CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

Reducing the Deficit: Spending and Revenue Options

A Report to the Senate and House Committees on the Budget

As Required by Public Law 93-344

REDUCING THE DEFICIT: SPENDING AND REVENUE OPTIONS

The Congress of the United States
Congressional Budget Office

For sale by the U.S. Government Printing Office
Superintendent of Documents, Mail Stop: SSOP, Washington, DC 20402-9328
ISBN 0-16-036104-4

NOTES

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

Details in the text and tables of this report may not add to totals because of rounding.

Preface

The Congressional Budget Office (CBO) is required by section 202(f) of the Congressional Budget Act of 1974 to submit an annual report on budgetary options to the Senate and House Committees on the Budget. The report is in two parts: Part I is titled *The Economic and Budget Outlook: Fiscal Years 1993-1997*, with this report constituting Part II.

Chapter 1 of this report provides general background information on trends in federal spending, revenues, and the deficit. It also shows why further reductions in the federal deficit could enhance economic growth. The next several chapters present a short introduction to the various components of the budget. The main body of the chapters is devoted to specific options in each of the major spending areas, and the last chapter reviews specific revenue options. For each option, an attempt is made to present both sides of the case as fairly as possible. CBO does not endorse the options included, nor does exclusion imply any recommendation. This report concludes with an appendix listing the options under the budget functions that would be affected.

All divisions of the Congressional Budget Office contributed to this report, which was coordinated by Robert W. Hartman. He also prepared Chapter 1. Chapters 2 through 5 were coordinated by Neil M. Singer, Roger Hitchner, Bruce Vavrichek, and Jon Hakken, respectively. Budget authority and outlay estimates were coordinated by Charles E. Seagrave, Robert A. Sunshine, Michael A. Miller, and William P. Myers. Revenue estimates were prepared by staff of the Congressional Budget Office and by the Joint Committee on Taxation and were reviewed by the Tax Analysis Division of CBO under the supervision of Rosemary D. Marcuss.

Paul L. Houts supervised the editing and production of the report, assisted by Sherry Snyder. Major portions were edited by Paul L. Houts, Sherry Snyder, Sherwood Kohn, and Roger Williams. Christian Spoor provided editorial assistance during production and coordinated the graphics. The authors owe special thanks to Mary Braxton, Jill Bury, Cindy Cleveland, Sharon Corbin-Jallow, Ronald Moore, Denise Thomas, Simone Thomas, and Donna Wood, who typed the many drafts. With the assistance of Martina Wojak, Kathryn Quattrone prepared the report for publication.

Robert D. Reischauer
Director

February 1992

Contents

ONE INTRODUCTION: WHY IS REDUCING THE DEFICIT STILL IMPORTANT? 1

The Economic Outlook 1
Raising Growth by Lowering Deficits 3
Deficits: Past, Present, and Future 4
How to Use This Report 8

TWO DEFENSE AND INTERNATIONAL DISCRETIONARY SPENDING 11

Force Structure

DEF-01 Increase Planned Reductions of Military Personnel and Forces 18

Strategic

DEF-02 Cancel the Remainder of the B-2 Bomber Program 20

DEF-03 Retire Minuteman II Missiles 22

DEF-04 Retire the B-1 Bomber Fleet 23

DEF-05 Reduce Spending on Intelligence Activities 25

DEF-06 Reduce Spending on DOE Warhead Activities 27

DEF-07 Cancel the Small ICBM (Midgetman) 29

DEF-08 Terminate Production of D5 Missiles 31

DEF-09 Limit SDI to an ABM-Compliant Ballistic Missile Defense and Continue Research 33

Navy Ships

DEF-10 Defer Procurement of New Aircraft Carrier 35

DEF-11 Terminate the SSN-21 Program 37

DEF-12 Cancel Procurement of Additional TAGOS Ships 39

DEF-13 Reduce Procurement of DDG-51 Destroyers 40

Navy and Air Force Tactical Aircraft

DEF-14 Cancel the Air Force's F-22 Aircraft Program 41

DEF-15 Cancel the Upgrade of the Navy's F/A-18 Fighter 43

DEF-16 Delay the Navy's AX Aircraft 45

DEF-17 Cancel the Advanced Air-to-Air Missile 47

Army Modernization and Procurement

DEF-18 Cancel the Kinetic Energy Anti-Satellite Weapon Program 49

DEF-19 Reduce Funding for the Modernization of Armored Systems 51

DEF-20 Cancel the Army's ADATS Program 53

Other Investment

DEF-21 Streamline the National Defense Stockpile 54

DEF-22 Cancel the C-17 Airlift Aircraft 56

DEF-23 Delay Development and Production of New Weapons for One Year 58

DEF-24 Limit Payments for Independent R&D 60

DEF-25 Cancel the National Aerospace Plane 62

Manpower

DEF-26 Increase Separations of Air Force Enlisted Personnel 64

DEF-27 Make Additional Reductions in the Officer Corps 67

DEF-28 Limit Military Pay Raises 69

DEF-29 Terminate Reserve Retirement Benefits 71

DEF-30 Deny Unemployment Compensation to Service Members Who Voluntarily Leave Military Service 73

DEF-31 Change Budgeting Method for Wage Board Pay Raises 74

DEF-32 Cut Reserve Strength 75

DEF-33 Reduce Drills for Noncombat Reserve Units 77

Medical Care

DEF-34 Reduce Per Capita Use of Hospital Services 78

DEF-35 Increase Charges for Direct Military Health Care Services 80

DEF-36 Charge Retired Military Personnel Premiums for Military Health Care 81

DEF-37 Close the Uniformed Services University of the Health Sciences 83

Operation and Maintenance

DEF-38 Adopt Short, Unaccompanied Tours for Europe 85

DEF-39 Reduce Optempo and Unit Training Costs 87

DEF-40 Reduce Funding for Classroom Training 89

DEF-41 Continue Civilian Hiring Freeze 91

DEF-42 Revamp Military Family Housing 93

DEF-43 Increase the States' Share of Army National Guard Costs 95

International Programs

DEF-44 Reduce Security Assistance 96

DEF-45 Consolidate Overseas Broadcasting 98

DEF-46 Reduce Eximbank Credits 99

DEF-47 Phase Out Special Defense Acquisition Fund 100

THREE DOMESTIC DISCRETIONARY SPENDING 103

Science and Space

DOM-01 Cancel New Spacecraft Development Projects in a Major NASA Program for Space Science and Applications 106

DOM-02 Reduce the Overhead Rate on Federally Sponsored University Research 107

DOM-03 Cancel the NASA Development Program for the Advanced Solid Rocket Motor 109

DOM-04 Cancel the Superconducting Super Collider 111

DOM-05 Cancel Spending for the Space Exploration Initiative 113

DOM-06 Cancel the NASA Space Station Program 115

Energy and Natural Resources

DOM-07 Eliminate Further Funding for the Clean Coal Technology Program 116

DOM-08 Reduce Department of Energy Acquisitions of Crude Oil for the Strategic Petroleum Reserve 118

DOM-09 Eliminate Below-Cost Timber Sales from National Forests 119

Environmental Protection

DOM-10 Eliminate Federal Grants for Construction of Wastewater Treatment Plants 120

DOM-11 De-emphasize Permanence in Superfund Cleanups; Emphasize Land-Use Controls and Containment Methods 122

DOM-12 Eliminate Health Assessments Done at Superfund Sites by the Agency for Toxic Substances and Disease Registry 123

DOM-13 Substitute Private Financing for Government Financing of the Superfund Program to the Maximum Extent Possible 124

Agriculture

DOM-14 Reduce Federal Support for Agricultural Research and Extension Activities 125

DOM-15 Reduce USDA Spending for Export Marketing and International Activities 126

DOM-16 Streamline the Operation of Farm Agencies' Field Offices 127

Credit and Commerce

DOM-17 End Small Business Administration Loans and Loan Guarantees 128

DOM-18 Discontinue Postal Subsidies for Not-for-Profit Organizations 130

DOM-19 Scale Back the Rural Rental Housing Assistance Program 132

DOM-20 Scale Back the Housing Loan Program for Rural Homeowners 134

DOM-21 Reduce the Budget of the Export Administration 136

DOM-22 Eliminate the Trade Promotion Activities of the International Trade Administration or Charge the Beneficiaries 137

Transportation

DOM-23 Reduce Federal Aid for Mass Transit 138

DOM-24 Eliminate Airport Grants-in-Aid 139

DOM-25 Eliminate Regulation of Motor Carriers and Abolish the Interstate Commerce Commission 140

Community and Regional Development

DOM-26 Eliminate Certain Rural Development Programs 141

DOM-27 End Funding for the Economic Development Administration 143

DOM-28 Eliminate the Appalachian Regional Commission 144

DOM-29 Eliminate or Restrict Community Development Block Grants 145

DOM-30 Reduce Federal Support for Tennessee Valley Authority Activities 147

Education and Social Services

DOM-31 Eliminate Ancillary Vocational Education Programs 148

DOM-32 Eliminate Education Programs That Have Largely Achieved Their Purpose 150

DOM-33 Eliminate State Student Incentive Grants 152

DOM-34 Eliminate or Reduce Funding to School Districts for Impact Aid 153

DOM-35 Eliminate Untargeted Funding for Mathematics and Science Education 155

DOM-36 Reduce Pell Grant Funding by Tightening the Definition of Independent Students 156

DOM-37 Eliminate Federal Funding for Campus-Based Student Aid 157

DOM-38 Eliminate or Reduce Funding for the Arts and Humanities 159

DOM-39 Consolidate Social Service Programs and Reduce Their Budgets 160

Health

DOM-40 Reduce the Maternal and Child Health Care Block Grant and the Preventive Health Services Block Grant 161

DOM-41 Reduce Funding for Research Supported by the National Institutes of Health 162

Housing Assistance

DOM-42 Reduce Federal Rental Subsidies by Shifting Some Costs to the States or Tenants 163

DOM-43 Maintain the Current Number of Housing Assistance Commitments 165

DOM-44 Shift Housing Assistance from New Construction to Vouchers 166

DOM-45 Eliminate HOPE Grants for Low-Income Home Ownership 168

DOM-46 Eliminate Special-Purpose HUD Grants 170

DOM-47 Modify the Fee Structure for Local and State Agencies That Administer Federal Housing Programs 171

Other Income Security

DOM-48 Eliminate or Scale Back Low-Income Home Energy Assistance 172

Veterans' Benefits and Services

DOM-49 Close or Convert Inefficient or Underused Facilities in Veterans' Hospitals 173

DOM-50 Promote More Efficient Management and Delivery of Health Care for Veterans 174

Law Enforcement and Other

DOM-51 Reduce Funding for Law Enforcement Control of Illegal Drugs 176

DOM-52 End Funding for the Legal Services Corporation 178

DOM-53 Modify the Davis-Bacon Act by Allowing Unrestricted Use of Helpers and Raising the Contract Threshold 179

DOM-54 Modify the Service Contract Act by Eliminating the Successorship Provision 180

FOUR ENTITLEMENTS AND OTHER MANDATORY SPENDING 181

Energy, Natural Resources, and Environment

ENT-01 Reduce Subsidies Provided by the Rural Electrification Administration 187

ENT-02 Require Department of Energy to Raise Rates for Federal Hydroelectric Power to Speed Debt Repayment 189

ENT-03 Improve Pricing for Commercial and Recreational Uses of Public Lands 191

ENT-04 Change Revenue-Sharing Formula from a Gross- to a Net-Receipt Basis for Commercial Activities on Federal Lands 195

ENT-05 Index Nuclear Waste Disposal Fees for Inflation 197

Agriculture

ENT-06 Reduce Deficiency Payments to Farmers Participating in USDA Commodity Programs by Lowering Target Prices 198

ENT-07 Eliminate the 0/92 and 50/92 Programs for Participants in USDA Commodity Programs 200

ENT-08 Replace Deficiency Payments in the Wheat, Feed Grains, Cotton, and Rice Programs with Declining Direct Payments 201

ENT-09 Raise the Proportion of Each Farmer's Base Acreage Ineligible for Deficiency Payments from 15 Percent to 25 Percent 202

ENT-10 Restrict Eligibility for Benefits from Price Support Programs and Reduce the Payment Limitation 203

ENT-11 Eliminate the Price Support Program for Wool and Mohair 205

ENT-12 Eliminate the Honey Program 206

ENT-13 Reduce Loan Guarantees Made Under the USDA's Export Credit Programs, and Eliminate Loans to Especially Risky Borrowers 207

ENT-14 Eliminate the Export Enhancement Program 208

ENT-15 Eliminate the Market Promotion Program 209

ENT-16 Reduce Costs for the Dairy Price Support Program by Requiring Producer Contributions 210

ENT-17 End the Federal Crop Insurance Program and Replace It with Standing Authority for Disaster Assistance 211

Commerce

ENT-18 Auction Licenses to Use the Radio Spectrum 213

ENT-19 Impose a Royalty Payment on Communications Users of the Radio Spectrum 215

ENT-20 Charge for Examinations of State-Chartered Banks 217

Transportation

ENT-21 Establish Charges for Airport Takeoff and Landing Slots 218

ENT-22 Establish User Fees for Air Traffic Control Services 219

ENT-23 Impose User Fees on the Inland Waterway System 220

Education and Social Services

ENT-24 Reduce Interest Subsidies for Stafford Loans 222

ENT-25 Require Postsecondary Institutions to Share the Risk of Defaults on Stafford Loans 224

ENT-26 Require Postsecondary Institutions to Pay a Co-origination Fee on Stafford Loans 226

ENT-27 Replace Stafford and SLS Loans with Direct Loans 227

ENT-28 Limit the Growth of Foster Care Administrative Costs to 10 Percent per Year 229

Health

ENT-29 Tighten Medicaid's Estate-Recovery Processes and Rules for Long-Term Care 230

ENT-30 Combine Funding to States for the Costs of Administering AFDC, Medicaid, and Food Stamps into a Single Indexed Grant 232

ENT-31 Prefund the Government's Share of Federal Retirees' Health Insurance 234

ENT-32 Reform the Federal Employees Health Benefits Program by Modifying Hospital Reimbursement 236

Medicare Providers

ENT-33 Eliminate the Disproportionate Share Adjustment for Most Hospitals in Medicare's Prospective Payment System 238

ENT-34 Reduce Medicare's Payments for the Indirect Costs of Patient Care That Are Related to Hospitals' Teaching Programs 240

ENT-35 Reduce Medicare's Direct Payments for Medical Education 241

ENT-36 Eliminate Medicare's Additional Payments to Sole Community Hospitals and Medicare-Dependent Hospitals 242

ENT-37 Eliminate Return-on-Equity Payments for Proprietary Skilled Nursing Facilities 243

ENT-38 Freeze Medicare's Prospective Payment System Rates for One Year 244

ENT-39 Continue Medicare's Transition to Prospective Rates for Facility Costs in Hospital Outpatient Departments 245

ENT-40 Charge a Fee for SMI Claims That Are Not Billed Electronically 246

ENT-41 Reduce Medicare's Payment for Intraocular Lenses to $100 247

ENT-42 Freeze Medicare's SMI Reimbursement Rates for One Year 248

Medicare Beneficiaries

ENT-43 Collect 20 Percent Coinsurance on All Home Health and Skilled Nursing Facility Services Under Medicare 249

ENT-44 Increase the Premium for Physicians' Services Under Medicare to 30 Percent of Program Costs 250

ENT-45 Increase and Index Medicare's Deductible for Physicians' Services 251

ENT-46 Collect 20 Percent Coinsurance on Clinical Laboratory Services Under Medicare 252

ENT-47 Relate the Premium for Physicians' Services Under Medicare to Enrollees' Incomes 253

ENT-48 Increase the SMI Coinsurance Rate to 25 Percent 254

Taxing Health Insurance

ENT-49 Tax a Portion of the Insurance Value of Medicare Benefits 255

ENT-50 Tax Employer-Paid Health Insurance 257

Income Security

ENT-51 Reduce Federal Employee Retirement Benefits 259

ENT-52 End or Scale Back Trade Adjustment Assistance 262

ENT-53 Increase Targeting of Child Nutrition Subsidies 263

ENT-54 Eliminate Small Food Stamp Benefits 265

ENT-55 Eliminate the $50 Child Support Payment to AFDC Families 266

ENT-56 Reduce the $20 Exclusion from Income in Supplemental Security Income 267

ENT-57 Reduce the Federal Matching Rate and Increase Fees in the Child Support Enforcement Program 268

ENT-58 Impose a Fee for Federal Administration of SSI State Supplementary Payments 270

Social Security

ENT-59 Restrict Cost-of-Living Adjustments in Non-Means-Tested Benefit Programs 271

ENT-60 Reduce the Replacement Rate Within Each Bracket of the Social Security Benefit Formula 275

ENT-61 Eliminate Social Security Benefits for Children of Retirees Aged 62-64 276

ENT-62 Lengthen the Social Security Benefit Computation Period by Three Years 277

ENT-63 Consider Veterans' Compensation When Determining Social Security Disability Income Payments 278

Veterans' Benefits and Services

ENT-64 Restrict Eligibility for Veterans' Compensation Payments 280

ENT-65 Raise the Loan Fee for Housing Loans Guaranteed by the Department of Veterans Affairs 282

ENT-66 Eliminate "Sunset" Dates on Provisions for Veterans in the Omnibus Budget Reconciliation Act of 1990 283

FIVE REVENUES 285

Raise Income Tax Rates

REV-01 Raise Marginal Tax Rates for Individuals and Corporations 287

REV-02 Amend or Repeal Indexing of Income Tax Schedules 290

REV-03 Increase the Alternative Minimum Tax Rate 291

REV-04 Tax All Corporate Income at a 34 Percent Rate 293

Restrict Itemized Deductions Under the Income Tax

REV-05 Eliminate or Limit Mortgage Interest Deductions 294

REV-06 Eliminate or Limit Deductions of State and Local Taxes 297

REV-07 Eliminate or Limit Deductions for Charitable Giving 299

REV-08 Limit the Tax Benefit of Itemized Deductions to 15 Percent 301

Restrict the Tax-Favored Treatment of Employment and Retirement Income

REV-09 Decrease Limits on Contributions to Qualified Pension and Profit-Sharing Plans 302

REV-10 Impose a 5 Percent Tax on Investment Income of Pension Plans and Individual Retirement Accounts 304

REV-11 Tax Nonretirement Fringe Benefits 305

REV-12 Tax the Income-Replacement Portion of Workers' Compensation and Black Lung Benefits 308

REV-13 Increase Taxation of Social Security and Railroad Retirement Benefits 309

REV-14 Phase Out the Dependent-Care Credit 312

Broaden Taxes on Wealth and Capital Gains

REV-15 Tax Capital Gains from Home Sales 313

REV-16 Tax Capital Gains Held Until Death 315

REV-17 Decrease the Exemption and Broaden the Base for Estate and Gift Taxes 318

Increase Taxes Dedicated to Social Insurance Trust Funds

REV-18 Expand Medicare and Social Security Coverage 320

REV-19 Repeal the Medicare Taxable Maximum 322

REV-20 Index the Unemployment Insurance Taxable Wage Base 323

Curtail Income Tax Preferences for Businesses

REV-21 Reduce Tax Credits for Rehabilitating Older Buildings 324

REV-22 Tax Credit Unions Like Other Thrift Institutions 325

REV-23 Repeal Tax Preferences for Extractive Industries 327

REV-24 Repeal the Possessions Tax Credit 329

REV-25 Eliminate Private-Purpose, Tax-Exempt Bonds 331

REV-26 Further Restrict Deductions for Business Meals and Entertainment 333

REV-27 Amortize a Portion of Advertising Costs 334

Increase Excise Taxes and Miscellaneous Fees

REV-28 Impose a Value-Added Tax 335

REV-29 Increase Excise Taxes on Tobacco and Alcoholic Beverages 338

REV-30 Increase Energy Taxes 340

REV-31 Impose a Carbon-Based Excise Tax on Fossil Fuels 343

REV-32 Impose an Excise Tax on Water Pollutants 345

REV-33 Impose Excise Taxes on Air Pollutants 347

REV-34 Double the SEC Fee on Securities Transactions 350

REV-35 Auction Off Import Quotas for Textiles, Apparel, and Sugar 351

REV-36 Extend the Gas-Guzzler Tax to Cover More Vehicles and Eliminate the CAFE Program 352

APPENDIX SPENDING AND TAXATION OPTIONS BY BUDGET FUNCTION 355

TABLES

1. CBO Deficit Projections 5

2. Savings from the Administration's 1991 Plan 13

3. Reductions in Military Forces by 1997 Under Illustrative Alternative, Assuming Proportional Cuts 14

4. CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance 183

5. Target Prices Under CBO Baseline Assumptions and Under 3 Percent Annual Reductions 199

6. The Size of Two Possible Tax Bases for a Value-Added Tax, 1990 336

FIGURES

1. The Economic Forecast and Projection 2

2. Federal Deficit as a Share of GDP 6

3. Required Reductions in Discretionary Spending 7

4. Domestic Discretionary Spending as a Share of GDP 104

REDUCING THE DEFICIT:
SPENDING AND REVENUE OPTIONS

Chapter One

Introduction: Why Is Reducing the Deficit Still Important?

Because the U.S. economy is currently struggling to recover from a prolonged recession, attention has naturally focused on fiscal measures that raise spending and reduce taxes, thereby increasing the budget deficit. Although many political leaders accept the desirability of fiscal stimulus in the short run, there are good reasons to put reducing the deficit high on the national agenda once the economy regains strength. Among the good reasons is the need to promote long-term economic growth.

