STATEMENT OF

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Mr. Chairman, I am happy to appear today to discuss the growth in so-called "uncontrollable" spending and to outline some options for reducing growth in these programs in the future.

I do not find the terms "controllable" and "uncontrollable" particularly useful. All parts of the budget can be controlled by the Congress, although some can be controlled more quickly than others. The President's budget classifies as "relatively uncontrollable" items such as payments to individuals mandated under current law, general revenue sharing, farm price supports, interest on the national debt, and prior obligations. These items are difficult to alter <u>in the short run</u>. Payments to individuals mandated under current law, the most rapidly growing part of the budget, can generally not be changed through the appropriations process, but can be altered through amendments to the authorizing legislation. Changing general revenue sharing and farm price support payments also requires modifying the authorizing legislation. Interest on the national debt can only be reduced over a lengthy period through decisions to reduce government borrowing. Outlays from prior-year contracts and obligations cannot be altered in the current year, although they were controllable in the year in which the commitments were made.

Moveover, many outlays that are classified in the President's budget as "controllable" are also difficult to reduce in any one year. Many of these outlays go for programs considered essential by the Congress--national defense and administration of programs mandated by law, for example. Other appropriated outlays are to a great extent fixed in the short run just because people expect continuity from their government and are understandably upset when they do not get it.

The fact that a large part of the budget cannot easily be altered in any one year is not a bad thing. It represents continuity and orderliness in public affairs. Few of us would want a government that failed to honor its contractual obligations or in which social policy as basic as retirement pensions was changed frequently without notice. But the price of such stability is that when a society does want to consider major changes in government activity, it has to be willing to plan ahead.

SPENDING TRENDS

Federal spending has been growing rapidly and has been claiming a gradually increasing share of the gross national product (GNP). Total federal spending increased from 20 percent of GNP in 1970 to 23 percent in 1980 despite a substantial decline during that period in the share of GNP going to national defense. With the reversal of the trend toward lower defense spending, federal spending could soon account for an even higher proportion of GNP unless decisive steps are taken by the Congress.

In this time of intense interest in cutting federal spending, only a small and declining portion of the budget is subject to review on an annual basis through the appropriations process. Excluding mandatory spending, only 25 percent of total outlays were in this category in 1980, but much of that was for national defense (see Table 1). The remainder--nondefense spending subject to review by the appropriations process in a single year--totalled only 10 percent of the budget. Such figures merely highlight what members of this Committee already know--that discretionary appropriated programs have been "crowded out" by the growth in nonappropriated programs.

The largest and most rapidly growing item that is outside the control of the appropriations process is payments to individuals. This category, which accounted for 46 percent of 1980 outlays, includes entitlement programs such as Social Security, Medicare, Medicaid, food stamps, unemployment insurance, and public assistance. It has grown extremely rapidly; in 1970 it accounted for only 31 percent of federal spending.

CAUSES OF GROWTH IN SPENDING

Spending on entitlement programs has grown rapidly in recent years because of

- inflation,
- unemployment,
- new or expanded entitlements, and
- demographic trends.

Of the 329 percent increase in payments to individuals from 1970 to 1980, roughly half was due to inflation and half due to the other three causes combined.

In an effort to protect beneficiaries of entitlement programs against erosion of their real benefits as prices rise, the Congress has indexed many of these programs for inflation. For example, Social Security benefits are adjusted each July to reflect increases in the Consumer Price Index (CPI) the previous year. Food stamp benefits are adjusted annually by a food price index. As a consequence, each one percentage point rise in the CPI increases federal outlays for indexed programs by about $2 billion per year.

Benefit levels in other programs also increase more or less automatically with inflation despite the absence of explicit indexing. The Medicare program pays medical care providers on the basis of reasonable costs that increase with inflation. Benefit amounts in public assistance programs such as Aid to Families with Dependent Children (AFDC) are periodically increased by state governments to maintain subsistence income levels, with the additional costs automatically shared by the federal government.

