and legal repercussions.

800-04 REQUIRE THE IRS TO DEPOSIT FEES FROM INSTALLMENT AGREEMENTS IN THE TREASURY AS MISCELLANEOUS RECEIPTS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	97	88
2001	99	99
2002	101	101
2003	103	103
2004	105	105
2005	106	106
2006	108	108
2007	110	110
2008	112	112
2009	113	113
Cumulative		
2000-2004	505	496
2000-2009	1,054	1,045

SPENDING CATEGORY:

Mandatory

The fiscal year 1996 appropriation act for the Department of the Treasury, the U.S. Postal Service, the Executive Office of the President, and certain independent agencies authorizes the Internal Revenue Service (IRS) to establish new fees and increase existing fees. The act also allows the IRS to retain and spend receipts collected from those fees, up to an annual limit of $119 million. The IRS has used the authority mainly to charge taxpayers a fee for entering into payment plans with the agency. In fiscal year 1998, the IRS collected and spent $98 million in fee receipts.

Requiring the IRS to deposit those receipts in the Treasury would eliminate the IRS's ability to spend them. That would reduce the IRS's direct spending by about $100 million a year, or more than $1 billion over the 2000-2009 period. That estimate assumes that removing the spending authority would not substantially reduce the amount the IRS collects each year from such fees.

An argument for eliminating the IRS's authority to spend the receipts is that processing payment plans with the taxpayers is an administrative function directly related to the IRS's mission—getting citizens to pay the taxes they owe—and for which the agency already receives an annual appropriation. For fiscal year 1999, for instance, the IRS received $7.9 billion in direct appropriations (not counting transfers). That argument may have particular merit because the IRS does not directly use the receipts collected from fees for installment agreements to fund the processing of those agreements. A second argument is that the spending authority could create the incentive for the IRS to unnecessarily encourage taxpayers to pay their taxes in installments. Similarly, it could encourage the agency to seek new and unnecessary fees.

An argument for continuing to allow the IRS to spend the receipts is that given the constraints on total discretionary spending, allowing the IRS to generate and use fee receipts helps ensure that the federal government's main revenue collector has sufficient funding to fulfill its mission. Some people would argue that even an annual decrease of $100 million could negatively affect revenue collection. In addition, eliminating the spending authority could reduce the IRS's incentive to allow, or its ability to provide for, installment payments, thus hurting those taxpayers who would benefit from such arrangements.

800-05 ELIMINATE FEDERAL ANTIDRUG ADVERTISING

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	185	46
2001	185	120
2002	185	167
2003	185	185
2004	185	185
2005	185	185
2006	185	185
2007	185	185
2008	185	185
2009	185	185
Cumulative		
2000-2004	925	703
2000-2009	1,850	1,628

SPENDING CATEGORY:

Discretionary

RELATED OPTIONS:

750-01 and 750-02

The fiscal year 1998 appropriation act for the Department of the Treasury, the U.S. Postal Service, the Executive Office of the President, and certain independent agencies authorized and provided funding of $195 million to the Office of National Drug Control Policy (ONDCP) for a national antidrug media campaign. The Omnibus Consolidated and Emergency Supplemental Appropriations Act provided $185 million for the program in fiscal year 1999 and authorized $195 million for each of fiscal years 2000 through 2002. Amounts provided to ONDCP can be used to test and evaluate advertising, purchase media time, and evaluate the effects. In addition, the agency must try to get donations from nonfederal sources to finance part of the costs.

Eliminating the antidrug media program would save $1.6 billion over the 2000-2009 period, assuming that the Congress will otherwise continue to provide the same level of funding for the program that it provided for fiscal year 1999.

Arguments for terminating funding of the advertising campaign are many. First, solid empirical evidence of media campaigns' effectiveness in either preventing or reducing drug use is lacking. Some analysts claim that media spots do not reduce drug use by minors as effectively as treatment or interdiction. Furthermore, since nonprofit organizations, such as the Partnership for a Drug-Free America, already conduct educational programs about the dangers of drug use, ONDCP's campaign may duplicate private and local efforts. In any event, with more than $300 million in available balances at the start of this year and the authority to solicit and use public donations, ONDCP could continue the media campaign, on a much smaller scale, without an annual appropriation.

Other analysts argue that educating the young about the hazards of drug use is a national responsibility. Some point to the "Just Say No" campaign begun by former First Lady Nancy Reagan in the 1980s as an example of the successful use of the national media to raise young people's awareness of the dangers of drugs. Proponents of the program also argue that the cost of drug abuse to the country is so high that it is worthwhile to maintain a program that reduces drug use even slightly.

920

Allowances

The President's budget and the Congressional budget resolution sometimes include amounts in function 920 to reflect proposals that are not clearly specified or that would affect multiple budget functions. Since the Congress actually appropriates money for specific purposes, there are never any budget authority or outlay totals for function 920 in historical data or in CBO's baseline projections. In this volume, function 920 includes options that cut across programs and agencies and would affect multiple functions.

920-01 ELIMINATE REQUIREMENTS THAT AGENCIES PURCHASE ALTERNATIVE-FUEL VEHICLES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	10	7
2001	11	11
2002	12	12
2003	13	13
2004	14	14
2005	15	15
2006	16	16
2007	17	17
2008	18	18
2009	19	19
Cumulative		
2000-2004	60	57
2000-2009	145	142

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

920-03

As part of the federal government's efforts on behalf of cleaner air, the Energy Policy Act (EPACT) requires federal agencies to acquire light-duty cars and trucks that can operate using an alternative fuel, such as compressed natural gas, denatured ethanol, or electricity. Beginning in 1999, with certain exceptions, 75 percent of light-duty vehicles acquired for federal fleets in high-density areas must be manufactured or converted to operate as a bi-fuel (gasoline or alternative fuel), flexible-fuel (mixture), or dedicated-fuel (alternative fuel only) vehicle. EPACT annually applies to more than 20,000, or just under half, of new vehicles.

Although agencies have yet to meet any of EPACT's annual targets for acquiring alternative-fuel vehicles (AFVs), they increasingly add AFVs to their fleets. To date, the government has acquired or converted close to 35,000 AFVs, which are often considerably more expensive to buy and operate than conventional vehicles. For example, the government spends about $4,000 more for a vehicle equipped to operate using compressed natural gas. Eliminating the EPACT requirement would save $142 million in federal transportation costs through 2009.

The estimate of annual savings assumes that agencies will continue under current law to fall short of the 75 percent requirement. If agencies were to meet current-law targets, increasing their use of AFVs, savings would be greater. The estimated budgetary effect of eliminating the EPACT requirement excludes annual savings to the Postal Service, which is classified as off-budget.

An obvious advantage of eliminating the requirement is that it would reduce transportation costs to the federal government and the taxpayers. In addition, given the annual limits set in law for total discretionary spending, and falling fuel prices, it may no longer be desirable to require agencies to purchase the more expensive AFVs.

A disadvantage of eliminating the requirement is that the federal government would no longer be leading the conversion to AFVs. Such a policy change could discourage similar efforts at the state and local levels. In addition, the development of the AFV market and of less expensive vehicles of that type could slow. Such a result could hurt clean air efforts. However, according to information from the General Services Administration and the Department of Energy, many agencies are buying bi-fuel vehicles that comply with EPACT but that do not require the use of alternative fuels.

920-02 REDUCE THE NUMBER OF POLITICAL APPOINTEES

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	48	46
2001	71	71
2002	76	76
2003	121	119
2004	108	109
2005	82	84
2006	87	87
2007	139	137
2008	123	124
2009	94	96
Cumulative		
2000-2004	425	421
2000-2009	951	947

NOTE: Savings measured from the 1999 funding level adjusted for pay raises and changes in employment.

SPENDING CATEGORY:

Discretionary

The term "political appointee" generally refers to employees of the federal government who are appointed by the President, some with and some without Senate confirmation, and to certain policy advisers hired at lower levels. For this discussion, the term "political appointee" refers to cabinet secretaries, agency heads, and other executive-schedule employees at the very top ranks of government; top managers and supervisors who are noncareer members of the Senior Executive Service; and confidential aides and policy advisers referred to as Schedule C employees. The total number of employees in such positions, according to Congressional Budget Office projections, will average about 2,800 over the next 10 years. If the government instead capped the number of political appointees at 2,000, savings over 10 years would total $947 million. The current average salary for political appointees, in CBO's calculations, is estimated to be $87,000.

Reports from several groups, including the National Commission on the Public Service and the Twentieth Century Fund, have called for cuts in the number of political appointees. The National Commission on the Public Service, also known as the Volcker Commission, called for setting a limit similar to the one described here. In addition to the problem of excessive organizational layering, the Volcker Commission described concerns about many appointees' lack of expertise in government operations and programs. In political appointments, the commission noted, political loyalties generally count more than knowledge of government. Moreover, few appointees are in office long enough to acquire the necessary skills and experience to master their job. That lack of experience, according to the commission, means that political appointees in many instances are not effective in carrying out the policies of the President they serve and can disrupt an agency's daily operations. As a result, career managers become frustrated and demoralized, making recruitment and retention difficult in the top ranks of the career civil service.

Critics of reducing the number of political appointees cite the importance of a President's establishing control over the vast bureaucracy by having like-minded individuals and allies strategically situated. Those appointees, critics note, form an important link to the electorate because they help to ensure governmentwide leadership that is consistent with the philosophy of each elected President. Such appointees, moreover, can offer fresh perspectives and innovation. The high rate of turnover among appointees, critics argue, means that those officials make way for someone new before they reach the point of burnout.

920-03 CHARGE FEDERAL EMPLOYEES COMMERCIAL RATES FOR PARKING

	Added Receipts (Millions of dollars)
Annual	
2000	110
2001	110
2002	110
2003	110
2004	110
2005	110
2006	110
2007	110
2008	110
2009	110
Cumulative	
2000-2004	550
2000-2009	1,100

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

920-01

The federal government leases and owns more than 200,000 parking spaces, which it allocates to its employees—in most cases without charge. Requiring federal government employees to pay commercial rates for their parking could yield receipts of $110 million in 2000, $550 million over five years, and $1.1 billion over 10 years.

Federal workers in the largest metropolitan areas would bear the brunt of the new charges. Those in the Washington, D.C., metropolitan area would be affected the most, paying about 75 percent of the total charge. (Federal employees in less commercially developed areas, where charging for parking is uncommon, would not face new parking charges.) Employees who continued to use federally owned or managed parking would, on average, pay about $120 per month; employees who currently use free or heavily subsidized parking could choose alternative means of transportation, such as public transportation or carpooling, to avoid the charge.

Supporters of this option favor charging commercial rates for parking because it would encourage federal employees to use public transportation or carpool. That would reduce the flow of cars into urban areas, cutting down on energy consumption, air pollution, and congestion. By acting as a model employer in this regard, the federal government could more effectively call on others to reduce pollution and energy consumption. In addition, commercial pricing would indicate the demand for parking by federal workers more accurately, enabling the government to allocate spaces to those who valued them the most. Moreover, if commercial rates reduced demand for spaces sufficiently, the government might be able to put the unused spaces to new, higher-valued uses. Finally, some observers argue that the federal government should not provide a valuable commodity, such as parking, free to workers who can afford to pay for it.

Critics of this option argue that by charging for parking, the government would unfairly penalize workers in urban areas who have difficulty obtaining access to alternative transportation or who drive to work for valid personal reasons. Charging for parking would also reduce federal employees' total compensation. In addition, critics note that many private-sector employers provide free parking. Some people also have argued that charging commercial rates would merely re-ration the existing spaces without reducing the number of people who drive to work. According to that view, the spaces would simply be allocated by willingness to pay rather than by rank, seniority, or other factors.

920-04 IMPOSE A FEE ON GSE INVESTMENT PORTFOLIOS

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	550	550
2001	550	550
2002	550	550
2003	550	550
2004	550	550
2005	550	550
2006	550	550
2007	550	550
2008	550	550
2009	550	550
Cumulative		
2000-2004	2,750	2,750
2000-2009	5,500	5,500

SPENDING CATEGORY:

Mandatory

RELATED OPTION:

370-10

RELATED CBO PUBLICATIONS:

Assessing the Public Costs and Benefits of Fannie Mae and Freddie Mac (Report), May 1996.

Controlling the Risks of Government-Sponsored Enterprises (Report), April 1991.

Government-sponsored enterprises (GSEs) are private financial institutions chartered by the federal government to support the flow of funds to agriculture, housing, and higher education. GSEs achieve their public purposes by borrowing on the strength of an implicit federal guarantee of their debt obligations. Investors infer the guarantee from the exemption of GSE securities from the normal protection afforded to investors, Congressional support for the enterprises' public purposes, their exemption from state and local taxes, and the huge volume of their outstanding obligations. The implicit guarantee lowers GSEs' cost of borrowing, thus conveying subsidies that give them a competitive advantage in financial markets.

Before the 1990s, GSEs generally used the money they borrowed to make loans or buy loans made by other lenders. More recently, the three largest GSEs—Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System—have used borrowed funds to acquire enormous portfolios of debt securities. The investments consist mainly of mortgage-backed securities (MBSs) but also include corporate bonds and asset-backed securities. At the end of 1998, the investment portfolios of those three enterprises totaled $586 billion, or 52 percent of their combined assets. A fourth GSE, Farmer Mac, has acquired a smaller investment portfolio. The four enterprises conduct an arbitrage between the market for GSE debt and that for private debt, profiting from the difference between the yields on their investments and their own subsidized cost of funds.

Imposing an annual fee on the four GSEs that earn arbitrage profits that would equal 10 cents for every $100 (10 basis points) of each GSE's holdings of debt securities that the enterprise finances with debt would save $550 million in 2000, $2.8 billion over five years, and $5.5 billion by 2009. The fee would reduce the competitive advantage that GSEs have in holding debt securities and, at least initially, would reduce the net income of the four that do so; their net income exceeded $6.5 billion (after taxes) in calendar year 1998. The enterprises could avoid the fee by reducing their investment portfolios but would probably not do so because their cost advantage in issuing debt exceeds the fee. The GSEs could also try to recoup lost arbitrage profits by increasing their risk or the prices they charge.

Proponents of imposing the fee argue that no public policy objectives are served by allowing GSEs to seek high yields in investments unrelated to their missions. The profits of each enterprise subject to the fee, except Farmer Mac, would remain above competitive levels. Even if the three housing GSEs reduced their MBS holdings, it would not adversely affect the markets for those securities, which are deep, liquid, and extremely efficient. Critics counter that greater risk taking by the four enterprises could increase the government's risk exposure. Federal risk-based capital requirements and regulatory examinations, if effective, would limit the amount of any increase in the GSEs' risk borne by the government. Fannie Mae and Freddie Mac could possibly raise the interest rates on new mortgages they bought, but competition from wholly private firms and between those two GSEs would limit their ability to do so.

920-05 REPEAL THE SERVICE CONTRACT ACT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	610	580
2001	610	610
2002	610	610
2003	610	610
2004	610	610
2005	610	610
2006	610	610
2007	610	610
2008	610	610
2009	610	610
Cumulative		
2000-2004	3,050	3,020
2000-2009	6,100	6,070

SPENDING CATEGORY:

Discretionary

The McNamara-O'Hara Service Contract Act of 1965 (SCA) sets basic labor standards for employees working on government contracts whose main purpose is to furnish labor, such as laundry, custodial, and guard services. Contractors covered by the act generally must provide those employees with wages and fringe benefits that at least equal those prevailing in the contractors' locality or those specified by a collective bargaining agreement of the previous contractor. The Department of Labor measures prevailing wages in an area according to the specific wages and benefits earned by at least 50 percent of workers in a particular type of job or by the average of the wages and benefits paid to workers in that type of job. The provision about collective bargaining agreements applies to successor contractors, regardless of whether their employees are covered by such an agreement.

In 1998, the SCA covered approximately 55,000 contracts valued at more than $19 billion. The Department of Defense accounted for about 42 percent of that dollar value, the Army Corps of Engineers for 16 percent, and the National Aeronautics and Space Administration for 15 percent.

The cost of services procured by the federal government could be reduced by repealing the SCA. Repealing the act would reduce outlays by about $600 million in 2000 and by about $6.1 billion over the 2000-2009 period, provided federal agency appropriations were reduced to reflect the anticipated reduction in costs.

Federal procurement costs would fall because repealing the SCA would promote greater competition among bidders, although the precise magnitude of the savings is difficult to measure. Repealing the SCA would give contractors added flexibility that could allow them to reduce the costs of providing services. Opponents of this option are concerned, however, that it would allow bidders to undermine existing collective bargaining agreements. In addition, repealing the SCA would reduce the compensation of workers in some firms that provide services to the government, which opponents argue could reduce the quality of such services.

920-06-A REPEAL THE DAVIS-BACON ACT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	580	245
2001	580	660
2002	580	900
2003	580	1,020
2004	580	1,100
2005	580	1,130
2006	580	1,130
2007	580	1,130
2008	580	1,130
2009	580	1,130
Cumulative		
2000-2004	2,900	3,925
2000-2009	5,800	9,575

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

920-06-B

Since 1935, the Davis-Bacon Act has required that "prevailing wages" be paid on all federally funded or federally assisted construction projects with contracts of $2,000 or more. The Department of Labor measures prevailing wages in an area according to the specific wages and benefits earned by at least 50 percent of workers in a particular type of job or the average of the wages and benefits paid to workers in that type of job. Those procedures, as well as the classifications of workers who receive prevailing wages, favor union wage rates in some cases.

In 1999, approximately $52 billion in federal discretionary funds was authorized for construction projects covered by the Davis-Bacon Act. Fifty-three percent of that amount went to transportation projects, 14 percent went to the Department of Housing and Urban Development and other community and regional development projects, and 13 percent went to the Department of Defense. (Most of the spending authority for transportation projects is controlled by limitations on obligations rather than by budgetary authority.)

The federal government could reduce outlays for construction by repealing the Davis-Bacon Act. Doing so would reduce discretionary outlays by about $245 million in 2000 and by about $9.6 billion over the 2000-2009 period, provided that federal agency appropriations were reduced to reflect the anticipated reduction in costs. Mandatory spending would fall by about $10 million in 2000 and by about $260 million over the 10-year period.

Repealing Davis-Bacon would allow the federal government to spend less on construction, although the precise effect of repealing the act on contractors' costs is difficult to measure. In addition, it would probably increase the opportunities for employment that federal projects would offer less skilled workers. However, such a change would lower the earnings of some construction workers. In addition, opponents of this option argue that eliminating Davis-Bacon requirements could jeopardize the quality of federally funded or federally assisted construction projects. They contend that by requiring firms to pay at least the locally prevailing wage, the people they hire are more likely to be able workers, resulting in fewer defects in the finished projects and more timely completion.

920-06-B RAISE THE THRESHOLD FOR COVERAGE UNDER THE DAVIS-BACON ACT

	Savings (Millions of dollars) Budget Authority	Outlays
Annual		
2000	325	60
2001	325	205
2002	325	305
2003	325	360
2004	325	395
2005	325	405
2006	325	415
2007	325	415
2008	325	415
2009	325	415
Cumulative		
2000-2004	1,625	1,325
2000-2009	3,250	3,390

SPENDING CATEGORY:

Discretionary

RELATED OPTION:

920-06-A

An alternative to repealing the Davis-Bacon Act (see option 920-06-A) would be to raise the threshold for determining which projects are covered by the act. In recent years, several bills have been introduced that would raise the threshold by various amounts. Raising it from $2,000 to $1 million would save about $60 million in 2000 and about $3.4 billion over the 2000-2009 period in discretionary outlays, provided that federal agency appropriations were reduced to reflect the anticipated reduction in costs. In addition, it would save $2 million in 2000 and $35 million over the 10-year period in mandatory spending. Although this option would save only about one-third of the amount that would be saved by repealing Davis-Bacon, the option would reduce firms' and the government's administrative burden by restricting coverage to the largest contracts.

As with repealing Davis-Bacon, raising the threshold would allow the federal government to spend less on construction, although the precise effect of raising the threshold on contractors' costs is difficult to measure. In addition, it would probably increase the opportunities for employment that federal projects would offer less skilled workers. However, such a change would lower the earnings of some construction workers. In addition, opponents of this option argue that raising the threshold could jeopardize the quality of federally funded or federally assisted construction projects. They contend that by requiring firms to pay at least the locally prevailing wage, the people they hire are more likely to be able workers, resulting in fewer defects in the finished projects and more timely completion.

Part Two

Revenue Options

REV-01 LIMIT MORTGAGE PRINCIPAL ELIGIBLE FOR INTEREST DEDUCTION TO $300,000

	Added Revenues (Billions of dollars)
Annual	
2000	2.2
2001	3.1
2002	3.2
2003	3.4
2004	3.7
2005	4.1
2006	4.5
2007	5.0
2008	5.5
2009	6.0
Cumulative	
2000-2004	15.6
2000-2009	40.8

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-02

A home is the largest consumer purchase and the main investment for most Americans. The tax code has historically treated homes more favorably than other investments. Most investments pay their return in cash that is subject to income taxes. Homes, however, pay their return in housing services directly to the owner, and that return is not subject to taxation. Furthermore, owners who help finance their home purchase with a mortgage are allowed to deduct the interest even though the investment produces no taxable income. The tax code also exempts most capital gains from home sales.