The Economic Outlook

According to the latest Congressional Budget Office (CBO) forecast, economic growth should resume by mid-1992. By 1993, the rate of growth of the gross domestic product (GDP) should be around 3 percent and the unemployment rate should level out and begin to decline (see Figure 1). The rise in the consumer price index should stabilize at around 3 1/2 percent and long-term government bond yields at about 7 percent.

This outlook reflects numerous assumptions about the different sectors of the economy, but much of the reason for expecting the turnaround stems from the recent easing of monetary policy by the Federal Reserve, one sign of which is shown in the sharp decline in short-term interest rates. These changes should stimulate housing and business investment and, through the effect of mortgage refinancing and easier credit terms, should rouse consumers from the doldrums of the past year.

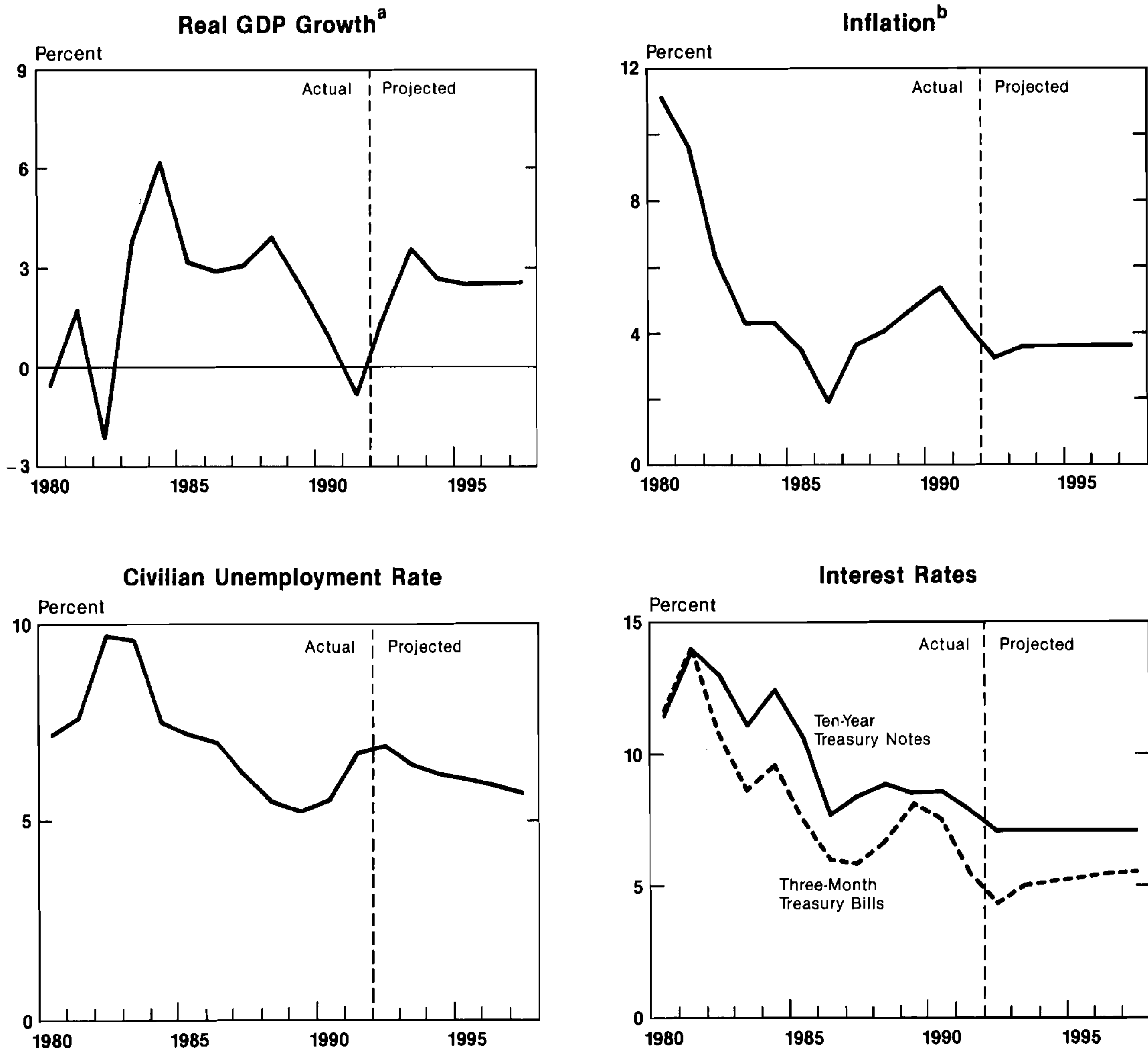
The recovery, however, is expected to be weak by historical comparison. Over the entire period from 1992 to 1997, real economic growth will average about 2 1/2 percent. This growth rate is substantially below the average for the past three decades for a number of reasons. In the initial stages of the recovery, growth is likely to be held back as overbuilt commercial real estate depresses construction, as lingering budgetary pressures hold down state and local government spending, and as retrenchment continues in industries that are coping with rapidly changing markets.

As the recovery matures, other factors that influence the economy's capacity to produce will become more important in determining economic growth. First, the labor force will be growing more slowly as the birth-dearth generation of the late 1960s and 1970s moves into the work force. Second, economic growth is projected to be weak because the pace at which productivity per worker expands is assumed to exceed the slow growth pattern of the 1980s only slightly.

One problem the low rate of postrecession growth poses for society is a challenge to the American Dream that each generation will be better off than its parents. The slowdown in

productivity is a major reason why there was no change in the real earnings of men working year round and full time in the last decade. Some families were able to maintain or improve their standards of living as wives began to work or increased their work hours; after adjusting for inflation and family size, the income of the typical married couple with children rose 7 percent between 1979 and 1989. Families with only one earner, how-

Figure 1.
The Economic Forecast and Projection



SOURCE: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Federal Reserve Board.

NOTE: All data are annual values; growth rates are year-over-year.

a. The annual value for real growth in gross domestic product (GDP) for 1991 is estimated by CBO. GDP is the total market value of all goods and services produced domestically during a given period.

b. Consumer price index for all urban consumers (CPI-U). The treatment of home ownership in the official CPI-U changed in 1983. The inflation series in the figure uses a consistent definition throughout.

ever, fared less well. The real income of the typical single mother with children fell over 6 percent in the decade.

Hastening growth in productivity is the only way to avoid the spread of this stasis or erosion of living standards to growing segments of the population. Even if immigration or birth rates pick up, they will not help because there will be more mouths to feed. Greater voluntary participation in the labor force seems unlikely. In any event, although more workers would help raise measured standards of living, this would probably come about because fewer mothers stay at home with small children or fewer older people get a chance to enjoy retirement, both of which may entail social costs.

Raising Growth by Lowering Deficits

Most economists agree that lowering the deficit should raise growth in productivity, although it is not the only ingredient. Currently, nearly $3 trillion in federal debt is held outside of federal government accounts. In relation to GDP, this debt stands at about 50 percent, double the ratio only 18 years ago when growth in productivity began to ebb. Annual deficits continue to drive up this ratio. Coupled with low rates of private saving and growing worldwide demand for capital, heavy government borrowing diverts funds from investment that enhances productivity.

Finding a way to stimulate private saving would provide more resources for investment, but there is no consensus on an effective way to do it. The citizens of Japan and most other industrial countries save a lot more (and borrow less) than Americans. As a result, new debt issues of their governments are absorbed with a healthy margin left over to finance private investment. In contrast, in the United States, a low private saving rate means that little saving remains to finance investment after the government's deficit has been funded.

Some people are enamored of the idea of enticing Americans to save more to ease that situation. However, many of the schemes put forward do not raise private savings at all; they just transfer it to accounts that benefit from a special incentive. Usually that incentive to save more is a tax break that reduces federal revenues. As a result, even if it leads to more private savings, there is also more new public debt to be absorbed. Thus, as long as Americans save as little as they do now, few resources will be available to allow increases in investment. Domestic saving has been supplemented in recent years by borrowing from foreign savers, but they have acquired greater ownership of U.S. assets. Gains in productivity financed by borrowing from abroad will eventually flow out of U.S paychecks into dividends, rents, and interest paid to foreign owners.

Chronically high federal budget deficits persist despite the carrying out of a budget agreement reached at the summit in 1990.

Some deficit spending probably helps U.S. productivity, but it is wrong to attribute the high deficits of recent years to such spending. Building a needed highway, teaching someone to read, and reducing drug use are all examples of government investments that can be every bit as important to future economic growth as installing automatic teller machines for bank customers. To the extent that federal deficits remain high because such activities are being expanded, such deficits could be

viewed with equanimity. They are matched by more productivity-enhancing government services, so they are not a problem. (An exactly analogous case could be made for deficits stemming from tax cuts that spur investment, dollar for dollar.) Unfortunately, it is hard to make the case that past, present, and future deficits have increased because these kinds of spending related to growth have been spurred or because a shift has occurred in the tax system to favor investment. Instead, deficits have been driven up at various times in the last 20 years by general tax cuts, increases in defense spending, and growth in spending on retirement and medical care.

Deficits: Past, Present, and Future

The prospects for reducing the deficit under current law are disappointing. Even the modest reductions in CBO's projections will require further legislative activity. Moreover, although prospective reductions in defense spending offer some help in the deficit outlook, public measures to relieve unmet domestic needs could swamp such gains.

The Budget Outlook

CBO has recently released its projection of the budget for the 1993-1997 period. These baseline projections assume that current laws are not changed throughout the period and that discretionary spending keeps up with inflation once the Budget Enforcement Act's (BEA's) caps expire in 1995. Under these assumptions, the deficit will rise from $269 billion in 1991 to $352 billion in 1992, and then decline to $226 billion in 1997. That is the good news. In fact, a large part of the rise in the deficit in 1992 and the subsequent decline is the result of swings in government financing of bank closings and temporary flows of foreign contributions to pay for Operation Desert Storm.

The flows of cash in the budget for the cleanup of deposit insurance are dominated first by the need to buy up the assets of defunct banks and later by the inflows of cash as the government disposes of the assets. Unlike other government spending, these transactions do not generate income. Similarly, the budget treatment of foreign contributions to pay for Desert Storm--which are treated just like tax increases in the standard budget accounts--is misleading. Accordingly, a better measure of underlying budget trends is obtained by omitting these two factors from the totals.

The deficit excluding deposit insurance and Desert Storm contributions falls substantially from $290 billion in 1992 to $210 billion in 1995, but then returns to an upward course (see Table 1). To put these numbers in historical perspective, by 1997--after about five years of recovery from the recession--the deficit would stand at 3.2 percent of GDP. That share would exceed the level attained in all but two years in the 1960-1980 period (see Figure 2). Although a deficit of 3 percent of GDP does look better than the outcomes in the first half of the 1980s, when deficits were driven up by a severe recession, it hardly represents significant progress in reducing the deficit. Moreover, the deficit in relation to GDP is unlikely to come down, even if the projection is extended on the same basis to 2002. CBO's projection to that year shows the baseline deficit at about 4 percent of GDP, largely as a result of soaring costs for Medicare and Medicaid.

The Budget Summit and the New Enforcement Process

These chronically high federal budget deficits persist despite the carrying out of a budget agreement reached at the summit in 1990. That agreement entailed nearly $500 billion (cumulated over the five years from 1991 through 1995) in deficit reduction. Tax increases amounting to nearly $160 billion and cuts in entitlement programs of about $75 bil-

lion have already been enacted. "Caps" on annually appropriated spending that contribute another $190 billion to savings were also agreed on, and they helped restrain spending bills for fiscal year 1992. But for future legislative activity, the caps appear to pose a problem.

The enforcement of the targets reached in the 1990 budget summit was codified in the Budget Enforcement Act of 1990. These new procedures have significant implications for the need to find savings in existing programs. But first, the terms of the law itself need a brief explanation.

Unlike the Gramm-Rudman-Hollings procedure that had guided Congressional budgetmaking since 1985, the BEA emphasized putting restraints on legislated changes in spending and taxing, not on setting overall deficit limits. These restraints are carried out by two processes, one limiting annually appropriated program spending (caps) and the other trying to ensure that entitlement and mandatory programs and revenues combined do not worsen the deficit (Pay-as-You-Go or PAYGO).

PAYGO

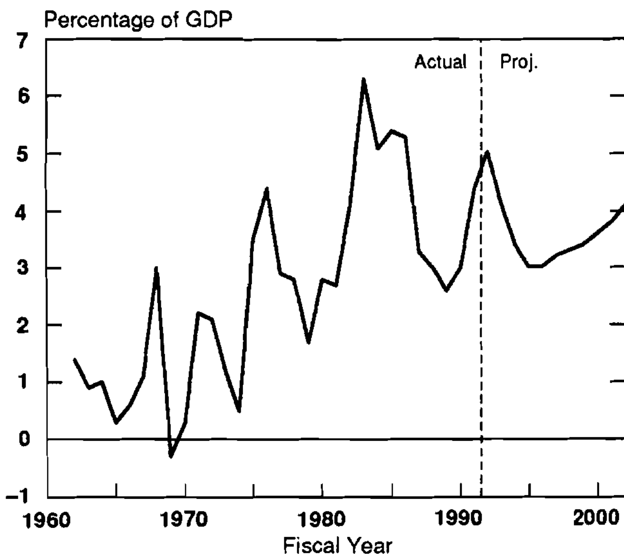
The BEA requires that any liberalization in an entitlement or mandatory program or any legislated reduction in taxes or fees be (at least) offset in each year by legislated spending reductions in other PAYGO programs or by tax increases. The only real test of the PAYGO procedure in its first year of operation came when the Congress decided to extend unemployment benefits to those who exhausted the available aid. After some extended wrangling, new revenue sources sufficient to pay for these added costs were placed in the same bill and it was passed.

Table 1.
CBO Deficit Projections (By fiscal year)

	Actual 1991	1992	1993	1994	1995	1996	1997
			In Billions of Dollars				
Total Deficit Assuming Discretionary Caps	269	352	327	260	194	178	226
Deficit Excluding Deposit Insurance and Desert Storm Contributions	246	290	258	227	210	222	254
			As a Percentage of GDP				
Deficit Excluding Deposit Insurance and Desert Storm Contributions	4.4	5.0	4.1	3.4	3.0	3.0	3.2
Revenues	18.7	18.9	18.9	19.1	19.2	19.1	19.0
Outlays	23.1	23.8	23.0	22.5	22.2	22.1	22.2

SOURCE: Congressional Budget Office.

Figure 2.
Federal Deficit as a Share of GDP



SOURCE: Congressional Budget Office.

NOTE: Excludes deposit insurance and Desert Storm contributions.

The general view in the Congress is that the PAYGO procedures pose a substantial hindrance to those who wish to liberalize entitlement spending or cut taxes. The PAYGO rule is not, however, sacrosanct. It can be overridden if the Congress and the President agree that a particular action constitutes an emergency or if a law is enacted declaring that economic circumstances have deteriorated so much that the BEA provisions should be suspended. Consideration of such a suspending law was triggered last year, but it was not enacted.

Caps

The BEA placed caps--dollar ceilings--on each of three categories of programs whose annual activity is controlled by discretionary appropriations. For 1991, 1992, and 1993, separate budget authority (generally, appropriations) and outlay limits are set for defense, international, and domestic programs. For 1994 and 1995, budget authority and outlay caps are set for discretionary spending as a whole. The caps are enforced by a provision that requires that if any cap is exceeded, spending is cut back proportionately in all programs under the particular, offended cap until it measures up to size. This automatic cutback is called sequestration. (A similar enforcement procedure applies to the PAYGO rule.)

The appropriation caps roughly preserved spending on domestic and international programs in real terms through 1992, and held defense to a declining course agreed to by the Congress and the Administration during that period. But for 1993 and later years the caps will pinch. Figure 3 shows what spending would be after 1992 if the appropriations in that year were updated only for inflation ("Preserve 1992 real spending" on the chart), as well as the amounts allowed under the BEA caps. In 1993, most of the paring from the 1992 real spending path will be in defense. It will have to be cut by $15 billion, or about 5 percent; domestic spending will have to be cut about 3 percent in real terms. For 1994 and 1995, when the individual caps are no longer specified, discretionary spending as a whole will have to be reduced about 5 percent and 3 percent, respectively, to meet the BEA targets. By 1997, the total required cut in discretionary spending would amount to about $70 billion.

In short, just to keep the federal deficit on the glide path discussed earlier in this

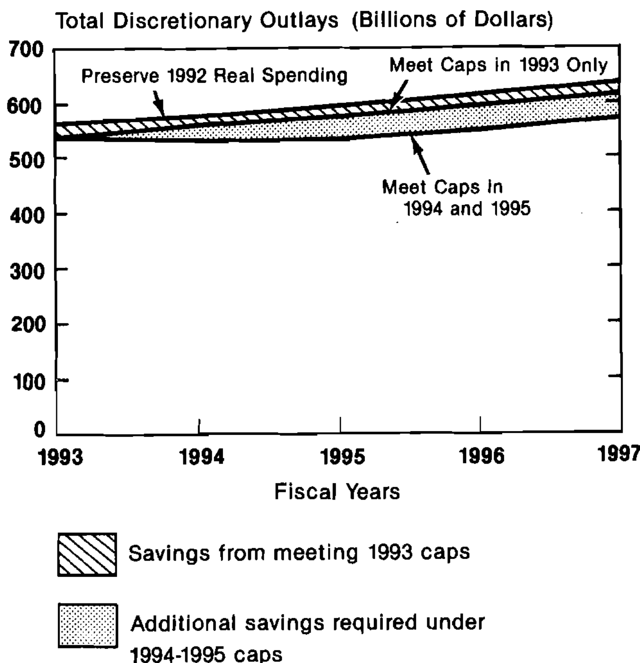
Deficit-reducing legislation is needed just to fulfill the conditions of the current legally mandated path.

chapter--which assumes that the BEA appropriation caps are met--will require substantial cuts in discretionary spending to meet the caps. Thus, deficit-reducing legislation is needed just to fulfill the conditions of the current legally mandated path.

Meeting Needs

It gets worse. CBO's spending projections are based on maintaining existing programs only, modified by the caps. No allowance is made for meeting new or deferred needs. Judging from the plans of both major political parties, however, a number of areas for increased federal participation seem to be bubbling up to the surface. This is not the place to comprehensively list these areas, but giving some flavor of them seems warranted.

Figure 3.
Required Reductions in Discretionary Spending



SOURCE: Congressional Budget Office.

NOTE: Calculations exclude 1992 spending designated as emergencies.

The peace dividend will not be big enough without some help from the tax side or from scaling down existing domestic spending.

Addressing the problems facing the 35 million U.S. citizens not covered by health insurance and the financial pinch on the covered population facing ever-increasing premium charges seems ripe for federal action. Recognition has become more widespread that the nation's schools are failing to prepare the future work force for contributing to productivity and that greater federal investment in science and technology may be needed to keep the country competitive.

To many policymakers, declines in the soundness of the nation's infrastructure, the continuing degradation of the environment, the failure of taxes to give adequate investment incentives, and the need to address rising poverty rates for a segment of the population cry out for a policy response. At the same time, calls intensify for public action on the problems of drug abuse, crime, and homelessness. Although addressing any one of these problems need not entail massive increases in the deficit, a realistic assessment would have to make a hefty allowance for meeting any major subset of these needs.

The point is that there is no room in the current or prospective budget outlook to finance any of these arguably good things. Some part of existing spending must be cut back or taxes must be raised if any of the initiatives are to be undertaken, or else the deficit will grow worse.

Much hope is riding on the peace dividend to solve the multiple dilemmas outlined up to now. That hope has a real basis, but it is frequently overdrawn (for a fuller discussion, see the next chapter). Defense spending peaked in the mid-1980s. Since 1990, it has been declining at a substantial pace. In recognition of these trends, the defense spending caps decided at the budget summit programmed continuing annual declines in real resources devoted to national defense.

CBO's deficit projections presented earlier in this chapter fully account for all these reductions. In no sense can the cuts programmed through the summit be used as a dividend to pay for new initiatives or to improve the deficit outlook. That requires further defense cuts. Fortunately, such cuts may be feasible with no increase in the country's vulnerability because of the diminished threat from the military forces of the former Soviet Union. The next chapter of this volume discusses the magnitude of the force reductions now being promulgated. In a nutshell, adopting more ambitious defense reduction programs would enable the United States to realize substantial deficit reduction or to fund a significant part of the backlog of unmet needs. But the peace dividend will not be big enough to do both without some help from the tax side or from scaling down existing domestic spending.

How to Use This Report

The remainder of this report is organized along lines of the BEA. Chapters 2 and 3 cover the discretionary programs--national defense, international, and domestic programs. The first two categories are combined in the National Defense chapter. Chapters 4 and 5 present options that are subject to PAYGO limitations. Chapter 4 covers entitlements and other mandatory programs. That chapter also presents options that involve raising fees, which may be counted under the PAYGO scorecard or as discretionary savings, depending largely on which committee initiates the legislative action. Chapter 5 discusses options that would raise revenues.

At the start of each of the options presented is a table showing five-year "savings." The numbers in these tables show the difference between what the program would have cost under current law (baseline) and what it would cost if the modification proffered were enacted. For domestic and international discretionary programs, this baseline is simply the fiscal year 1992 appropriation, adjusted by CBO's projection of inflation from 1993 to 1997. The national defense baseline is CBO's estimate of the cost of the Pentagon's five-year plan, issued in 1991, modified by fiscal year 1992 appropriation actions and inflated by CBO's projection of inflation. For entitlements, the baseline is CBO's estimate of outlays under current law, assuming that CBO's economic projections hold true. In the case of revenues, tabular entries show the increase in revenues that would take place if the option were enacted over and above the revenues due under current law. Revenue options are shown in billion dollar amounts; others are given in millions.