High unemployment also leads to increased federal outlays. This happens directly through payments to states in support of unemployment insurance benefits and indirectly through increased eligibility for means-tested programs such as Medicaid, AFDC, and food stamps. A one percentage point increase in the unemployment rate increases federal spending by $5 billion to $7 billion per year.

Legislated increases in eligibility and benefits in various programs have also increased spending. In the last two years, qualifying income levels in the food stamps program have been raised, thereby increasing the eligible population and expanding benefit levels. In the Middle Income Student Assistance Act of 1978, the Congress expanded eligibility for the Guaranteed Student Loan Program by eliminating the family income ceiling.

Long-term demographic shifts have also increased spending in these programs. Perhaps the most important shift is the growth in the elderly population, which directly affects outlays for Social Security, Medicare, and Medicaid. Other trends, such as growth in the number of single-parent families and the decline in average family size, affect spending in Medicaid, AFDC, and other programs.

Prospects for future reversal of these spending trends without substantial legislative changes are poor. Most forecasters expect inflation to remain high for some time. Efforts to reduce inflation may keep unemployment rates high. Legislated benefit increases have been continuing. For example, even last year's budget reconcilation act (P.L. 96-499), which was designed to reduce spending, actually increased Medicare benefits. Finally, the proportion of the population aged 65 and over will continue to increase through the 1980s and beyond.

LEGISLATIVE CHANGES THAT WOULD LIMIT SPENDING

While spending trends under current policies are gloomy, there are many options for changing policies in order to limit spending over time. Three broad alternatives are discussed below:

- o Changing the indexing of benefits for inflation,
- o Revising eligibility criteria and benefit structures in entitlement programs, and
- o Limiting the use of tax expenditures.

Changes in Indexing

The Congress could revise the indexing of benefits to reflect more accurately changes in the cost of living, or second, to limit the increases to amounts less than the full cost-of-living changes.

One deficiency in the present system of indexing is that the CPI overstates the actual rise in the cost of shelter and the importance of housing in total living costs. In its 1982 budget, the Carter Administration proposed switching to a variant of the CPI, the CPI-X1, which is based on a rental-equivalence approach to measuring housing costs. If the CPI-X1 were implemented in time to affect the July 1981 adjustment in Social Security benefits, fiscal 1982 outlays would be reduced by about $2 billion. The impact on federal outlays in future years is very difficult to predict, however.

Alternatively, the Congress could cap the indexing of benefits. For example, limiting the July 1981 Social Security benefit increase to 85 percent of the increase in the CPI would lower fiscal year 1982 spending by about $2.8 billion. Such a cut might be defended on the ground that Social Security benefits have been increasing at a higher rate than earnings and are expected to do so again this year. But if an 85 percent cap was made permanent, substantial declines in benefit levels would ultimately result. For example, by late 1986, benefits for the average retired worker would be about 8 percent lower than under current policies.

Alternatively, Social Security benefits could be indexed to a cost-of-living measure or a wage-level measure, whichever was lower. This would mean that in normal years, when wages were rising faster than prices, the purchasing power of benefits would be protected. In periods of recession, however, when wages lagged behind price increases, Social Security beneficiaries would be called on to make sacrifices comparable to those of wage earners. This option would reduce federal outlays by an estimated $3.8 billion in 1982 and $26.1 billion over the 1981-1986 period. Over time, it would lower real benefits below the levels anticipated under current law, but this reduction would probably be less than that involved in moving to a permanent 85 percent cap. Either this option or the cap could be applied to Military Retirement, Civil Service Retirement, and Railroad Retirement. In this case, savings would increase proportionately.

Finally, the Congress could make cost-of-living increases less automatic by instituting a procedure like the one now used to adjust white-collar federal pay scales. Each year the President could propose a cost-of-living increase not to exceed the rise in the CPI. The recommendation would take effect unless the Congress acted to alter it. Such a procedure would permit tailoring benefit increases to current economic and fiscal conditions.

Revising Eligibility and Benefits

The Congress could also cut spending by reducing the number of people eligible for benefits and by cutting the amounts they receive from entitlement programs. Such changes could be used to target the cuts primarily on those who are least in need of assistance.