Limiting mortgage interest deductions would reduce the preferential treatment of home ownership for owners who must borrow to purchase their homes. Under current law, taxpayers may deduct interest on up to $1 million of debt that they have incurred to acquire and improve first and second homes. They may also deduct interest on up to $100,000 of other loans they have secured with a home (home-equity loans), regardless of purpose. No other type of consumer interest is deductible. Current law also limits the extent to which interest deductions for carrying assets other than first and second homes can exceed income from such assets.

Lowering the limit on the amount of principal eligible for the mortgage interest deduction from $1 million to $300,000 would reduce deductions for about half a million taxpayers with large mortgages and increase revenues by $40.8 billion over the 2000-2009 period. That change would reduce the deduction only for owners of relatively expensive homes. Only 4 percent of new mortgages originated in 1998 exceeded $300,000. The fraction affected would be greatest in high-cost areas such as Honolulu and San Francisco.

Preferential treatment for home ownership encourages people to become homeowners and to purchase larger homes. Increasing home ownership may contribute to social and political stability by strengthening people's stake in their communities and governments. In addition, such preferential treatment may stabilize neighborhoods by encouraging longer-term residence and home improvement. The amount of preference, however, is probably larger than needed to maintain a high rate of home ownership among people buying homes valued over $300,000. Canada achieves about the same rate of home ownership as the United States without allowing the deduction of mortgage interest. Instead of the deduction, some provinces provide a limited tax credit for low- and middle-income people who save for a down payment.

A disadvantage of providing preferential tax treatment for investment in home ownership is that it reduces the amount of savings available for investment in taxable business enterprises. In recent years, about 30 percent of net private investment has gone into owner-occupied housing. Consequently, a reduction in investment in owner-occupied housing could raise investment noticeably in other sectors.

REV-02 LIMIT THE MORTGAGE INTEREST DEDUCTION FOR SECOND HOMES

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	0.7
2002	0.7
2003	0.7
2004	0.8
2005	0.8
2006	0.8
2007	0.8
2008	0.9
2009	0.9
Cumulative	
2000-2004	3.4
2000-2009	7.6

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-01

Taxpayers who borrow to purchase or improve a second home may deduct the interest on that mortgage on the same terms as for a first home. The only limit on the amount borrowed for the two homes is that it be under $1 million. Furthermore, equity in both homes may be used as collateral to borrow $100,000 that can be used for any purpose and whose interest may be deducted (home-equity loans).

Several arguments for and against limiting the deductibility of all mortgage interest appear in option REV-01. Additional considerations apply to mortgage interest on second homes. Permitting taxpayers to deduct the interest from mortgages on second homes—many of which are vacation homes—may seem inequitable when taxpayers cannot deduct interest from consumer loans used to finance either medical expenses or other consumer purchases. However, limiting the deduction of mortgage interest to a single home would retain the current deduction for taxpayers with high mortgage interest on a costly primary home while partially denying it for other taxpayers with equal combined mortgage interest on two less costly homes.

The deductibility of mortgage interest could be limited to debt that taxpayers incur to acquire and improve a primary residence, plus $100,000 of other debt secured by that home. That approach would require interest deductions for second homes to qualify under the $100,000 limit on home-equity loans if they are to be deductible. The limitation would increase revenue by $7.6 billion for the 2000-2009 period.

REV-03 LIMIT DEDUCTIONS OF STATE AND LOCAL TAXES TO THE EXCESS OVER 2 PERCENT OF ADJUSTED GROSS INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	5.3
2001	17.9
2002	18.4
2003	18.9
2004	19.5
2005	20.0
2006	20.4
2007	20.8
2008	21.2
2009	21.5
Cumulative	
2000-2004	80.0
2000-2009	183.9

SOURCE: Joint Committee on Taxation.

In determining their taxable income, taxpayers may claim a standard deduction or itemize and deduct from their adjusted gross income (AGI) certain specific expenses, including state and local income, real estate, and personal property taxes. For taxpayers who itemize, those deductions provide a federal subsidy of state and local tax payments. Consequently, the deductions indirectly finance increased state and local government spending at the expense of other uses of federal revenues.

Limiting the deductibility of state and local tax payments to the amount in excess of 2 percent of AGI would continue the mitigating effect of the deduction on differences in taxes among states and increase federal revenues by about $184 billion over the 2000-2009 period. An alternative approach would be to prohibit deductions above a fixed ceiling, which also might be a percentage of AGI. A ceiling set at 5.75 percent of AGI would increase revenues by about the same amount—$187 billion in 2000 through 2009. A floor and a ceiling, however, would have very different effects on incentives for state and local spending. A floor would retain the incentive for increased spending, but a ceiling would reduce it.

As a way to assist state and local governments, deductibility of state and local taxes has several disadvantages. First, the deductions reduce federal tax liability only for itemizers. Second, because the value of an additional dollar of deductions increases with the marginal tax rate, the deductions are worth more to higher-bracket taxpayers. Third, deductibility favors wealthier communities. Communities with a higher average income level have more residents who itemize and are therefore more likely to spend more because of deductibility than lower-income communities. Fourth, deductibility may discourage states and localities from financing services with nondeductible user fees, thereby discouraging efficient pricing of some services.

An argument against restricting deductibility is that a taxpayer with a large state and local tax liability has less ability to pay federal taxes than one with equal total income and a smaller state and local tax bill. In some areas, a taxpayer who pays higher state and local taxes may receive more benefits from publicly provided services, such as recreational facilities. In that case, the taxes are more like payments for other goods and services (for example, private recreation) that are not deductible. Alternatively, higher public expenditures resulting from deductibility benefit all members of a community, including lower-income nonitemizers who do not receive a direct tax saving.

REV-04 LIMIT DEDUCTIONS FOR CHARITABLE GIFTS OF APPRECIATED PROPERTY TO TAX BASIS

	Added Revenues (Billions of dollars)
Annual	
2000	0.3
2001	1.7
2002	1.8
2003	1.8
2004	1.9
2005	1.9
2006	2.0
2007	2.0
2008	2.1
2009	2.1
Cumulative	
2000-2004	7.5
2000-2009	17.6

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-05, REV-23-A, REV-23-B, and REV-24

Under current law, taxpayers who itemize deductions may deduct the value of contributions they make to qualifying charitable organizations up to a maximum of 50 percent of adjusted gross income in any year. In 1996, 32 million taxpayers claimed just over $86 billion of deductions for charitable contributions, reducing federal revenues by about $22 billion. In addition to cash donations, taxpayers may deduct the fair market value of a contribution of appreciated property that they have held for more than 12 months, regardless of how much they paid for the property.

The deduction provides significant government support for charitable activities. But one criticism of the deduction is that it provides unequal federal matching rates for contributions by different taxpayers. The government subsidy rates can approach 40 percent of contributions for the highest-income taxpayers but are only 15 percent for taxpayers in the lowest tax bracket and zero for people who do not itemize deductions. Another criticism is that the electorate as a whole, and not individual donors, should make decisions about which activities deserve taxpayer support.

Limiting the deduction of appreciated property to a taxpayer's cost of an asset under the regular income tax would increase revenues by about $0.3 billion in 2000 and by more than $17.6 billion over 10 years. The existing provision allows taxpayers to deduct the entire value of assets they contributed even though they paid no tax on the gain from appreciation. That outcome provides preferential treatment to one kind of donation relative to other kinds and expands the preferential treatment of capital gains (see options REV-23A, REV-23B, and REV-24). Indisputably, however, the current provision encourages people to donate appreciated assets, such as stock or art, to eligible activities rather than leave them to their heirs at death, when any gains also escape income tax (see also option REV-05).

REV-05 LIMIT DEDUCTIONS FOR CHARITABLE GIVING TO THE AMOUNT EXCEEDING 2 PERCENT OF ADJUSTED GROSS INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	1.5
2001	10.3
2002	10.9
2003	11.4
2004	12.0
2005	12.6
2006	13.3
2007	14.0
2008	14.7
2009	15.4
Cumulative	
2000-2004	46.1
2000-2009	116.1

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-04

Current law allows taxpayers who itemize to deduct the value of contributions they make to qualifying charitable organizations up to a maximum of 50 percent of adjusted gross income (AGI) in any year. It also allows contributions of appreciated property to be deducted at fair market value. One proposed change would limit the deduction for donations of appreciated property to its tax basis (see option REV-04). Another way to limit the charitable deduction but retain an incentive for giving would be to allow taxpayers to deduct only contributions that exceed 2 percent of AGI.

Such a limit would retain the incentive for increased giving by people who donate a large share of their income but would remove the incentive for people who contribute smaller amounts. It would completely disqualify the charitable deductions of about 17.6 million taxpayers in 2000 and reduce allowed deductions for roughly another 16.1 million. The option would increase revenues by about $1.5 billion in 2000 and by about $116 billion over the 2000-2009 period. Such a change would eliminate the tax incentive for just over half of the taxpayers who currently make and deduct charitable contributions. As a result, overall charitable giving would decline. In addition, it would encourage taxpayers who planned to make contributions over several years to lump them together in one tax year to qualify for a deduction with the 2 percent floor.

REV-06 PHASE OUT THE CHILD AND DEPENDENT CARE CREDIT

	Added Revenues (Billions of dollars)
Annual	
2000	0.3
2001	1.4
2002	1.4
2003	1.4
2004	1.4
2005	1.3
2006	1.3
2007	1.2
2008	1.1
2009	1.0
Cumulative	
2000-2004	5.9
2000-2009	11.8

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-12

Taxpayers who incur employment-related expenses for the care of children and certain other dependents may claim an income tax credit. The credit per dollar of qualifying expenses declines from 30 percent for taxpayers whose adjusted gross income (AGI) is $10,000 or less to 20 percent for taxpayers whose AGI is above $28,000. Tax law limits creditable expenses to $2,400 for one child and $4,800 for two or more. The maximum credit for a taxpayer with one child and income above $28,000 is thus $480 each year. Creditable expenses cannot exceed the earnings of the taxpayer or, in the case of a couple, the earnings of the spouse with lower earnings. In 1996, taxpayers claimed about $2.5 billion in credits on 6 million tax returns.

About two-fifths of the credit benefits taxpayers with an AGI of $50,000 or more. Retaining the credit for only lower-income families would reduce its revenue cost. One way to do that would be to lower the percentage of credit as income rises. For example, trimming the credit percentage by 1 percentage point for each $1,500 of AGI over $30,000—and thus eliminating it completely for those with an AGI over $58,500—would raise $11.8 billion from 2000 through 2009. That option would reduce or eliminate the credit for about 72 percent of currently eligible families. Alternatively, phasing out the credit between $50,000 and $78,500 would raise about $7.8 billion in the same period. That option would reduce or eliminate the credit for nearly half of the eligible families. Finally, phasing out the credit between $65,000 and $93,500 would raise $5.6 billion in the same period, reducing or eliminating the credit for about one-third of eligible families.

The credit provides a work subsidy for families with children. Phasing out the credit for higher-income families targets the subsidy toward families with greater economic need, but it may discourage parents in families with a reduced credit from working outside the home.

If the credit was phased out, higher-income employees could seek other tax benefits for dependent care by asking their employers to provide subsidized day care. Current law allows workers to exclude from taxable income up to $5,000 of annual earnings used to pay for dependent care through employer-based programs. If more employer-subsidized dependent care was provided, budgetary savings would fall. To preclude taxpayers from using that alternative, the Congress could limit the use of that fringe benefit (see option REV-12).

REV-07 INCLUDE SOCIAL SECURITY BENEFITS IN THE PHASEOUT OF THE EARNED INCOME TAX CREDIT

	Added Revenues[a] (Billions of dollars)
Annual	
2000	1.0
2001	1.1
2002	1.1
2003	1.2
2004	1.2
2005	1.2
2006	1.3
2007	1.3
2008	1.4
2009	1.4
Cumulative	
2000-2004	5.6
2000-2009	12.2

SOURCE: Joint Committee on Taxation.

a. Includes outlay savings.

Under current law, the earned income tax credit (EITC) is phased out as the larger of earned income or adjusted gross income (AGI) exceeds a certain threshold. To phase out the EITC, the Taxpayer Relief Act of 1997 expanded the definition of AGI to include tax-exempt interest and nontaxable distributions from pensions, annuities, and individual retirement arrangements not rolled over into similar vehicles. The modified AGI still excludes most transfer income, however. Low-income families with significant transfer income can thus claim the EITC with total income that would reduce or deny the credit to otherwise equivalent families whose income is fully included in their AGI. For single taxpayers with income above $25,000 and joint filers with income above $32,000, AGI includes up to half of Social Security benefits. This option would require that taxpayers include all Social Security benefits in a modified AGI used to phase out the EITC. That change would increase federal revenues and decrease outlays for the EITC by a total of $1 billion in 2000 and $12.2 billion over the 2000-2009 period.

Counting all Social Security benefits to phase out the EITC would give the same EITC to low-income taxpayers receiving Social Security and claiming the EITC as that received by otherwise comparable taxpayers whose income derives entirely from sources fully included in AGI. The Internal Revenue Service (IRS) already receives information on taxpayers' Social Security benefits, so administering this option would require only minor procedural changes.

Because the modified AGI would still exclude some forms of transfer income, however, this option would not remove all differences in EITC for families with the same total income. The IRS does not currently receive information on most forms of taxpayers' transfer income. As a result, counting all transfer income would require a substantial expansion of information reporting to the IRS and a marked increase in taxpayers' compliance costs. Furthermore, because most transfer income not included in AGI is means-tested, counting all transfers in phasing out the EITC would offset, at least in part, the goal of providing income to poor recipients. Even so, excluding any transfers from the income measure used to phase out the EITC would result in differential treatment of otherwise equivalent taxpayers.

In addition, counting Social Security benefits for the EITC phaseout would increase compliance costs for Social Security recipients claiming the EITC and would further complicate the already complex form required for the EITC. That would run counter to recent efforts to simplify procedures for claiming the EITC.

REV-08 LIMIT THE TAX BENEFIT OF ITEMIZED DEDUCTIONS TO 15 PERCENT

	Added Revenues (Billions of dollars)
Annual	
2000	35.9
2001	81.7
2002	86.5
2003	91.7
2004	97.5
2005	103.9
2006	111.0
2007	118.5
2008	126.6
2009	135.2
Cumulative	
2000-2004	393.2
2000-2009	988.3

SOURCE: Joint Committee on Taxation.

Current law allows taxpayers to reduce taxable income by the amount of itemized deductions. Taxpayers who itemize may deduct state and local income and property taxes, home mortgage interest payments, contributions to charity, employee business expenses, moving expenses, casualty and theft losses, and medical and dental expenses. Taxpayers benefit from itemizing if their deductions exceed the standard deduction. Current law limits some itemized deductions to the amount in excess of a percentage of adjusted gross income, and it reduces all itemized deductions for high-income taxpayers.

The tax benefit of itemized deductions, like all deductions, increases with a taxpayer's marginal tax bracket. For example, $10,000 in itemized deductions would reduce taxes by $1,500 for a taxpayer in the 15 percent tax bracket, $2,800 for a taxpayer in the 28 percent bracket, and $3,960 for a taxpayer in the 39.6 percent bracket. Most taxpayers do not itemize deductions. Of the 30 percent of taxpayers who do itemize, however, about half are in tax brackets above 15 percent. This option would limit the tax benefit of itemized deductions to 15 percent for those higher-bracket taxpayers. The limit would increase revenues by about $393 billion over five years and $988 billion over 10 years.

Limiting the tax benefit of itemized deductions would make the income tax more progressive by raising average tax rates for most middle- and upper-income taxpayers. The limit might also improve economic efficiency because it would reduce tax subsidies that lower the after-tax prices of selected goods, such as mortgage-financed, owner-occupied housing.

The itemized deductions for health expenses, casualty losses, and employee business expenses, however, are not subsidies of voluntary activities but are instead allowances for costs that reduce the ability to pay income tax. Under this option, some taxpayers would pay tax on income they use to defray such costs because they would pay tax on their gross income at rates above 15 percent but could deduct only 15 percent of the cost of earning income. Thus, an individual with unusually high medical bills, for example, would pay more tax than another individual with the same ability to pay but low medical bills.

Like other limits on itemized deductions, this option would create incentives for taxpayers to avoid the limit by converting itemized deductions into reductions in income. For example, taxpayers might draw down assets to repay mortgages, reducing both income and mortgage payments, or donate time or services rather than cash to charities. The option would also make calculating taxes more complex for itemizers.

REV-09 IMPOSE AN EXCISE TAX ON NONRETIREMENT FRINGE BENEFITS

	Added Revenues (Billions of dollars)
Annual	
2000	5.6
2001	8.3
2002	8.8
2003	9.4
2004	10.0
2005	10.6
2006	11.2
2007	11.8
2008	12.6
2009	13.2
Cumulative	
2000-2004	42.1
2000-2009	101.7

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-10, REV-11, and REV-12

Unlike employee compensation paid in cash, many fringe benefits are exempt from income and payroll taxes. The exemption of employer-paid health and life insurance premiums from tax will cost about $55 billion in income taxes and $40 billion in payroll taxes in 2000. In addition, the law explicitly excludes from gross income employer-paid dependent care and miscellaneous benefits such as employee discounts and parking valued below a specified limit. Imposing an excise tax on fringe benefits would diminish the effects of those exclusions.

Excluding fringe benefits from gross income effectively subsidizes their cost, leading people to consume more of such benefits than they would if they had to pay the full price. As a result, resources may be allocated inefficiently. For example, excluding employer-provided health insurance has contributed to the large and growing demand for health care services (see option REV-10).

Such exclusions are inequitable because individuals whose compensation is paid all in cash pay more tax than others with the same total income paid partly in fringe benefits. That inequity is exacerbated to the extent that employees' higher demand for fringe benefits drives up their price for people who have to purchase them with after-tax dollars. Moreover, because the tax exclusion is worth more to taxpayers in higher tax brackets and because higher-income taxpayers receive more fringe benefits than lower-income people, the tax savings from the exclusion are unevenly distributed among income groups.

Making all fringe benefits taxable poses difficulties in valuing benefits and in assigning their value to individual employees. That problem could be avoided by imposing on employers an excise tax on the value of the benefits they provide. Those benefits would include the employer's share of health insurance (see option REV-10); premiums to fund the first $50,000 of life insurance, the part that is excluded from income (see option REV-11); dependent care (see option REV-12); athletic facilities; employee discounts; and parking with a value up to the amount above which it is currently taxed. (Under current law, employees must include in taxable income in 1999 the market value in excess of $175 per month of any parking provided free of charge by an employer.) A 3 percent excise tax imposed on fringe benefits, for example, would raise $101.7 billion from 2000 through 2009. The bulk of those revenues would come from taxing employer-paid health insurance.

This option would require that employers know only their total fringe benefit costs, not the value of benefits paid to each employee. Because the excise tax rate would be much lower than the tax rate on wages, this option would maintain most of the incentive for employers to provide fringe benefits instead of taxable wages. An excise tax on employers would be relatively more favorable to employees in higher-wage firms than including fringe benefits in employees' taxable income because the excise tax rate would not rise with employees' income.

REV-10 LIMIT THE TAX EXEMPTION OF EMPLOYER-PAID HEALTH INSURANCE

	Added Revenues (Billions of dollars) Income Tax	Payroll Tax
Annual		
2000	6.2	3.9
2001	9.7	6.1
2002	10.8	6.8
2003	12.1	7.6
2004	13.6	8.5
2005	15.2	9.6
2006	17.0	10.7
2007	19.1	12.0
2008	21.4	13.4
2009	23.9	15.0
Cumulative		
2000-2004	52.4	32.9
2000-2009	149.0	93.7

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-09

RELATED CBO PUBLICATION:

The Tax Treatment of Employment-Based Health Insurance (Study), March 1994.

Employees do not pay taxes on income they receive in the form of employer-paid health insurance. In addition, health insurance premiums and health care costs paid through cafeteria plans are generally excludable from income and payroll taxes. Those exclusions will reduce income tax revenues and payroll tax revenues by a total of about $92 billion in 2000.

One way to limit the exclusion would be to treat as taxable income for employees any employer contributions for health insurance plus health care costs paid through cafeteria plans that exceed $425 a month for family coverage and $175 a month for individual coverage. Those amounts are estimated average contributions for 2000 and would be indexed to reflect future increases in the general level of prices. The option would increase income tax revenues by $149 billion and payroll tax revenues by $93.7 billion over the 2000-2009 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays for Social Security benefits in the future that could offset a significant part of the added payroll tax revenues from this option over the long run.