The options discussed in this volume present the pros and cons of the various proposals. CBO does not endorse these proposals, nor is the exclusion of any proposal an indication of its lesser worth. The purpose of this study is to present the consequences of a broad range of possible changes in current policy in an impartial manner. The decision as to whether to carry out any of them is for elected officials to make.

Virtually all of the options presented here would, in isolation, reduce employment. Accordingly, this particular drawback is not noted in each discussion. Similarly, since all the proposals that would reduce grants for state and local governments would make their financial status worse, that fact is not repeated in each discussion.

A last caveat is that some options may not be counted in meeting the BEA's implementation requirements, even though they reduce the deficit. An example would be the sale of government assets. Another case would be a reduction in Social Security spending, which would not enter either the discretionary or PAYGO calculus, since Social Security was given its own limiting rule in the BEA. Generally, these uncountables are noted in the write-ups.

Finally, though all of the options, if devoted to deficit reduction, would reduce federal interest costs, these savings are not part of the calculations made. Ordinarily when CBO is presented with a detailed budgetary plan, the individual options are "costed " as in this book, but a supplementary additional saving is scored for the effect of the whole package on net interest spending. Moreover, when such budget packages are put together, any interactions of the costs of different parts can be adjusted for--something that could not be done for the options discussed here.

The options in this volume are listed in the contents and in the appendix. The contents lists the options by spending or revenue category and, within each category, by subject. The appendix lists them under the budget function that would be affected.

Chapter Two

Defense and International Discretionary Spending

Recent geopolitical and military events have occurred almost too fast for policymakers to keep abreast of them. Political upheavals that began in Eastern Europe in 1989 have been followed in rapid succession by German unification and the formal dissolution of the Warsaw Pact. Agreement was reached on treaties dealing with strategic forces and the balance of conventional forces in Europe, only to have their effects extended and even overshadowed first by internal changes within the Soviet polity and then by the accelerating pace of reciprocal unilateral measures to reduce the level of international tension. The magnitude of these events dwarfed even Iraq's invasion of Kuwait and the dramatic military successes of Operation Desert Storm.

These events, together with the prospect of further change, give new currency to the old question about national defense, How much is enough? Forces must, of course, be structured to respond to threats. U.S. forces must always be strong enough to ensure national security and the attainment of national interests within an acceptable level of risk. Many people would argue that the requisite force structure should not be constrained by budgets; rather, budgets should accommodate the forces that are necessary to avoid unacceptable risk.

The threat, however, has changed dramatically in recent years. The likelihood of a conventional war between East and West in Europe has virtually disappeared, and with it has gone the need for a corresponding size and structure of U.S. forces. The decline in superpower tension has affected the threat in other ways as well. Regional conflicts have been resolved or show progress toward rapprochement in places as disparate as Afghanistan, Ethiopia, El Salvador, Korea, and even the Middle East.

These developments do not mean an end to war. Armed conflict will continue to be a threat in many countries. But the emerging spirit of international cooperation that has supplanted superpower confrontation indicates that future regional conflicts are more likely to remain regional, as illustrated by the Persian Gulf War. Instead of planning to fight a global war centering around a ground war in Europe, the United States today can focus on threats posed by individual countries.

Budget Trends

Along with threats to national security, the availability of defense funding will influence the size and nature of the U.S. military as funds are balanced against the risk of having too few forces to achieve policy objectives. In late 1990, awaiting the Administration's proposals for drawing down the military services, the Chairman of the House Committee on Armed Services commented that the Department of Defense's (DoD's) budget was in free-fall. That perception seemed to be halted, at least temporarily, by the agreement

on defense spending contained in the Budget Enforcement Act of 1990 and by the specifics of the Administration's defense plan set forth during 1991.

That defense plan, presented in February 1991 in conjunction with the Administration's 1992 budget request, proposed downsizing and reconfiguring U.S. military forces into what the Administration terms its "base force." By 1997, the base force would consist of four principal components: strategic (nuclear) forces; two conventional forces, including both active and reserve components, oriented respectively toward the Atlantic and Pacific theaters; and a "contingency force" composed entirely of active forces. Both active and reserve end strengths would be drawn down approximately 20 percent from their 1990 levels, to 1.63 million and 920,000, respectively. The 1991 plan funded readiness and many modernization programs at prior levels to ensure that units of the base force were fully trained and kept equipped with the best available weapons.

General Colin Powell, Chairman of the Joint Chiefs of Staff, has repeatedly described the base force as the minimum force necessary to meet enduring U.S. national security needs. That this view remains unchanged by events during the past year is shown by his and Defense Secretary Richard Cheney's testimony in February 1992 in support of the Administration's 1993 budget request. In that request the Administration proposed significant reductions in selected procurement programs and some modest acceleration of the force drawdown, but no fundamental change in the 1997 base force. Meanwhile, geopolitical and economic events during 1991 have sparked greater Congressional interest in additional cuts.

There is no agreement on how large any additional spending cuts might be, or on how U.S. military forces might be structured at levels below those proposed by the Administration. A number of alternative spending plans have been set forth, however, in the course of Congressional discussion of defense spending. The Chairman of the House Committee on the Budget, for example, called for a phased sequence of defense cuts that, by the year 2001, could result in a defense budget about half the size of the 1990 budget after adjustment for inflation. By 1997, under his plan, defense spending would be 13 percent below the Administration's proposed level. The Chairman of the Senate Committee on the Budget announced a plan calling for a cut that by 1997 would result in spending as much as 18 percent less than the Administration proposes, and the Chairman of the Senate Committee on Finance called for a 5 percent annual reduction in defense spending. Without endorsing any particular reduction, the Director of the Congressional Budget Office (CBO) has noted that simply complying with the spending limits in the Budget Enforcement Act, while maintaining nondefense budget authority at its real (inflation-adjusted) 1992 level, would require cutting defense budget authority in 1993 through 1997 by $135 billion, compared with levels proposed in the Administration's 1991 plan.

Within any funding total, there are many ways that U.S. military forces could be structured. The Administration's 1991 plan, for example, reflects the lessening of East/West tensions by calling for larger reductions in the Army and the tactical elements of the Air Force than in other services, while maintaining the readiness and mobility of the remaining forces for smaller contingencies elsewhere. The 1991 plan also retains funding for most of the services' new modernization and research and development programs.

The remainder of this chapter sets forth 47 specific options that would depart from the Administration's 1991 plan. Although some of these alternatives are already included in the Administration's latest plan, prepared in conjunction with its budget request for 1993, most are not. How might some of these alternatives fit together to produce a different military force? What would be the capability of that force? To help answer those important questions, the remainder of this introductory section examines an illustrative military force.

Table 2.
Savings from the Administration's 1991 Plan

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	7,000	16,100	26,100	38,900	54,800	142,900
Outlays	3,000	9,500	18,100	30,100	45,400	106,100

The illustration is drawn from an earlier CBO analysis that assesses the effects of several such alternatives.[1]

An Example of Larger Military Force Reductions

CBO analyzed reductions in real defense spending averaging about 7 percent annually for the 1993-1997 period, compared with 3 percent under the Administration's 1991 plan. By the end of the period, the defense budget would be about 40 percent below its 1990 level; the Administration's 1991 plan cut the budget by some 26 percent over the same period. Under the larger cut, national defense budget authority for 1997 would total $250 billion, in contrast to the Administration's $305 billion.[2] Table 2 shows the pattern of savings associated with this option compared with the 1991 plan.[3] Details about the Administration's latest plan were not available when this report was prepared. Inasmuch as the Administration's 1993 budget request proposes to cut a total of roughly $50 billion between 1993 and 1997 relative to the 1991 plan, overall savings under this option probably would be about $50 billion less if compared with the latest plan.

These additional spending reductions could affect military forces in many ways. To develop a specific illustration of the effects, CBO made a number of important assumptions.

- Cuts in personnel and in funds for day-to-day operations were limited in order to minimize the number of people forced out of the military and the adverse effects on readiness. Specifically, reductions in the number of active-duty military personnel were raised above the Administration's level, but were limited to no more than 110,000 persons a year (similar to the largest reduction in recent years).

- Funds for day-to-day operations--that is, money in the operation and maintenance accounts--were cut only in proportion to the number of military personnel to ensure that the military services would continue to be able to train and support their remaining forces at current levels. The personnel levels and force structure of the reserve components were reduced below the levels requested in the Administration's 1991 plan by about 22 percent.

1. See Congressional Budget Office, "Implications of Additional Reductions in Defense Spending," CBO Staff Memorandum (October 1991).

2. This figure for the entire national defense budget function (050) includes a CBO projection of spending for Department of Energy defense programs. In its 1991 plan, the Administration projected total obligational authority for the Department of Defense at $288 billion in 1997.

3. These estimates show savings from CBO's projection of the costs of the Administration's 1991 defense plan, based on military compensation programs, force levels, and CBO's economic assumptions as of October 1991.

- o Funds for DoD's "investment" accounts--procurement, research and development (R&D), and military construction--were reduced sufficiently to meet the 1997 budget authority target of $250 billion through equal cuts in 1993 through 1997. The composition of cuts within these accounts could be varied to reflect different priorities that might be placed on activities such as research or weapons acquisition, but CBO assumed proportional cuts.

By 1997, the active components of this illustrative force would have 1.34 million personnel, compared with 1.63 million under the Administration's base force--a further 18 percent cut. Reserve personnel would be cut by 22 percent below the Administration's 1991 plan. If these personnel cuts were allocated proportionally among all combat and support units, then the Army would lose two more active divisions than it would under the base force. The Air Force would be reduced by an additional three active fighter wings. The Navy would lose two more carrier battle groups. Marine Corps forces would also be cut. (See Table 3.)

These reductions would result in operating savings of only about $57 billion in budget authority compared with the 1991 plan. Savings of $143 billion must be realized in 1993 through 1997, however, in order to meet the target level of $250 billion in 1997. The remaining $86 billion would have to come from the investment accounts, primarily from procurement and R&D. In 1997, investment funds would have to be cut by 21 percent below the level in the Administration's 1991 plan. Such substantial reductions would require canceling a number of the larger defense procurement and research programs and slowing acquisition of other weapon systems. Reductions in supporting procurement also would be required. In its latest defense plan,

Table 3.
Reductions in Military Forces by 1997 Under Illustrative Alternative, Assuming Proportional Cuts

	Administration's Base Force	Illustrative Alternative	Reduction
	Active Forces		
Army Divisions	12	10	2
Carrier Battle Groups	12	10	2
Navy Ships	448	368	80
Air Force Tactical Fighter Wings	$15\frac{1}{2}$	$12\frac{1}{2}$	3
Marine Corps Brigades	7	6	1
	Reserve Forces		
National Guard Divisions	6	$4\frac{2}{3}$	$1\frac{1}{3}$
Tactical Fighter Wings	11	$8\frac{1}{2}$	$2\frac{1}{2}$
Marine Corps Brigades	3	2	1

SOURCE: Congressional Budget Office.

the Administration proposed some investment cuts, but much larger ones would be needed under this option.

Effects of the Alternative Reduction on Military Capability

The prospect of cuts below the Administration's planned level of funding raises the question of whether the remaining forces would be sufficiently capable to defend against foreseeable military threats. At issue are the size of the forces, the readiness of forces to fight early in a war, and their modernization.

Size of Forces

Based on judgments that the Administration has expressed to date, the size of the forces remaining under this illustrative alternative would not fully meet U.S. military requirements. The forces under this alternative are about 20 percent smaller than the base force.

The Administration's assessment of U.S. security requirements might reflect the desire to have enough active forces to meet the military needs of a large regional contingency like Operation Desert Storm, while also maintaining a substantial number of forces as backup for other contingencies. The active forces under this alternative--particularly the ground combat forces--would not be large enough to meet such a requirement.

The forces remaining under this alternative would be substantial, however, in comparison with those of other countries that maintain large military forces, including the former Soviet Union's constituent republics, North Korea, and China. The active forces also would be large enough to meet the needs of a large regional contingency such as Desert Storm if reserve forces were called to active duty as backups for other contingencies.

Moreover, these illustrative forces should be adequate to handle smaller contingencies of the sort that have occurred in the past. Leaving aside Operation Desert Storm and wars for which the United States has used conscription to build up its military, the largest previous deployment of U.S. forces consisted of the 27,000 troops used in Panama in 1990 for Operation Just Cause. A military consisting of 1.3 million active-duty personnel should be able to handle such relatively small contingencies.

Readiness

Readiness for war is another criterion used to judge military capability. During the transition to a smaller force, military readiness under this option would probably be reduced in comparison with that of the base force. As additional units were eliminated, personnel would need to be reassigned and perhaps retrained, and equipment would need to be transferred or prepared for storage. The larger scale of reductions in this option would mean a greater disruption in training and readiness. Once this transition is past, however, the level of operating funds available for a typical unit should be sufficient to permit training, maintenance, and other activities related to readiness to continue at current levels.

Readiness also depends on the number, quality, and experience of military and civilian personnel. Unless the military services draw down their forces in a balanced manner, they might be left with more senior personnel and fewer accessions than they need. That could result in assignment mismatches, slower promotions, lower morale, and--in the long run--a shortage of midcareer commissioned and noncommissioned officers. Those problems could also arise with the base force, but perhaps with less severity.

Modernization

During the next decade or so, the Administration plans to equip many military units with new and expensive weapons. The additional reduction in funding for procurement under this option would force many of these modernization plans to be abandoned or delayed significantly. Systems affected could include those in all four services and strategic as well as conventional (nonnuclear) forces. The Administration's latest defense plan proposes some cutbacks in modernization, but more would be needed under this illustrative option.

Canceling or delaying weapon systems could adversely affect the defense industrial base. Procurement budgets have already fallen sharply from levels of the 1980s. Coupled with the high prices of many new weapons, the lower procurement budgets envisioned in this option would cause the industrial base for weapons production to shrink even more than under the Administration's latest plan, perhaps jeopardizing the ability of the United States to produce weapons in large quantities in the future, should that be needed.

The reductions in capability associated with this alternative could be offset, at least for some types of forces, if disproportionate cuts could be made in other types of units. For example, the diminution of the threat in Europe might permit the Administration to demobilize a larger share of European forces than it now plans to do. Nuclear forces might also be subject to larger-than-proportional reductions, consistent with some of the initiatives mentioned in the President's State of the Union address in January 1992.

Specific Options for Reducing Defense Spending

Many of the issues touched on briefly in this introduction are discussed at greater length in connection with the specific options presented in the remainder of the chapter. Those options are grouped according to topic. The option labeled DEF-01 discusses the effects on operating costs of specific force cuts, including the one in the illustrative alternative. DEF-02 through DEF-25 address changes in investment plans. These options include possible reductions in funding for strategic systems, Navy ships and related systems, tactical aircraft in the Navy and Air Force, and Army procurement, as well as other issues related to procurement.

Options for reducing the costs of manpower (both military and civilian) and support activities are presented in DEF-26 through DEF-43. Some of these options would reduce pay, and others would change personnel policies, funding for operation and maintenance, and military medical care. Finally, options dealing with international affairs (budget function 150) are presented in DEF-44 through DEF-47.

These options are neither recommendations about nor a comprehensive list of ways to modify the Administration's defense budget request. Options were included here because CBO judged that they met one or more of several criteria: they had previously been the subject of Congressional debate, the need for them might be affected by recent changes in threats, or their efficacy is supported by analysis. Other analysts applying the same criteria might well reach different conclusions about which options to include; still others might use wholly different criteria.

Estimates of cost savings are shown relative to the CBO baseline, which is constrained to levels consistent with the Budget Enforcement Act of 1990. It usually is difficult to associate specific defense programs with such a baseline, but the Administration's 1992 budget request and its projections for later years are consistent with the current CBO baseline because both meet the act's caps. For the most part, accordingly, the estimates shown here are consistent with the Administration's defense plan submitted in February 1991.

The defense baseline differs from the Administration's plan to reflect specific Congressional actions, to incorporate CBO's inflation assumptions rather than those of the Administration, and to reestimate the Administration's request for differences in costing methodology. For example, the baseline assumes the same drawdown in active-duty personnel as in the Administration's plan, but a smaller drawdown in reserves because of specific Congressional action limiting such cuts. In those cases where CBO has been able to estimate savings from changes proposed by the Administration in its 1993 budget request, those estimates are discussed in the text.

DEF-01 INCREASE PLANNED REDUCTIONS OF MILITARY PERSONNEL AND FORCES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	1,000	3,850	9,450	19,250	32,850	66,400
Outlays	750	2,950	7,450	15,250	26,500	52,900

NOTE: Savings estimates shown here are not consistent with those in Table 2 for several reasons. Although active forces are cut at the same rate, reserve forces are drawn down differently, and the baseline projects reserve forces at a higher level than either the Administration's 1991 plan or its current plan. In addition, the baseline incorporates estimates of new compensation programs enacted late in 1991 and uses CBO's current economic assumptions.

By 1997, the personnel drawdown currently planned by the Administration would leave a total of approximately 1.63 million military personnel on active duty and 920,000 in reserve units. This base force would include 18 Army divisions, 26 tactical fighter wings, and 448 Navy ships. To reach these personnel levels, the Administration currently proposes annual cuts of between 61,000 and 99,000 in active-duty personnel in 1993 through 1995, with small additional annual cuts of about 10,000 personnel in 1996 and 1997. (These personnel cuts represent a modest acceleration of the drawdown proposed in the Administration's 1991 plan, but by 1997 personnel levels would be virtually the same as under the earlier plan.) The end strength of the Selected Reserve would be reduced by between 20,000 and 80,000 annually from 1993 through 1995. At the end of the drawdown, the military services intend to have forces with roughly the same mix of officers and enlisted personnel and experience levels that they now have.

This option examines the effects of annual reductions of 110,000 active-duty personnel in 1993 through 1997. Such an annual reduction would be only slightly larger than the largest one-year cut approved so far. Reductions of Selected Reserve personnel would be increased in proportion to those for active-duty personnel. Under this approach, the military in 1997 would include 1.34 million active-duty personnel and 805,000 reserves. Eventually, these larger reductions could require the involuntary separation of a substantial number of active-duty personnel. For the next few years, however, the number of involuntary separations would probably be small because recruiting levels can be reduced sharply and because voluntary losses should increase in response to the newly enacted incentive packages of separation benefits.

Compared with the CBO baseline, savings under this option would amount to $1.0 billion in 1993 and $66.4 billion through 1997. Savings in 1993 compared with the Administration's latest budget request would be slightly smaller. About half of the savings would come from reductions in pay and allowances for military personnel. The rest would come from the operation and maintenance (O&M) accounts, which pay for other day-to-day operating costs and which are assumed to be reduced in proportion to cuts in funds for military personnel. (Though not included in the above table, additional savings might be achieved because fewer weapons would be needed to equip a smaller military.)

The largest savings from these additional force cuts, compared with those assumed in the both the CBO baseline and the Administration's current plan, would be realized toward the end of the five-year period. The Administration plans only small cuts in personnel in 1996 and 1997, whereas this option assumes substantial reductions in those

years. Furthermore, personnel savings in the early years are offset by the added costs of separation pay and benefits.

The Administration would oppose these larger reductions in military personnel because they would require cuts in force structure below the levels in the Administration's proposed base force. If these cuts were proportional to reductions in end strength, for example, the Army would lose an additional two active divisions and two reserve brigades. The Air Force would have three fewer active tactical fighter wings and four fewer reserve squadrons, and the Navy would lose an additional 80 combat vessels. The Administration, however, has asserted that the base force is the minimum required to meet enduring U.S. security needs. The Administration might also contend that additional force cuts should not begin now because of the great uncertainty about future changes in the former Soviet Union and elsewhere.

Even after the reductions were completed, however, the forces remaining under this option would be substantial compared with those of most regional military powers. The remaining active forces, with their 1.34 million personnel, should be capable of responding to smaller conflicts of the sort that have occurred in the past (such as the Panama invasion that involved 27,000 U.S. troops). They would also be able to engage in a large regional conflict, such as Operation Desert Storm, though some combat reserves would probably have to be called to active duty. Prosecuting a major global war would require a long buildup of forces, but even a several-year delay might be acceptable in view of the greatly reduced chance of such a war and the longer warning that is likely to precede it.

The forces that remain under this option should be able to maintain the current level of training and other readiness-related activities because day-to-day operating funds (O&M appropriations) would be reduced only in proportion to cuts in personnel funds. While the drawdown was under way, however, readiness could be expected to fall because of the reassignment of personnel and equipment and the likely need to retrain some service members. These effects will also occur under the Administration's proposed drawdown, although perhaps not to as great an extent.

Instead of annual cuts of 110,000 active-duty personnel, the Congress could mandate a more rapid drawdown, perhaps requiring annual cuts of 120,000 to 150,000 active-duty personnel. Compared with cuts of 110,000 per year, a more rapid drawdown would lead to smaller military forces, thus exacerbating concerns about the ability to meet future threats, and to an increase in the number of involuntary separations that would eventually be needed. Savings would be only modestly larger in 1993 because of increases in separation costs, but savings over the next five years would be substantially greater.

Alternatively, the Congress could plan on a military of 1.34 million active-duty personnel in 1997, the same size as under this option, but require a large cut (perhaps 200,000 or 250,000 active-duty personnel) in 1993 and smaller cuts thereafter. This approach would markedly increase turbulence in the first year, and first-year separation costs would rise sharply, but total savings in 1993 through 1997 would be about $19 billion larger than those in the option. Moreover, a large first-year cut would reduce the uncertainty some military personnel face about whether they will be able to complete their military careers.

DEF-02 CANCEL THE REMAINDER OF THE B-2 BOMBER PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	3,800	5,000	5,300	5,000	4,300	23,400
Outlays	180	1,160	2,890	4,060	4,590	12,880

The B-2 bomber, also known as the Stealth or Advanced Technology bomber, is the newest U.S. bomber aircraft. Sixteen aircraft have been authorized so far (though approval of the sixteenth would require majority votes in both Houses of Congress in 1992). The President's budget proposal of January 1992 requests funding for four more aircraft, which would bring total procurement to 20 combat aircraft. This year's funding request totals about $2.7 billion for procurement of the four aircraft (excluding associated spares) and nearly $1.3 billion for research, development, test, and evaluation.