The impact of the demographic trends I have mentioned could be partly offset by increasing the age at which full Social Security retirement benefits are paid. This would reduce benefits to those most capable of working while leaving unaffected the more elderly beneficiaries. Gradual phasing in would be necessary to avoid injuring those persons who have already made commitments on the basis of current law. Raising the normal retirement age to 68 (65 for reduced benefits) has been estimated by the Social Security Administration Actuary as saving 1.42 percent of taxable payroll per year when fully implemented. In 1981, this would amount to $15.8 billion, or about 9 percent of total outlays from the Social Security trust funds.

Another option to cut outlays while targeting assistance on the most needy would restore the family income ceiling on eligibility for guaranteed student loans. If a ceiling of $40,000 per year was applied only to students not borrowing at present under the program, outlays would decline by less than 0.1 billion in 1982 but by $1.6 billion over the 1982-1986 period.

The benefits people receive could also be reduced. As an example of such a change, the rate at which food stamp benefits are reduced in response to increased incomes could be raised. Increasing this rate from the current 30 percent to 35 percent would reduce federal outlays by $1.2 billion in 1982 and $7.2 billion over five years.

Cutting Tax Expenditures

An alternative to reducing spending is to reduce tax expenditures, that is, to alter provisions of the tax code that exclude certain income from taxation in order to further particular policy objectives. As an example, the exclusion of employer-paid health insurance benefits from employees' taxable income, and from the Social Security earnings base, could be restricted. In 1982, this tax expenditure will account for a revenue loss of $28 billion. Limiting the exclusion to $120 per month in 1981 and indexing the limit thereafter would raise $2.6 billion in revenues in 1982 and $25 billion over five years. Health care costs might be restrained as well, since the exclusion is a subsidy to the purchase of first-dollar health insurance coverage, which increases both the use of medical services and medical care prices.

CONCLUSION

The task of controlling federal spending will be a difficult one. Its solution will require the cooperation of the authorizing committees, the appropriations committees, the tax-writing committees, and the budget committees. An example of such cooperation was the series of actions taken by the last Congress to control spending through the reconciliation process. Legislation passed as part of this process reduced fiscal year 1981 outlays by $4.6 billion and increased revenues by $3.6 billion.

The single-year nature of our budget process makes controlling federal spending difficult, however. As I mentioned at the beginning of my testimony, a large proportion of spending cannot be altered for the next fiscal year because of legal and moral commitments to those who benefit from government programs. Given a few years' lead time, however, major cuts in spending can be effected. The problem is how to bring to bear the out-year implications of policy decisions on the current year's budget and appropriations processes.

Procedural changes in how Congress makes its spending decisions might be considered. One option, which CBO has recommended, would have the Congress vote binding advance budget targets, perhaps for the budget year and the four following years. This procedure would increase the importance of out-year spending implications of proposals and allow the Congress to give more serious considerations to proposals whose major impacts on spending are not realized for several years. Another option, which CBO has also recommended, would shift to a two-year appropriation for those programs identified as being amenable to such longer-term planning. Such an option would probably increase the appropriations committees' control over spending, as greater lead time could be given when cuts were desired.

TABLE 1. BUDGET OUTLAYS, FISCAL YEARS 1970 AND 1980 (In billions of dollars)

	1970		1980	
	Amount	Percent of Outlays	Amount	Percent of Outlays
Outlays Mandated Under Current Law	81.8	41.6	337.1	58.2
Payments to individuals	62.5	31.8	167.6	46.2
Social Security	29.7	15.1	116.0	20.0
Medical care, unemployment assistance, and other	32.8	16.7	151.6	26.2
Net interest	14.4	7.3	52.5	9.1
General revenue sharing, farm price supports, and other	1.4	0.7	3.9	0.7
Outlays from Prior-Year Contracts and Obligations	41.5	21.1	96.5	16.6
Outlays from Current-Year Appropriations	73.3	37.3	146.0	25.2
Defense	51.6	26.3	87.5	15.1
Civilian programs	21.7	11.0	58.7	10.1
Total Outlays	196.6	100.0	579.6	100.0