This option would eliminate the tax incentive to purchase additional coverage beyond the ceiling. Employees would have more incentive to economize in the medical marketplace, which could reduce both upward pressure on medical care prices and the provision of unnecessary or marginal services. The option would index the ceiling amounts to the overall inflation rate, and since health care costs have been rising faster than that, it could constrain health care costs even more over time. The Congress has already limited the exclusion for employer-paid group term life insurance in a similar way.

One disadvantage of limiting the tax exemption of employer-paid medical insurance premiums is the difficulty of determining when extensive coverage becomes excessive. In addition, the level of coverage purchased by a given premium depends on such factors as geographic location and the characteristics of a firm's workforce. As a result, a uniform ceiling would have uneven effects. Finally, if health insurance costs continued to rise faster than the general level of prices, indexing to reflect that level would gradually reduce subsidies for employer-paid health insurance. Taken together, those factors could increase the number of workers without health insurance and generate inequities among taxpayers by region and type of employer.

REV-11 INCLUDE EMPLOYER-PAID LIFE INSURANCE IN TAXABLE INCOME

	Added Revenues (Billions of dollars) Income Tax	Payroll Tax
Annual		
2000	1.0	0.6
2001	1.5	0.9
2002	1.5	0.9
2003	1.6	1.0
2004	1.6	1.0
2005	1.7	1.0
2006	1.7	1.1
2007	1.8	1.1
2008	1.9	1.1
2009	1.9	1.2
Cumulative		
2000-2004	7.2	4.4
2000-2009	16.2	9.9

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-09 and REV-15

Tax law excludes from taxable income the premiums that employers pay for group term life insurance but limits the exclusion to the cost of the first $50,000 of insurance. The exclusion is not available to the self-employed. Employer-paid life insurance is the third most expensive tax-advantaged fringe benefit (after health insurance, discussed in option REV-10, and pensions). Including employer-paid premiums in taxable income would add $16.2 billion to income tax revenues and $9.9 billion to payroll tax revenues from 2000 through 2009.

Like the tax exclusion for other employment-based fringe benefits, the tax exclusion for life insurance creates a subsidy for the fringe benefit, which causes people to purchase more life insurance than they would if they had to pay the full cost themselves. Furthermore, the tax exclusion allows workers whose employers purchase life insurance for them to pay less tax than workers who have the same total compensation but must purchase insurance on their own (see option REV-09). In addition, the value of employer-paid life insurance, unlike some other fringe benefits, could be accurately measured and allocated. Employers could report the premiums they paid for each employee on the employee's W-2 form and compute withholding in the same way as for wages. Indeed, employers already withhold taxes on life insurance premiums that fund death benefits above the $50,000 limit.

A tax subsidy to provide life insurance might be called for, however, if people buy too little life insurance because they systematically underestimate the potential financial hardship to their families resulting from their death. But whether people purchase too little insurance for that reason is unclear. Moreover, even if it was clear, a more efficient way of allocating resources might be to provide a direct tax subsidy to all purchasers of life insurance and avoid limiting the subsidy to insurance provided by employers.

REV-12 ELIMINATE THE EMPLOYER EXCLUSION FOR DEPENDENT CARE

	Added Revenues (Billions of dollars)
Annual	
2000	0.1
2001	0.2
2002	0.3
2003	0.3
2004	0.3
2005	0.4
2006	0.4
2007	0.4
2008	0.4
2009	0.5
Cumulative	
2000-2004	1.2
2000-2009	3.3

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-06 and REV-09

The tax system provides two types of subsidies for child and other dependent care expenses of working taxpayers. Those subsidies are provided as exclusions from income paid to an employee or as a tax credit for those not using employment-based subsidies. Although those subsidies provide benefits for the same activities, the value of the subsidy from employer-based exclusions can be much larger than that provided under the child and dependent care credit. Eliminating the exclusions and making all tax benefits for child and dependent care available only through the credit would increase revenues by $3.3 billion from 2000 through 2009.

Employers may exclude up to $5,000 for child and dependent care expenses from the taxable wages of their employees, either as care provided directly by the employer or as other-than-employer care if the employer has established a qualified plan. The maximum exclusion amount is limited to a taxpayer's earnings or the earnings of the lesser-earning spouse for married taxpayers, and—as with all types of exclusions—the value of the exclusion depends on the marginal tax rate of the taxpayer. The exclusion also reduces employers' and employees' liability for Social Security and Medicare payroll taxes.

Taxpayers who do not receive employment-based subsidies may claim a nonrefundable income tax credit, limited to expenses of $2,400 for one dependent and $4,800 for two or more dependents. As with the exclusion, the total amount of qualifying expenses may not exceed the earnings of the taxpayer or, in the case of a couple, the lower-earning spouse. The credit rate per dollar of qualifying expenses is 30 percent for taxpayers whose adjusted gross income (AGI) is under $10,000 and is phased down to 20 percent for taxpayers whose AGI is over $28,000. Most taxpayers receive the 20 percent rate with a resulting maximum credit of $480 for one child and $960 for two or more children. In 1996, about 6 million taxpayers claimed $2.5 billion in credits.

Even though they subsidize the same activities, the credit and the exclusion provide significantly different benefits. For example, a high-income taxpayer with one child may receive an income tax benefit of up to $1,980 under the employer exclusion but only $480 under the credit. In addition, the exclusion reduces payroll taxes, but no such benefit is available with the credit. Eliminating the exclusion would provide equitable treatment for taxpayers with similar dependent care circumstances regardless of whether their employer has established a qualifying exclusion program. In addition, it would reduce complexity by simplifying taxpayer calculations.

However, eliminating the exclusion would reduce the total subsidies available for dependent care expenses and could induce some workers (particularly second earners in couples) to leave the labor force. If dependent care is considered a cost of employment, then eliminating the exclusion may be inappropriate since some costs of employment are excludable.

REV-13 INCLUDE THE INCOME-REPLACEMENT PORTION OF WORKERS' COMPENSATION AND BLACK LUNG BENEFITS IN TAXABLE INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	5.0
2001	5.3
2002	5.5
2003	5.7
2004	6.0
2005	6.2
2006	6.4
2007	6.6
2008	6.8
2009	7.2
Cumulative	
2000-2004	27.5
2000-2009	60.8

SOURCE: Joint Committee on Taxation.

Current law exempts workers' compensation and Black Lung benefits from income tax. Taxing the portion of those benefits that replaces the income employees lose from work-related injuries or black lung disease would increase revenues by $60.8 billion from 2000 through 2009. The remaining portion of benefits, which reimburses employees for their medical costs (about 40 percent), would continue to be exempt from taxation.

Taxing the income-replacement portion of those benefits would make their tax treatment comparable with that of unemployment benefits and the wage-replacement benefits that employers provide through sick pay and disability pensions. It would also improve work incentives for disabled workers who are able to return to work. (Under current law, the after-tax value of the wages they are able to earn may be less than the tax-free benefits they receive while disabled.)

An argument against taxing such benefits is that legal or insurance settlements for non-work-related injuries are not taxable, even if a portion of them reimburses lost income. Taxing workers' compensation benefits would be inconsistent with that approach.

Furthermore, if the current levels of wage-replacement benefits were established under the assumption that they would not be taxed, this option would reduce benefits below desired levels. Enacting the option might therefore lead to efforts to increase benefits, thereby potentially reducing the budget surplus.

REV-14-A INCLUDE 85 PERCENT OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS IN TAXABLE INCOME FOR ALL RECIPIENTS

	Added Revenues (Billions of dollars)
Annual	
2000	8.6
2001	21.9
2002	22.8
2003	23.6
2004	24.4
2005	24.9
2006	25.3
2007	26.0
2008	27.3
2009	28.7
Cumulative	
2000-2004	101.3
2000-2009	233.6

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-14-B, REV-14-C, and REV-16

RELATED CBO PUBLICATION:

Reducing Entitlement Spending (Study), September 1994.

Under current law, most benefits from Social Security and Railroad Retirement are not subject to tax. Only if the sum of adjusted gross income (AGI), nontaxable interest income, and one-half of Social Security and Tier I benefits exceeds a fixed threshold does a recipient pay tax on any benefits. If that sum exceeds $25,000 for single returns or $32,000 for joint returns, up to 50 percent of benefits are subject to tax. Above a second set of thresholds—$34,000 (single) and $44,000 (joint)—up to 85 percent of benefits are subject to tax. About one-third of households receiving Social Security will pay income tax on some portion of their benefits in 2000, and about one-half of those households will pay tax on 85 percent of their benefits. Because the thresholds remain fixed over time, as nominal incomes increase, the percentage of households that pay tax on benefits will grow to 36 percent in 2004. Bills to remove the 85 percent rate were proposed in 1998 but were not enacted.

Requiring all beneficiaries to include 85 percent of their benefits in their AGI would raise $233.6 billion from 2000 through 2009. That change would increase the share of recipients paying tax on their benefits from 32 percent to 74 percent. Other features of the tax code would continue to exempt about one-fourth of elderly households from taxation.

Eliminating the thresholds would reduce tax disparities among middle-income households. Social Security beneficiaries receive a tax preference not available to other taxpayers because they may exclude a portion of their income—benefits below the thresholds—from AGI. As a result, middle-income elderly families pay less tax than nonelderly families with comparable income.

This option would treat Social Security roughly the same as contributory pension plans. Workers receiving benefits from the latter pay income tax on the excess of benefits over their own contributions. Social Security actuaries estimate that among workers now entering the labor force, employee-paid payroll taxes will amount to no more than 15 percent of expected benefits. Thus, 85 percent is the minimum fraction of benefits in excess of past contributions.

Retirees might consider increased taxes on benefits to violate the implicit promises of the Social Security and Railroad Retirement programs. The government has, however, changed the Social Security and Railroad Retirement programs often, altering the benefit formula, introducing partial taxation of benefits, and raising payroll tax rates to finance the programs. Finally, increased taxation of benefits is one way to apply a means test to program payments.

REV-14-B INCLUDE 85 PERCENT OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS IN TAXABLE INCOME FOR HIGHER-INCOME RECIPIENTS AND INCLUDE 50 PERCENT FOR ALL OTHER RECIPIENTS

	Added Revenues (Billions of dollars)
Annual	
2000	4.1
2001	10.5
2002	10.9
2003	11.3
2004	11.6
2005	12.0
2006	12.3
2007	12.7
2008	13.1
2009	13.5
Cumulative	
2000-2004	48.4
2000-2009	112.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-14-A, REV-14-C, and REV-16

RELATED CBO PUBLICATION:

Reducing Entitlement Spending (Study), September 1994.

Under current law, low-income Social Security recipients pay no income tax on their benefits. Recipients with modified adjusted gross income (AGI) above $25,000 ($32,000 for joint filers) pay tax on up to half of their Social Security benefits; those with modified AGI above $34,000 ($44,000 for joint filers) must include up to 85 percent of their benefits in taxable income (see option REV-14-A). This option would continue to tax up to 85 percent of benefits for taxpayers with income above the higher thresholds but require all other recipients to include half of their benefits in AGI. It would raise $112 billion from 2000 through 2009.

Under this option, the Social Security benefits of couples with combined income below $32,000 and individuals with combined income below $25,000 would be subject to tax. Almost all beneficiaries currently taxed on up to 50 percent of their benefits—couples with combined income between $32,000 and $44,000 and individuals with combined income between $25,000 and $34,000—would be unaffected. (Because the taxation of benefits is phased in under current law, some couples with combined income just above $32,000 and singles with income just above $25,000 are now taxed on less than a full 50 percent of their benefits.)

Compared with the previous option (REV-14-A), this proposal would protect a larger share of benefits received by lower-income beneficiaries from taxation. Roughly 39 percent of beneficiaries would continue to pay no taxes, compared with about 26 percent under the previous option.

Under this option, however, beneficiaries with somewhat higher income (whose benefits now are taxed at less than 50 percent) would receive lower after-tax benefits. Any such reduction in benefits might be viewed by recipients as violating promises made during their working years about the benefits they could expect to receive during retirement.

REV-14-C INCLUDE 85 PERCENT OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS IN TAXABLE INCOME FOR HIGHER-INCOME RECIPIENTS

	Added Revenues (Billions of dollars)
Annual	
2000	2.5
2001	5.2
2002	5.6
2003	6.0
2004	6.5
2005	7.0
2006	7.6
2007	8.2
2008	8.8
2009	9.4
Cumulative	
2000-2004	25.8
2000-2009	66.6

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-14-A, REV-14-B, and REV-16

RELATED CBO PUBLICATION:

Reducing Entitlement Spending (Study), September 1994.

Under current law, low-income Social Security recipients pay no income tax on their benefits. Recipients with modified adjusted gross income (AGI) above $25,000 ($32,000 for joint filers) pay tax on up to half of their Social Security benefits; those with modified AGI above $34,000 ($44,000 for joint filers) must include up to 85 percent of their benefits in taxable income (see option REV-14-A). This option would continue to exempt the Social Security benefits of low-income recipients from taxation but require recipients with modified AGI above $25,000 ($32,000 for joint filers) to include up to 85 percent of their benefits in AGI. It would raise $66.6 billion from 2000 through 2009. Moreover, it would almost exclusively affect individuals with income between $25,000 and $34,000 and couples with modified income between $32,000 and $44,000.

Few of the 70 percent of all recipients whose benefits are not now subject to the income tax would be taxed under this option. Because 85 percent rather than 50 percent of benefits would be included in modified AGI measured against the thresholds, some of those beneficiaries who now fall just below the thresholds would move above them and have a portion of their benefits subject to tax.

Like option REV-14-A, this option would treat Social Security benefits the same as private pensions, taxing roughly that portion of benefits that exceeds the recipient's own contributions. But by maintaining the thresholds, lower-income recipients would continue to receive the favorable tax treatment now accorded to their Social Security benefits.

Continuing to have thresholds, however, would also maintain some disincentive for workers to save for their retirements. Recipients whose benefits are only partly over the taxable threshold face increased effective taxes on income from savings. An additional dollar of interest income, for example, would incur not only an income tax on that dollar but would also make an additional 85 cents of Social Security benefits subject to tax by pushing that additional amount over the threshold. The dollar of interest income would thus face an effective tax rate 1.85 times that incurred by a person whose benefits are either taxed fully or not at all. Therefore, a taxpayer in the 15 percent tax bracket would owe an additional $27.75 of tax on $100 more of interest income. Although current law also has a disincentive to saving, its effect would be exacerbated by the increase in the share of benefits subject to taxation above the thresholds from 50 percent to 85 percent.

REV-15 INCLUDE INVESTMENT INCOME FROM LIFE INSURANCE AND ANNUITIES IN TAXABLE INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	11.3
2001	22.9
2002	23.6
2003	24.3
2004	25.1
2005	25.9
2006	26.7
2007	27.5
2008	28.4
2009	29.3
Cumulative	
2000-2004	107.2
2000-2009	244.9

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-11

Life insurance policies and annuities often combine features of both insurance and tax-favored savings accounts. The investment income from the savings, sometimes called "inside buildup," is not taxed until it is paid out to the policyholder. If it is left to the policyholder's estate or used to pay for life insurance, it can escape taxation entirely.

Under this option, life insurance companies would notify policyholders annually of the investment income realized on their account, just as mutual funds do now. Individuals would include those amounts in their taxable income. Life insurance disbursements and annuity benefits would no longer be taxable as they were paid. Making the investment income taxable in that way would raise almost $245 billion in 2000 through 2009. Investment income from annuities purchased as part of a qualified pension plan or qualified individual retirement account would still be tax-deferred until benefits were paid.

The tax deferral currently allowed for life insurance and annuities is similar to the deferral allowed for unrealized capital gains income. Taxing the investment income from life insurance and annuities annually would equalize their tax treatment with that of a bank account, taxable bond, or mutual fund.

A tax incentive to purchase life insurance is desirable if people systematically underestimate the financial hardship on spouses and families caused by their own death. Such shortsightedness could cause them to buy too little life insurance. Similarly, it might cause people to buy too little annuity insurance to protect them against outliving their assets. But it is not currently known whether people would buy too little insurance without the tax incentive or the extent to which the tax incentive might increase the amount of life insurance or annuity coverage purchased. If the incentive is justified to correct for people's shortsightedness rather than subsidize the inside buildup, a better policy might be to subsidize life insurance directly by allowing a tax credit or partial deduction for insurance premiums. Annuities receive other tax incentives through the special tax treatment of pensions and retirement savings.

A tax preference for inside buildup in life insurance policies and annuities has an uncertain effect on saving. It may encourage saving because it would increase people's income when they are older for each dollar they saved when they were younger. The tax preference might, however, reduce saving because it also enables people to save less when they are younger without reducing their expected income when they are older.

REV-16 INCLUDE AN INCOME-RELATED PORTION OF THE INSURANCE VALUE OF MEDICARE BENEFITS IN TAXABLE INCOME

	Added Revenues (Billions of dollars)		
	Tax HI Only	Tax SMI Only	Tax Both
Annual			
2000	3.0	1.8	4.9
2001	7.5	4.8	12.7
2002	8.0	5.4	13.8
2003	8.6	6.2	15.2
2004	9.3	7.1	16.8
2005	10.3	8.0	18.8
2006	11.3	9.1	21.0
2007	12.5	10.3	23.4
2008	13.7	11.6	26.0
2009	15.0	13.1	28.9
Cumulative			
2000-2004	36.4	25.3	63.4
2000-2009	99.3	77.6	181.5

SOURCE: Joint Committee on Taxation.

NOTE: HI = Hospital Insurance; SMI = Supplementary Medical Insurance.

RELATED OPTIONS:

REV-14-A, REV-14-B, REV-14-C, 570-18, 570-19-A, and 570-19-B

RELATED CBO PUBLICATION:

Reducing Entitlement Spending (Study), September 1994.

Even though Social Security benefits are at least partially taxable under current law (see options REV-14-A, REV-14-B, and REV-14-C), Medicare benefits are not subject to tax. This option would include 85 percent of the insurance value of Hospital Insurance (HI) and 75 percent of the insurance value of Supplementary Medical Insurance (SMI) in adjusted gross income (AGI), to the extent that combined income (AGI plus nontaxable interest income plus one-half of Social Security, Railroad Retirement, and Medicare benefits) exceeds $34,000 for single returns and $44,000 for joint returns. Administering this option would be straightforward because a mechanism is already in place for taxing Social Security benefits. (The percentages roughly represent the share of program costs not paid for by recipients through either payroll taxes during their working years or SMI premiums.) Taxpayers with combined income below those thresholds but above $25,000 (single) and $32,000 (joint) would include 50 percent of the insurance value of both HI and SMI in AGI. Taxpayers with lower income would be unaffected. Because the thresholds are not indexed for inflation, however, a larger fraction of Medicare insurance benefits would become taxable over time.

From 2000 through 2009, the HI tax alone would increase federal revenues by $99.3 billion, and the SMI tax alone would yield $77.6 billion. Imposing both taxes simultaneously would raise revenues by about $181.5 billion over 10 years. The combined tax would generate more revenue than the sum of the HI and SMI taxes because some taxpayers would face higher tax rates as their AGI increased. In addition, combining HI and SMI taxes would move more enrollees above the threshold.

Earmarking revenues from taxing HI benefits for the HI trust fund would delay the deficit of the trust fund projected for 2007. A tax on SMI benefits would shift some SMI costs from taxpayers to enrollees. Using income thresholds would leave lower-income enrollees unaffected. In fact, because many enrollees do not have to pay income taxes, this proposal would affect only about 34 percent of enrollees in 2000.

Because the tax would apply to in-kind benefits rather than cash income, some enrollees might object that the additional income does not generate cash with which to pay the tax liability.

An alternative option would forgo income thresholds and include 85 percent of the insurance value of HI benefits and 75 percent of the insurance value of SMI in AGI for all taxpayers. With no income thresholds, the HI and SMI taxes would raise $293.6 billion over the 2000-2009 period.

REV-17 RAISE THE AGE LIMIT FOR THE KIDDIE TAX FROM 14 TO 18 FOR TAXING INVESTMENT INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	a
2001	0.1
2002	0.1
2003	0.1
2004	0.1
2005	0.2
2006	0.2
2007	0.2
2008	0.2
2009	0.3
Cumulative	
2000-2004	0.4
2000-2009	1.5

SOURCE: Joint Committee on Taxation.

a. Gain of less than $50 million.

Under current law, investment income received by a dependent child under age 14 in excess of specified limits is subject to federal income tax at the parents' marginal tax rate. In 1998, the applicable limit was $1,400. The provision—often referred to as the "kiddie tax"—is intended to limit the ability of parents to reduce the income tax on investment income by transferring ownership of assets to their young children. It does not, however, preclude parents from reducing their tax bills by giving investment assets to children older than 13. This option would raise from 14 to 18 the age limit below which a child's investment income is taxed at parents' rates. It would increase income tax revenues by $1.5 billion over the 2000-2009 period.