This option would terminate the B-2 program at 15 aircraft, the number that to date has been approved unconditionally by the Congress. Under this option, the B-2 development program would be completed, and five aircraft now designed for purposes of testing would be converted to a combat configuration. Compared with the CBO baseline, savings under this option would be $3.8 billion in 1993 and would total $23.4 billion through 1997. Savings are large because the CBO baseline, which is based on the Administration's 1991 plan, includes funding for the purchase of enough aircraft to bring total procurement to 75 planes.

Savings compared with the Administration's latest plan would be substantially smaller than those under the baseline--amounting to as much as $1 billion in 1993--because the Administration decided this year to buy only 20 B-2 aircraft rather than the 75 planes envisioned in last year's plan. Even though no more planes would be bought, this option would not save all the funds the Administration has requested in its 1993 budget. Some of the requested funds would be required to complete the development program and pay contract termination costs of perhaps $1.8 billion that would be associated with canceling further procurement of the B-2. Moreover, the Administration's latest budget plan includes about $5 billion in unexplained costs associated with the B-2 program, which could further reduce savings compared with the Administration's plan.

Advocates of buying 20 B-2 aircraft emphasize their potential usefulness in conventional bombing missions, extrapolating from the apparent success of stealth technology in the F-117 fighter in the Persian Gulf War. They also argue that, with 20 aircraft in the fleet, the military could more easily maintain a single operational unit, or squadron, of B-2 bombers throughout the lifetime of the aircraft. Such strategic bomber squadrons customarily include about 14 to 16 operational aircraft, with the exact number varying from situation to situation. With 20 B-2s in its inventory, the Air Force could afford to lose a plane or two over the lifetime of the bomber and also to keep several aircraft in backup mode while maintaining an operational squadron of about 14 to 16 planes.

Countering this argument, some experts--such as the Chairman of the House Committee on Armed Services--point out that the 15 B-2 aircraft already authorized and funded would have as great a payload as the entire F-117 fleet and could deliver the munitions at several times the range of the F-117. More-

over, a fleet of 15 B-2 aircraft would be comparable in number with the recently retired SR-71 reconnaissance fleet, and thus probably would be a viable force despite earlier Air Force arguments that it would not make operational sense to fly a small number of B-2 bombers.

Opponents of buying more B-2 aircraft also argue that additional planes are not needed to protect against military threats from the former Soviet republics. Because of the unilateral but mutual nuclear reduction initiatives of Presidents Bush and Gorbachev in the fall of 1991, implementation of which has accelerated of late, it may not make sense to continue a multibillion-dollar nuclear modernization program. If the West needs bargaining chips to help reduce military spending by the republics, economic and technical incentive programs could be much more effective instruments than the B-2.

The reportedly serious problems that the B-2 aircraft is experiencing in tests of its radar cross section, the technological hurdles it would have to overcome in order to find mobile missile targets, and the current absence of a precision-guided munition deployable on the B-2 also suggest that the plane may have technical shortcomings that could drive up costs or limit the aircraft's capability. Terminating the program might limit those added costs.

DEF-03 RETIRE MINUTEMAN II MISSILES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	200	360	270	170	60	1,060
Outlays	110	230	220	170	100	830

In his arms control initiative of September 27, 1991, President Bush declared he would immediately remove Minuteman II missiles--the oldest intercontinental ballistic missiles (ICBMs) in the U.S. arsenal--from their constant alert status. While on alert, each of the 450 Minuteman II missiles was ready to be launched on very short notice. (It was this constant alert status that earned the missiles their nickname in the 1960s.) The President's announcement merely accelerated implementation of an earlier decision to remove these missiles from alert status and retire them. That earlier decision had been made largely because the Strategic Arms Reduction Talks (START) were expected to require such reductions. (The START treaty was eventually signed in July 1991 and is expected to be considered by the Senate in 1992.)

The President's announcement to take the missiles off alert status does not affect the jobs of missile crews, who remain at their previously assigned posts to provide security and maintenance and to be prepared to return the missiles to alert status should circumstances change.

This option would go one step further, retiring all the missiles in 1993. Compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, savings would be $200 million in the first year and would total $1.1 billion over five years. Savings compared with the Administration's latest plan should be similar in size.

Opponents of retiring the missiles might argue that, for quite modest costs, the Minuteman II missiles could be retained, thus providing an added hedge against uncertainty over the future course of events in Russia and the other former Soviet republics. People who believe that the Soviet Union's restraint in nuclear matters and its willingness to engage in arms control negotiations were affected by the details of U.S. nuclear policy, and that unilateral concessions did not generally induce Soviet restraint, may find virtue in keeping Minuteman II missiles for several more years. Moreover, advocates of an orderly drawdown of the U.S. armed forces may believe that a gradual reduction in forces is less likely to damage military morale than more rapid changes; this same rationale may apply to a reduction of the U.S. ICBM force.

Even by immediately committing the United States to permanently retiring these missiles, however, this option would reduce the U.S. strategic arsenal by only about 5 percent--at a time when many people, including a panel recently commissioned by the Air Force, are calling for deep additional cuts in superpower nuclear forces. Minuteman II missiles are not particularly accurate or modern weapons. Thus, retiring these missiles early may be viewed as acceptable.

DEF-04 RETIRE THE B-1 BOMBER FLEET

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	420	880	910	940	970	4,120
Outlays	300	670	790	870	920	3,550

The B-1 bomber, also known as the Lancer bomber, was built in the 1980s and remains a cornerstone of the U.S. nuclear deterrent. Of the 97 aircraft in its inventory (three of the original 100 having been lost in accidents), the Air Force considers 84 to be operable at any given time.

This option would retire all B-1 bombers in fiscal year 1993. Aircraft would be retired to open storage at Davis-Monthan Air Force Base in Arizona. Relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, savings would be about $400 million in 1993 and $4.1 billion over the 1993-1997 period. Savings compared with the Administration's latest plan should be similar in size.

Most potential savings associated with the B-1 bomber are in the area of operation and support--salaries for crews and mechanics, spare parts, fuel and lubricants for routine training missions, and so forth. Costs for these types of activities are not trivial for modern high-performance aircraft; for a single B-1 bomber, they total about $10 million a year once all direct and indirect costs are taken into account.

Additional savings might follow from ending efforts to overcome various deficiencies in the B-1 bomber. The most persistent difficulty has been in so-called defensive avionics--the radar-receiving and -emitting devices designed to determine when the B-1 is being tracked by hostile radar and then to blind or fool the radar. Other modifications have been intended to make the B-1 more resilient to wear and tear and less prone to accident. In addition, the Air Force is reportedly considering upgrading the B-1 so it can carry precision-guided conventional munitions of the general type used in the Persian Gulf War.

Further savings, not included in the above table, might arise in less direct ways. Most notably, it might be possible to reduce the costs of owning and operating a large fleet of refueling tanker aircraft and the costs of building and maintaining warheads for the B-1 fleet. With a smaller strategic bomber force, the Air Force might need fewer tanker aircraft, though other Air Force missions also impose demands on the tanker fleet. Retiring several squadrons of KC-135 tankers could yield additional savings of several hundred million dollars a year. Another $200 million a year or so, on average, might be saved by reducing the stockpile of U.S. nuclear warheads in a manner consistent with retiring 97 long-range bombers.

Proponents of retiring the B-1 aircraft might argue that the above-mentioned problems with the aircraft may explain lower availability rates for the B-1 in 1991, and why it was not deployed to the Persian Gulf during the recent war against Iraq. In fairness, it should be noted that the Air Force may have decided not to deploy the B-1 to the Gulf because it had no particular need for an aircraft with the B-1's set of characteristics, rather than because of technical flaws in the aircraft (some of which were, by the way, subse-

quently repaired in 1991). Either way, however, these issues raise the question of whether or not the B-1 is likely to be important in future conventional bombing missions.

Nor is it clear that, given the end of the Cold War and the tremendous size of the U.S. nuclear force structure, the United States needs to deploy strategic bombers--including the B-1--to deter nuclear war. Both the Administration's decision to curtail procurement of the new B-2 bomber and its apparent decision to assign older B-52 bombers primarily to conventional missions support this conclusion. The older B-52 aircraft, with highly capable cruise missiles that can be fired without overflying hostile airspace, presumably could be used for nuclear missions if that ever were necessary. Nuclear weapons also would remain on largely invulnerable submarines and on land-based missiles.

Defenders of the B-1, however, might argue that it is the only so-called strategic "penetrating bomber" that the United States owns today that is capable of low-altitude bombing runs against well-defended targets. Some missions in the U.S. Single Integrated Operational Plan may call for the flexibility and accuracy of penetrating bombers. Although one can debate whether these missions are necessary, they reportedly remain in U.S. war plans today. Moreover, long-range aircraft capable of delivering precision-guided munitions could be highly valuable in a future conventional conflict in a region that has no air bases and that naval aircraft cannot reach. The B-2 aircraft already purchased may be able to conduct many such missions. But demanding scenarios could require more capability than the small number of B-2 aircraft that now seem likely to be purchased. Under such circumstances, at least one or two squadrons of B-1 aircraft might be quite valuable for conventional missions, provided that they were modified to carry precision-guided conventional munitions.

Indeed, if strategic bombers are to be retired, it may make more sense to retire the older B-52 bombers rather than the B-1 aircraft. Because of their greater maneuverability and smaller radar cross sections, B-1 bombers might be valuable in a wider range of conflicts than are B-52 aircraft. It may be more feasible to evaluate the trade-offs involved in such a decision once the Department of Defense clarifies its plans for the strategic bomber force.

If the B-1 fleet were retired, the Air Force might attempt to protect its investment in the aircraft by constructing shelters to reduce wear from wind, heat, and precipitation. In this way, the B-1 fleet might remain available for use into the next century when the B-52 bomber fleet would no longer be capable of operations. This CBO option, however, does not assume the allocation of any funds to construct special storage facilities for the B-1 fleet. Nor is it clear whether, even with shelters, the B-1 fleet could economically be returned to service in the next century.

DEF-05 REDUCE SPENDING ON INTELLIGENCE ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	300	800	1,400	2,000	2,400	6,900
Outlays	285	775	1,370	1,970	2,380	6,780

U.S. intelligence activities are conducted by a variety of organizations including the National Security Agency, the Central Intelligence Agency, the Defense Intelligence Agency, the Defense Mapping Agency, the National Reconnaissance Office, the specialized intelligence agencies of the individual military services and commands, and elements of the Departments of State, Justice, Treasury, and Energy. These agencies monitor arms control agreements and, more generally, assess the military and economic capabilities of the former Soviet republics and other countries. They survey the military activities of countries, resistance armies, terrorist organizations, and drug groups to detect early signs of operations that could be harmful to the United States or its allies, and carry out certain covert operations. In a conflict, they also provide information of critical importance for choosing and carrying out U.S. or allied armed operations. Although much of the requested funding for these activities is classified, statements in the press and at open intelligence hearings suggest that current funding is about $30 billion per year.

This option would reduce the number of intelligence personnel by 20 percent. Personnel cutbacks of 5 percent a year through 1996 were called for in the National Defense Authorization Act for Fiscal Year 1991. Because funding for intelligence is highly classified, it is not clear whether reductions were made in 1992. But if the annual level of 5 percent reductions were enforced from 1993 through 1996, savings from the personnel cuts would total more than $2 billion a year once fully carried out.

Although these estimates of savings do not assume any reductions in equipment, a reduction in the amount of monitoring equipment acquired and operated by the intelligence community might be consistent with this option. The equipment reductions could focus on imaging satellites, but also might include some aircraft and radars used for tactical intelligence. Reducing the number of imaging satellites might save around $1 billion annually, if their steady-state number is reduced from the reported level of about seven to the historical average of about three. Cutting other technical equipment by the same percentage as personnel would save at least another $1 billion a year. In all, therefore, this option might eventually help reduce intelligence spending by over $4 billion a year.

In estimating savings, CBO assumed that the Administration intends to keep funding at current real levels indefinitely, an assumption that may make CBO's estimates of savings somewhat high. But this Administration continues to accord intelligence activities a very high priority, so such an assumption may be a reasonable approximation of true budget plans. More should be known about the Administration's plans for intelligence spending once the Director of Central Intelligence presents a plan, expected in March 1992, for restructuring the intelligence community.

Changes in U.S. intelligence operations should be made with a good deal of caution. Unless properly carried out, such changes could damage highly valuable intelligence-gathering activities. Moreover, in a period of increased trust and disarmament between the United States and the former Soviet republics, enhanced intelligence capabilities may provide a prudent and economical form of insurance against volatility in central Eurasia. If there is a choice between devoting too much funding to intelligence or too little, according to this line of reasoning, it is better to spend more to be sure that necessary operations are carried out. As recent world events have shown, moreover, intelligence activities must focus on developments in many countries besides those of the former Soviet Union. Consequently, reductions in intelligence funding, though they may be feasible, should be attempted only when waste or inefficiency is clearly identified.

In the view of some critics, however, there may be a good deal of redundancy in the operations of the roughly 20 intelligence organizations. Given the complexities and uncertainties intrinsic to intelligence work, there undoubtedly are benefits to having more than one independent group study any given issue. But the benefits of such overlap clearly must diminish at some point, and--if the 1991 Defense Authorization Act is a fair indication--many Members of Congress apparently have determined that such a point has been reached. Moreover, in a period of changing U.S. national security priorities and of a general improvement in superpower relations, the time is ripe for reconsidering how the United States collects and analyzes information on other countries.

Similar arguments about excess and redundancy may also apply to technical systems used in reconnaissance. For example, imaging satellites of the KH and Lacrosse varieties are currently deployed in greater numbers than in the past and are expected to receive continued high funding. But these satellites may produce so much data that they overwhelm systems for collection and analysis. In addition, one of their key missions--finding and tracking mobile intercontinental ballistic missiles of the former Soviet state--might even hinder deterrence and the prospects for arms control by making Russia and other former republics uneasy about the survivability of their forces, whether or not the satellites have all the capabilities that worst-case planners in those countries might attribute to them. Many electronic intelligence and reconnaissance aircraft--such as RF-4Cs and P-3s--as well as tactical radar and radio listening centers and some underwater sonar arrays might no longer be necessary in forward theaters where the forces of the former Soviet Union have drastically curtailed their presence and their operations.

Mission-specific cuts in intelligence such as these, if properly thought through, should not reduce U.S. capabilities to conduct missions that remain important in the post-Cold War era--missions such as tracking arms shipments between countries, monitoring some countries' nuclear weapons programs, and supporting U.S. and allied forces engaged in combat.

DEF-06 REDUCE SPENDING ON DOE WARHEAD ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	800	1,700	2,600	3,600	3,700	12,400
Outlays	600	1,400	2,300	3,300	3,700	11,300

The Department of Energy (DOE) manufactures the materials for nuclear weapons and disposes of nuclear waste; it also designs, tests, manufactures, and maintains the weapons themselves, and is responsible for the safety of its production and manufacturing sites. The Administration is requesting $12.1 billion for 1993 for atomic energy defense activities. Of this total amount, $4.6 billion would be allocated for environmental restoration and waste management and $800 million for naval reactors. Other funds would be used for materials production, warhead design and testing, and warhead production and maintenance.

This option eventually would reduce DOE funds for developing, testing, producing, and maintaining nuclear materials and nuclear warheads by almost 50 percent. After the cutbacks, funding would roughly equal the level of fiscal year 1980 (adjusted for inflation). As an indication of the adequacy of that level of funding, in 1980 the United States maintained--but was not engaged in expanding--an arsenal of about 25,000 warheads, perhaps twice as many as it seems likely to retain in the 1990s. This option would not reduce planned expenditures on environmental restoration activities at DOE sites. Nor would it interfere with fueling nuclear-powered naval vessels.

Reduced funding seems reasonable in light of recent progress in nuclear arms control. Presidents Bush, Gorbachev, and now Yeltsin have moved beyond the levels that appear in the recently concluded Strategic Arms Reduction Talks (START) Treaty: in January 1992, Presidents Bush and Yeltsin proposed still deeper cuts. Even lower warhead levels have been advocated by a number of important groups and individuals in recent months, especially in the wake of the failed Soviet coup in August 1991. They also have been recommended by the National Academy of Sciences and analyzed in recent studies (see, for example, Congressional Budget Office, *The START Treaty and Beyond*, October 1991).

Under this option, DOE funding would be cut selectively. DOE could reduce or eliminate the research, development, and testing of new warheads; prolong its current self-imposed moratorium on production and processing of fissile materials and warheads; and further postpone the construction of a new reactor. DOE could also indefinitely postpone work on a new nuclear reactor to produce tritium--a gas used in nuclear warheads. (Construction of the reactor has already been postponed for at least two years.) Tritium decays with a half-life of about 12 years, and thus must be replenished rather frequently. It can be extracted from retired warheads, however, and used to replenish the tritium reservoirs in warheads that are retained in the arsenal. In this way, the United States has coped with the absence of a full-time working tritium reactor since 1988, and could make do without one for at least the next two decades if it can make the deep cuts in warheads mentioned above.

Funding reductions under this option would not require reductions in activities necessary to dismantle warheads. A good deal of dismantlement already has become inevitable as a consequence of President Bush's nuclear initiative of September 27, 1991; much more would be needed under this option. This option also would allow the Department of Energy to continue its cleanup operations and its fueling of nuclear-powered naval vessels. Finally, it would permit selective modernization of some remaining warheads in order to improve their safety.

DEF-07 CANCEL THE SMALL ICBM (MIDGETMAN)

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	500	400	400	400	400	2,100
Outlays	270	400	380	380	380	1,810

Since 1984, the United States has appropriated $3.9 billion to develop a small intercontinental ballistic missile (SICBM), called Midgetman, that carries a single warhead. The SICBM program was intended to enhance the ability of the ICBM leg of the strategic triad to survive a Soviet nuclear attack by providing the United States with a mobile ICBM. For SICBM, mobility would have been maintained by deploying the missile on a truck hardened to withstand the effects of a nuclear attack. Although the Defense Department's 1992 plans provided no detail on SICBM deployment, earlier plans supported an initial operating capability date of 1997.

Mobile ICBMs enhance survivability because they can be dispersed quickly over a wide area and remain hidden, forcing an attacker to search for and destroy the missiles one by one (a difficult and time-consuming task) or to cover large portions of the dispersal area with nuclear warheads (an extremely inefficient use of warheads). On September 27, 1991, however, President Bush announced that the United States would forgo mobile basing for the SICBM, and instead would deploy it in silos.

This option would cancel the SICBM program. Relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, savings would be $500 million in 1993, $400 million in 1994, and $2.1 billion through 1997. SICBM acquisition savings beyond fiscal year 1997--the period when the Air Force would buy these missiles--could total $30 billion. These savings reflect only the costs to develop the missile for silo basing and to buy the missile. Costs associated with mobile basing have already been excluded from current plans.

Relative to the Administration's latest plan, which also proposes cancellation of the SICBM, this option would not yield any savings. In its budget request for 1993, however, the Administration proposed spending much of the savings from SICBM cancellation on improving the accuracy of the existing Minuteman III missile. The CBO option does not include any funds for that purpose, which the Department of Defense estimates would cost $0.1 billion in 1993 and $2.3 billion through 1997.

Canceling the SICBM would mean forgoing several advantages inherent in the missile itself. The SICBM would be more accurate than the existing Minuteman III missile and therefore would enhance the ability of the United States to destroy targets hardened against nuclear attack, such as silos and command bunkers. It might also increase the price that an attacker must pay in warheads to destroy U.S. missiles because the attacker would have to use more than one warhead to have high confidence of destroying the silo-based SICBM with its single warhead. Finally, the SICBM would modernize the U.S. ICBM

force, which consists predominantly of Minuteman III missiles that were deployed in the early 1970s.

This option, however, would be consistent with the Congressional directive about the SICBM program in the 1992 defense authorization bill. In that bill, the Congress urged the Administration either to pursue a mobile-basing mode for the SICBM or to terminate the program and instead modernize existing Minuteman III missiles. This option would be consistent with the latter directive.

Moreover, canceling the current SICBM program would have no measurable effect on the ability of U.S. ICBMs to survive an attack. The advantage of the mobile SICBM's survivability has been eliminated by the Administration's silo-basing plan. Without mobility, the SICBM's only advantage--enhanced capability to destroy hardened targets--may become a lower priority for U.S. war planners if nuclear arsenals are reduced, as President Bush and President Yeltsin have proposed. Such a cut would reduce the number of hardened targets. Finally, planned upgrades to the existing force of Minuteman III missiles, which the SICBM presumably would be replacing, will make them usable through 2010. At that time, a replacement ICBM could be developed, if necessary.

DEF-08 TERMINATE PRODUCTION OF D5 MISSILES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	0	0	1,600	1,600	1,500	4,700
Outlays	0	0	150	670	1,250	2,070

The D5 missile (also called the Trident II missile) is the most accurate and powerful submarine-launched ballistic missile in the U.S. inventory. The result of more than 15 years of research and development, it is the keystone of the Navy's plan to modernize its ballistic missile force. Because of its accuracy and the size of its warheads, the D5 missile is the first submarine-launched missile that has a high probability of destroying targets such as missile silos and command bunkers (so-called counterforce targets) that are hardened against nuclear attack. This capability will allow the Navy to assume some of the counterforce targeting previously borne by the Air Force's land-based intercontinental ballistic missiles (ICBMs) and long-range bombers.

The Administration plans to have 24 D5 missiles on each of the 18 Trident submarines that the Navy intends to deploy. To date, the Navy has deployed 12 Trident submarines and is building the remaining six. The first eight deployed submarines carry the C4 missile (also called the Trident I missile), which is less accurate and carries less powerful warheads than the D5. The other four deployed submarines carry the newer D5 missile, as will the six submarines still under construction. In addition, the Navy plans to modify (backfit) the first eight submarines after 1998 so that they can carry the larger D5 missile. Thus, by 2005, the Navy plans to have D5 missiles deployed on all 18 Trident submarines. Each D5 missile will carry eight nuclear warheads.

This option would terminate D5 production after 1994 and deploy C4 missiles from the recently retired Poseidon submarines in the final four of the six Trident submarines currently under construction. The missile tubes and fire control systems in these four submarines would be designed like those in the first eight Trident submarines, which carry C4 missiles. This option would also terminate the program to backfit the first eight Trident submarines to carry the larger D5 missile. Terminating D5 production after 1994 would give the United States an arsenal of 355 D5 missiles--enough to fill the six Trident submarines (four deployed and two under construction) equipped with D5 missiles under this option and to conduct a modified testing program likely to meet Joint Chiefs of Staff requirements for establishing reliability. This number of missiles might not be sufficient, however, to conduct the testing program planned by the Navy. Reducing the number of D5 test flights per year would be consistent with a similar Administration policy that recently reduced the number of annual test flights of the MX missile.

Relative to the CBO baseline and the plan the Administration set forth in February 1991, savings under this option would start in 1995 and would total $4.7 billion through 1997. This option also would yield no savings in 1993 compared with the Administration's latest plan. Beyond 1997, the option would save an additional $12 billion, which includes

savings of $2 billion from canceling the back-fit program. Even though the latter savings would not begin until 1998, a decision on this approach should be made during debate over the 1993 budget. Otherwise, the final four Trident submarines will not be configured to carry the existing C4 missile.

Deployed on the Trident submarine, the D5 missile significantly enhances the U.S. ability to destroy targets hardened against nuclear attack. If deployed on all 18 submarines, as the Navy plans, the D5 arsenal would contain 3,456 warheads capable of destroying hardened targets, compared with fewer than 2,000 such warheads likely to be deployed on land-based ICBMs under the Strategic Arms Reduction Talks (START) Treaty. Furthermore, because submarines at sea would be far less vulnerable to attack than land-based missiles, the D5 warheads would be much more likely to survive an attack. Canceling the D5 would reduce the number of surviving warheads that could attack counterforce targets.

Nevertheless, changes in Europe and the former Soviet Union may have fundamentally altered the chances of nuclear war between the superpowers, which in turn may reduce the perceived need to maintain large numbers of hard-target warheads to deter the former Soviet republics from considering a nuclear attack. Although this option would reduce the number of submarines carrying D5 missiles below the Administration's goal, the six D5 submarines that the option would retain, along with the ICBM and bomber arsenal, may provide enough capability to deter nuclear war. Indeed, the six D5 submarines would have more potential to destroy hardened targets than today's entire ballistic missile submarine fleet. If the United States and former Soviet republics were to reduce their arsenals below START levels, either bilaterally or unilaterally, even fewer D5 missiles would be needed as there would be fewer missile silos and other hardened targets.

DEF-09 LIMIT SDI TO AN ABM-COMPLIANT BALLISTIC MISSILE DEFENSE AND CONTINUE RESEARCH

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	2,500	2,900	3,400	3,800	4,400	17,000
Outlays	1,300	2,500	3,100	3,500	4,000	14,400

Since 1984, the Department of Defense has invested over $26 billion in the Strategic Defense Initiative (SDI) program to research and develop technologies that could lead to the deployment of a defense against ballistic missiles. Throughout this period, there has been vigorous debate about the future direction of the program--should defenses be deployed, when should they be deployed, what threat might these defenses address, and what types of defenses would be most appropriate. Though differences remain, the Congress and the Administration seem to agree about the need for limited defenses designed to protect the United States against an accidental or unauthorized attack by a few long-range ballistic missiles from the former Soviet Union, or an attack by a future adversary that might not have long-range ballistic missiles today.

These defenses, however, would require substantial funding, which may not be available during the next few years. This option would respond to tight funding and concerns about compliance with the Anti-Ballistic Missile (ABM) Treaty by limiting SDI to an ABM-compliant defense with 100 interceptors deployed at a single site. Deployment would begin near the end of the decade. As a hedge against a threat from a future adversary armed with ballistic missiles that could reach the United States, this option would continue a modest level of research and development of more advanced interceptors and beam weapons. Funding for tactical or shorter-range ballistic missile defenses would be sustained at the level proposed by the Administration, which would allow defenses against short-range missiles to be deployed in the late 1990s. Relative to the CBO baseline and the Administration's February 1991 plan, savings would total $2.5 billion in 1993 and $17 billion from 1993 through 1997. Compared with the Administration's budget request for 1993, the option would yield 1993 savings of $2.5 billion.

The 1992 defense authorization bill calls for a deployment of 100 ground-based interceptors at Grand Forks, North Dakota, by 1996, or as soon as is technologically feasible. This deployment is to be consistent with the existing ABM treaty. In addition, the Congress has urged the Administration to try to renegotiate the ABM treaty with an eye toward future deployment of a larger system of limited, ground-based defenses. The larger system might consist of ground-based interceptors deployed at multiple sites as well as space-based sensors--similar to the Administration's Global Protection Against Limited Strikes (GPALS) system, except that GPALS also includes space-based interceptors. Because this option would deploy defenses at the end of the decade (the same schedule that the Administration has proposed for its GPALS system) rather than by 1996, and because it would limit defenses to only one site and 100 interceptors, this option would not be completely consistent with recent Congressional action.

To opponents of this option, the Persian Gulf War has demonstrated the dangers of

ballistic missile proliferation, and the breakup of the Soviet Union has increased the chances of an unauthorized launch. Because the GPALS system would address these threats, it is important, in the view of opponents, to proceed quickly with this multiple-site defense, including space-based interceptors. By limiting the SDI program to an ABM-compliant defense, this option would delay deployment of a more robust limited defense against long-range missiles. Furthermore, a 100-interceptor defense based at one site might not be able to defend the populous coastal regions of the United States against all limited threats.

Supporters of this option argue that a single-site, 100-interceptor defense would be sufficient to meet any reasonable threat for the foreseeable future, especially if development is not rushed for a 1996 deployment. By deferring a decision to exceed the limits of the ABM treaty, this option would save money but still retain the capability to deploy a more effective multiple-site, ground-based defense in the future if the ballistic missile threat against the United States should change.

By limiting radars to just one site, this option would also reduce the risk of breakout posed by a multiple-site system like GPALS that would have radars at several sites throughout the country. This nationwide radar network could provide an essential element for a larger national defense: one only needs to add more interceptors at each site to enhance significantly the capability of the defense. Expanding a multiple-site system enough that it jeopardized the nuclear retaliatory capability of the former Soviet republics could lead to instability during a crisis. Creating a national defense large enough to affect stability is much more difficult to accomplish under the ABM treaty, which severely limits the number and location of ABM radars for just this reason. Therefore, supporters view this option as striking a careful balance between the need to protect against a limited strike and the need to ensure that defenses remain limited and do not threaten an opponent's retaliatory capability. Furthermore, by virtue of technology development and research activities, this option provides a hedge against possible future ballistic missile threats.

DEF-10 DEFER PROCUREMENT OF NEW AIRCRAFT CARRIER

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	850	0	3,300	0	0	4,150
Outlays	40	110	340	580	800	1,870

Aircraft carriers form the centerpieces of the Navy's battle groups, which protect U.S. interests around the world in peacetime and project military power during war. Aircraft carriers are also important to the budget because they have a decisive influence on the size of virtually all of the rest of the Navy. The number of carriers helps determine the Navy's need to buy other ships--including surface combatants, submarines, and logistics ships--as well as aircraft and weapon systems. These decisions, in turn, affect needs for personnel.

The Department of Defense plans to reduce the number of aircraft carriers in the Navy from the 1992 planned level of 13 to 12 carriers by 1995, and to maintain 12 for the foreseeable future. In order to maintain 12 carriers, and retire older carriers after about 45 years of service, the Navy plans to buy another aircraft carrier in 1995. Advance procurement funds for this new vessel are included in the 1993 budget. These funds would be used to buy components of the 1995 carrier that take an especially long time to manufacture. According to last year's budget, the new carrier will cost about $4.2 billion to build. However, the Pentagon has reportedly reestimated the price to be about $4.9 billion. The carrier should cost about $250 million a year to operate.

This alternative would defer until after 1997 the aircraft carrier the Navy plans to purchase in 1995 as well as any funds for advance procurement of that ship. Compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, this option would save $850 million in budget authority in 1993 and $4.2 billion from 1993 through 1997. Compared with the Administration's current plan, this option would save about $830 million in 1993. Because the Administration has not yet provided the details of its plan after 1993, five-year savings cannot be estimated.

This approach has some disadvantages. If the Congress decides to maintain 12 aircraft carriers, delaying production of a new carrier could mean that the service life of an existing carrier would have to be extended for several years, which could require a modest increase in funding for carrier maintenance after the year 2000. Also, delaying the authorization of a new aircraft carrier might disrupt the process of building new aircraft carriers at the one shipyard that constructs them, which could increase future construction costs.

Deferring the carrier would be consistent, however, with a decision to have fewer than 12 aircraft carriers. Some Members of Congress and defense analysts have suggested that a smaller fleet of carriers could meet security needs with acceptable risks. For example, the Chairman of the Senate Committee on Armed Services has recommended a fleet of 10 to 12 carriers, and a recent study by the Brookings Institution suggested a markedly smaller fleet of six carriers.

A smaller carrier fleet might also be consistent with recent world events. The current goal of 12 carriers and related naval forces was formulated before the dissolution of the former Soviet Union. During the 1980s, the

Reagan Administration tied the need for a large Navy to threats the former Soviet Union posed to U.S. security. To the extent that those threats have been reduced, there is uncertainty about both the desirable size of the Navy and the funds that will be available to support naval forces. This option would allow the Congress more time to consider how changing defense needs should affect the size of the Navy, and might prevent a substantial investment in a carrier that is not needed.

Moreover, the National Academy of Sciences recently released a study of possible improvements in aircraft carrier technology. Deferring the carrier would allow the Navy more time to study technological improvements and, if desirable, incorporate them into new carriers.

A decision to reduce the size of the fleet below 12 carriers would have collateral effects that are discussed in other options. The merits of overall reductions in U.S. forces, of which naval force cuts would be a part, were reviewed in the introduction to this chapter. Decreasing the number of aircraft carrier battle groups could lead to savings in destroyers that escort carriers (DEF-13) and carrier-based aircraft (DEF-15 and DEF-16).

DEF-11 TERMINATE THE SSN-21 PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	2,700	2,800	2,900	4,900	4,000	17,300
Outlays	310	740	1,220	1,700	2,350	6,320

The SSN-21 (Seawolf class) submarines were designed to counter projected improvements in Soviet submarines. Like the SSN-688 (Los Angeles class) submarines that it follows, the SSN-21 is designed to detect and destroy enemy submarines and surface ships and to launch cruise missiles against ships and targets on land. According to the Navy, the SSN-21 submarine would have many advantages over the SSN-688. The SSN-21 would be able to dive deeper, carry more weapons, and operate more quietly at higher speeds. In addition, it would have advanced sensors for detecting enemy submarines and a more powerful computer system to coordinate its sensors and weapons. These improvements have not come cheaply. For example, the SSN-21 that the Congress funded last year cost about $2 billion, about twice as much as an SSN-688.

The Congress has approved the purchase of three SSN-21 submarines and, as of last year, the Administration called for the purchase of six additional submarines between 1993 and 1997. In its 1993 budget request, however, the Administration proposes canceling two of the three SSN-21 submarines that the Congress funded in earlier years and terminating all future SSN-21 procurement and research. As a result, the Navy would build only one SSN-21, which would be delivered to the fleet in 1996.

Like the Administration's current plan, this option cancels the SSN-21 program, and thus saves no money relative to that plan. This option would save $2.7 billion in budget authority in 1993 and a total of $17.3 billion from 1993 through 1997 relative to the CBO baseline, which is based on the Administration's 1991 plan.

The primary disadvantage of this option, and of the Administration's latest plan, is that the Navy would forgo the improvements offered by additional SSN-21 submarines. The submarines of the former Soviet Union, the vast majority of which are stationed in Russia, are the only vessels that could pose a serious threat to U.S. submarines. If the former Soviet republics produce more capable submarines in large numbers and present a more immediate military threat to the United States in the future, then this disadvantage could be important.

The risks of canceling the SSN-21, however, might be acceptable in light of recent events. The social and economic problems of the former Soviet republics might slow or halt submarine modernization. Indeed, the Defense Department cited the collapse of the Soviet Union as its rationale for canceling the SSN-21. Moreover, the Administration has stated that U.S. submarines are superior to those fielded by the former Soviet Union. In addition, the Navy no longer accords antisubmarine warfare as high a priority as other naval missions, such as projecting military power ashore.

The Navy has also announced plans to design a new class of attack submarine named the Centurion. According to Navy officials, the goal of the Centurion program is to design

a submarine that is more affordable than the SSN-21, but that nevertheless maintains U.S. superiority in submarine technology. Many years of design work will have to be completed before the first Centurion class submarine can be built.

DEF-12 CANCEL PROCUREMENT OF ADDITIONAL TAGOS SHIPS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	50	210	360	40	40	700
Outlays	30	50	80	110	120	390

The Navy currently operates 19 TAGOS surveillance ships that search for enemy submarines. Each TAGOS ship is equipped with a sophisticated sonar system that listens for the distinctive sounds created by the submarines of potential enemies and reports their location to ships or aircraft that can attack them.

There are three different classes of TAGOS ships. The Navy purchased 18 TAGOS-1 class ships from 1979 through 1987, and bought four TAGOS-19 class ships from 1987 through 1989. The Congress funded the first TAGOS-23 class ship in 1990 and the second in 1992. The Navy plans to buy a total of five TAGOS-23 class vessels. Compared with the TAGOS-1 vessels, the TAGOS-19 and TAGOS-23 class ships are larger and have a unique dual hull (Small Waterplane Twin Hull or SWATH) design, which makes the new ships more stable in rough seas. The TAGOS-23 class ships also house more effective sonar systems.

Despite these advantages, this option would cancel the procurement of new TAGOS-23 class ships. Relative to the CBO baseline and the Administration's February 1991 plan, this option would save $50 million in 1993 and a total of $700 million in 1993 through 1997. The Administration's budget request for 1993 does not contain enough information to estimate savings that would result from this option.

A reduction in the TAGOS mission is already apparent. According to last year's plan, the Navy intends to remove six TAGOS-1 class ships from active duty in 1992 and 1993. According to press reports, an additional 12 TAGOS ships will be mothballed or placed in reserve status before 1997. These ships are relatively new. For example, the six ships that the Navy plans to remove from the active fleet in 1992 and 1993 will average only eight years of service. Canceling procurement of new TAGOS ships may therefore reflect priorities implicit in the Navy's force planning.

If the TAGOS-23 program is canceled, the Navy would not benefit from the ships' superior ability to operate in rough seas and their more advanced sonar systems. These systems are designed to counter advanced submarine threats. Thus, the loss of these vessels would be especially worrisome if the submarines of the former Soviet Union pose an increased threat in the future.

Unless there is a renewed Soviet threat, however, fewer TAGOS ships might be needed. Only the republics of the former Soviet Union have submarines of sufficient quantity and quality to pose a serious threat to U.S. submarines and ships. Part of the rationale for building better stability into the TAGOS-23 was to allow the ships to operate more effectively in northern latitudes, where the Soviet republics' submarines are deployed.

Moreover, until very recently, the Navy stated that antisubmarine warfare was its most important wartime priority. In light of the reduced threat from the republics of the former Soviet Union, the Navy now places higher priority on other missions, such as projecting military power ashore. Since the only mission of the TAGOS ships is antisubmarine warfare, the Navy's change in priorities might argue against further investment in that ship.

DEF-13 REDUCE PROCUREMENT OF DDG-51 DESTROYERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	1,700	1,000	1,000	1,900	1,100	6,700
Outlays	90	280	530	710	960	2,570

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 DDG-51s incorporate the AEGIS combat system and other improvements in speed, weapons, and armor. The Navy states that the DDG-51s also will be more difficult for enemy forces to detect because of design features that reduce their radar, sonar, and infrared signatures. To date, the Congress has funded 22 of the DDG-51s. The Administration requests an additional four for 1993 and, based on last year's plan, a total of 17 through 1997.

This option would buy only 10 DDG-51s from 1993 through 1997, at a rate of two a year. Relative to the CBO baseline and the Administration's current plan, forgoing the construction of two new destroyers would save about $1.7 billion in budget authority in 1993. Compared with the CBO baseline and the Administration's 1991 plan, savings from 1993 through 1997 would total $6.7 billion. In addition, the smaller fleet of surface combatants in the next decade would result in savings in operation and support costs, which are not included in this option.

Even with the slower rate of construction, the Navy should still be able to meet its goals for this type of ship. The Navy has testified to the Congress that it seeks to maintain a force of 150 surface combatants (cruisers, destroyers, and frigates). CBO estimates that, under the Administration's plan, the Navy would exceed its goal in 2002, the year in which the DDG-51 ships funded in 1997 would enter the fleet. In that year, the Navy would have 158 surface combatants. This option would result in a fleet of 151 surface combatants in 2002, still above the Navy's goal of 150 ships.

Having fewer DDG-51 destroyers may also be consistent with reductions in other naval forces and with reduced threats. Because of the declining Soviet threat, the Congress might mandate a reduction in the number of naval aircraft carriers (see DEF-10). Procuring fewer DDG-51 destroyers would be in keeping with that decision. DDG-51 destroyers also incorporate sophisticated combat systems, such as the AEGIS system, that would be needed most in a major war with the former Soviet Union. Such a conflict now seems unlikely, which may reduce the number of DDG-51 vessels that are needed.

This option could have disadvantages, however. Only two shipyards build surface combatants, and reducing procurement to two of these vessels a year would probably force one of the two shipyards out of the business of building surface combatants, and possibly out of business altogether. The shipbuilding industrial base has declined markedly over the past decade, and the Congress would have to weigh carefully the possible effects of further reductions to the country's naval shipbuilding capabilities.

DEF-14 CANCEL THE AIR FORCE'S F-22 AIRCRAFT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	2,320	2,520	2,320	2,420	1,740	11,320
Outlays	1,280	2,120	2,180	1,830	1,560	8,970

The F-22 aircraft is being developed as the Air Force's next premier fighter, replacing the F-15 aircraft by the mid- to late-1990s. Fighter aircraft are designed primarily to destroy enemy planes, thus guaranteeing the United States and its allies control of the air. The Air Force wants the F-22 aircraft to have supersonic cruise speed as well as stealth characteristics that make it difficult for enemy sensors to detect. The F-22 aircraft would also be designed to fly long distances and to have highly effective avionics that could make it more capable than other fighters in many types of combat. The F-22 entered full-scale development in 1991 and the first F-22s were to be bought in 1996, according to last year's plan.

This option cancels the F-22 program on the grounds that its additional capability may be both unnecessary and too expensive. Compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, and assuming no further cost increases, canceling the F-22 would save $2.3 billion in 1993 and $11.3 billion for the 1993-1997 period. Relative to the Administration's current plan, this option would save $2.2 billion in 1993.

The improved capabilities of the F-22 aircraft will be costly. The 650 aircraft that the Air Force plans to buy will cost a total of about $52 billion in 1993 dollars ($78 billion in current dollars, adjusted for inflation). The average unit procurement cost of the F-22 will be about $81 million in 1993 dollars, about 65 percent more than that of the F-15 aircraft in 1991, the last year that fighter was in production. Since the costs of many weapon systems increase during the full-scale development phase that the F-22 entered in 1991, actual costs could be even higher. Unit costs may also rise if F-22 procurement is reduced below the planned level.

The F-22 may also be unnecessary, in part because its main technological advantage--stealth characteristics--is being questioned. General Merrill McPeak, the Air Force Chief of Staff, has suggested that the stealthy B-2 bomber could be detected by Soviet radars, though presumably at shorter ranges than nonstealthy aircraft. The F-22 aircraft is smaller than the B-2 bomber, and size is one factor that determines radar signature. But the Defense Department recently suggested that the F-117 aircraft, a smaller plane than the F-22, also may be detectable by certain kinds of radars. The F-22's technological advantages may not be worth the investment, if stealth technology proves to be less promising than has been expected.

Perhaps more important, some analysts would argue that, in view of the reduced threat posed by forces of the former Soviet Union, the F-22 provides more capability to attack enemy fighters than the United States needs. Events in the Persian Gulf suggest that current Air Force aircraft are able to counter any threat less severe than that formerly posed by the Soviet Union, which many analysts consider to have been the only country whose air force had the capability to threaten U.S. fighters.

Moreover, other types of aircraft may prove to be more useful in future conflicts. The extensive use of tactical bombing in the Persian Gulf War emphasizes the value of aircraft that can attack land targets, perhaps in preference to aircraft such as the F-22, which is designed to combat enemy fighters. Given the changes in the nature of the threat, strategies other than buying expensive F-22 aircraft might better meet future Air Force needs. Such strategies might include upgrading existing aircraft or developing a new plane that is less capable but cheaper than the F-22 aircraft.

Nor does the Air Force need to buy the F-22 any time soon to support the reduced size of its tactical forces. CBO analysis suggests that even if the Air Force procured no fighter aircraft after 1993, it would have more than enough aircraft to support the currently planned force of 26 tactical wings through 2005.