Extending the kiddie tax to older children would help prevent parents from sheltering assets to reduce their tax liability. Under current law, income from assets in the name of a child over age 13 is taxed at the child's rate, generally 15 percent, rather than at the parents' tax rate, which can be as high as 39.6 percent. On annual asset income of $10,000, for example, that difference can cut the family's tax bill from $3,960 to $1,500, or more than 60 percent.

Raising the age for the "kiddie tax" to 18 could lead to higher taxes on the income of assets properly owned by children older than 13. Not all assets are owned by older children because their parents want to shelter investment income by shifting assets into their children's names. An older child may have earned and saved substantial funds for many years, in which case it is reasonable that the income from those assets should be taxed at the child's rate rather than the parents' rate. Imposing the parents' higher rate could discourage teenagers from saving earnings or monetary gifts. Furthermore, a policy that discourages young people's saving would conflict with the intent of recent legislation designed to promote saving for higher education.

REV-18 EXPAND MEDICARE COVERAGE TO INCLUDE STATE AND LOCAL GOVERNMENT EMPLOYEES NOT NOW COVERED

	Added Revenues (Billions of dollars)
Annual	
2000	1.1
2001	1.4
2002	1.4
2003	1.3
2004	1.2
2005	1.2
2006	1.1
2007	1.0
2008	0.9
2009	0.8
Cumulative	
2000-2004	6.4
2000-2009	11.3

Certain groups of state and local government employees are not covered by Medicare, despite expansions of coverage in 1985 and 1990. (All federal employees have been covered since 1983, as required by the Tax Equity and Fiscal Responsibility Act of 1982.) The Consolidated Omnibus Budget Reconciliation Act of 1985 mandated that state and local employees who began work after March 31, 1986, pay Medicare payroll taxes, but it did not make coverage mandatory for those hired before that date. The Omnibus Budget Reconciliation Act of 1990 expanded Medicare coverage to include all state and local government employees not covered by any retirement plan.

Under current law, many state and local employees will qualify for Medicare benefits on the basis of other employment in covered jobs or their spouse's employment. Those employees will receive benefits as if they had worked continuously in covered employment. One out of six state and local employees is not covered by Medicare through employment, but about 85 percent of those not covered receive Medicare benefits through their spouse or because of work in covered employment.

Requiring all state and local employees to pay Medicare payroll taxes would make their coverage resemble that of federal employees. Broader coverage would reduce the inequity from the high benefits those employees receive in relation to payroll taxes paid. Expanding Medicare coverage to include more state and local employees would increase the government's liability for future program benefits. The additional revenues, however, would most likely more than offset increased benefits permanently.

Expanding Medicare coverage to include state and local government employees who began work before April 1, 1986, would raise $11.3 billion from 2000 through 2009. The annual revenue gain would decline gradually as employees who were hired before April 1986 leave state and local government payrolls.

REV-19 MAKE CALCULATION OF TAXABLE WAGES FOR SELF-EMPLOYED PEOPLE EQUIVALENT TO CALCULATION FOR OTHER WORKERS

	Added Revenues (Billions of dollars) On-Budget	Off-Budget
Annual		
2000	0.2	0.1
2001	0.2	0.1
2002	0.2	0.1
2003	0.2	0.1
2004	0.2	0.1
2005	0.2	0.1
2006	0.2	0.1
2007	0.2	0.1
2008	0.3	0.1
2009	0.3	0.2
Cumulative		
2000-2004	1.0	0.6
2000-2009	2.0	1.3

Social Security and Medicare taxes come in two forms: the Federal Insurance Contribution Act (FICA) tax paid on wages and the Self-Employment Contribution Act (SECA) tax paid on self-employment income. For FICA taxes, employees and employers each pay a 6.2 percent Social Security tax on wages up to a taxable maximum ($72,600 in 1999) and a 1.45 percent Medicare tax on all wages.

Until 1983, the SECA rate was explicitly set lower than the combined employer and employee FICA rate. As part of the Social Security Amendments of 1983, the Congress increased effective SECA rates starting in 1984. The conference committee said that the law was "designed to achieve parity between employees and the self-employed" beginning in 1990. Nonetheless, the current method for calculating SECA taxes allows a self-employed taxpayer to pay less tax than a non-self-employed worker with the same nominal income. For example, an employee earning $50,000 and his or her employer each pay $3,825 in FICA taxes, so that employee's total compensation is $53,825 and the total FICA tax is $7,650. But if that worker's self-employed sibling also earns total compensation of $53,825, under current law that person would pay only $7,605 in SECA taxes, $45 less than the non-self-employed sibling would pay.

For people with earnings above the taxable maximum, the amount of Social Security tax paid is the same for the self-employed and the non-self-employed; however, the amount of Medicare tax paid is less for the self-employed. For example, an employee earning $100,000 and his or her employer each pay $4,501 in Social Security taxes and $1,450 in Medicare taxes, so that employee's total compensation is $105,951 and the total FICA tax is $11,902. That person's self-employed sibling—with the same total compensation—pays the same maximum Social Security tax but a Medicare tax of only $2,838, or $62 less. High-income, self-employed taxpayers may have a SECA Medicare tax liability as much as 6.3 percent less than that of non-self-employed taxpayers. That difference has existed since 1991, when the Congress first set the Medicare taxable maximum higher than the Social Security taxable maximum. Correcting the difference would require a slight addition to Schedule SE, but it would directly affect only self-employed taxpayers with income above the taxable maximum.

Changing the SECA calculation formula would increase on-budget revenues by $2 billion from 2000 to 2009. Off-budget SECA revenues, which are deposited into the Social Security trust funds, would increase by $1.3 billion.

REV-20 ELIMINATE THE SOURCE RULES EXCEPTION FOR INVENTORY SALES

	Added Revenues (Billions of dollars)
Annual	
2000	1.4
2001	2.9
2002	3.1
2003	3.3
2004	3.6
2005	3.8
2006	4.1
2007	4.4
2008	4.8
2009	5.1
Cumulative	
2000-2004	14.3
2000-2009	36.5

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-21

Under current law, income allocation rules can provide a subsidy for the export of U.S.-made products of some multinational corporations. The "title passage" rule, which specifies the allocation of income between domestic and foreign business activities, routinely allows U.S. multinational corporations to use excess foreign tax credits to offset about half of the U.S. tax on their export income by characterizing it as foreign-source income, even if the inventory is purchased in the United States and the income from the sale is not subject to foreign tax.

U.S. corporations generally pay U.S. tax on their worldwide income. Corporations are allowed a tax credit against their U.S. tax liability on foreign income for the amount of income tax paid abroad on that income. The credit is limited to the U.S. tax liability that would have been assessed on that income. If the corporation paid more foreign tax on foreign income than it would have paid on otherwise identical domestic income, the firm has excess foreign tax credits. The title passage rule allows a company with excess foreign tax credits to classify more of its export income as foreign source than it could justify solely on the basis of the location of its business activities, implicitly giving the company an export subsidy. About half of the export income of such companies is effectively exempted from U.S. tax. Replacing the title passage rule with an activity-based rule, which would apportion income on the basis of actual economic activity, would increase tax revenues by $1.4 billion in 2000 and by $36.5 billion over the 2000-2009 period.

Export subsidies increase investment and employment in export industries, but most economists agree that such subsidies do not increase the overall levels of domestic investment and domestic employment as a result of foreign-exchange effects that cause imports to increase as much as exports. That reduces investment and employment in import-competing industries in the United States. Export subsidies distort the allocation of resources domestically and abroad and result in the United States receiving fewer imports in exchange for exports. In addition, the existing rule gives U.S. multinational exporters a competitive advantage over U.S. exporters that conduct all of their business domestically. Current allocation rules make U.S. corporations with excess foreign tax credits more competitive with foreign corporations operating in the same markets; U.S. corporations without foreign tax credits do not receive that advantage. Finally, the U.S. income tax treaty system, established since the title passage rule was enacted 70 years ago, often protects U.S. export sales income from local taxation in the country where the goods are sold. Because export sales income is not usually subject to foreign tax, it may not be appropriate to allow foreign tax credits to be used to offset U.S. tax liability on that income.

REV-21 TREAT FOREIGN SALES CORPORATIONS LIKE OTHER FOREIGN SUBSIDIARIES

	Added Revenues (Billions of dollars)
Annual	
2000	1.0
2001	2.1
2002	2.3
2003	2.5
2004	2.7
2005	2.9
2006	3.1
2007	3.3
2008	3.5
2009	3.7
Cumulative	
2000-2004	10.6
2000-2009	27.1

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-20

The tax code subsidizes U.S. exports through rules for foreign sales corporations (FSCs). Those rules offer U.S. companies an opportunity to exempt about 15 percent of their export income from U.S. tax by characterizing it as income of a foreign subsidiary that is not effectively connected with a U.S. trade or business. According to a decision by the governing council of the General Agreement on Tariffs and Trade (GATT), export income can be exempted from U.S. tax only if the economic activity that produces the income takes place outside the United States. In response to the GATT decision, the Congress amended the tax code to allow U.S. companies to charter FSCs in low-tax countries and either supply goods to the FSCs for resale abroad or pay commissions to them on export sales.

Many FSCs are largely paper corporations with very few employees. Under the tax code, when a U.S. company sells exports through an FSC, about 23 percent of the total income from production and marketing is attributed to the FSC and about 65 percent of the FSC's export income is exempt from U.S. tax. The exempt income, which is approximately 15 percent of the income from the sale, remains free from U.S. tax when the company receives it as a dividend from the FSC. The rules provide an incentive for U.S. taxpayers to locate investment domestically.

Export subsidies, such as FSCs, reduce global economic welfare and may even reduce the welfare of the country granting the subsidy, even though domestic export-producing industries may benefit. FSC rules may reduce the incentive for U.S. corporations to move economic activity, such as manufacturing, abroad. However, the effects of export subsidies on foreign exchange, which raise the value of the dollar and lower the cost of imports, cause imports and exports to increase. Consequently, companies in import-competing industries reduce domestic investment and employment.

This option would curtail the subsidy resulting from FSC rules by treating FSCs like other foreign subsidiaries. In general, all of the income repatriated from FSCs would be subject to U.S. tax. The tax on any income from an FSC that was deemed foreign-source income could be offset by unused foreign tax credits. This option would increase tax revenues by $1 billion in 2000 and by $27.1 billion over the 2000-2009 period.

REV-22 MAKE FOREIGN SUBNATIONAL TAXES DEDUCTIBLE RATHER THAN CREDITABLE

	Added Revenues (Billions of dollars)
Annual	
2000	2.3
2001	4.8
2002	5.0
2003	5.3
2004	5.5
2005	5.8
2006	6.1
2007	6.4
2008	6.7
2009	7.0
Cumulative	
2000-2004	22.7
2000-2009	54.9

SOURCE: Joint Committee on Taxation.

Under current law, U.S.-owned corporations deduct U.S. state and local income taxes from taxable income, but they receive tax credits for income taxes paid to foreign governments, including foreign subnational governments, such as states, cities, and provinces. That may favor foreign over domestic investment if the combination of federal and local income taxes imposed on domestic income exceeds the foreign tax imposed on the same type and amount of foreign-source income. U.S. local income taxes are only deductible against U.S. federal income taxes; however, all foreign income taxes generally can be credited against U.S. federal income taxes. That situation may affect the decisions of U.S. taxpayers regarding whether to invest here or abroad.

This option would equalize the tax treatment of domestic and foreign subnational income taxes by allowing corporations to credit foreign taxes to the extent that they exceed a fixed percentage of foreign-source income or a fixed percentage of foreign income taxes. The fixed percentage would be set to reflect the overall U.S. ratio of local to federal income taxes. Taxes for which credits are denied under this option would be deducted from foreign-source gross income to yield foreign-source taxable income. The rule could defer to or override existing tax treaties.

Making the federal tax treatment of foreign subnational income tax payments consistent with the tax treatment of domestic state and local income tax payments would increase tax revenues by $2.3 billion in 2000 and $54.9 billion over the 2000-2009 period. It would also level the playing field between domestic and foreign investment: it would reduce the slight incentive that U.S.-based multinational corporations have to make additional investments in countries where the overall level of foreign income tax on a foreign investment is lower than the combination of U.S. federal and local tax on domestic investment. In turn, equalizing the tax rates between foreign and domestic investment would increase the economic efficiency of the international allocation of capital.

In some cases, however, removing the creditability of foreign subnational income taxes would make U.S. corporations operating in a foreign country less competitive with other foreign corporations operating in that country. In addition, firms would probably reduce their repatriation of income from prior overseas investments to avoid paying the additional U.S. tax required under the provision. Finally, if foreign countries implemented similar rules for the U.S.-earned income of their corporations, the amount of capital flowing into the United States might decline.

REV-23-A INCLUDE ACCRUED CAPITAL GAINS IN THE LAST INCOME TAX RETURN OF THE DECEASED

	Added Revenues (Billions of dollars)
Annual	
2000	a
2001	11.2
2002	12.0
2003	10.5
2004	8.6
2005	7.5
2006	7.3
2007	7.2
2008	7.0
2009	6.8
Cumulative	
2000-2004	42.3
2000-2009	78.1

SOURCE: Joint Committee on Taxation.

a. Gain of less than $50 million.

RELATED OPTIONS:

REV-04, REV-23-B, and REV-24

A capital gain or loss is the difference between the current value of a capital asset and the owner's basis. The owner's basis is the initial cost of the asset plus the cost of any subsequent improvements and minus any deductions for depreciation. When a capital asset is sold, tax law normally requires that the owner include any realized gain in taxable income. The owner may deduct any realized losses against realized gains, and when the owner has no gains in excess of losses, he or she may deduct up to $3,000 of the loss against other income.

An exception occurs when an owner holds an asset until death. In that case, tax law allows the inheritor to "step up" the basis to the asset's value as of the date of the decedent's death. When the asset is sold, the inheritor pays income tax on the gain that accrued after the decedent's death. The gain that accrued before the decedent's death is permanently excluded from taxable income. The estate of the decedent may pay taxes under the separate estate tax, but that tax applies equally to assets on which the decedent previously paid income tax and to assets with accrued capital gains that had escaped income taxation.

Stepping up basis at death provides a tax break for capital gains income not available for other income such as wages, interest, and rental income. That encourages people to hold assets until death that they would have preferred to sell earlier. If holding those assets until death offered less of a tax benefit, people would feel freer to adjust their asset holdings as their circumstances changed. Furthermore, stepping up basis at death has spawned many tax-sheltering schemes in which, for example, people borrow against their assets for current consumption but have the loan paid off by selling the assets after they die.

A disadvantage of taxing gains at death is that the tax might force the decedent's family to sell assets to pay the tax. Sales of illiquid assets at an inopportune time can reduce their value substantially. Forcing heirs to sell a family farm or business would impose a particular hardship on families wanting to continue the enterprise. Another disadvantage of taxing gains at death is that the decedent may have left inadequate documentation of the asset's basis.

Taxing accrued but unrealized gains on the final income tax return of the decedent would raise about $78.1 billion from 2000 through 2009. This option would exclude gains on assets that a spouse inherits. Instead, the spouse would assume the basis of the decedent and pay tax on the full gain only when the asset was sold. Any gains on assets that the decedent left to charity would also be exempt. This option also includes special provisions to defer taxes for family businesses, allow use of the exclusion for gains on a home, and exclude small gains on personal property. About 10 percent of decedents would owe taxes on accrued gains on their final income tax return. Finally, taxes paid on gains realized at death would be deductible under the estate tax.

REV-23-B ENACT CARRYOVER BASIS FOR CAPITAL GAINS HELD UNTIL DEATH

	Added Revenues (Billions of dollars)
Annual	
2000	a
2001	0.9
2002	1.7
2003	2.8
2004	3.9
2005	5.2
2006	6.0
2007	6.9
2008	7.9
2009	9.1
Cumulative	
2000-2004	9.3
2000-2009	44.4

SOURCE: Joint Committee on Taxation.

a. Gain of less than $50 million.

RELATED OPTIONS:

REV-04, REV-23-A, and REV-24

Carrying over a decedent's basis in assets (known as carryover basis) is an alternative to taxing gains held at death on the last income tax return of a deceased person (see option REV-23-A). Under this option, heirs would adopt the basis of the decedent on assets they inherit. The decedent's capital gains would then be taxed when the heirs sold the assets. To allow for inadequate recordkeeping by decedents on an asset's basis, the option would allow heirs to set the basis of an inherited asset at 50 percent of the asset's current value. In addition, if the decedent's estate paid any estate tax, shares of that tax would be added to the basis of all of the estate's assets in proportion to the assets' share of the estate's value. This option would raise roughly $44.4 billion from 2000 through 2009.

Carryover basis would avoid a major disadvantage of taxing gains on the final income tax return of the deceased: the heirs would not be faced with an overwhelming tax bill that could force the sale of the assets at an inopportune time. Carryover basis could also ease the way for a family seeking to continue to operate the deceased's business. But it would not ease the problem of inadequate recordkeeping by the deceased, except to the extent that the 50 percent rule suggested above would create a safe harbor.

Carryover basis would achieve some of the objectives of taxing gains on the final tax return of the deceased. It would make most gains held at death taxable eventually, removing some of the inequity that arises from never taxing gains held until death. Furthermore, it would reduce the barrier to adjusting asset holdings before death as circumstances change. Finally, it would reduce the rewards to tax shelters that provide access to investment funds before death without an outright sale of the asset until after death. Carryover basis would succeed less in achieving those objectives than would taxing gains at death, however, because it would still provide the benefits of deferral for heirs who could afford to postpone the sale of inherited assets with large capital gains.

Gains held until death have always been exempt from income tax. The Congress enacted a carryover basis in the Tax Reform Act of 1976 but postponed it in 1978 and repealed it in 1980. Therefore, it never took effect. The primary objection voiced in the Congress at the time carryover basis was repealed was that recordkeeping by many asset owners would be inadequate for their heirs to document basis.

REV-24 ELIMINATE LIKE-KIND EXCHANGES

	Added Revenues (Billions of dollars)
Annual	
2000	0.1
2001	0.6
2002	0.6
2003	0.6
2004	0.6
2005	0.7
2006	0.7
2007	0.7
2008	0.7
2009	0.7
Cumulative	
2000-2004	2.5
2000-2009	6.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-04, REV-23-A, and REV-23-B

The tax law requires that people who sell or exchange capital assets report any capital gain or loss as income. An exception occurs for exchanges of certain like-kind assets, mainly real estate. No gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a like kind that is to be held for the same reasons. In those exchanges, the gain in the original property carries over to the new property, and its recognition is deferred until the new property is sold. Like-kind real estate assets are broadly defined as any properties located in the United States.

Exchanges can involve the concurrent swapping of like-kind property between two owners, but in many exchanges a single owner sells one property to a second party and purchases a replacement property from a third party. For those transactions to qualify as like-kind exchanges, the proceeds from the sale of the original property must be held outside the seller's control—for example, by a qualified intermediary—and used to purchase the replacement property. In addition, the like-kind replacement property must be designated within 45 days and purchased within 180 days.

Capital gains cannot be deferred on the trading of many financial assets. Any gain from the selling of one stock to purchase another and of a share in one partnership to purchase another is taxable in the year exchanged. Gains from trades of bonds, mortgages, and other debt instruments are taxed similarly. Eliminating the deferral for like-kind exchanges would tax people who buy and sell real estate the same way as people who buy and sell stocks, bonds, or shares in partnerships. The option would raise $6 billion from 2000 to 2009.

A justification for continuing like-kind exchanges is that the new property is a continuation of the same investment as the previous one, and no tax should be levied until the owner leaves that line of investing. When properties are swapped without cash payments, no money becomes available for payment of the tax. Furthermore, allowing like-kind exchanges facilitates property exchanges in response to changing conditions of the taxpayer or property markets. But those justifications apply to many exchanges of stocks, bonds, and partnership shares as well and therefore do not support continuing the current differential tax treatment of those assets. One reason for either continuing the current differential treatment or phasing it out slowly is that many investors purchased properties with the understanding that they would be able to exchange them for other properties without paying capital gains taxes. Changing the treatment abruptly would impose hardships on some investors and could possibly depress property prices. Finally, some tax-deferred swaps of corporate equities are permitted, such as those that take place in business mergers.

In 1987, the Ways and Means Committee passed a provision limiting the amount of gain that can be deferred under like-kind exchanges of real property to $100,000. In 1989, the committee considered limiting deferral of gain to exchanges of properties that are similar or related in service or use. That stricter standard already applies to gains on involuntary conversions. In 1997, the Treasury Department proposed that the same standard be applied to real estate exchanges.

REV-25 CONVERT THE CREDIT FOR STATE DEATH TAXES TO A DEDUCTION

	Added Revenues (Billions of dollars)
Annual	
2000	0
2001	3.7
2002	3.8
2003	4.1
2004	4.3
2005	4.6
2006	4.8
2007	5.2
2008	5.3
2009	5.7
Cumulative	
2000-2004	15.9
2000-2009	41.5

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-26 and REV-27

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on transfers at death. One of the credits used to offset final tax liability is for state death taxes: a fraction of the taxes paid to states is directly deductible from federal estate and gift tax liability.