The Air Force counters that the improved capabilities of the F-22 aircraft would be required even in a world in which U.S. tactical air forces are smaller and the former Soviet threat is much reduced. If the United States canceled the F-22 program, then the capability of fighters in the first decade of the next century would be similar to that of today's F-15 aircraft, which entered development in the 1960s. By the next decade, regional powers such as Iraq may possess fighter aircraft that are at least the equal of the F-15. Thus, to maintain its edge, the Air Force believes that the United States needs the improved capability the F-22 aircraft offers.

DEF-15 CANCEL THE UPGRADE OF THE NAVY'S F/A-18 FIGHTER

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	1,000	1,100	700	1,400	1,600	5,800
Outlays	540	880	810	790	880	3,900

For the foreseeable future, the F/A-18 aircraft will account for the bulk of the Navy's fleet of carrier-based aircraft that perform fighter and attack missions. The F/A-18 attacks targets both in the air (the fighter mission) and at sea or on the ground (the attack mission). The current version of the F/A-18 is designated the "C/D" model.

In 1991, the Navy announced plans to develop a new "E/F" variant of the F/A-18. The E/F version features several modifications: a longer fuselage, a larger wing, and a more powerful engine than are now on the C/D version. These changes would enable the E/F version to carry a larger load of weapons than the C/D version, or to carry the same load about 50 percent farther. Both attributes are important factors in determining the plane's capability in the attack role. The new engine will enable the heavier E/F aircraft to retain the speed and maneuverability of the earlier version, important performance considerations in fighter combat.

Though more capable, the E/F version will also be more expensive than the C/D model--about 50 percent more by some estimates--and the Navy will have to pay about $3.7 billion between 1993 and 1997 to develop the plane. This option would cancel development of the new E/F model and instead would buy additional C/D aircraft to maintain the Administration's planned production rates. Relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, savings would total $1 billion in 1993 and $5.8 billion over the next five years.

This alternative would save $1.1 billion in 1993 compared with the request submitted by the Administration in January 1992. The Administration's 1993 budget requested about $150 million more for 1993 than the Administration had proposed in its 1991 plan. This increase may indicate that the cost of the development program is growing, as has been suggested by press reports.

The requirement for an upgraded F/A-18 aircraft may be questionable in view of today's reduced military threat. It seems highly unlikely that the United States will find itself in direct conflict with the republics of the former Soviet Union, at least for many years to come. In other conflicts, current U.S. fighters probably will continue to have an edge in capability for quite some time.

Canceling the upgrade might also address some concerns raised in the Congress. In its report on the fiscal year 1992 defense appropriation bill, the Senate Committee on Appropriations reduced proposed funding for the upgrade, questioning the need for it. The committee challenged the clarity of the Navy's plans for combat aircraft and the role of the E/F version of the F/A-18 aircraft in those plans. The committee also questioned the accuracy of the Navy's projections for the cost

of the plane, the accelerated pace of the program, and the legitimacy of the Navy's claims for improvements in capability. Of particular concern to the committee was whether, in an era of tight budgets, the Navy needs to pay to develop this plane when it is also developing the AX aircraft, a new plane that would be designed primarily as an attack aircraft but might also have fighter capability. If the AX has some capability as a fighter, then according to the committee the costly benefits derived from modifying the F/A-18 aircraft would be short-lived because the Navy would substitute the more capable AX aircraft in the fighter role as soon as it became available.

Canceling the E/F development program would have some disadvantages. Even in conflicts with smaller nations, improvements in the F/A-18's range might be useful in the attack mission; indeed, critics of the C/D version believe its relatively short range limits its usefulness. Moreover, the E/F upgrade could provide the Navy with a fallback if the AX program runs into cost or performance problems or if production of that new aircraft is delayed. (See DEF-16 for a discussion of this issue.)

DEF-16 DELAY THE NAVY'S AX AIRCRAFT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	210	610	160	-440	1,160	1,700
Outlays	120	400	310	-140	510	1,200

Early last year the Navy announced its plan to develop the AX attack aircraft to replace the A-12 aircraft, which was canceled by Defense Secretary Richard Cheney in January 1991. According to the Secretary, the A-12--a carrier-based aircraft that was designed to be stealthy, or difficult for enemy sensors to detect--was canceled because of cost overruns and schedule slippage. The A-12's mission of attacking sea or ground targets, including targets that are far away from the carrier, continued to be an important one, however. Soon after the A-12's cancellation, the AX aircraft program was initiated to produce a new plane to carry out this mission.

The Navy wants its new AX aircraft to be stealthy and to be able to fly long ranges while carrying a large payload of munitions. According to press reports, the service may also want the new plane to be able to fire several types of air-to-air missiles. This capability, which the A-12 aircraft was not expected to possess, would permit the AX aircraft to carry out part of the mission of today's F-14 fighter, which is designed to defend aircraft carriers from attack by destroying long-range enemy bombers before they are close enough to fire their own air-to-surface missiles. The Navy has also apparently expressed an interest in having AX aircraft perform a variety of other missions, such as electronic warfare.

The Navy has suggested that it wants the AX aircraft to be less expensive than the A-12. Estimates prepared by the Department of Defense's Cost Analysis and Improvement Group of the average cost to procure one A-12 aircraft had reached $105 million (in 1992 dollars) before its cancellation. Despite the goal of lower cost, the Navy seems to want the AX to have many of the same capabilities as the A-12 plus a few more. Since improvements in capability typically are expensive, the Navy will probably find it difficult to resolve the conflicting goals of holding down cost increases and achieving high performance.

This alternative would delay development of the AX by two years to give the Navy the time to examine these issues and would provide $100 million in both 1993 and 1994 to pay for studying the needs of naval aviation. Savings in 1993 would total $200 million against CBO's baseline, which is generally consistent with the Administration's 1991 plan, but would total only about $70 million compared with the Administration's latest budget request. Savings would be about $1.7 billion over the 1993-1997 period. This delay would also give the Navy time to reconsider the role for aircraft carriers, since the threats the carriers are intended to counter are changing because of changes in relations with the countries that used to be part of the former Soviet Union. A review of these missions would enable the Navy to determine which capabilities it needs most in the planes that make up its future air wings.

If development of the AX is delayed, however, the Navy will not be able to retire A-6 aircraft as early as is now planned. Those aircraft already average about 19 years of age, and some have experienced problems such as wing cracks. Nevertheless, the Navy contends

that it will be able to retain a number of other carrier-based aircraft for extended periods, and it may be able to do the same with some A-6 aircraft. Moreover, the problem of aging A-6s may become less pressing if the number of aircraft carriers, and hence the number of carrier-based aircraft, declines in response to reduced threats to U.S. security.

Even if delaying the AX program causes some problems, the delay may be worthwhile. A precipitous development effort could result in problems similar to those encountered with the A-12, perhaps leading to another program cancellation rather than a new aircraft.

DEF-17 CANCEL THE ADVANCED AIR-TO-AIR MISSILE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	100	200	200	200	300	1,000
Outlays	60	160	220	240	250	930

The Advanced Air-to-Air Missile (AAAM) is now under development. The AAAM is a follow-on to the Phoenix air-to-air missile (designated the AIM-54C). Like the Phoenix, the AAAM is designed to attack enemy bombers at long ranges from Navy ships, before the bombers can approach closely enough to launch their antiship cruise missiles. Destroying a single bomber is easier than intercepting and destroying the many antiship missiles that it might launch.

In its budget request for 1993, the Administration proposes canceling engineering and manufacturing development for the AAAM. In keeping with its newly announced policy to emphasize researching new weapons instead of producing them, the Administration proposes to continue research on technologies for the AAAM in the program's current development stage, which the Defense Department refers to as demonstration and validation.

This option would cancel the entire AAAM program, providing no funds in years beyond 1992. Compared with the Administration's current plan, this approach would save $100 million in budget authority in 1993 and a total of $500 million from 1993 through 1997. Compared with the CBO baseline, which is based in part on the Administration's 1991 plan and so assumes engineering and manufacturing development of the AAAM program, this option would save $100 million in 1993 and a total of $1 billion from 1993 through 1997.

One argument for canceling the AAAM program is that the threat the AAAM was designed to counter has diminished or, perhaps, disappeared. The AAAM program was initiated during the mid-1980s to counter improvements in Soviet bombers and weapons. With the reduction in the military threat from the former Soviet Union, the AAAM program may not be as high a priority as it was several years ago, and the Navy could rely on existing air-to-air weapons, such as the AIM-54 Phoenix, the AIM-7 Sparrow, and the new AIM-120 Advanced Medium-Range Air-to-Air Missile.

In addition, some Members of Congress have recommended canceling the AAAM because it is intended for use only by the Navy. These Members believe that, in an era of declining defense budgets, the Defense Department should invest only in weapons that would be used by both the Air Force and the Navy. Both services jointly use every other air-to-air weapon, with the single exception of the Navy's AIM-54 Phoenix missile.

Under this option, however, the Navy would forgo the advanced capability promised by the AAAM. The loss of this capability might be particularly important during the next decade, after the Navy begins to retire aging F-14 aircraft and, according to current plans, replace them with an upgraded version of today's F/A-18 aircraft. The F/A-18 aircraft does not have a radar that is compatible with the existing Phoenix missile system. The Navy has assumed that with AAAMs, the up-

graded F/A-18 aircraft would match or exceed today's capability to engage enemy aircraft at long range. If the AAAM is canceled, the Navy may not be able to engage enemy aircraft at long ranges as effectively during the next decade as it can today.

DEF-18 CANCEL THE KINETIC ENERGY ANTI-SATELLITE WEAPON PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	70	70	70	70	70	350
Outlays	40	60	70	70	70	310

In 1989, the Department of Defense initiated a weapon program to develop a rocket interceptor to attack Soviet satellites. The Army's Kinetic Energy Anti-Satellite Attack (ASAT) program is the latest in a series of antisatellite research and development programs that date back to the 1970s. Under the current program, the Army plans to begin producing land-based ASAT missiles in 1999 and expects to deploy them at a single, fixed site in 2002. The Air Force plans to develop a battle management capability as well as command, control, and communications to assist in operating the ASAT system. DoD has spent more than $1.8 billion over the past decade to develop an antisatellite capability.

Because of recent changes in the former Soviet Union and tight U.S. defense budgets, the ASAT program has been given a lower priority. For example, shortly after an initial research contract was awarded in August 1990, the Army recommended canceling funding for ASAT. Initially, DoD and the Administration concurred, and plans were made to terminate the program. The Administration subsequently revised its position and restored enough funding for the program to support near-term research while the Army restructured the overall program to reduce its cost. The fiscal year 1992 defense appropriation bill funded $51 million. Production of these weapons would start in 1998, with total acquisition costs possibly reaching $2 billion.

This option would terminate the Army program and related support efforts elsewhere in the department. Compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, canceling the ASAT program would save about $70 million in fiscal year 1993 and about $350 million during the 1993-1997 period. Compared with the Administration's latest budget request, savings would be smaller because the Administration has requested only $25 million annually through 1997 while it reformulates its ASAT program. Beyond this period, savings could approach $2 billion.

Canceling the ASAT program would reduce future budget problems. DoD estimates that the total program will cost about $2.3 billion. Relative to the program that the Army has proposed, however, the Future Years Defense Plan underfunds ASAT by some $1.5 billion to $2.0 billion during the 1993-1997 period. The Army has not identified offsets that could compensate for the additional expenditures that would be needed to support the current program. In addition, the program does not have an approved operational military requirement based on an updated assessment of the threat.

The diminished threat of a world war between the superpowers reduces the military justification for the ASAT program. In addition, alternative programs (including the Mid-Infrared Chemical Laser and the Strategic Defense Initiative's interceptor rockets) are under way that are designed to meet the requirements of the antisatellite mission.

Proponents of the Army's ASAT program might contend that, when deployed, it could

destroy satellites operating at low and middle altitudes. Satellites at these altitudes could provide important intelligence information and communications capability. The ASAT program might also be useful in regional conflicts, should nations other than the Soviet Union develop and deploy military satellites or avail themselves of services provided by Soviet satellite coverage. In addition, unlike the other existing antisatellite research programs, the ASAT program would provide this protection without violating the Anti-Ballistic Missile Treaty.

DEF-19 REDUCE FUNDING FOR THE MODERNIZATION OF ARMORED SYSTEMS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	500	600	400	200	500	2,200
Outlays	280	500	460	300	390	1,930

The Army's Armored System Modernization (ASM) program would develop six new systems to replace the current generation of tanks, infantry fighting vehicles, and other armored combat and support vehicles. These new vehicles would eventually replace some of the M1 tanks, the Bradley fighting vehicles, the M109 155mm howitzers, and three other armored vehicles currently in the Army's inventory. A separate program would procure a new armored gun for the Army's light forces. About $3.7 billion would be spent over the next five years to develop and procure some of these new systems.

Of the six vehicles included within the ASM program, the Army would first develop a new howitzer and new artillery support vehicle, with second priority given to developing the new line-of-sight antitank system to replace the current 1960s-vintage Improved TOW Vehicle. Efforts within the ASM program to develop a new tank, a new combat engineering vehicle, and a new infantry fighting vehicle were deferred until after 1997 by the Administration in its request for 1993. Finally, another system, known as the armored gun system, would be based on an existing model and would be purchased after limited investment in research and development.

Questions can be raised concerning the need for some of these systems. Of the systems that will be developed during the next five years, one--the new artillery support vehicle--would directly replace a system that entered production in the 1980s and has only recently completed production. The Army's current 155mm howitzer and antitank vehicle have undergone numerous upgrades in the past 20 years and already incorporate modern and sophisticated technology. It is doubtful that these systems will be outdated 10 years from now when their successors--the planned new howitzer and antitank system that are products of the ASM program--are scheduled to enter the field. In addition, the reduced threat from the former Soviet Union calls into question the need for highly sophisticated armored systems.

This alternative would reduce funding for the entire ASM program to $100 million a year, to be used to investigate potential improvements in the Army's artillery propellant charges and other aspects of armored combat rather than to develop replacement vehicles. This alternative would not reduce funds for the armored gun system, which is intended to replace the one Army armored system generally acknowledged to be obsolete, the M551 Sheridan. Relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, this alternative would save $500 million in 1993 and $2.2 billion over the next five years. Relative to the Administration's latest budget request, this alternative would save $400 million in 1993 and a total of $2.7 billion over the 1993-1997 period.

Reducing funding for the ASM program, however, would undoubtedly delay the fielding of the next generation of Army armored systems. Although the M1 tank, the Bradley fighting vehicle, the field artillery support vehicle, and the M9ACE have all been pur-

chased in the last decade or so, the remaining two systems--the Improved TOW Vehicle and the M109 howitzer--are much older. Both systems have undergone extensive upgrades in the past decade, but they are carried on 1960s-vintage chassis. Furthermore, Members of Congress have expressed support for the expeditious fielding of replacements for these weapons. This alternative would not respond to those Congressional concerns.

DEF-20 CANCEL THE ARMY'S ADATS PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	200	500	400	400	400	1,900
Outlays	a	100	270	400	410	1,180

a. Less than $50 million.

Following the cancellation of the Sergeant York Division Air Defense Gun (DIVAD) in August 1985, the Army initiated a program to improve its ability to defend troops positioned well forward in the battle area against enemy aircraft, particularly helicopters. This Forward Area Air Defense (FAAD) program contains five elements designed to (1) improve communications among air defense and sensors; (2) purchase a new weapon to perform the mission of the canceled DIVAD; (3) procure a system, called Avenger, to provide air defense for the rear of the battle area; (4) develop a system to attack enemy helicopters hiding behind hills, trees, or buildings; and (5) improve the air defense capability of the Army's existing helicopters, tanks, and fighting vehicles.

This alternative would eliminate one element of the FAAD program, the one devoted to purchasing the sophisticated and expensive air defense weapon designed to replace the DIVAD. Relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, savings under this alternative in 1993 would be $200 million, and a total of $1.9 billion could be saved from 1993 through 1997. Savings reflect termination of the Air Defense Antitank System (ADATS) program, selected by the Army as the follow-on to the DIVAD program, but do not reflect additional funds designated by the Administration for research and development of improved anti-aircraft seekers.

Although the ADATS system is already in use with the Canadian military, it has experienced problems as it has been modified for use by the U.S. Army. These problems caused the Army to cancel purchases previously scheduled for 1991 and 1992 and, finally, to terminate the program. There would be no savings relative to the Administration's current plan, because the Administration canceled the program in its 1993 budget submission.

DEF-21 STREAMLINE THE NATIONAL DEFENSE STOCKPILE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	150	150	150	150	150	750
Outlays	150	150	150	150	150	750

The National Defense Stockpile (NDS) is designed to provide a source of imported raw materials that the United States would require in the event of a national emergency, when normal sources of supply might not be available. Included in the stockpile are materials such as titanium, cadmium, germanium, and indium. The present inventory of the NDS is valued at approximately $9 billion, but much of that inventory consists of materials that were acquired during the 1950s and 1960s and that have little worth in the event of a national emergency today. A report by the Defense Department in 1989 suggested that, under certain scenarios, the actual industrial requirements would dictate an NDS valued at $7.3 billion. But even this plan may overstate the real needs of the stockpile, and DoD is reviewing its stockpile specifications to delineate a plan that would better reflect the present world situation.

Each year the Congress authorizes the stockpile manager to sell certain materials that are outdated or overabundant, to purchase materials that would be required in a national emergency, and to exchange raw materials for semiprocessed goods that would be easier to use in the event of an emergency. For the past several years, the Congress has required that the dollar volumes of stockpile sales and purchases be equal and at a fairly low level. For example, the fiscal year 1992 defense authorization bill capped sales and purchases at $150 million. Although the Congress has authorized trades of raw materials to pay for the cost of making the inventory more useful, it has neither established any levels of activity nor spurred the process on with specific goals.

This alternative would reduce the deficit and speed the modernization of the NDS by accelerating the sales of materials that exceed the needs of the stockpile and limiting the acquisitions so that the total value of materials in the stockpile is reduced to levels consistent with today's needs. In addition, the option would permit some upgrades of currently held materials that are in unusable forms. Although CBO has not examined the specific requirements for every item and proposed material in the stockpile, this option would speed modernization in three ways.

First, this option would double the sales of obsolete materials from the Congressionally mandated level of $150 million in 1992. Included in the list of excess inventory items are industrial-grade diamonds, various grades of mica, quartz crystals, sapphires and rubies, silver, and tin. In total, the inventory exceeds the stockpile goal for 18 families of materials, whose value exceeds $1.7 billion. Many of the excess materials would be difficult or impossible to sell because they have no market (asbestos is a good example). The sale of other commodities, such as silver, would drive down the market price and thus could face political opposition from representatives of states that mine and market those commodities. Similarly, the sale of goods like bauxite and tin would be restricted by international agreements and policies of the

State Department. Even so, the excess inventory is large enough that the Congress should be able to mandate annual sales of a portion of these excess items--say, $300 million in each of the next five years.

Second, this option would require a specific program level for upgrading raw materials to alloys that more readily meet defense needs. In the past, these conversions have been limited to alloys of ferrous metals and chrome or manganese. The stockpile, however, also contains vast amounts of bauxite and other materials that would require lengthy processing before they could be used. The Congress could expand the list of materials that may be upgraded and could set specific targets for completing the upgrade. This upgrading would have no net effect on the deficit, because the stockpile manager would trade to refiners a portion of the raw materials that is equal to the value added to the materials from the refining process.

Third, the stockpile goals have not been met for some required items--such as germanium, cobalt, indium, and tantalum--and this option would restrict the volume of purchases of those required materials to the 1992 authorized level. To make the best use of this smaller purchase allotment, the Congress could specifically prohibit purchases of materials that already meet stockpile goals, and require that the most important materials be purchased before less necessary materials. Making purchases at a slow pace would allow sufficient time to reevaluate the stockpile's goals and would permit purchases of the most essential commodities to ensure defense readiness in the event of a national emergency. Coupled with the annual sales of $300 million, these purchases would result in net savings of $150 million a year.

Compared with the CBO baseline, this alternative would improve the usefulness of the National Defense Stockpile and reduce the deficit by $750 million over the next five years. However, the increased volume of stockpile sales would be considered an asset sale under the definition set forth by the Budget Enforcement Act. This act defines an asset sale as the sale to the public of any asset wholly or partly owned by the United States. Budgetary savings from the proceeds of asset sales cannot be credited unless the sales were mandated before September 18, 1987, or the sales are at levels consistent with agency operations in fiscal year 1986. Because this option proposes to double the sales activity of the stockpile, these savings could not be credited on the pay-as-you-go scorecard to a committee proposing this option, nor could they be counted as an outlay reduction under the defense spending caps.

DEF-22 CANCEL THE C-17 AIRLIFT AIRCRAFT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	4,290	4,070	4,020	3,620	3,600	19,600
Outlays	310	1,300	2,710	3,360	3,600	11,280

The C-17 is a four-engine transport aircraft that can carry its maximum payload of about 162,000 pounds of cargo for a distance of 2,400 nautical miles without aerial refueling. It is being produced as the next-generation strategic airlift aircraft to replace the C-141 Starlifter. Because it is designed to land at relatively small airfields with short runways, it also is expected to play an important role in meeting transport needs within a combat theater and will lessen requirements for aircraft such as the C-130 that traditionally assume that role.

This option would cancel the C-17 program, saving $4.3 billion in budget authority in 1993 and $19.6 billion over the 1993-1997 period, compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan. Measured against the Administration's current plan, savings would be $2.9 billion in 1993. A substantial part of these savings might be spent to replace some of the capability that the C-17 would have supplied, perhaps through buying more C-5 aircraft.

The C-17 program has a troubled history. The development program began in 1981, but the first aircraft were not authorized for procurement until 1988. Funds have been appropriated for a total of 14 C-17s since then. The Air Force's original plan was to purchase 210 C-17s by 1998. But the program was among those subject to the Secretary of Defense's Major Aircraft Review in 1990. After that review, the Secretary announced a reduction of 43 percent in the number of C-17s, to only 120 aircraft.

Administration estimates in September 1990 indicated that the reduction in quantity would save $10.5 billion, or 25 percent, of the total C-17 costs included in the 1991 budget. But more technical problems and schedule delays ensued. Subsequent program estimates revealed that reducing the number of aircraft and stretching out the production schedule resulted in a 48 percent increase in total program unit costs--from $199 million in the fiscal year 1991 budget to $294 million in last year's budget--eliminating much of the savings. The reduction in the number of C-17s also meant forgoing the Department of Defense's goal of raising airlift capability to 66 million ton-miles a day; instead, the Administration's announced goal is to maintain airlift capability at its current level of about 48 million ton-miles a day.

Canceling the C-17 aircraft would have little immediate effect on U.S. airlift capability. Today's fleet of aircraft gives the United States an unparalleled capability to move forces rapidly. That fleet includes 109 C-5, 234 C-141, and 57 KC-10 cargo/tanker aircraft, together with some 150 civilian cargo aircraft available to DoD in an emergency. U.S. airlift capability was amply demonstrated during Operation Desert Shield when about 99,000 tons of equipment and materiel were delivered in the first 45 days of operations.

Within a few years, however, cancellation of the C-17 program could adversely affect U.S. airlift capability. The C-141 fleet is currently about 26 years old, on average, and older C-141 planes might begin retiring in 1997. Without C-17s or other aircraft as

replacements, U.S. capability would begin to decline.

The Department of Defense could put in place programs to extend the service life of the C-141 aircraft for another 10 to 15 years by replacing elements of the aircraft's wing structure. The cost of such modifications is at issue: a DoD official has testified that the cost might be $12 billion or more, if new engines and new wing boxes were procured; the Lockheed Corporation claims that a more modest program could fix the wings for about $3 billion and that new engines are not necessary.

Nor is extending the C-141's life the only alternative. Production of C-5B aircraft could be resumed, at a unit cost of about $184 million, compared with $230 million to buy each of the remaining 106 C-17s. Because the average payload of a C-5B is about 40 percent greater than that of a C-17, fewer C-5s would be needed to replace the 120 C-17s. CBO's calculations, based only on payload comparisons, suggest that matching the capability of 120 C-17s would require 85 C-5Bs at a total cost of $16.2 billion. That amount compares with an estimate of $24.5 billion to complete the C-17 program.

Buying more C-5B aircraft, however, is strongly opposed by the Air Force and the Office of the Secretary of Defense. Their analyses conclude that, because the C-17 is being designed to operate at a higher rate of use than the C-5B, 120 C-5Bs would be required to offset the loss of the C-17. Approximately 120 C-130 aircraft would be required to fill the role the C-17 would play in moving cargo over shorter ranges. Including these additional factors, costs for the C-5 alternative could run as much as $24 billion, about the same as the cost to complete the C-17 program. In addition, DoD officials have expressed concern about the higher cost of operating the C-5 in peacetime, when its greater capabilities are generally less useful, and about its inability to use smaller airfields efficiently.

DEF-23 DELAY DEVELOPMENT AND PRODUCTION OF NEW WEAPONS FOR ONE YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	1,450	-1,450	0	0	0	0
Outlays	250	50	10	-130	-10	170

NOTE: The 1993 DoD budget request does not provide sufficient detail to compute annual savings beyond 1993 for this alternative.

The significant changes in the international politico-military and domestic budgetary environments suggest that a more gradual approach to purchasing weapons may be appropriate. Some analysts have proposed that the acquisition process proceed more methodically to ensure that new weapons being developed will meet performance and cost goals even if more time is required to do so. Others have been concerned that projected reductions in the procurement budget will make existing and planned weapon systems more difficult to afford in the future. Delaying by one year the start of all new research and development (R&D) programs, full-scale development programs, or programs of initial or full-rate production could yield near-term savings, improve overall affordability, and provide time to reassess military priorities consistent with changing national security needs.

This option identifies three new R&D and production programs planned by the Department of Defense for 1993 and submitted in last year's plan. Measured against the CBO baseline, which is generally based on last year's plan, delaying the acquisition process for these three programs for one year could save as much as $1.5 billion in 1993.

In the Administration's latest plan, DoD has also requested funding for about 40 additional new R&D, full-scale development, and production programs (either entering low- or full-rate production) planned by the Department of Defense for 1993 and 1994. Delaying the acquisition process for all of these programs for one year could save as much as $2.6 billion in 1993.

New Research and Development Programs. The Administration's budget for 1993 requests $38.8 billion for research and development--an increase of about $2 billion over R&D funding for 1992. Beyond 1993, the Department of Defense plans further increases in funding for R&D to preserve technological superiority for future military forces. Consistent with this goal, DoD has proposed about 25 new R&D programs for 1993. Total funding requested for all new R&D programs is over $850 million in 1993--about 2 percent of the total budget request for research, development, test, and evaluation.

Although the funding request for most programs is modest--exceeding $50 million in 1993 for only six of the new programs--out-year funding requirements historically have accelerated rapidly. The Administration, however, has proposed a new acquisition approach that would develop new weapons, build prototypes, but not begin production. This approach could provide significant savings from past practices in which virtually all major development programs eventually entered production. It is unclear at this time, however, how the new approach will be applied to new development programs now entering the acquisition process and to what extent savings can be achieved.

Delaying the funding for all of these new programs for one year could save about $850 million in 1993 and possibly reduce out-year funding requirements accordingly. A one-year delay, however, could add to the eventual overall cost of these programs, assuming that administrative, labor, and material costs experience real increases in the future. In addition, a delay could extend the time until a weapon could be deployed. Alternatively, the Congress could choose to authorize a given amount for new R&D programs, say $250 million, and direct DoD to allocate the funds to those programs with the highest priority. Doing so would save $600 million in 1993, with a resultant delay in procurement funding requirements in the future.

Programs Entering Full-Scale Development. DoD authorizes a weapon system to enter full-scale development when a program demonstrates that its operational and acquisition management concepts are sound and that the technology to be used is valid and feasible. Many programs enter full-scale development prematurely, however, and costly program adjustments are necessary. The risk of incurring delays and added costs can be reduced by developing and testing prototypes of a system or its components during advanced development, though doing so increases the time needed to complete advanced development.

The Administration's budget contains a request for funding the full-scale development of a few major weapon programs in 1993, including the joint-service standoff weapon systems, the joint-service direct attack munition, and the S-3 aircraft system improvement program. Delaying full-scale development, however, could add to the long-run cost of these programs.

New Production Programs. Funding for defense production programs has decreased in real terms each year since 1985. The Administration's budget request for DoD procurement in 1993 is about 10 percent below the appropriated level in 1992 in real terms.

If future procurement budgets do not meet DoD's projections, production programs will become less affordable. As a result, production of weapons may have to be cut back or canceled to accommodate unanticipated budgetary constraints. Reflecting both the reduced threat and increased budgetary constraints, DoD canceled or discontinued 17 weapon programs in this year's budget request, including major systems such as the small intercontinental ballistic missile, the Seawolf attack submarine, and the Comanche helicopter. In addition, DoD is purchasing other weapons, most notably the C-17 aircraft, at reduced production rates in order to save money.

The Administration's budget for 1993 contains funding leading to initial or full-rate production for about 10 weapon programs. Delaying initial or full-rate production but providing requested research funds would save $1.6 billion in 1993--$800 million in savings from delaying the advance procurement funds for the 1995 carrier--and no additional savings in the next five years.

DEF-24 LIMIT PAYMENTS FOR INDEPENDENT R&D

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	2,900	3,000	3,100	3,200	3,300	15,500
Outlays	1,570	2,640	2,960	3,120	3,260	13,550

One of the categories of Department of Defense funding for research and development is known as independent research and development (IR&D). This program allows contractors to undertake research of their own choosing and to be reimbursed by DoD if the research meets eligibility criteria outlined in section 824 of the 1991 Defense Authorization Act. Among the allowable categories of cost are expenses of preparing certain bids and proposals (B&P). In 1990, DoD subsidies for IR&D totaled about $3.6 billion, of which $1.4 billion compensated contractors for B&P costs.

This option illustrates the effects of canceling the $3.6 billion program on the grounds that its value is uncertain and its costs are substantial, and instead providing direct subsidies for defense basic research. Savings would amount to $2.9 billion in 1993, relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan, and would total $15.5 billion through 1997. These savings estimates are based on the assumption that IR&D costs will not grow in real terms from the level in 1990, the latest year available.

Despite the substantial cost of the IR&D programs, the empirical literature on IR&D presents mixed views of how much additional research has been undertaken (besides what contractors would have done on their own), whether DoD could have obtained the same research at lower cost, and whether the subsidies are being spent on projects of the highest priority to DoD.

How much additional research does IR&D create? A Congressionally mandated study by the RAND Corporation concluded that IR&D subsidized less than 25 percent of contractors' costs and that each dollar spent on IR&D increased total R&D spending by contractors by $2.20. These results suggest that DoD spending on IR&D is an efficient way to generate additional defense-related research. RAND's analysis, however, may reflect the past willingness of defense contractors to spend their own funds on R&D to win anticipated procurement contracts. Given the prospects for reduced defense procurement spending during the remainder of this decade, IR&D may not generate as much additional defense-related research in the future.

Moreover, other studies have differed with RAND's conclusions. Two studies found that the average subsidy to contractors was much larger--up to 80 percent--and that, even so, the subsidy caused only a negligible increase in total R&D spending by contractors. Critics also argue that IR&D spending on at least some projects is unnecessary because contractors would undertake these projects even without subsidy.

As to whether the funds are spent on projects of importance to DoD, the evidence is also mixed. Advocates of the program contend that it provides a hedge against the narrow decisions of agency research managers by letting private contractors develop their own research ideas. Case studies of the transfer of technology support the use of IR&D to give contractors an incentive to pursue R&D.

The bulk of IR&D spending, however, appears to be allocated to development rather than to basic research that might arguably be of greater long-run benefit to DoD, though of less value to contractors. And the amount of subsidy that any individual contractor receives depends more on that company's total contract volume with DoD than on the merits of the contractor's research program.

About 40 percent of IR&D spending compensates contractors for preparing bids and proposals. In many cases, particularly for highly technical projects, B&P costs may include considerable supportive research and development. In others, bids and proposals may require little if any additional research by the firm, so IR&D spending clearly would not be appropriate.

This option takes a moderate position with regard to the effectiveness of the IR&D program. It assumes that each dollar of IR&D subsidy increases R&D spending by 30 cents--less than the $2.20 found in the RAND report, but more than the negligible amounts estimated by the other two analyses. And it accepts that at least some of the specific research subsidized by IR&D meets the criteria set forth in the 1991 Defense Authorization Act, so that cancellation of the program should be accompanied by an alternative provision for supporting the same type of research.

The assumption that each dollar of IR&D subsidies expands total R&D spending by 30 cents implies that cancellation would reduce total spending on DoD research and development by about $1 billion. To offset this consequence, the option provides for a substitute program of $1 billion in direct R&D grants that DoD would use primarily for basic research. The overall volume of DoD's R&D efforts would thus be unchanged, but the focus of that R&D would be shifted away from development projects selected by contractors and toward basic research selected by DoD. The savings from the CBO baseline reflect this substitute program.

DEF-25 CANCEL THE NATIONAL AEROSPACE PLANE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	200	100	100	100	100	600
Outlays	100	110	100	100	100	510

In January 1986, the Department of Defense initiated a joint effort with the National Aeronautics and Space Administration (NASA) to design and build a National Aerospace Plane (NASP) that can deliver civilian and military payloads into orbit from conventional runways. The NASP, or X-30 aircraft, is envisioned as an experimental hypersonic aerospace aircraft that will employ highly advanced propulsion, structures, and materials technologies.

In 1987, DoD estimated that it would cost $3.1 billion to develop, build, and flight-test two experimental vehicles by 1994. Since then, however, the program has encountered numerous problems, including technical difficulties, budget reductions, changes in management structure, and major adjustments to scope and schedule. In a 1991 report to the Congress, DoD estimated that the cost of the program had increased to about $10 billion. The NASP's planned first flight in the atmosphere has slipped from 1994 to late 1997.

Commitment to the NASP has lacked a strong supportive consensus among various government components involved with the program. Neither DoD, NASA, nor the Congress appears to be strongly committed to the program. According to this year's Senate report on the Defense Authorization Act for 1992 and 1993, DoD has appropriated or budgeted only about $2 billion of the $5 billion to $10 billion required for the program in the current Future Years Defense Plan. In December 1990, the NASA Advisory Committee on the Future of the U.S. Space Program concluded that although the program was valid for technological reasons, it did not merit "high schedule urgency." Funding requests by NASA for the NASP for 1992 and 1993 indicate a low level of commitment to the program relative to DoD's requests.

The Congress remains divided over the program. During the past two years, for example, the House Committee on Armed Services has approved DoD's requests for funding, and the Senate Committee on Armed Services has voted to terminate the program. In 1992, the Congress authorized and appropriated $200 million of the $231 million DoD requested. The Congress simultaneously authorized only $5 million of the $72 million NASA requested for the NASP in 1992, but indicated a willingness to consider a reprogramming request from NASA to compensate for the reduction. Unless the Administration requests approval to reprogram at least $25 million and the Congress approves the request, a decision to proceed with production of the NASP would be delayed from 1993 to 1994. Further delays in production will increase overall program costs.

This option would cancel further funding for the NASP. Compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, and the plan contained in the Administration's latest budget request, the option would save about $200 million in 1993 and a total of $600 million over the next five years.

The NASP is intended to provide the technological base for the nation's long-range plan for space transport for both civilian and military missions. The plane's speed and ability to operate both in space and in the earth's atmosphere could provide important capabilities for various military missions. Although the Air Force has not approved a military requirement for the NASP because it is a technology demonstration program, its missions might include delivering payloads into space, attacking enemy targets with weapons (including nuclear weapons), intercepting high-value targets such as enemy strategic aircraft, and performing space control and reconnaissance.

DoD could still accomplish these missions without the NASP. For example, payloads are now delivered into space by lift programs that include the space shuttle, Titan IV rockets, and, in the future, the Advanced Launch System. Strategic attack missions can be accomplished by the existing strategic triad, which is the subject of extensive modernization programs. The Strategic Defense Initiative is planned to meet the need for intercepting strategic attack vehicles and would provide some space control. Intelligence satellites and planes currently provide reconnaissance capability.

The NASP, however, could enhance the performance of some missions. The aircraft's hypersonic capability, combined with its ability to operate from a conventional airfield, promises quicker execution of various military missions. Unlike other delivery vehicles such as rockets, the NASP could be recalled or reassigned during a military operation. The NASP also could provide important spinoff benefits to other programs as a result of advanced technology research in the areas of propulsion, materials, and aeronautics.

DEF-26 INCREASE SEPARATIONS OF AIR FORCE ENLISTED PERSONNEL

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	-340	-120	50	340	330	260
Outlays	-190	0	100	220	220	350

The Administration plans to reduce the active-duty Air Force to about 430,000 personnel by the end of 1995. This would be a drop of nearly 80,000 (16 percent) from the service's size at the end of 1991, and roughly 180,000 from the Air Force's strength as recently as 1987. Such large personnel cuts will yield large savings: Air Force costs for basic pay alone should be at least $1 billion lower in 1996 than in the current year (in constant 1992 dollars).

How much the Air Force saves in costs for military personnel will depend on how it makes the personnel reductions. For officers, the limitations imposed by the Defense Officer Personnel Management Act give the service little discretion in managing the reduction. (Officer reductions are discussed separately in DEF-27.) For enlisted personnel, however, the service has considerable latitude. The Air Force had planned to accommodate most of the reduction in enlisted personnel by sharply reducing enlistments of new recruits--an "accession-heavy" approach.

It now appears that the Air Force will pursue a more balanced approach by using the new incentives for voluntary separations that the Congress authorized in the 1992 Defense Authorization Act, along with its power to separate enlisted personnel involuntarily. Such an approach would reduce the number of senior personnel while keeping the flow of new recruits at a level more in line with the service's long-term needs. (This is the approach that the Army, the other service facing large personnel reductions, apparently has planned to follow.) Because senior personnel are more costly than new recruits, separating more career personnel would increase long-run savings, although the voluntary incentives and severance payments could raise costs in the short run.

This option assumes that the Air Force maintains annual enlisted accession levels at no less than 40,000--roughly the number that the Air Force estimates is required to sustain an enlisted force of the size it plans for 1995 and beyond (and about 10 percent below the sustaining number that CBO estimates). In comparison, past Air Force plans called for only about 30,000 new enlistees per year through 1995--25 percent below its own estimate of the sustaining level of accessions. Under this option, the Air Force would mix separations of career personnel with cuts in accessions below past levels, but the approach would leave the service sufficient flexibility to avoid forcing out personnel who are just short of their eligibility for retirement.

Net savings in budget authority under this option could total $260 million over the 1993-1997 period, compared with the CBO baseline, but in the first two years the option would probably increase costs. (Some or all of these costs and savings may already be reflected in the Administration's latest plan.) In terms of outlays, five-year savings would be even larger ($350 million) and initial costs lower. One reason for the difference is the accounting treatment of military retirement. Pay-related savings are higher in terms of

budget authority than of outlays because a portion of the savings in budget authority arises from reduced accrual charges for military retirement, which would not be reflected in reduced outlays until the discharged personnel had retired.

Budget authority for separation costs also exceeds outlays because the cost of DoD's new voluntary separation incentive (VSI, described below) will be funded on an accrual basis beginning in 1993. A number of factors could reduce separation costs: if VSI proves less popular than DoD's other voluntary program (see below), total separation costs over the 1993-1997 period could fall by as much as $200 million (of budget authority); if no one elects to separate under either voluntary program and involuntary separations are required, separation costs could fall by $420 million; and if the Air Force moves up separations of career personnel into 1992, offsetting costs in 1993 and beyond could virtually disappear.

In addition to the cost savings, this option would improve the ability of the Air Force to manage its enlisted forces after the personnel reductions are completed. An accession-heavy approach could create a deep trough in the service's experience structure that would be manifested as a shortage of junior noncommissioned officers (NCOs) in the late 1990s and of senior NCOs in the following decade. Aggressive policies to achieve high reenlistment rates among personnel in the small cohorts might alleviate these shortages, but not without reenlistment bonuses and other incentives whose costs could be substantial.

Some of the advantages of this option--with its more balanced experience structure and the attendant cost savings--might be offset by the negative effects on morale of separating large numbers of career personnel. In addition, some people might argue that the option would break faith with service members, who have implicitly been promised a full military career in return for continued good performance. The Air Force itself, however, has recently limited first reenlistments to those most highly qualified, rather than all those who perform acceptably.

The new incentives that the Congress authorized may have weakened the resistance of the Air Force to separating career personnel. The voluntary separation incentive program offers selected career personnel who leave voluntarily a stream of annual payments calculated under a formula similar to that used for military retirement. The VSI could be sufficiently attractive to appeal to enlisted members with 10 or more years of service. (Normal retirement is available only after 20 years of service.) Members with fewer years of service might find the second program, which provides a lump-sum payment, more attractive than the voluntary separation incentive. This second program offers the full range of transition benefits available to personnel who are separated involuntarily, as well as a severance payment that is 50 percent larger. Personnel who are offered separation under the two voluntary programs are free to choose which they prefer.

The Air Force now plans to offer the voluntary separation incentives to 61,000 career enlisted personnel during 1992, more than one-third of its current enlisted force. This wide-scale offering, however, does not mean that the service expects or wants all of those offered the incentives to accept the offer; it has indicated a desired number of takers of 24,000. In comparison, 26,000 separations of career enlisted personnel could be necessary under the option considered here.

If most of the required separations could be accomplished voluntarily, the only remaining strong argument against this option would be that the voluntary separation incentives might attract some of the Air Force's best people and not merely its poor performers. The Air Force could limit this effect, however, through its control over what combinations of pay grades, years of service, and occupational specialties would qualify personnel for the separation incentives, and the service retains the authority to reject individual applications for the incentives. Fur-

ther, to the extent that increased numbers of senior personnel decide to leave the service because of the incentives, the Air Force should be able to improve promotion opportunities for junior personnel and thus encourage the best among them to remain in the service.

DEF-27 MAKE ADDITIONAL REDUCTIONS IN THE OFFICER CORPS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	-90	70	160	510	790	1,440
Outlays	-60	90	180	360	580	1,150

In authorizing the Department of Defense's budget for 1987, the Congress mandated reductions in the number of commissioned officers, in part in reaction to the growth in the officer corps relative to that of the enlisted ranks between fiscal years 1980 and 1986. One measure of this growth was that the ratio of enlisted personnel to officers declined from 6.4 in 1980 to 5.9 in 1986. In response to the Congressional directive, the enlisted-to-officer ratio rose slightly to 6.0 in 1987. Since then, however, the ratio has slipped back to 5.8. Although the services intend to reduce their officer strengths steadily through 1995, they plan equal or slightly greater percentage cuts in enlisted personnel, so the enlisted-to-officer ratio will decline somewhat to 5.7.

This pattern is at odds with the intent that the Congress expressed in the 1987 legislation and gives rise to concern that the military services have failed to balance readiness adequately against equity. Among the concerns of DoD in carrying out the planned military drawdown is to maintain a combat-ready force and at the same time be fair to current service members, many of whom have built career expectations and financial plans upon continued military service. Combat readiness, however, may require a more balanced pattern of officer separations than the services are able to impose, given the constraints of equity and the officer personnel management system.