Gift and estate taxes together constitute a unified tax: one progressive tax is imposed on cumulative transfers during life and at death. Credits built into the system have always excluded most transfers from taxation, so less than 2 percent of deaths result in an estate tax filing. The Taxpayer Relief Act of 1997 increased the credits for the first time since the late 1980s to prevent the number of estates subject to tax from rising and to lower the taxes paid by taxable estates.

The credit for state death taxes built into the federal estate tax system lowered revenues by about $3.8 billion in 1996, which is over 25 percent of total revenue in that year. State death taxes currently reduce a taxpayer's federal tax liability by a credit that ranges from 0.8 percent on transfers of $40,000 to 16 percent on transfers of more than $10 million. When enacted in 1926, the credit sometimes virtually eliminated the federal tax liability because the top marginal rate in the federal estate and gift tax was 20 percent.

The credit acts as a state revenue-sharing system for estates taxed up to the 16 percent exclusion level. Consequently, a majority of states have adopted state death tax systems that simply redistribute estate tax revenues from the federal to state governments. That shift is accomplished by imposing state death taxes according to a schedule that exactly matches the amount of the federal credit.

Changing the credit to a deduction would raise about $41.5 billion over the 2000-2009 period and would correspond to the treatment of state and local income and property taxes as itemized deductions under the federal income tax. The immediate effect of changing the credit to a deduction would be to raise the effective tax rate on state death taxes from zero to one minus the marginal tax rate under the federal estate tax, which ranges from 37 percent to 55 percent for positive tax liabilities. That would cause the biggest increase in taxes for taxpayers in states where death taxes are high.

In the long run, states may choose to change their own death tax rules to partially restore the levels and distribution of effective estate tax rates. If states behave that way, reduced state tax revenues will offset any increase in federal tax revenues, and the reduced state revenues will have to be made up by some other changes in state-level taxes or spending.

REV-26 INCLUDE LIFE INSURANCE PROCEEDS IN THE BASE FOR ESTATE TAXES

	Added Revenues (Billions of dollars)
Annual	
2000	0
2001	0.5
2002	0.5
2003	0.5
2004	0.5
2005	0.5
2006	0.6
2007	0.6
2008	0.6
2009	0.7
Cumulative	
2000-2004	2.0
2000-2009	5.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-25 and REV-27

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on transfers at death. One form of wealth transfer gets preferential treatment under the estate tax: payouts on life insurance policies are not counted as transferred wealth if the owner of the policy is not the decedent. Including life insurance proceeds in the tax base would raise estate tax revenues by about $5 billion between 2000 and 2009.

Gift and estate taxes together constitute a unified tax: one progressive tax is imposed on cumulative transfers during life and at death. Credits built into the system have always excluded most transfers from taxation, so that less than 2 percent of deaths result in an estate tax filing. The Taxpayer Relief Act of 1997 increased the credits for the first time since the late 1980s to prevent the number of estates subject to tax from rising and to lower the taxes paid by taxable estates.

Wealth transferred at death through life insurance is generally not subject to estate tax; if the policyowner is not the decedent, the policy payout amount is not taxable. Thus, one important element of estate tax planning during a wealthy taxpayer's lifetime is to make life insurance payments, with the intended heirs as the beneficiaries, directly or through trust arrangements. Premiums paid are not taxed as long as the amounts are below the $10,000 annual gift exclusion.

Life insurance proceeds were first included in the estate tax base in 1918, two years after the modern estate and gift tax system was put in place. The 1918 act included in the base proceeds from policies owned by the decedent and payouts in excess of $40,000 on policies owned by others. In 1942, all proceeds from policies in which the decedent paid the premiums or owned the policies were also made taxable. Legislation enacted in 1954 dropped the "premiums paid" test, leading to the current system in which only policies owned by the decedent are included in the estate tax base.

The tax advantage of excluding life insurance from the base for estate taxes can be significant. The initial transfer of premiums does not affect tax liability because those amounts could be transferred tax-free under the annual $10,000 exclusion for any reason. The real benefit comes later, however, as premiums invested in whole-life plans earn interest and dividends not subject to income tax.

Another argument for excluding life insurance from the base for estate taxes is to lower the cost of transferring wealth when assets are not liquid. For example, the owner of a closely held business can use life insurance to prepay the estate tax that will be liable on the business, and the heirs can avoid having to sell the business to pay the taxes. This option would increase the cost of that practice. The Congress raised the exclusion for closely held businesses in 1997 to help prevent businesses from being sold when the owner dies.

REV-27 ELIMINATE NONBUSINESS VALUATION DISCOUNTS UNDER THE ESTATE TAX

	Added Revenues (Billions of dollars)
Annual	
2000	0
2001	0.5
2002	0.5
2003	0.5
2004	0.6
2005	0.6
2006	0.7
2007	0.7
2008	0.8
2009	0.8
Cumulative	
2000-2004	2.1
2000-2009	5.7

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-25 and REV-26

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on such transfers at death. One accounting practice taxpayers are using is transferring marketable securities, such as stocks and bonds, to holding companies, which then issue shares (claims to the securities) to intended heirs. Although transferred assets are still taxable, the common practice of discounting minority holdings of business assets is often applied to security holding companies to undervalue the assets for the taxable estate computation.

The gift and estate taxes together constitute a unified tax: one progressive tax is imposed on cumulative transfers during life and at death. Credits built into the system have always excluded most transfers from taxation, so that less than 2 percent of deaths result in an estate tax filing. The Taxpayer Relief Act of 1997 increased the credits for the first time since the late 1980s to prevent the number of estates subject to tax from rising and to lower the taxes paid by taxable estates.

The value of minority interests in nonpublicly traded business assets are typically discounted when computing taxable estates. The practice is justified on the grounds that a buyer purchasing a minority share in an ongoing operation would generally not pay market value for the fractional interest because the majority owners can adversely affect the long-term value of the fractional owner's share. For example, if the majority owners are also officers of the company, they could in theory make decisions that would increase their income at the expense of the minority owners. Because the goal of the estate tax system is to tax only the value of the asset that would be paid by a willing buyer, large discounts are standard.

The use of such a practice for nonbusiness assets cannot be defended on the same grounds. In nonbusiness situations, a taxpayer contributes marketable assets to a family limited partnership or limited liability company and simultaneously gives or bequeaths minority interests in the holding company to intended heirs. The taxpayer then claims discounts on those gifts, using the guidelines generally agreed on for transferring business assets. The taxpayer claims a reduced value in the marketable asset simply because it was placed in a holding company before being given or bequeathed.

Restricting the practice of valuation discounts to active businesses would raise $5.7 billion over the 2000-2009 period. The exact proposal would require that interests in an entity be valued at a proportional share of the fair market value of the entity's net worth to the extent that net worth includes readily marketable assets (cash, cash equivalents, foreign currency, publicly traded securities, real property, annuities, royalty-producing assets, non-income-producing property, such as art or collectibles commodities, options, and swaps) when given or bequeathed. If the entity is part of an active business, the net worth held in marketable securities for working capital would be subject to the usual business valuation practices.

REV-28 REDUCE TAX CREDITS FOR REHABILITATING BUILDINGS

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.2
2002	0.2
2003	0.2
2004	0.2
2005	0.2
2006	0.2
2007	0.2
2008	0.2
2009	0.2
Cumulative	
2000-2004	0.9
2000-2009	2.0

SOURCE: Joint Committee on Taxation.

The Congress enacted tax credits for rehabilitation to promote the preservation of historic buildings, encourage businesses to renovate their existing premises rather than relocate, and encourage investors to refurbish older buildings. The credit rate is 10 percent for expenditures on commercial buildings built before 1936 and 20 percent for commercial and residential buildings that the Department of the Interior has certified as historic structures because of their architectural significance.

The credits favor commercial use over most rental housing and may therefore divert capital from more productive uses. Moreover, in favoring renovation over new construction, the credits may encourage more costly ways of obtaining additional housing and commercial buildings.

Rehabilitation may have social benefits when it discourages the destruction of historically noteworthy buildings. The government could promote that objective at a lower cost, however, by permitting a credit only for the renovation of certified historic buildings and lowering the credit rate. Some surveys indicate that a 15 percent credit would be sufficient to cover the extra costs of both obtaining certification and undertaking a rehabilitation of historic quality. Reducing the credit for historic structures to 15 percent and repealing the credit for nonhistoric structures would increase revenues over the 2000-2009 period by about $2 billion. Repealing both credits would raise about $6 billion over the same period.

REV-29 REPEAL THE LOW-INCOME HOUSING CREDIT

	Added Revenues (Billions of dollars)
Annual	
2000	0.1
2001	0.3
2002	0.6
2003	1.0
2004	1.5
2005	1.9
2006	2.3
2007	2.7
2008	3.1
2009	3.6
Cumulative	
2000-2004	3.5
2000-2009	17.0

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

370-06

The low-income housing credit (LIHC) subsidizes the construction and substantial rehabilitation of low-income rental housing. Individuals and corporations who qualify for the LIHC receive tax credits over a 10-year period that are worth up to 70 percent, measured in present value, of the construction or rehabilitation costs of qualifying projects. The percentage is limited to 30 percent for projects that receive other federal subsidies.

To qualify for the LIHC, project owners must set aside at least 20 percent of rental units for families whose income is below 50 percent of area median income, or 40 percent of units for families whose income is below 60 percent of median income. Rents are restricted. The set-aside and rent restrictions apply for at least 15 years. State housing agencies allocate the credits subject to statutory limits.

The LIHC will reduce federal revenue by $3.3 billion in 1998 and is estimated to grow to $3.9 billion in 2001. Repealing the tax credit for new projects would raise $17 billion from 2000 through 2009.

Housing assistance could be provided to the same number of people at lower cost if the assistance was provided in the form of an expanded housing voucher program. Low-income tenants can use housing vouchers to pay for all or part of the rent for the housing of their choice, as long as it meets minimum standards for habitability. By contrast, the low-income housing credit subsidizes only new and substantially rehabilitated housing, which is the most expensive kind of housing.

High overhead costs also make some housing subsidized by the LIHC even more expensive to produce and rent. Private investors in low-income housing syndicates require high rates of return to compensate for the inherent risk of such investments as well as the specific risks imposed by the credit. For example, projects that fail to comply with the requirements of the program may be subject to heavy penalties. In addition, some investors cannot use the credits every year because of the limits on passive losses and on the use of business tax credits. Moreover, the administrative and marketing costs in organizing low-income housing syndicates are high.

Advocates of the LIHC argue that it, in combination with rental assistance subsidies, assists many poor families and can be an important part of neighborhood revitalization efforts. In addition, affordable housing that meets minimal housing standards is scarce in some areas with low-income families. For those reasons, a supply subsidy such as the LIHC might be a more effective policy tool than a demand subsidy such as housing vouchers. Advocates also argue that lower-middle-income people who benefit from the credit are neglected by traditional housing programs, which primarily assist poor families, and that state governments, which allocate the credits, are better able to assess the housing needs of their communities than is the federal government. Finally, budget constraints on discretionary spending might make it difficult to repeal the credit in favor of an expanded voucher program funded by annual appropriations.

REV-30-A TAX CREDIT UNIONS LIKE OTHER THRIFT INSTITUTIONS

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	0.8
2002	0.8
2003	0.9
2004	0.9
2005	0.9
2006	1.0
2007	1.0
2008	1.1
2009	1.1
Cumulative	
2000-2004	3.9
2000-2009	9.0

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-30-B

Credit unions are nonprofit institutions that provide their members with financial services such as accepting deposits and making loans. The federal income tax treats credit unions more favorably than competing thrift institutions, such as savings and loan institutions and mutual savings banks, by exempting their retained earnings from taxation. That situation reduces economic efficiency because different tax treatment of like institutions hinders competition and the provision of services at the lowest cost. In addition, more credit unions and fewer taxable thrift institutions now exist than would otherwise be the case.

Credit unions, savings and loans, and mutual savings banks were originally all tax-exempt, but in 1951 the Congress removed the tax exemptions for savings and loans and mutual savings banks. It considered those institutions to be similar to profit-seeking corporations. Credit unions, unlike the other depository institutions, were designed to be cooperatives whose members shared a common bond.

Since 1951, many credit unions have come to resemble other thrift institutions. Credit unions no longer limit membership to people sharing the common bond of having the same employer or occupation. Since 1982, credit union regulators have allowed credit unions to extend their services to members of other organizations. Although that was legally challenged, recent legislation (the Credit Union Membership Access Act of 1998) allows multiple, unrelated groups to join the same credit union as long as the group has 3,000 or fewer members when it joins the credit union. In addition, most credit unions allow members and their families to participate permanently, even after members have left the sponsoring organization.

Credit union membership has grown from about 5 million in 1950 to about 70 million today. Credit unions, like taxable thrifts, now serve the general public. They also resemble thrift institutions in that they retain earnings. Although credit unions argue that earnings retention protects them against unexpected events, other thrift institutions complain that credit unions use the retained earnings to finance expansion.

Finally, credit unions now provide many of the services offered by savings and loans and mutual savings banks. A significant number of credit unions offer mortgages and car loans, direct deposit, access to automatic tellers, preauthorized payments, credit cards, individual retirement accounts, safe deposit boxes, and discount brokerage services. Moreover, some large credit unions offer electronic account access by telephone as well as business loans.

Taxing credit unions like other thrift institutions would raise $3.9 billion over the five-year period from 2000 to 2004 and $9.0 billion from 2000 to 2009.

REV-30-B TAX CREDIT UNIONS WITH MORE THAN $10 MILLION IN ASSETS LIKE OTHER THRIFT INSTITUTIONS

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	0.7
2002	0.8
2003	0.8
2004	0.8
2005	0.9
2006	0.9
2007	1.0
2008	1.0
2009	1.0
Cumulative	
2000-2004	3.6
2000-2009	8.4

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-30-A

An alternative to taxing all credit unions like other thrift institutions (see option REV-30-A) would be to tax only large credit unions and allow small credit unions to retain their tax-exempt status. Unlike large credit unions, small credit unions are similar to nonprofit mutual organizations and should have similar tax treatment. Most small credit unions have members with a single common bond or association. In some cases, volunteers from the membership manage and staff the credit union. In addition, many of the small credit unions do not provide services comparable with other thrift institutions.

To protect the smaller credit unions, the Congress could choose to tax only credit unions with assets greater than $10 million. Such an action would exempt 8 percent of all assets in the credit union industry and about two-thirds of all credit unions from taxation.

Taxing credit unions with more than $10 million in assets like other thrift institutions would raise $3.6 billion over the five-year period from 2000 to 2004 and $8.4 billion from 2000 to 2009.

REV-31 REPEAL THE EXPENSING OF EXPLORATION AND DEVELOPMENT COSTS FOR EXTRACTIVE INDUSTRIES

	Added Revenues (Billions of dollars)
Annual	
2000	0.4
2001	0.5
2002	0.5
2003	0.5
2004	0.5
2005	0.6
2006	0.6
2007	0.7
2008	0.7
2009	0.7
Cumulative	
2000-2004	2.4
2000-2009	5.7

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-32, REV-33, REV-35, and REV-40

The current tax system favors extractive industries (oil, gas, and minerals producers) over most other industries through various tax preferences (see also option REV-32). One preference allows certain types of oil and gas producers and producers of hard minerals to deduct some exploration and development costs when they are incurred (a process called expensing) rather than over time as the resulting income is generated. That immediate deduction of costs contrasts with the normal tax treatment facing other industries, in which costs are deducted more slowly according to prescribed rates of depreciation or depletion. The Tax Reform Act of 1986 established uniform capitalization rules that require certain direct and indirect costs allocatable to property to be either deducted when inventory is sold or recovered over several years as depreciation deductions (so that any deduction of costs is postponed). However, intangible drilling and development costs and mine development and exploration costs are exempt from those rules. Thus, the expensing of such costs results in a tax preference for extractive industries that other industries do not have. (See options REV-33, REV-35, and REV-40 for other exceptions.)

Expensible exploration and development costs include costs for excavating mines and drilling wells. They also include prospecting costs for hard minerals but not for oil and gas. Although current law allows full expensing for independent oil and gas producers and noncorporate mineral producers, it limits expensing to 70 percent of costs for "integrated" oil and gas producers (companies involved in substantial retailing or refining activities) and corporate mineral producers. Firms subject to the 70 percent limit must deduct the remaining 30 percent of costs over a 60-month period.

Although the original rationale for expensing was that the costs of exploration and development were considered ordinary operating expenses, continuing the preference has been justified on the grounds that oil and gas are "strategic minerals," essential to national energy security. However, expensing distorts the efficient allocation of resources in several ways. First, it causes resources to be overallocated to drilling and mining, when some of those resources might be used more productively elsewhere in the economy. Second, although the preference might reduce dependence on imported oil in the short run, it encourages current extraction, perhaps at the cost of reduced future extraction and greater future reliance on foreign production. Third, expensing may result in an inefficient allocation of production within those extractive industries because the extent of the subsidy depends on factors not systematically related to economic productivity—such as the difference between the immediate deduction and the true useful life of such capital as well as on whether the producer must pay the alternative minimum tax (in which case expensing is limited).

Repealing the expensing of exploration and development costs would improve the allocation of resources and raise $5.7 billion from 2000 through 2009, assuming that firms could still expense costs from unproductive holes and mines.

REV-32 REPEAL THE PERCENTAGE DEPLETION FOR EXTRACTIVE INDUSTRIES

	Added Revenues (Billions of dollars)
Annual	
2000	0.4
2001	0.4
2002	0.4
2003	0.4
2004	0.5
2005	0.5
2006	0.5
2007	0.5
2008	0.5
2009	0.5
Cumulative	
2000-2004	2.1
2000-2009	4.6

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-31 and REV-33

The current tax system favors extractive industries (oil, gas, and mineral producers) over most other industries in various ways. One way is by allowing producers to deduct exploration and development costs when they are incurred (see option REV-31). Another way is by allowing some firms to use the "percentage depletion" method to recover costs rather than the standard "cost depletion" method.

The percentage depletion method of cost recovery allows certain types of extractive companies (independent producers and royalty owners, or nonintegrated companies) to deduct a certain percentage of a property's gross income in each taxable year, regardless of the actual capitalized costs. In contrast, other industries (and since 1975, integrated oil companies as well) use the cost depletion method. Under cost depletion, the costs recovered cannot exceed the taxpayer's expenses in acquiring and developing the property. But under percentage depletion, they may. Thus, the percentage depletion method results in a tax preference for certain types of extractive companies that other companies do not have. Unlike the expensing of exploration and development costs, however, percentage depletion applies only to a small subset of total oil, gas, and minerals production because it excludes the large integrated producers.

Current law typically allows nonintegrated oil and gas companies to deduct 15 percent of the gross income from oil and gas production up to 1,000 barrels per day. The Omnibus Budget Reconciliation Act of 1990 made percentage depletion even more generous, however, for nonintegrated companies that are considered to be "marginal" producers (those with very low total production or production that is entirely made up of heavy oil). The deduction for marginal properties can be up to 25 percent of gross income if the market price of oil drops low enough. Producers of hard minerals may also use percentage depletion, but the statutory percentages vary from 5 percent to 22 percent depending on the type of mineral. Tax law limits the amount of percentage depletion to 100 percent of the net income from an oil and gas property and 50 percent of the net income from a property with hard minerals.

Percentage depletion has been justified on the grounds that oil and gas are "strategic minerals," essential to national energy security. Percentage depletion distorts the allocation of resources, however, by encouraging production in those industries over other types of industries. It can also cause an inefficient allocation of production by extractive businesses in the same way that expensing does as well as in other ways. In particular, percentage depletion subsidizes firms according to gross income and not according to investment. Thus, it encourages developing existing properties over exploring for new ones.

Repealing the percentage depletion for extractive industries would improve the allocation of resources and raise $4.6 billion over the 2000-2009 period.

REV-33 REPEAL THE TAX CREDIT FOR ENHANCED OIL RECOVERY COSTS AND EXPENSING OF TERTIARY INJECTANTS

	Added Revenues (Billions of dollars)
Annual	
2000	0.1
2001	0.1
2002	0.1
2003	0.1
2004	0.1
2005	0.1
2006	0.1
2007	0.1
2008	0.1
2009	0.1
Cumulative	
2000-2004	0.4
2000-2009	0.8

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-31, REV-32, REV-35, and REV-40

RELATED CBO PUBLICATION:

Climate Change and the Federal Budget (Memorandum), August 1998.

The tax code provides a 15 percent credit for the costs of recovering domestic oil by a qualified "enhanced oil recovery" (EOR) method. Qualifying methods are those that allow the recovery of oil that is too viscous to be extracted by conventional methods. The costs of labor, materials, equipment, repairs, intangible drilling, and development qualify for the credit, which is phased out for oil prices above $28 per barrel (adjusted for inflation). Without the credit, EOR would not be realistic because it is more expensive than recovering oil by conventional methods.

In addition, the tax code provides for the expensing of tertiary injectants—the fluids, gases, and other chemicals that are injected into oil or gas reservoirs to extract highly viscous oil. The tax code permits deducting the full cost of the chemical injectants in the year in which the injectants are used to extract oil. The expenditures for injectants also qualify for the 15 percent EOR credit; however, the credit must be subtracted from the deduction if both are claimed for the same expenditure. Without tax incentives, the use of tertiary injectants to extract oil would not be economical.

The EOR credit was enacted as part of the Omnibus Budget Reconciliation Act of 1990 to increase the domestic supply of oil and reduce the demand for imported oil, particularly from producers in the Persian Gulf and other politically unstable areas. The expensing of tertiary injectants was enacted in 1980 for similar reasons but also to ensure that the costs of injectants would be treated the same as intangible drilling costs, which are also expensed.

Both provisions offer capital subsidies to lower the cost of producing oil by unconventional, more expensive methods. Whether the federal government should subsidize the production of high-cost domestic oil depends on the external costs of oil imports. Increased domestic production lessens short-term dependency but depletes domestic resources, encouraging long-term dependency on imports.

The world market price of oil is currently low, and oil production in the United States has been declining. Although the United States is more dependent on foreign oil than it used to be, it is less vulnerable to supply disruptions because of the stockpiling of oil under the Strategic Petroleum Reserve, the weakened power of the Organization of Petroleum Exporting Countries, and the increased competitiveness in world oil markets.

Eliminating both the EOR credit and the expensing of tertiary injectants would increase revenues by $0.8 billion over the 2000-2009 period. Eliminating the EOR credit alone would increase revenues by $0.7 billion, and eliminating expensing alone would increase revenues by $0.1 billion during the same period.

REV-34 REPEAL THE PARTIAL EXEMPTION FOR ALCOHOL FUELS FROM EXCISE TAXES ON MOTOR FUELS

	Added Revenues (Billions of dollars)
Annual	
2000	0.4
2001	0.5
2002	0.5
2003	0.5
2004	0.5
2005	0.5
2006	0.5
2007	0.5
2008	0.5
2009	0.5
Cumulative	
2000-2004	2.4
2000-2009	5.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-45 and 270-03

The tax code imposes excise taxes on motor fuels, but it partially exempts fuels that are blends of gasoline and alcohol. Repeal of the partial excise tax exemption would raise $5 billion in revenues over the 2000-2009 period. That estimate assumes that the Congress also repeals the alcohol fuels credit, an alternative tax benefit that can be used instead of the partial excise tax exemption. The credit, however, is in almost all cases less valuable than the exemption and is rarely used.

Ethanol (an alcohol fuel produced primarily from corn and sugar) used as a fuel is eligible for a nonrefundable tax benefit (through credit or exemption) of up to 54 cents per gallon. The exact size of the tax benefit depends on the percentage of alcohol in the fuel and whether the alcohol was made from a fossil (nonrenewable) or nonfossil (renewable) fuel source. The exemption applies only to alcohol fuels produced from nonfossil fuel sources. For example, gasohol, which is 90 percent gasoline and 10 percent ethanol (a renewable source) receives a 5.4 cents per-gallon exemption from the 18.3 cents per-gallon tax on gasoline.

The Transportation Equity Act of 1998 extended the ethanol fuels credit, which had been scheduled to expire at the end of fiscal year 1999. The tax benefit rate drops to 53 cents per gallon for 2001 to 2002, 52 cents per gallon for 2003 to 2004, and 51 cents per gallon for 2005 to 2007. The entire tax benefit is now scheduled to expire at the end of fiscal year 2007.

One purpose of the tax benefit—enacted in the late 1970s—was to increase national security by reducing the demand for imported oil and thereby reduce U.S. dependence on foreign oil sources. Another purpose was to provide an additional market for U.S. agricultural products by encouraging domestic production of ethanol. Over the past several years, U.S. environmental action has increased the value of ethanol by mandating the oxygen content of motor fuels in many areas of the country. Use of oxygenated fuels in motor vehicles generally produces less carbon monoxide pollution than does gasoline. The tax benefit appears to have successfully encouraged energy producers to substitute ethanol for gasoline.

The Clean Air Act Amendments of 1990, however, reduced the need for the partial excise exemption by mandating the minimum oxygen content of gasoline used in areas with poor air quality. Moreover, since ethanol production uses more resources than gasoline production, the allocation of resources resulting from the partial exemption may be economically inefficient if the value of those resources in alternative uses outweighs the value of the reduction in air pollution.

Repealing the excise tax exemption could result in higher federal outlays for price support loans for grains. But any increase in outlays—not included in the budget estimates shown above—would probably be much smaller than the estimated revenue increase.

REV-35 CAPITALIZE THE COSTS OF PRODUCING TIMBER

	Added Revenues (Billions of dollars)
Annual	
2000	0.3
2001	0.5
2002	0.5
2003	0.5
2004	0.5
2005	0.4
2006	0.4
2007	0.4
2008	0.4
2009	0.4
Cumulative	
2000-2004	2.3
2000-2009	4.4

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-31, REV-33, and REV-40

The current tax system allows timber producers to deduct ("expense") most of the production costs of maintaining a timber stand when those costs are incurred. That tax treatment contrasts with the uniform capitalization rules applied to most other industries. (See options REV-31, REV-33, and REV-40 for other exceptions.) Established under the Tax Reform Act of 1986 (TRA-86), such rules require that production costs not be deducted until the sale of the produced goods or services. When businesses do not account for costs properly, business income is not measured correctly because the costs of producing goods and services are not matched with the sale of the goods and services.

Although the costs of planting a timber stand are in fact subject to capitalization rules, subsequent maintenance and production costs are not. Timber producers can expense indirect carrying costs, such as property taxes, interest, insurance costs, and administrative overhead, as well as the costs of labor and materials to remove unwanted trees and to control fire, disease, and insects. By allowing timber producers to deduct such production costs before the timber is harvested or sold, the tax code in effect subsidizes timber production by deferring tax that producers otherwise would owe on their income. (Under certain circumstances, however, the deferral granted to noncorporate producers of timber may be greatly curtailed by the limits of the tax code on losses from passive business activities.)

The original rationale for expensing timber production costs was a general perception that such costs were maintenance costs and thus deductible as ordinary costs of a trade or business. When TRA-86 established uniform capitalization rules, the general reason given for exempting timber costs was that applying the rules to those industries might have been unduly burdensome.

Expensing timber production costs distorts investment behavior in two ways: more private land is devoted to timber production, and trees are allowed to grow longer before they are cut. Unless timber growing offers spillover benefits to society that are not captured by market prices, the tax preference leads to an inefficient allocation of resources and an inefficient harvesting rate.

Whether or not timber production offers important spillover benefits is unclear. Standing timber provides some spillover benefits by deterring soil erosion and absorbing carbon dioxide (a gas linked to global warming), but cutting timber can lead to soil erosion. In addition, producing and disposing of wood and paper products contribute to pollution.

Capitalizing the costs of timber production incurred after December 31, 1999, would raise $4.4 billion in revenue from 2000 through 2009 by accelerating tax payments from timber producers. In the long run, capitalizing timber production costs would raise the price of domestic timber and lower the value of land used to grow it. Moreover, lease payments to private land owners by timber growers would probably fall, causing some land that historically has been devoted to growing timber to be used in other ways. In the short run, however, capitalizing timber production costs might lower the price of domestic timber because producers would have an incentive to harvest it earlier.

REV-36 REPLACE CORPORATE CREDIT WITH A DEDUCTION FOR EMPLOYER FICA ON CERTAIN TIP INCOME

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.3
2002	0.3
2003	0.3
2004	0.3
2005	0.3
2006	0.3
2007	0.3
2008	0.3
2009	0.4
Cumulative	
2000-2004	1.4
2000-2009	3.1

SOURCE: Joint Committee on Taxation.

Since 1993, employers in the food and beverage industry have been entitled to a nonrefundable corporate income tax credit against Federal Insurance Contributions Act (FICA) taxes paid on employee tips (except for any amount of tips that makes up the difference between regular wages and the minimum wage). Replacing that tax credit with a deduction, which is the standard tax treatment for such labor costs, would increase revenues by $3.1 billion from 2000 to 2009.

Until 1988, all employers were required to pay FICA tax on tips only to the extent that the federal minimum wage exceeded the actual wage paid by the employer. Following a proposal in the President's budget, the Omnibus Budget Reconciliation Act of 1987 expanded the definition of wages subject to FICA tax to include all cash tips.

Opponents of the expanded definition of wages tried to repeal it several times. One provision in the Revenue Act of 1992 would have retained the expanded definition for FICA purposes but would have granted a full, nonrefundable credit against the new FICA tax as part of the general business credit, which applies mostly to corporate taxpayers. Legislators used that indirect approach because Congressional budget rules make lowering Social Security revenues particularly difficult. Although both houses passed the bill, President Bush pocket-vetoed it.

A similar provision was finally enacted as part of the Omnibus Budget Reconciliation Act of 1993, but the credit applied only to tips received at food and beverage establishments. The Small Business Job Protection Act of 1996 expanded the credit to tips received in connection with food served for takeout or delivered off premises, relaxed restrictions on the timing of affected wages, and allowed the credit to apply to tips not reported by the employee.

Proponents of replacing the credit with a deduction argue that the credit creates jobs. But because the credit grants a tax preference to a specific industry (food service) and a specific form of compensation (tips), the credit could be creating jobs in one sector at the cost of more productive jobs in other sectors. Proponents also assert that tips differ from wages since they are paid by customers, not employers. From an economic perspective, however, tips are the same as wages because they are earned by employees for services performed. Tips could be considered self-employment income, but such treatment would greatly increase the administrative burden of tax collection.

Because the wages of waiters and waitresses are much lower than those of most employees, the credit makes the overall tax system more progressive, at least to the extent that the credit is passed through by the recipient firms to the servers instead of to the customers, shareholders, or higher-paid employees.

REV-37 REPEAL THE "LOWER OF COST OR MARKET" INVENTORY VALUATION METHOD

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.4
2002	0.3
2003	0.3
2004	0.3
2005	0.1
2006	0.1
2007	0.1
2008	0.1
2009	0.1
Cumulative	
2000-2004	1.5
2000-2009	2.0

SOURCE: Joint Committee on Taxation.

Under the inventory valuation method called "lower of cost or market" (LCM), businesses may deduct immediately the accrued losses on year-end inventories but defer paying tax on gains until the year of sale. That situation provides favorable tax treatment, although only to firms using the first-in, first-out method of inventory accounting. Furthermore, under either the LCM or the cost method of inventory valuation, firms may deduct immediately any losses from inventory goods that arise from damage, imperfections, broken lots, or certain other causes (subnormal goods method). In that case as well, firms receive favorable tax treatment to the extent that such goods are sold—and hence income is realized—in later tax years.

This option would repeal LCM and the subnormal goods method of inventory valuation for all firms with gross receipts averaging more than $5 million annually over a three-year period. It would therefore require the businesses to value their inventories at cost and include in taxable income both gains and losses from the change in inventory value only when those goods are sold. The Administration proposed this option in its past four budgets.

LCM not only causes a timing mismatch between recognition of gains and losses, but it also has two mechanical shortcomings. First, once a firm has reduced the value of inventories using the LCM method, it need not ever record an increase in the value, even if the actual value of the inventories subsequently rises. Second, the definition of market value is somewhat skewed. Retailers are allowed to deduct losses on inventory following a markdown of the retail price, even if the new retail price remains above the original cost. Those shortcomings could be addressed, however, without repealing the LCM method.

This option would increase revenues by $2 billion over the 2000-2009 period. The increase in liability has two components—a one-time increase from the revaluation of existing inventory to exclude unrealized (accrued) losses and a smaller, permanent increase from growth in the excluded losses over time. Because the option phases in the new rules, the one-time revaluation component raises liability every year for four years. The permanent component increases over time because unrealized losses grow annually.

REV-38 TIGHTEN RULES ON INTEREST DEDUCTIONS FOR CORPORATE-OWNED LIFE INSURANCE

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.4
2002	0.4
2003	0.4
2004	0.4
2005	0.5
2006	0.5
2007	0.5
2008	0.5
2009	0.6
Cumulative	
2000-2004	1.8
2000-2009	4.4

SOURCE: Joint Committee on Taxation.

Corporations purchase life insurance policies in part as protection against financial loss from the death of their more important employees or owners. Purchases of cash-value life insurance provide a tax benefit if corporations indirectly finance them by increasing debt or other liabilities and then deduct the resulting interest expense from taxable income. The Internal Revenue Service disallows the interest deduction if it can establish a direct link between increases in debt or other liabilities and the purchase of cash-value insurance. A direct link is difficult to establish, however, because firms increase liabilities for many purposes.

This option would disallow a proportion of a firm's total interest deductions equal to the proportion of its total assets invested in cash-value life insurance policies. The option would not apply to insurance on the life of owners with 20 percent or more interest in the firm. It would raise an estimated $4.4 billion over the 2000-2009 period.

The tax code allows the tax benefit by exempting the investment income (or "inside buildup") of a life insurance policy from corporate income tax and permitting a corporation to deduct from taxable income the interest on debt that is indirectly used to finance the investment. Such asymmetric treatment provides an opportunity for tax arbitrage because corporations can generate interest deductions that they can use to shelter other taxable income. Individuals may not use that tax benefit because the tax code does not allow them to deduct those interest payments.

In 1996, the Congress disallowed the deductibility of interest on loans from an insurance company with the cash-value policy as collateral (with exceptions for insurance on certain key employees). In 1997, the Congress enacted a proportional disallowance of interest deductions, but it applied only to firms that purchase cash-value insurance on the life of people who were not employees or owners. This option would further disallow such interest deductions except for purchases of insurance on the life of those who own at least 20 percent of the firm. The Administration has proposed this option in its past two budgets. In 1986, the Congress also enacted a similar disallowance of a proportion of interest deductions for financial institutions that purchased state and local government securities whose interest was tax-exempt.

Opponents of this option argue that a firm may have business reasons to purchase life insurance policies on its employees and owners as well as other business reasons to issue debt and that the firm may not be linking the two decisions to create a tax shelter. Proponents of the option, however, argue that firms intend to use the policies and debt as tax shelters.

REV-39 REPEAL TAX-FREE CONVERSIONS OF LARGE C CORPORATIONS TO S CORPORATIONS

	Added Revenues (Billions of dollars)
Annual	
2000	a
2001	a
2002	a
2003	0.1
2004	0.1
2005	0.1
2006	0.1
2007	0.1
2008	0.1
2009	0.1
Cumulative	
2000-2004	0.2
2000-2009	0.7

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Under current law, a C corporation may reduce taxes on some income by electing to be treated as an S corporation or converting to a partnership. The income of C corporations is generally taxed twice, once when it is earned by the corporation and again when it is distributed to stockholders. S corporation and partnership income is taxed only once, at the personal tax rates of the firm's owners. Over time, the distinction between S corporations and partnerships has become somewhat blurred, but conversion from a C corporation to either of those two corporate forms continues to receive differential tax treatment.

The election of S corporation filing status receives preferential tax treatment compared with conversion to a partnership. Converting to an S corporation is tax-free under many situations; converting to a partnership is taxable and requires the corporation to recognize any built-in gain on its assets and the shareholders to recognize any such gain in their corporate stock. Under section 1374 of the Internal Revenue Code, if a C corporation converts to an S corporation, the appreciation of the corporation's assets while it was a C corporation is not subject to the corporate-level tax unless the assets are sold within 10 years of the conversion. Current law allows a corporation to avoid the two-tier corporate tax by converting tax-free to an S corporation.

This option would repeal tax-free conversions for corporations with a value of more than $5 million at the time of conversion, thereby making the tax treatment of the two types of conversions more similar. When a C corporation with a value of over $5 million converted, to an S corporation, the corporation and its shareholders would immediately recognize the gain in their appreciated assets. This option would increase income tax revenues by $0.7 billion over the 2000-2009 period.

Repealing those tax-free conversions would equalize the tax treatment of economically similar conversions from two-tier corporate systems to single-tier flow-through systems, reducing the effect of tax considerations on decisions about organizational form. For people who think S corporations more closely resemble corporations than they do flow-through entities, such as partnerships, preserving the current differential tax treatment may be considered beneficial. According to that viewpoint, current law merely allows a corporation to change its filing status from that of C corporation to S corporation, providing it meets the legal requirements, without having to pay tax for changing its choice of corporate form.

REV-40 REPEAL THE EXPENSING OF CERTAIN AGRICULTURAL COSTS

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	2.9
2002	1.6
2003	0.9
2004	0.6
2005	0.4
2006	0.3
2007	0.3
2008	0.4
2009	0.4
Cumulative	
2000-2004	6.5
2000-2009	8.2

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-31, REV-33, and REV-35

Like its treatment of some costs of producing timber, the current tax code allows most farmers—except farm corporations, partnerships, and tax shelters—to expense (deduct immediately) certain capital outlays and production costs, even when such investments generate income over several years. That tax treatment contrasts with the depreciation and uniform capitalization rules applicable to most other industries, which deduct such costs more slowly. (See options REV-31, REV-33, and REV-35 for other exceptions.)

Agricultural expenses qualifying for immediate deduction include tool purchases; the costs of breeding, feeding, and raising livestock; certain soil and water conservation expenses; fertilizer purchases; and the development and planting expenses of crops that require two years or less between planting and harvesting.

Because in many cases such investments produce income over a period exceeding one year, expensing those costs understates income in the year of deduction and overstates income in the year of realization. Thus, farmers can defer taxes, which reduces their effective tax rate. The Tax Reform Acts of 1976 and 1986 limited the use of expensing for farm corporations and tax-shelter operations; the 1986 act required most other types of businesses to deduct production and resale costs more slowly according to the uniform capitalization rules. Thus, current law regarding expensing of agricultural costs favors production of small farms over that of larger ones and of the agricultural industry in general over most other industries. Such a tax preference can lead to an inefficient allocation of resources.

The original justification for the expensing of such costs, however, was to simplify financial recordkeeping for farmers. Although the administrative costs of recordkeeping are clearly lower today than they used to be, it may still be simpler for farmers to deduct costs in one period than in several periods.

Agriculture receives other special tax treatment as well. One example is income averaging, in which farmers may elect to average all or a portion of taxable income over the previous three-year period in computing current year tax liability. The Tax and Trade Relief Extension Act of 1998 made that provision permanent to mitigate the adverse tax consequences resulting from fluctuating income levels. The 1998 act also extended the carryback period for net operating losses from two to three years for farming losses incurred from disasters that have been designated as such by the President.

Subjecting all farms to the normal depreciation and uniform capitalization rules would level the tax treatment among businesses and industries, neutralizing the effects of the tax system on economic decisions. Such a change would raise $8.2 billion in revenue from 2000 through 2009.

REV-41 ELIMINATE EXEMPTION OF INCOME FOR COOPERATIVELY OWNED ELECTRIC AND TELEPHONE UTILITIES

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.3
2002	0.3
2003	0.3
2004	0.3
2005	0.3
2006	0.3
2007	0.3
2008	0.4
2009	0.4
Cumulative	
2000-2004	1.4
2000-2009	3.1

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

270-05, 270-06, and 270-07

RELATED CBO PUBLICATIONS:

Should the Federal Government Sell Electricity? (Study), November 1997.

Electric Utilities: Deregulation and Stranded Costs (Paper), October 1998.

Electric and telephone cooperatives, which are owned by their customers, are effectively or explicitly exempt from corporate income tax. Eliminating those tax exemptions and taxing those co-ops as regular for-profit corporations would raise $0.2 billion in 2000 and $3.1 billion over the 2000-2009 period.

Cooperatives may exclude from income amounts that they are required to distribute as dividends to their members. In addition to that exclusion, electric and telephone co-ops also may exclude earnings from other sources from taxable income, as long as at least 85 percent of their income is collected from members for providing their primary service (electricity or telephone service). Some forms of outside income are not even counted toward the remaining 15 percent, including rental income from telephone poles that are leased to cable or telephone companies and income from the Yellow Pages, cable TV, and Internet access. In addition, distributions of dividends to cooperative members, whether cash or payments in kind in the form of household utility services, are free from income tax. Eliminating the tax exemption on dividends to individuals could generate additional revenues.

Those tax breaks, along with the low-interest loan program available through the Rural Utilities Service (see option 270-05) were created to encourage the wiring of rural areas for service. However, since 95 percent of the United States is already connected to the electricity grid, the cost to distributors is probably the same for rural and urban customers. Moreover, all electric cooperatives have those subsidies, even generation cooperatives, which may not need subsidies. Generating electricity does not cost more in rural areas.

If the tax exemption ends and cooperatively owned electric and telephone utilities must pay the same corporate income tax as other suppliers of electricity, then electricity rates to the cooperatives' customers may rise. Electric and telephone co-ops would be subject to taxes that other co-ops do not pay. Privately owned utilities claim, however, that subsidies to rural cooperatives are unnecessary and unfair. If electricity is deregulated, this tax exemption will treat electric cooperatives differently than the investor-owned utilities they will be competing with for customers. If policymakers decide that subsidies are needed for distributing electricity in rural areas, a more direct approach would be through universal service provisions, which would provide a fund to subsidize the wire portion of the electricity service.

REV-42 INCREASE THE EXCISE TAX ON CIGARETTES BY 50 CENTS PER PACK

	Added Revenues (Billions of dollars)
Annual	
2000	4.9
2001	6.4
2002	6.3
2003	6.3
2004	6.3
2005	6.2
2006	6.2
2007	6.1
2008	6.1
2009	6.0
Cumulative	
2000-2004	30.2
2000-2009	60.8

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-44

RELATED CBO PUBLICATIONS:

Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels (Study), August 1990.

The Proposed Tobacco Settlement: Issues from a Federal Perspective (Paper), April 1998.

Taxes on certain goods and services can influence consumer choices, causing people to purchase less of the taxed items. That generally leads to a less efficient allocation of society's resources unless some costs associated with the taxed items are not reflected in their price. Tobacco creates costs to society that are not reflected in its pretax cost. Examples of those "external costs" include higher health insurance costs to cover the medical expenses linked to smoking and the effects of cigarette smoke on the health of nonsmokers. Taxes increase prices and can result in consumers paying the full cost of smoking.

Currently, the federal cigarette excise tax is 24 cents per pack; it will increase to 34 cents in 2000 and 39 cents in 2002. (Other tobacco products have similar taxes.) Federal tobacco taxes raised about $5.8 billion in fiscal year 1998, about 0.3 percent of total federal revenues. Increasing the cigarette tax by 50 cents a pack (in addition to the scheduled increases) would increase net revenue by $61 billion between 2000 and 2009. State excise taxes will average about 40 cents per pack in 1999. In addition, a settlement reached between state attorneys general and major tobacco manufacturers requires payments equivalent to an excise tax of about 35 cents per pack.

Some economists estimate the external costs of smoking to be significantly less than those taxes and fees, but others think that taxes should be increased more. Technical issues cloud the debate; for example, the magnitude of the health impact of secondhand smoke is uncertain. But much of the debate involves varying theories, such as whether to consider the health effects on the smoker's family or the public health and pension savings that arise because smokers have shorter lives.

Increasing excise taxes may be desirable regardless of the magnitude of external costs if consumers underestimate the harm of smoking or how addictive nicotine is. Teenagers, especially, may not be prepared to evaluate the long-term effects of beginning to smoke. However, all populations know that smoking has health risks.

Increasing excise taxes leads to reduced consumption of tobacco. Each 10 percent increase in cigarette prices is likely to lead to a decline in cigarette consumption of 2.5 percent to 5 percent, probably with a larger decline for teenagers.

Both because lower-income people are more likely to smoke than higher-income people and because expenditures on cigarettes for those who smoke do not rise appreciably with income, taxes on tobacco are regressive; that is, such taxes take up a greater percentage of income for low-income families than for middle- and upper-income families.

Several bills introduced in the last Congress proposed raising the excise tax. In his 2000 budget, the President proposed an increase of 55 cents per pack in the tobacco tax.

REV-43 INCREASE ALL ALCOHOLIC BEVERAGE TAXES TO $16 PER PROOF GALLON

	Added Revenues (Billions of dollars)
Annual	
2000	3.6
2001	4.4
2002	4.4
2003	4.5
2004	4.5
2005	4.5
2006	4.5
2007	4.6
2008	4.6
2009	4.6
Cumulative	
2000-2004	21.4
2000-2009	44.2

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-44

RELATED CBO PUBLICATION:

Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels (Study), August 1990.

Federal excise taxes on distilled spirits, beer, and wine raised $7.5 billion in fiscal year 1998, about 13 percent of all excise tax revenue and almost 0.5 percent of total federal revenues. Current federal excise taxes on beer and wine remain much lower than the federal excise tax on distilled spirits in tax per ounce of ethyl alcohol. The current tax on distilled spirits of $13.50 per proof gallon results in a tax of about 21 cents per ounce of alcohol. The current tax on beer of $18 per barrel results in a tax of about 10 cents per ounce of alcohol (assuming an alcohol content for beer of 4.5 percent), and the current tax on table wine of $1.07 per gallon results in a tax of about 8 cents per ounce of alcohol (assuming an average alcohol content of 11 percent).

Increasing the federal excise tax to $16 per proof gallon for all alcoholic beverages would raise about $44 billion between 2000 and 2009. A tax of $16 per proof gallon is equivalent to about 25 cents per ounce of ethyl alcohol. It would raise the tax on a 750-milliliter bottle of distilled spirits from about $2.14 to $2.54, the tax on a six-pack of beer from about 33 cents to 81 cents, and the tax on a 750-milliliter bottle of table wine from about 21 cents to 70 cents.

Alcohol consumption creates costs to society not reflected in the pretax cost of alcoholic beverages. Examples of those "external costs" include health costs covered by the public, productivity losses borne by others, and the loss of lives and property in alcohol-related accidents and crime. Calculating those costs creates both practical and theoretical difficulties, but a study sponsored by the National Institute on Alcohol Abuse and Alcoholism estimated the external economic costs of alcohol abuse to be over $80 billion in 1992.

By raising the price of alcoholic beverages, excise taxes generally result in consumers paying more of the costs of drinking. Studies consistently show that higher prices lead to lower consumption and less abuse of alcohol, even among heavy drinkers. Therefore, increasing taxes would reduce the total external costs of alcohol abuse.

Increasing excise taxes to reduce consumption may be desirable regardless of the effect on external costs if consumers are either unaware of or underestimate the harm that their drinking causes to them and others or how addictive alcohol can be.

Taxes on alcoholic beverages are regressive when compared with annual family income; that is, such taxes take up a greater percentage of income for low-income families than for middle- and upper-income families. In addition, alcohol taxes fall not only on problem drinkers but also on drinkers who impose no costs on society and are thus unduly penalized. Taxes are also likely to reduce consumption by some light drinkers who would have received beneficial health effects.

REV-44 INDEX TOBACCO AND ALCOHOL TAX RATES FOR INFLATION

	Added Revenues (Billions of dollars)
Annual	
2000	0.2
2001	0.5
2002	0.7
2003	1.1
2004	1.3
2005	1.7
2006	2.1
2007	2.4
2008	2.8
2009	3.0
Cumulative	
2000-2004	3.8
2000-2009	15.8

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-42 and REV-43

RELATED CBO PUBLICATIONS:

Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels (Study), August 1990.

The Proposed Tobacco Settlement: Issues from a Federal Perspective (Paper), April 1998.

Federal alcohol and tobacco taxes raised over $13 billion in 1998, including about $7.5 billion from taxes on distilled spirits, beer, and wine and about $5.8 billion from taxes on tobacco. Together those taxes represented nearly one-quarter of revenues from all excise taxes and almost 0.8 percent of total federal revenues. Tobacco and alcohol excise taxes are currently imposed on a per-unit basis. In the absence of legislation, their real cost declines with inflation. For example, despite several small legislative increases, excise taxes on distilled spirits have declined by nearly 80 percent in real terms since 1951.

Indexing the tax rates for tobacco and alcoholic beverages for inflation would raise nearly $16 billion in the 2000-2009 period. Indexing those tax rates would prevent inflation from eroding real tax rates and would avoid the need for abrupt nominal increases in the future.

Smoking and drinking create costs to society that are not reflected in the pretax prices of tobacco and alcoholic beverages, which cover only production and distribution costs. Examples of those "external costs" include medical expenses linked to smoking and drinking that are covered by the public, the effects of cigarette smoke on the health of nonsmokers, and the loss of lives and property in alcohol-related accidents.

By raising the price of tobacco and alcoholic beverages, excise taxes can result in consumers paying the full cost of smoking and drinking. Since increased excise taxes lead to reduced consumption of tobacco and alcoholic beverages, such increases will reduce the total external costs of smoking and drinking. If those external costs come mainly from heavy or abusive consumption by a minority of consumers, however, higher excise taxes could unduly penalize moderate and occasional smokers and drinkers.

Taxes on tobacco and alcoholic beverages are regressive when compared with annual family income; that is, such taxes are a greater percentage of income for low-income families than for middle- and upper-income families. In recent years, tobacco taxes have become increasingly regressive as the smoking rate has declined faster among wealthier groups.

An alternative to indexing would be to convert to ad valorem taxes, which equal a percentage of the manufacturer's price. That method would link tax revenues to price increases, although it would tie revenues to the price of taxed goods, not the general price level. A shortcoming of the ad valorem tax is that it creates incentives for manufacturers to artificially lower the prices they charge company-controlled wholesalers, thus reducing their tax liability.

REV-45 INCREASE MOTOR FUEL EXCISE TAXES BY 12 CENTS PER GALLON

	Added Revenues (Billions of dollars)
Annual	
2000	10.9
2001	14.6
2002	14.4
2003	14.4
2004	14.6
2005	15.0
2006	15.3
2007	15.6
2008	16.0
2009	16.3
Cumulative	
2000-2004	68.9
2000-2009	147.0

SOURCE: Joint Committee on Taxation.

RELATED OPTION:

REV-34

RELATED CBO PUBLICATION:

Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels (Study), August 1990.

Increasing petroleum taxes could encourage conservation by making petroleum more expensive, reduce pollution, and decrease the country's dependence on foreign oil suppliers while raising significant amounts of revenue.

Imposing new or higher petroleum taxes would raise petroleum prices and reduce consumption. To the extent that taxes on oil reduced the demand for imported oil, foreign suppliers would absorb part of the tax through lower world oil prices. To the extent that petroleum taxes reduced petroleum consumption, the taxes would also reduce carbon dioxide emissions and could therefore help reduce global warming.

Taxing petroleum is not the only way of reducing dependence on foreign oil supplies. Stockpiling oil would arguably be a better way of coping with the risks of increased dependence on imports because it would not artificially reduce current energy use by households and businesses. That argument is based on the premise that aside from the problem of interruptions in supply, world oil prices accurately reflect real resource costs and thus already provide an appropriate incentive to conserve.

A tax increase would reduce consumption of gasoline and diesel fuel by encouraging people to drive less or purchase more fuel-efficient cars and trucks. In addition, the tax would offset, though imperfectly, the costs of pollution and road congestion that automobile use produces. A rate increase on motor fuel taxes would not adversely affect U.S. producers relative to foreign producers because final consumers and the domestic transportation industry purchase most of the motor fuel. Moreover, the overall motor fuel tax rate is low in the United States compared with the rates in other countries.

Increasing tax rates on motor fuels would impose an added burden on the trucking industry and on people who commute long distances by car, who are not necessarily the highway users who impose the highest costs of pollution and congestion on others. Pollution and congestion costs are much higher in densely populated areas, primarily in the Northeast and coastal California, whereas per capita consumption of motor fuel is highest in rural areas. In addition, taxes on gasoline and other petroleum products take up a greater percentage of income for low-income families than for middle- and upper-income families.

Federal motor fuel taxes are currently 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel fuel. A 12 cent increase would raise revenue by $10.9 billion in 2000 and $147 billion over the 2000-2009 period. It would raise the total federal tax rate for gasoline to 30.4 cents per gallon. To bolster the overall budget, the Congress could allocate the increased revenues to the general fund—as it did in 1998—rather than use the additional revenues to finance further highway spending.

REV-46-A TAX WATER POLLUTANTS ON THE BASIS OF BIOLOGICAL OXYGEN DEMAND

	Added Revenues (Billions of dollars)
Annual	
2000	1.4
2001	2.1
2002	1.9
2003	1.9
2004	1.8
2005	1.8
2006	1.7
2007	1.7
2008	1.7
2009	1.7
Cumulative	
2000-2004	9.1
2000-2009	17.6

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-B, REV-47-A, REV-47-B, REV-47-C, and REV-47-D

Major facilities that discharge pollutants directly into water or indirectly into sewer systems have to abide by regulations that specify pollution abatement technology or impose concentration limits on their discharges. Taxes on water pollutants discharged by those facilities could encourage further reductions in pollution below the level required by current regulations. Taxes can reduce pollution cost-effectively by encouraging firms with the lowest abatement costs to reduce pollution, allowing firms with high abatement costs to continue polluting and pay the tax. Reductions in discharges caused by the tax would increase welfare if the additional abatement costs were less than or equal to the social benefits from reduced pollution levels.

According to a recent survey of water quality submitted to the Environmental Protection Agency by states, tribes, and other jurisdictions, over 36 percent of the nation's surveyed rivers, lakes, and estuaries fail to meet water-quality standards at some time during the year. Organic water pollutants contribute to that failure by depleting the oxygen in the water as they decompose. Dissolved oxygen is necessary to sustain fish and other aquatic life. Biological oxygen demand (BOD) measures the intensity of oxygen-demanding wastes in water. (One BOD equals 1 milligram of oxygen consumed per 2.2 pounds of effluent.)

One option is to impose a tax on the level of BOD in discharges. Generally, firms subject to water pollution standards do not pay taxes or fees on effluents (discharges) that regulations still allow. Most of the high-volume BOD dischargers, sometimes referred to as point sources, are publicly owned treatment works (POTWs), paper and pulp mills, food processors, metal producers, and chemical plants. Discharges by point sources total about 12.5 million pounds of effluent per day, and publicly owned treatment works discharge about 8.4 million pounds of that amount.

The cost of controlling discharges at POTWs and many industries subject to Clean Water Act regulations averages about 50 cents to 75 cents per pound of effluent removed. A charge on BOD levels in discharges could encourage manufacturing facilities and POTWs with lower abatement costs to reduce pollution. Assuming effluents record an average concentration of 22 BOD, a tax of about 65 cents per pound of effluent discharged would raise $9.1 billion from 2000 through 2004 and about $17.6 billion over the 2000-2009 period.

The costs of administering a BOD water pollution excise tax would be small because allowable levels of BOD discharges are specified in the permits that state and local governments issue to regulated sources of water pollution. Levying a tax on effluents from POTWs and large industrial dischargers would ensure that the tax base included all of the largest dischargers of BOD. The tax option, however, might raise constitutional issues about federal taxation of local governments. In that case, POTWs (or a federal authority) could collect the tax directly from polluters that discharge into municipal sewer systems.

REV-46-B IMPOSE AN EXCISE TAX ON TOXIC WATER POLLUTANTS

	Added Revenues (Billions of dollars)
Annual	
2000	0.1
2001	0.2
2002	0.2
2003	0.2
2004	0.2
2005	0.2
2006	0.2
2007	0.2
2008	0.2
2009	0.2
Cumulative	
2000-2004	0.9
2000-2009	1.7

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-A, REV-47-A, REV-47-B, REV-47-C, and REV-47-D

RELATED CBO PUBLICATION:

Decreasing the Discharge of Bioaccumulative Toxic Water Pollutants: A Policy Analysis (Memorandum), December 1992.

Taxes on major facilities that discharge water pollutants can both raise revenue and provide incentives for firms to reduce pollution cost-effectively (see option REV-46-A). Harmful levels of toxic chemicals and metals in the water are a key concern because they do not readily break down in natural ecosystems, allowing them to accumulate in the environment. One option is to impose a tax of varying rates on companies that discharge certain toxic substances.

Manufacturers in the United States discharged more than 170 million pounds of toxic substances into water directly in 1996 and more than 230 million pounds into water indirectly through sewers. Toxic pollutants generally include organic chemicals (such as solvents and dioxins), metals (such as mercury and lead), and pesticides. Those pollutants may threaten the aquatic environment and human health.

The amount of environmental harm that toxic water pollutants cause depends on their toxicity. The Environmental Protection Agency (EPA) has devised a weighing method to indicate the toxicity of various pollutants. Using that weighing system makes it possible to measure the quantities of different types of toxic pollutants by their "toxic pound equivalents," which the EPA defines as the pounds of the pollutant multiplied by its toxic weight. This option adopts tax rates developed by the Congressional Research Service (CRS) in a study on the discharges of manufacturing firms in 1987. CRS defined five categories of pollutants on the basis of their toxicities. The tax rates varied from 65 cents per pound for the least toxic category of pollutants to $63.40 per pound for the most toxic category. Those rates correspond to a charge of $32.35 for the equivalent of each toxic pound. The variable tax rates provide firms with a greater incentive to reduce their most toxic discharges.

According to the EPA, the cost of controlling the equivalent of an incremental toxic pound varies among industries, ranging from $1.50 to $606.00 (in 1991 dollars). The tax, therefore, could encourage industries and firms with low abatement costs to reduce their toxic discharges and would raise $1.7 billion from 2000 through 2009.

The Internal Revenue Service could use information that the EPA's Toxic Release Inventory (TRI) provides on toxic discharges by manufacturing firms to assess tax payments, or the EPA could collect the tax on behalf of the Internal Revenue Service. An important consideration, however, is that the accuracy of TRI data is questionable. The TRI contains self-reported data, and many facilities that meet the reporting requirements fail to file reports or file inaccurate ones. To improve the accuracy of the TRI database and enhance enforcement, frequent auditing would be necessary.

REV-47-A IMPOSE A TAX ON SULFUR DIOXIDE EMISSIONS

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	0.8
2002	0.7
2003	0.7
2004	0.6
2005	0.6
2006	0.6
2007	0.5
2008	0.5
2009	0.5
Cumulative	
2000-2004	3.3
2000-2009	6.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-A, REV-46-B, REV-47-B, REV-47-C, REV-47-D, and REV-48

RELATED CBO PUBLICATION:

Factors Affecting the Relative Success of EPA's NO_x Cap-and-Trade Program (Paper), June 1998.

Under the Clean Air Act, the Environmental Protection Agency (EPA) sets national standards for ambient air quality designed to protect public health and welfare. The EPA defines acceptable levels for six "criteria" air pollutants: sulfur dioxide (SO_2), nitrogen oxides (NO_x), ozone, particulate matter, carbon monoxide (CO), and lead. Along with emissions from natural sources, emissions of air pollutants from stationary sources (such as industrial facilities and commercial operations) and mobile sources (automobiles, trains, and airplanes) contribute to the ambient levels of those criteria pollutants.

Sulfur dioxide belongs to the family of sulfur oxide gases formed during the burning of fuel containing sulfur (mainly coal and oil) and during the operation of metal smelting and other industrial processes. Exposure to high concentrations of SO_2 may promote respiratory illnesses or aggravate cardiovascular disease. In addition, SO_2 and NO_x emissions are considered the main cause of acid rain, which the EPA believes degrades surface waters, damages forests and crops, and accelerates corrosion of buildings.

The Clean Air Act Amendments of 1990 adopted a new acid rain control program that introduces a market-based system for emission allowances to reduce SO_2 emissions. An emission allowance is a limited authorization to emit a ton of SO_2. The EPA allots tradable allowances to affected electric utilities according to their past fuel use and statutory limits on emissions. Once the allowances are allotted, the act requires that annual SO_2 emissions not exceed the number of allowances held by each utility plant. Firms may trade allowances, bank them for future use, or purchase them through periodic auctions held by the EPA. Firms with relatively low abatement costs have an economic incentive to reduce emissions and sell surplus allowances to firms that have relatively high abatement costs.

In general, taxes on emissions can also help reduce pollution in a cost-effective manner by encouraging firms with the lowest abatement costs to reduce pollution and allowing firms with high abatement costs to continue polluting and pay the tax. The following three options (REV-47-B, REV-47-C, and REV-47-D) would also base tax rates on an estimate of the average cost of reducing an additional ton of pollution. Consequently, some firms with lower-than-average abatement costs might reduce their pollution levels below allowable standards.

One option is to tax emissions of SO_2 from stationary sources not already covered under the acid rain program. Imposing a tax of $200 per ton of SO_2 emissions from those sources would raise roughly $6 billion over the 2000-2009 period. Most firms do not pay taxes or fees on emissions that regulations still allow, although major stationary sources must pay fees annually to cover program costs of operation permits under the Clean Air Act Amendments of 1990. Basing the tax on the terms granted in those air pollution permits would minimize the cost of administering the tax for the Internal Revenue Service. Opponents argue that such a tax would impose an additional burden on many firms that already incur costs to comply with current regulations on emissions.

REV-47-B IMPOSE A TAX ON NITROGEN OXIDE EMISSIONS

	Added Revenues (Billions of dollars)
Annual	
2000	6.7
2001	9.7
2002	9.2
2003	8.9
2004	8.7
2005	8.5
2006	8.3
2007	8.2
2008	8.2
2009	8.2
Cumulative	
2000-2004	43.2
2000-2009	84.7

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-A, REV-46-B, REV-47-A, REV-47-C, REV-47-D, and REV-48

RELATED CBO PUBLICATION:

Factors Affecting the Relative Success of EPA's NO_x Cap-and-Trade Program (Paper), June 1998.

Nitrogen oxides (NO_x) usually enter the air as the result of high-temperature combustion processes such as those found in automobiles and power plants. Nitrogen oxides play an important role in the atmospheric reactions that generate ground-level ozone (smog) and acid rain. The Environmental Protection Agency (EPA) believes that nitrogen oxides can irritate the lungs and lower resistance to respiratory infections such as influenza. NO_x and pollutants formed from NO_x can be transported over long distances, so problems associated with the pollutant are not confined to areas where NO_x are emitted.

The Clean Air Act (CAA) requires states to implement programs to reduce ground-level ozone. Since NO_x and ozone can be transported long distances, the CAA requires upwind states to establish programs that will help downwind states meet statutory standards. The EPA ruled in 1998 that 22 northeastern states and the District of Columbia have to revise their plans to further reduce NO_x emissions. The rule does not mandate how NO_x are to be reduced but gives each affected state a NO_x emission target. The goal of the rule is to have programs in place by 2003 that reduce NO_x emissions by about 1.2 million tons in the affected states by 2007.

In addition, the EPA is encouraging the formation of a regional NO_x allowance trading program similar to the national SO_2 trading program. Such a program could be structured to encourage firms with relatively low costs for abatement to reduce their emissions and sell surplus NO_x allowances to firms that have relatively high costs for abatement.

One way to help control NO_x would be to tax the stationary sources of NO_x that do not participate in the regional NO_x allowance trading program. The cost of controlling NO_x from stationary sources ranges between $600 and $10,000 per ton abated. A tax of $1,500 per ton of NO_x emissions from stationary sources would encourage abatement at facilities with lower abatement costs. For example, firms might adopt currently available abatement techniques whose capitalized costs are lower than the tax they would otherwise pay. A tax at that level would raise about $39 billion from 2000 to 2009. Those revenue estimates assume high participation in a NO_x regional allowance trading program. If the states declined to participate in a regional allowance trading program and sources in those states were subject to the tax, the proposed tax would raise about $85 billion over the 2000-2009 period.

Proponents of pollution taxes argue that such taxes discourage activities that impose costs on society. Opponents argue that the additional cost to firms of such a tax may be greater than the additional benefits to society. Accurate estimates of additional social benefits from reducing pollution levels may not exist in some cases.

REV-47-C IMPOSE A TAX ON PARTICULATE MATTER

	Added Revenues (Billions of dollars)
Annual	
2000	0.5
2001	0.7
2002	0.6
2003	0.6
2004	0.6
2005	0.6
2006	0.6
2007	0.6
2008	0.6
2009	0.6
Cumulative	
2000-2004	3.0
2000-2009	6.0

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-A, REV-46-B, REV-47-A, REV-47-B, REV-47-D, and REV-48

Particulate matter (PM) is the general term used for a mixture of solid particles and liquid droplets found in the air. Those particles come in a wide range of sizes: fine particles are less than 2.5 micrometers in diameter, and coarse particles are larger than 2.5 micrometers. The particles originate from many different stationary and mobile sources as well as from natural sources. Fine particles result from fuel combustion in motor vehicles, power generation, and industrial facilities as well as from residential fireplaces and wood stoves. Coarse particles are generally emitted from power plants and factories and sources such as vehicles traveling on unpaved roads, materials handling, and crushing and grinding operations as well as from windblown dust. Some particles are emitted directly from their sources such as smokestacks and cars. In other cases, gases such as sulfur dioxide (SO_2), nitrogen oxides (NO_x), and volatile organic compounds interact with other compounds in the air to form PM.

According to Environmental Protection Agency (EPA) studies, emissions of PM (alone or combined with other air pollutants) are linked to some adverse health effects. For example, particulate matter can carry heavy metals and cancer-causing organic compounds into the lungs, increasing the incidence and severity of respiratory diseases. Other health effects may include increased hospital admissions and emergency room visits for respiratory-related illnesses and chronic bronchitis.

Under the Clean Air Act, the EPA sets national standards for ambient air quality and is directed to review those standards every five years. In 1997, the EPA completed its review of the standards, finalized standards for fine particulate matter, and revised those for ozone and coarse particulate matter. The new standard for fine particles will require that a national monitoring network be established before states can develop plans showing how areas will attain the new PM standard. Under the EPA's current timetable, states would begin to submit plans for controlling fine PM for EPA approval in 2005. The deadline for compliance with the new standard for fine PM is approximately 2017.

Since monitoring systems and a permit system are already in place for coarse particle emissions, one option would be to tax such emissions from stationary sources. That tax could be administered similarly to the taxes on SO_2 and NO_x. A tax of $500 per ton of coarse PM would raise about $6 billion from 2000 through 2009. A tax on coarse PM may cause some electric utilities and manufacturing plants to install improved electrostatic precipitators, wet scrubbers, or other equipment to reduce their PM emissions and lower their tax burden. Reductions in emissions caused by the tax would be economically efficient if the additional abatement costs were less than the social benefits from reduced pollution.

Opponents of such a tax argue that it would impose an excessive burden on firms that already incur costs to comply with current standards. Furthermore, to the extent that a tax on PM would eventually raise the price of energy, it might be regressive.

REV-47-D IMPOSE A TAX ON VOLATILE ORGANIC COMPOUNDS

	Added Revenues (Billions of dollars)
Annual	
2000	12.0
2001	17.3
2002	16.3
2003	15.5
2004	14.8
2005	14.2
2006	13.7
2007	13.7
2008	13.8
2009	13.9
Cumulative	
2000-2004	75.9
2000-2009	145.3

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-46-A, REV-46-B, REV-47-A, REV-47-B, REV-47-C, and REV-48

Ground-level ozone has remained a pervasive pollution problem in many areas of the United States. Ozone is not emitted directly into the air but is formed by the reaction of volatile organic compounds (VOCs) and nitrogen oxides (NO_x) in the presence of heat and sunlight. Ozone occurs naturally in the stratosphere (the upper atmosphere) and provides a protective layer high above the earth. At ground level, however, ozone is the prime ingredient of smog. Short-term exposures (one to three hours) to ambient ozone concentrations have been linked to increased hospital admissions and emergency room visits for respiratory causes. Repeated exposure to ozone may make people more susceptible to respiratory infection and lung inflammation. In 1997, the Environmental Protection Agency (EPA) revised the national ambient air-quality standards for ozone. The new standard will replace the 0.12 parts per million (ppm) standard measured over one hour with a more stringent 0.08 ppm standard measured over eight hours.

To control ozone pollution, the EPA has traditionally focused on reducing emissions of VOCs (and, more recently, NO_x). VOCs include chemicals such as benzene, toluene, methylene chloride, and methyl chloroform. VOCs are released from burning fuel (gasoline, oil, wood, coal, natural gas, and the like) or from using solvents, paints, glues, and other products.

One option is to tax emissions of VOCs from stationary sources. (See options REV-47-B and REV-48 on taxing emissions of NO_x and emissions from mobile sources, respectively.) Those sources range from huge industrial facilities, such as chemical plants, petroleum refineries, and coke ovens, to small sources, such as bakeries and dry cleaners. The vast number and diversity of stationary sources make it difficult to estimate emissions and the cost of abatement. A tax of $3,000 per ton on all VOC emissions from stationary sources might promote some abatement and would generate slightly over $145 billion in revenues from 2000 through 2009.

The advantage of a broad-based tax on VOCs is that it would affect large and small sources of the compounds. The EPA estimates that the small sources account for a large portion of emissions from stationary sources. Because stationary sources emitting less than 2.5 tons of VOCs per year are not currently subject to federal regulation, however, a broad-based VOC tax would be administratively harder to implement than a tax on the large sources alone. Imposing the tax on small sources of VOCs through technology-based estimates of emissions rather than measured emissions would reduce administrative costs but it would also somewhat reduce the incentive to emit less. A disadvantage of such a broad-based tax is that it may be regressive. To the extent that the tax raises the prices of consumer goods, including food, it may take up a larger share of household income for low-income consumers than for higher-income consumers.

REV-48 IMPOSE A ONE-TIME TAX ON EMISSIONS FROM NEW AUTOMOBILES AND LIGHT TRUCKS

	Added Revenues (Billions of dollars)
Annual	
2000	2.0
2001	2.9
2002	2.9
2003	2.9
2004	2.9
2005	2.9
2006	2.9
2007	2.9
2008	2.9
2009	2.9
Cumulative	
2000-2004	13.6
2000-2009	27.9

SOURCE: Joint Committee on Taxation.

RELATED OPTIONS:

REV-47-A, REV-47-B, REV-47-C, and REV-47-D

The Clean Air Act Amendments of 1990 strengthened the components of the earlier law that addressed mobile sources of pollution. They raised the tailpipe standards for cars, buses, and trucks and expanded inspection and maintenance programs to include more regions with pollution problems and to promote more stringent testing. The amendments also introduced several regulations to reduce air pollution from mobile sources, including regulations for selling improved gasoline formulations in some polluted cities to reduce pollutant levels. In addition, the amendments provided new programs that tighten emission standards for vehicles to encourage the development of even cleaner cars and fuels.

Despite progress to date in controlling air pollution from motor vehicles, mobile sources continue to significantly affect national air quality. On average nationwide, highway motor vehicles account for over one-quarter of all volatile organic compound (VOC) emissions, almost one-third of nitrogen oxide (NO_x) emissions, and about 60 percent of carbon monoxide (CO) emissions. A tax on emissions from mobile sources could provide an additional incentive for consumers to purchase cleaner cars and trucks, which could help to reduce emissions from those sources.

One option is to tax emissions of NO_x, VOCs, and CO from mobile sources. A one-time tax imposed on new automobiles and light trucks could be based on grams of NO_x, VOCs (measured in grams of hydrocarbons), and CO emitted per mile as estimated by the emissions tests that the Environmental Protection Agency requires for every new vehicle. The tax could be administered like the "gas guzzler" excise tax. The auto dealer would collect the tax on behalf of the Internal Revenue Service from the vehicle's purchaser.

Such a tax averaging $250 per new passenger car and light-duty truck could raise $27.9 billion in revenues from 2000 through 2009. Vehicles made in earlier years have been excluded from the estimate because of the administrative problems of collecting the tax. A disadvantage of excluding older vehicles, however, is that they account for a larger share of emissions from mobile sources than do new vehicles. Opponents of this option argue that such a tax would raise vehicle prices and therefore might encourage people to delay purchasing new vehicles.

Appendix

Scorekeeping Guidelines

These budget scorekeeping guidelines are to be used by the House and Senate Budget Committees, the Congressional Budget Office, and the Office of Management and Budget (the "scorekeepers") in measuring compliance with the Congressional Budget Act of 1974 (CBA), as amended, and GRH as amended.[1] The purpose of the guidelines is to ensure that the scorekeepers measure the effects of legislation on the deficit consistent with established scorekeeping conventions and with the specific requirements in those Acts regarding discretionary spending, direct spending, and receipts. These rules shall be reviewed annually by the scorekeepers and revised as necessary to adhere to the purpose. These rules shall not be changed unless all of the scorekeepers agree. New accounts or activities shall be classified only after consultation among the scorekeepers. Accounts and activities shall not be reclassified unless all of the scorekeepers agree.

1. CLASSIFICATION OF APPROPRIATIONS: Following (pages 1014-1053 of conference report) is a list of appropriations that are normally enacted in appropriations acts. The list identifies appropriated entitlements and other mandatory spending in appropriations acts, and it identifies discretionary appropriations by category.

2. OUTLAYS PRIOR: Outlays from prior-year appropriations will be classified consistent with the discretionary/mandatory classification of the account from which the outlays occur.

1. Reprinted from U.S. House of Representatives, *Balanced Budget Act of 1997*, conference report to accompany H.R. 2015, Report 105-217 (July 30, 1997), pp. 1007-1012.

3. DIRECT SPENDING PROGRAMS: Entitlements and other mandatory programs (including offsetting receipts) will be scored at current law levels as defined in section 257 of GRH, unless Congressional action modifies the authorization legislation. Substantive changes to or restrictions on entitlement law or other mandatory spending law in appropriations laws will be scored against the Appropriations Committee section 302(b) allocations in the House and the Senate. For the purpose of CBA scoring, direct spending savings that are included in both an appropriation bill and a reconciliation bill will be scored to the reconciliation bill and not to the appropriation bill. For scoring under sections 251 or 252 of GRH, such provisions will be scored to the first bill enacted.

4. TRANSFER OF BUDGET AUTHORITY FROM A MANDATORY ACCOUNT TO A DISCRETIONARY ACCOUNT: The transfer of budget authority to a discretionary account will be scored as an increase in discretionary budget authority and outlays in the gaining account. The losing account will not show an offsetting reduction if the account is an entitlement or mandatory.

5. PERMISSIVE TRANSFER AUTHORITY: Permissive transfers will be assumed to occur (in full or in part) unless sufficient evidence exists to the contrary. Outlays from such transfers will be estimated based on the best information available, primarily historical experience and, where applicable, indications of executive or congressional intent.

This guideline will apply both to specific transfers (transfers where the gaining and losing accounts and the amounts subject to transfer can be ascertained) and general transfer authority.

6. REAPPROPRIATIONS: Reappropriations of expiring balances of budget authority will be scored as new budget authority in the fiscal year in which the balances become newly available.

7. ADVANCE APPROPRIATIONS: Advance appropriations of budget authority will be scored as new budget authority in the fiscal year in which the funds become newly available for obligation, not when the appropriations are enacted.

8. RESCISSIONS AND TRANSFERS OF UNOBLIGATED BALANCES: Rescissions of unobligated balances will be scored as reductions in current budget authority and outlays in the year the money is rescinded.

Transfers of unobligated balances will be scored as reductions in current budget authority and outlays in the account from which the funds are being transferred, and as increases in budget authority and outlays in the account to which these funds are being transferred.

In certain instances, these transactions will result in a net negative budget authority amount in the source accounts. For purposes of section 257 of GRH, such amounts of budget authority will be projected at zero. Outlay estimates for both the transferring and receiving accounts will be based on the spending patterns appropriate to the respective accounts.

9. DELAY OF OBLIGATIONS: Appropriation acts specify a date when funds will become available for obligation. It is this date that determines the year for which new budget authority is scored. In the absence of such a date, the act is assumed to be effective upon enactment.

If a new appropriation provides that a portion of the budget authority shall not be available for obligation until a future fiscal year, that portion shall be treated as an advance appropriation of budget authority. If a law defers existing budget authority (or unobligated balances) from a year in which it was available for obligation to a year in which it was not available for obligation, that law shall be scored as a rescission in the current year and a reappropriation in the year in which obligational authority is extended.

10. CONTINGENT LEGISLATION: **If** the authority to obligate is contingent on enactment of a subsequent appropriation, new budget authority and outlays will be scored with the subsequent appropriation. **If** a discretionary appropriation is contingent on enactment of a subsequent authorization, new budget authority and outlays will be scored with the appropriation. **If** a discretionary appropriation is contingent on the fulfillment of some action by the Executive Branch or some other event normally estimated, new budget authority will be scored with the appropriation and outlays will be estimated based on the best information about when (or if) the contingency will be met. Non-law making contingencies within the control of the Congress are **not** scoreable events.

11. SCORING PURCHASES, LEASE-PURCHASES, CAPITAL LEASES, AND OPERATING LEASES: When a law provides the authority for an agency to enter into a contract for the purchase, lease-purchase, or lease of an asset, budget authority and outlays will be scored as follows:

For lease-purchases and capital leases, budget authority will be scored against the legislation in the year in which the budget authority is first made available in the amount of the estimated net present government's total estimated legal obligations over the life of the contract, except for imputed interest costs calculated at Treasury rates for marketable debt instruments of similar maturity to the lease period and identifiable annual operating expenses that would be paid by the government as owner (such as utilities, maintenance, and insurance). Property taxes will not be considered to be an operating cost. Imputed interest costs will be classified as mandatory and will not be scored against the legislation or for current level but will count for other purposes.

For operating leases, budget authority will be scored against the legislation in the year in which the budget authority is first made available in the amount necessary to cover the government's legal obligations. The amount scored will include the estimated total payments expected to arise under the full term of a lease contract or, if the contract will include a cancellation clause, an amount sufficient to cover the lease payments for the first fiscal year during which the contract is in effect, plus an amount sufficient to cover the costs associated with cancellation of the contract. For funds that are self-insuring under existing authority, only budget authority to cover the annual lease payment is required to be scored.

Outlays for lease-purchase in which the Federal government assumes substantial risk--for example, through an explicit government guarantee of third party financing -- will be spread across the period during which the contractor constructs, manufactures, or purchases the asset. Outlays for an operating lease, a capital lease, or a lease-purchase in which the private sector retains substantial risk, will be spread across the lease period. In all cases, the total amount of outlays scored over time against legislation will equal the amount of budget authority scored against that legislation.

No special rules apply to scoring purchases of assets (whether the asset is existing or is to be manufactured or constructed). Budget authority is scored in the year in which the authority to purchase is first made available in the amount of the government's estimated legal obligations. Outlays scored will equal the estimated disbursements by the government based on the particular purchase arrangement, and over time will equal the amount of budget authority scored against that legislation.

Existing contracts will not be rescored.

To distinguish lease purchases and capital leases from operating leases, the following criteria will be used for defining an operating lease:

-- Ownership of the asset remains with the lessor during the term of the lease and is not transferred to the government at or shortly after the end of the lease period.

-- The lease does not contain a bargain-price purchase option.

-- The lease term does not exceed 75 percent of the estimated economic lifetime of the asset.

-- The present value of the minimum lease payments over the life of the lease does not exceed 90 percent of the fair market value of the asset at the inception of the lease.

-- The asset is a general purpose asset rather than being for a special purpose of the government and is not built to unique specification for the government as lessee.

-- There is a private-sector market for the asset.

Risks of ownership of the asset should remain with the lessor.

Risk is defined in terms of how governmental in nature the project is. If a project is less governmental in nature, the private-sector risk is considered to be higher. To evaluate the level of private-sector risk associated with a lease-purchase, legislation and lease-purchase contracts will be considered against the following type of illustrative criteria, which indicate ways in which the project is less governmental:

-- There should be no provision of government financing and no explicit government guarantee of third party financing.

-- Risks of ownership of the asset should remain with the lessor unless the Government was at fault for such losses.

-- The asset should be a general purpose asset rather than for a special purpose of the Government and should not be built to unique specification for the Government as lessee.

-- There should be a private-sector market for the asset.

-- The project should not be constructed on Government land.

Language that attempts to waive the Anti-Deficiency Act, or to limit the amount or timing of obligations recorded, does not change the government's obligations or obligational authority, and so will not affect the scoring of budget authority or outlays.

Unless language that authorizes a project clearly states that no obligations are allowed unless budget authority is provided specifically for that project in an appropriations bill in advance of the obligation, the legislation will be interpreted as providing obligation authority, in an amount to be estimated by the scorekeepers.

12. WRITE-OFFS OF UNCASHED CHECKS, UNREDEEMED FOOD STAMPS, AND SIMILAR INSTRUMENTS: Exceptional write-offs of uncashed checks, unredeemed food stamps, and similar instruments (i.e., cumulative balances that have built up over several years or have been on the books for several years) shall be scored as an adjustment to the means of financing the deficit rather than as an offset. An estimate of write-offs or similar adjustments that are part of a continuing routine process shall be netted against outlays in the year in which the write-off will occur. Such write-offs shall be recorded in the account in which the outlay was originally recorded.

13. RECLASSIFICATION AFTER AN AGREEMENT: Except to the extent assumed in a budget agreement, a law that has the effect of altering the classification of spending and revenues (e.g., from discretionary to mandatory, special fund to revolving fund, on-budget to off-budget, revenue to offsetting receipt), will not be scored as reclassified for the purpose of enforcing a budget agreement.

14. SCORING OF RECEIPT INCREASES OR DIRECT SPENDING REDUCTIONS FOR ADDITIONAL ADMINISTRATION OR PROGRAM MANAGEMENT EXPENSES: No increase in receipts or decrease in direct spending will be scored as a result of provisions of a law that provides direct spending for administration or program management activities.

15. ASSET SALES: If the net financial cost to the government of an asset sale is zero or negative (a savings), the amount scored shall be the estimated change in receipts and mandatory outlays in each fiscal year on a cash basis. If the cost to the government is positive (a loss), the proceeds from the sale shall not be scored for the purposes of the CBA or GRH.

The net financial cost to the Federal government of an asset sale shall be the net present value of the cash flows from:

(1) estimated proceeds from the asset sale;

(2) the net effect on Federal revenues, if any, based on special tax treatments specified in the legislation;

(3) the loss of future offsetting receipts that would otherwise be collected under continued government ownership (using baseline levels for the projection period and estimated levels thereafter); and

(4) changes in future spending, both discretionary and mandatory, from levels that would otherwise occur under continued government ownership (using baseline levels for the projection period and at levels estimated to be necessary to operate and maintain the asset thereafter).

The discount rate used to estimate the net present value shall be the average interest rate on marketable Treasury securities of similar maturity to the expected remaining useful life of the asset for which the estimate is being made, plus 2 percentage points to reflect the economic effects of continued ownership by the Government.