To encourage a reduction that is more balanced between officers and enlisted personnel, this option would reduce the size of the officer corps through 1997 below the levels in the Administration's 1991 plan. The option would result in the separation of 22,700 additional officers, leaving the enlisted-to-officer ratio at the 1980 level, in accordance with the intent of the Congress. To ensure that cuts were made proportionally in officer pay grades, the option would grant DoD additional authority through 1995 to reduce the number of its senior commissioned officers. Pay savings would be exceeded in 1993 by the cost of separation payments. However, net pay savings of $70 million would be realized in 1994, and a total of $1.4 billion would be saved through 1997.

The military services can draw upon several management tools to reduce the size of the officer corps. They can encourage voluntary separations through specific actions such as tightening promotion criteria, liberalizing early-out procedures, and restricting the availability of regular commissions. The newly available voluntary separation incentives may assist the services in drawing down their forces in a balanced manner, although it is too soon to know how well these incentives will appeal to the officer corps. If voluntary separations are not sufficient, the services can use liberalized authority for involuntary separations, as conferred by the Congress in the 1991 Defense Authorization Act. They can conduct a reduction in force (RIF) of service members in pay grades O-3 and O-4. They can also impose selective early retirement (SER) on officers in the ranks of O-5 and O-6, although those officers are not subject to a RIF. If necessary, this option assumes that DoD is granted the authority, through 1997, to

separate additional senior officers involuntarily through either expanded SER authority or a reduction in force.

The military services might argue that separating additional senior officers would constitute a breach of faith because it would cut short the careers of some service members. The services might further contend that requirements for officers and enlisted personnel have been affected unequally by both the drawdown and changes in weapon technology and military doctrine. Newer weapons, and the research and maintenance they require, may demand that more of the force be officers. For these reasons, the services could argue, the declining enlisted-to-officer ratio is not a basis for mandating further reductions in the number of commissioned officers.

Additional officer cuts could be defended, however, on the grounds that the services' plans would result in a force that would be too senior and would contain more officers than needed to supervise the remaining enlisted personnel. Much of the expertise and combat readiness provided by senior officers could be obtained at lower cost from highly capable senior enlisted personnel and junior officers. To ease the pain of separation for individual officers, the services could offer the new packages of voluntary separation incentives to all those subject to a RIF, rather than offer the incentives more selectively. The cost of these incentives would reduce the savings shown above, but this trade-off might be seen as a desirable way of obtaining a balanced force reduction.

Indeed, even without offering the voluntary separation incentives, the mere existence of the additional authority might serve a useful purpose in that it might encourage some senior officers to retire voluntarily rather than face the possibility of being subject to an involuntary separation. Furthermore, by serving as a "stick," the additional authority might reduce the frequency and magnitude of involuntary separations. In the process, less qualified officers might opt to separate, leaving those of a higher caliber on active duty and offering the prospect of faster promotion as an incentive to stay in the military.

DEF-28 LIMIT MILITARY PAY RAISES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	960	2,190	3,370	4,690	6,080	17,290
Outlays	680	1,630	2,580	3,630	4,760	13,280

Since 1982, military pay has not risen as fast as average pay in the private sector, and the so-called comparability gap now exceeds 8 percent. Nonetheless, the approved raises have apparently been competitive--that is, sufficient for the military services to attract and retain the desired number and quality of personnel. Moreover, the Administration plans to cut the active-duty military to roughly 1.6 million personnel from nearly 2.2 million in 1987, and even deeper cuts have been proposed. If fewer personnel are needed in the future, military pay could be even lower than it is today and still be competitive.

This option illustrates one possibility for limiting military pay. Holding the annual raise in 1993 to 2 percentage points below the previous year's rate of increase in the employment cost index (ECI) would yield savings of $17 billion in budget authority over the next five years, relative to the CBO baseline, which is generally consistent with the Administration's 1991 plan. These savings assume that the Administration would otherwise authorize raises after 1993 that would match changes in the ECI, less one-half of a percentage point as permitted by law.

In past years, limited raises could have been expected to make the services' recruiting and retention goals more difficult to meet. With personnel cuts under way, however, these adverse effects are less worrisome. Indeed, large-scale personnel reductions create the problem of how to encourage experienced personnel to leave the military rather than how to convince them to stay. Recognizing this, the Congress in 1991 authorized two new programs of separation incentives for career personnel. How effective these programs will be is not clear, however, and if they are effective, they may also be expensive. Limiting military pay raises could accomplish the same goal of increasing voluntary separations but, unlike the incentives, would increase rather than offset the savings from personnel reductions.

Limited raises would have several disadvantages. First, most of the additional separations would probably be among relatively junior personnel, who account for most reenlistment decisions and are the most sensitive to changes in pay levels. Thus, although this approach would reduce the size of the career force, it would allow that force to become increasingly senior and more expensive per person. Second, those most likely to leave might be some of the services' most productive people rather than poorer performers who could be targeted by tightened reenlistment standards and selective involuntary separations. Third, the higher separation rates caused by lower military pay might continue even after the desired strength reductions had been achieved; thus, in the long run, both officer and enlisted forces could be more junior than today, with higher training costs, fewer people available for assignment to operational units, and diminished capability. More junior forces, however, would have lower average personnel costs.

The pay cut should not have a major effect on the quality of recruits in most of the ser-

vices, a concern during the early 1980s. Lower pay would make it harder for the services to attract well-qualified recruits, but in the Air Force and Army, at least, this effect should be offset by the sharply reduced numbers of new recruits required to sustain their smaller forces. (The excellent recruiting results for 1991 demonstrate the impact of lower accession requirements.) The Navy, however, could be adversely affected; its recruiting has lagged behind the other services in recent years, and it is scheduled for only modest personnel reductions. Any recruiting problems that do occur could be offset by using some of the savings to increase recruiting efforts.

Finally, the reduction in military pay under this option (relative to pay in the private sector) could lower the morale of military personnel, which could exacerbate problems with military readiness caused by the sharp drawdown in forces. If a decline in morale led to poorer retention, the services might have to expand recruiting or increase retention incentives. Either action would reduce the savings from this option below the amount shown in the table.

DEF-29 TERMINATE RESERVE RETIREMENT BENEFITS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	30	70	100	130	150	480
Outlays	0	0	0	0	0	0

The United States is the only country that offers retirement benefits to part-time military reservists. These benefits parallel those provided for active-duty service and have remained largely unchanged since 1948, when the current program of reserve retirement was enacted. Reservists are entitled to receive retired pay after 20 years of creditable service, of which at least the last eight must be served in a reserve component. Unlike active-duty personnel, who can receive retired pay immediately upon retirement, reservists must wait until age 60. Reservists' retired pay is calculated in a manner similar to that for active-duty retirees, on the basis of length of service and average highest three years' pay.

Reserve retirement benefits are provided at considerable cost. In 1991, reservists received $1.7 billion in retired pay. For fiscal year 1991, the accrual charge for reserve retired pay was 13.3 percent of reservists' total basic pay, or more than $500 million. (The accrual charge represents dollars set aside now to pay the future retirement costs of today's reserves.)

To reduce these costs, this option would terminate the reserve retirement program for those entering the reserve components after the end of fiscal year 1992. All current reservists would be grandfathered, but no new reservists--including those who enter the reserves from active duty--would be eligible to accumulate benefits.

From the standpoint of the total federal budget, savings would be realized initially only in budget authority, as no funds would need to be set aside for the retirement of new reserve personnel. Thus, the funds saved under this option could not be transferred to other programs without increasing the federal deficit. To prevent such transfers, it might be necessary to reduce the caps on budget authority for discretionary programs, established under the Budget Enforcement Act of 1990, by an amount equal to the savings shown above.

Changes in reserve retirement have been considered in the past, but outright termination has not generally been examined as an option. When the Congress modified the active-duty program in 1986, changes in reserve retirement were put off pending the report of the Sixth Quadrennial Review of Military Compensation. That report, which was released in 1989, concluded that reserve retirement is a major factor in the retention decisions of enlisted personnel as well as officers, and on that basis the report offered a number of proposals dealing with reserve retirement. None, however, proposed terminating the program. The farthest-reaching change would have maintained the average value of reserve retired pay while restructuring the system to provide stronger retention incentives for reservists with critical military skills.

The current distribution of benefits, however, suggests that the reserve retirement program has been a much stronger incentive for officers than for enlisted personnel to stay in the reserves. Retired officers, who constitute 68 percent of the population of reserve retirees, received more than 80 percent of the 1991 benefits, or more than $1.3 billion.

Enlisted retirees received only $300 million in benefits, even though 85 percent of reserve personnel are enlistees. In contrast, among active-duty retirees, only 26 percent are officers, and they receive only 44 percent of the total benefits paid to the group.

Given the pattern of benefits, terminating the reserve retirement system would chiefly affect the retention decisions of reserve officers rather than enlisted personnel, and thus could be expected to generate savings without greatly harming the ability of the reserve components to meet their personnel objectives. Personnel shortages in the reserves generally have been concentrated in the junior enlisted ranks--typically in pay grades E-3 and E-4--and thus have not been materially alleviated by reserve retired pay. If terminating the benefits aggravated personnel shortages in particular skills, some of the savings in retirement costs could be used to increase selective reenlistment or continuation bonuses.

Terminating the reserve retirement system, however, might entail some other adverse effects. Reserve retirement benefits appear to achieve their stated purpose of holding reservists for longer careers; a larger fraction of reservists remain for more than 20 years of service than do active-duty personnel. In addition, the reserve retirement program makes the reservists' compensation package more comparable with that of active-duty personnel, which may help to maintain a substantial reserve--a goal that the Congress has strongly supported in the past.

DEF-30 DENY UNEMPLOYMENT COMPENSATION TO SERVICE MEMBERS WHO VOLUNTARILY LEAVE MILITARY SERVICE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	240	240	240	240	240	1,200
Outlays	240	240	240	240	240	1,200

Many military personnel who leave active-duty service are eligible for unemployment benefits. Their payment amounts are calculated in the same way as those of civilian personnel who qualify for unemployment benefits. However, eligibility of former military personnel differs from that of recipients in the civilian labor force in one important respect. Former military personnel can apply for and receive unemployment benefits even if they voluntarily leave military service, but civilian recipients must have lost their jobs involuntarily because of layoffs or other situations resulting from a downsizing of the work force.

The majority of personnel who leave military service do so voluntarily. For example, many choose not to reenlist following completion of their term of service; others, who have completed a minimum of 20 years of service, opt for voluntary retirement. A much smaller group is separated involuntarily for reasons related to job or promotion performance or, in recent years, because of the drawdown of military forces.

This option would apply the same rules to former military personnel that other members of the civilian work force must follow by stipulating that only personnel who left service involuntarily because of force reductions would be eligible to receive payments. Eliminating payments to individuals who leave service voluntarily would reduce the number of recipients by at least 80 percent, resulting in savings of about $240 million annually. Because the Department of Defense ultimately reimburses the Department of Labor for the cost of unemployment payments to former service members, these savings would occur in the defense budget. Savings under this option are relative to the CBO baseline, which is generally based on the Administration's 1991 plan. Savings relative to the Administration's latest plan should be similar in size.

The Unemployment Insurance program was established with the intent of aiding those who lose their jobs involuntarily. Subjecting military personnel to the same rules as the rest of the work force regarding unemployment compensation thus could be seen as a more equitable use of an existing entitlement program. But if military service is considered to be fundamentally different from other types of employment, one could argue that voluntary separation from service is not comparable with voluntary termination of civilian employment and therefore should not be subject to the same restrictions on eligibility for unemployment compensation.

DEF-31 CHANGE BUDGETING METHOD FOR WAGE BOARD PAY RAISES

Savings from Admin. Request	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	170	150	160	150	160	790
Outlays	130	150	150	150	160	740

NOTE: These savings are already incorporated in the CBO baseline. See discussion in text.

The Department of Defense employs about 1 million civilians as part of its work force. Most of these employees are paid under the General Schedule (GS) or the Wage Board (WB) system. GS employees usually work in technical and administrative positions, and WB personnel typically serve in trade, craft, and general labor occupations. DoD calculates the cost of pay raises for all employees each year and includes these costs in its budget request.

WB salary increases are based on surveys that compare the wages of public- and private-sector workers in more than 100 regions. Current law sets WB pay raises based on any differences the surveys reveal, provided that WB raises do not exceed GS raises. For 1993, GS and WB salaries will rise by 3.7 percent.

By law, no pay raises can begin before January 1. WB pay raises occur throughout the year--following completion of the regional surveys--in contrast to GS pay raises, which all take effect on January 1. Thus, prospective WB raises for any one fiscal year can take effect as early as January 1, or as late as September 30, the last day of the fiscal year. The Administration's defense budget request does not recognize this difference between the two systems, and so it estimates the costs of WB pay raises as if they all took effect on January 1. Thus, the defense budget overstates the costs of providing for WB pay raises. The additional funding then becomes available for DoD to spend on other programs, chiefly in the area of operations and maintenance.

This option would reduce the DoD budget by the amount of its overstatement of WB raises. The savings compared with the Administration's current plan would be $170 million in 1993 and a total of $790 million through 1997. Savings would be slightly smaller if the Administration's proposal to delay the 1993 pay raise to April 1 is enacted. There would be no savings compared with the CBO baseline, which already assumes staggered raises.

The option would in no way affect pay raises for WB employees, who would still receive raises exactly as they do now. Instead, this option would force DoD to reduce its spending on other programs that it does not currently have to justify as part of its budget submission because it can fund them with surplus pay funds.

One disadvantage of this option is that the programs that would be cut may be worthy of funding even though DoD does not currently offer any independent justification. This option would reduce the department's total budget, and thus would force DoD either to find additional economies or to reallocate funds from other programs if it wished to maintain those activities that are currently funded indirectly through overbudgeting for WB raises.

DEF-32 CUT RESERVE STRENGTH

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	620	1,530	1,940	2,110	2,220	8,420
Outlays	560	1,430	1,880	2,080	2,200	8,150

The National Guard and Reserve are an integral part of the military services, accounting for over one-third of the total force structure and providing essential support to the active forces. In 1992, the reserves will total 1.1 million personnel compared with 1.9 million on active duty. As part of the overall downsizing plan in the 1993 budget request, the Administration has proposed reductions of about 13 percent to the active forces and 18 percent to the reserves between 1992 and 1997. Active forces would decrease by 239,000, and the reserves would fall by 200,000.

The 1992 Defense Authorization Act, however, includes language to restore most of the proposed cuts in the reserves. For 1992, the Administration proposed cutting 108,000 reservists, but the authorization cuts only 37,000. This action reflects the strong Congressional intent to keep reserve strengths up, despite significant cuts in the active forces.

This option would reduce reserve strength to the levels proposed in the Administration's plan, starting in 1993 and meeting strength levels through 1997. In 1993, reserve strength would be cut by 129,000 to reach the proposed level of just over 1 million. Because the option would return to the Administration's 1993 plan, there would be no savings relative to the budget request for funds for the reserves.

Compared with the CBO baseline, which incorporates 1992 Congressional action and assumes modest cuts in reserve forces beyond 1993, savings would be substantial. This option would reduce costs for personnel and day-to-day operations by $620 million in 1993 and by more than $8.4 billion through 1997. Total savings could be even greater if the Congress reduced funds for purchasing equipment for the reserves in proportion to the cuts in reserve strength.

As part of this reduction, the reserves could eliminate one particular category of part-time reservists--individual mobilization augmentees (IMAs). These reservists are affiliated with active rather than reserve units and occupy mobilization positions that are not filled during peacetime. In contrast to most regular part-time reservists, who participate in annual two-week training and 48 weekend drill periods annually, IMAs train for two weeks each year but usually perform only 24 weekend drills. Many of these reservists are highly graded and in areas such as combat support, administration, and medicine. On average, IMA reservists are a full grade and a half higher than non-IMA reservists. Savings from eliminating IMAs would be about $25 million each year and are included in the reductions.

The Congress has clearly expressed its view that DoD has placed too little value on the contribution of the reserves, as this option would. Some Members of Congress note that the cost of manning and operating reserve units typically ranges from about 25 percent to 80 percent of that of similar active units. The longer deployment and mobilization

times that the reserves require may not pose a problem in light of the reduced threat of a major European war. According to this view, the additional capability obtained through smaller cuts in the reserves would be well worth the additional cost, which could be offset by modest additional reductions in active forces.

In an era of diminishing threats to U.S. security, however, the Administration argues that reserve forces should be reduced along with active ones. According to the Administration, it makes little sense to retain all or most of the reserves--which in many cases supplement active units' combat capability or provide support to the active forces--when many of the active units are being eliminated. Indeed, the opposite approach may be appropriate: as forces become smaller, a larger fraction may have to be on active duty so they can respond to crises on short notice. The Administration also contends that, during a period of tight defense budgets, the extra expense associated with making only limited cuts in reserve forces would take away funds needed to operate and modernize active units.

DEF-33 REDUCE DRILLS FOR NONCOMBAT RESERVE UNITS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	140	140	140	150	150	720
Outlays	120	130	130	140	140	660

The National Guard and Reserve play an important role in U.S. defense policy by providing a trained, combat-capable force that can be mobilized in time of war. During Operations Desert Shield and Desert Storm, for example, almost 223,000 reservists were called to active duty.

Many reserve units have combat-related missions requiring a very high level of readiness. Some reserve units, however, have noncombat-related missions that may not be needed immediately or that may be available from the civilian sector. Included in this category are bands and units in areas such as administration, food services, registration of combat casualties, and laundry services. Just as in units that would be directly involved in combat, reservists in these noncombat units are paid to train full time for two weeks each year and to drill for one weekend each month (drills total 48 because there are four per weekend).

This alternative would reduce from 48 to 24 the number of weekend drills for the roughly 90,000 reservists in these noncombat units. Members would still be paid to train full time for two weeks each year, but on average they would train for one weekend every other month instead of each month.

Compared with the CBO baseline, savings in the first year would be $140 million, with cumulative five-year savings totaling $720 million. Savings would be smaller relative to the Administration's plan, which assumes smaller numbers of reservists. Included in these estimates are savings in retirement accrual costs. These funds are set aside to pay future retirement costs and would amount to about $10 million each year. Although they represent a real reduction in long-term costs, these retirement accrual savings appear only in the budget authority savings noted above because they would not affect government outlays for many years.

Reducing drills for these noncombat units may not harm readiness and war-fighting capabilities. In many cases, required skills could probably be maintained even with the reduced amount of weekend training. Because total pay would be reduced, fewer reservists might be willing to serve in these units, and shortages could occur. But most of the general skills required are readily available in the civilian sector, so qualified personnel could be recruited in the event of a war. Also, as levels of active-duty personnel are reduced, there will be a larger pool of available manpower from which to meet reserve requirements.

A decline in the number of personnel willing to serve in these units could, however, create some problems in peacetime. Increased recruiting efforts may be needed to maintain the size of the noncombat units. Costs for this extra effort are not reflected in the savings shown above. If the size of these noncombat units declines, some of their peacetime functions--particularly in the areas of administration and finance--might need to be transferred, resulting in increased work loads for other units or individuals.

DEF-34 REDUCE PER CAPITA USE OF HOSPITAL SERVICES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	460	470	480	505	530	2,445
Outlays	365	450	470	495	520	2,300

The 2.4 million dependents of active-duty personnel who live in the United States receive most of their hospital care through the military health care system. Sixty percent of their hospital care is provided by military hospitals, with the rest coming from civilian hospitals that are reimbursed through the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). In either case, the government bears most of the costs, for an annual total of more than $2 billion. The Department of Defense could lower those costs by more than $2.4 billion over the next five years by bringing down active-duty dependents' use of hospitals to rates more characteristic of the civilian sector. (These estimates assume that the number of active-duty dependents declines in proportion to reductions in active-duty personnel.) Savings in this option are measured relative to the CBO baseline, which is generally based on the Administration's 1991 plan, but savings should be similar in size relative to the Administration's latest plan.

Compared with the U.S. population at large, dependents of active-duty personnel make heavy use of the hospital. In 1988, civilians in the United States under the age of 65 used about 530 days of hospital care per 1,000 persons. When adjusted for the age and sex distribution of that civilian population, active-duty dependents under the age of 65 living in the United States (fewer than 0.5 percent are 65 years or older) used about 720 days of direct care and CHAMPUS care. Thus, active-duty dependents use hospital care at a rate more than one-third higher.

This option would have the Congress set a goal under the Coordinated Care program--DoD's current strategy for revamping the military health care system--of 530 hospital days (adjusted for the age and sex distribution of civilians) per 1,000 dependents. Each military installation's medical commander would be required to limit hospital use through measures now common in the private sector, such as preadmission review of all hospital admissions, review of care for medical necessity, prospective limits on length of hospital stays, and coverage of certain procedures on an outpatient basis. Curbing hospital use would save DoD about $500 million a year. Even greater savings are possible if medical commanders also curb hospital use by active-duty military personnel and by retired military personnel and their dependents.

Opponents of setting goals might argue that high rates of hospital use do not necessarily imply abuse of the medical care system. For example, because many civilians lack financial or geographic access to care, nationwide rates of hospital use by civilians may actually be lower than medical considerations warrant. Perhaps dependents of active-duty personnel are healthier than might otherwise be the case because of their unimpeded access to hospital care. That said, civilian health maintenance organizations have shown that high-quality care is achievable with rates of hospital use well below 400 days per 1,000 enrollees.

Another argument is that the unique stresses of military life give active-duty de-

pendents a relatively greater need for hospital services. Any arbitrary attempts to curb hospital access thus could jeopardize health and morale. Yet, active-duty dependents' overall rates of use mask considerable variation across the country. In some catchment areas (the 40-mile circle around a military hospital), dependents use more than 1,000 days; in other catchment areas, fewer than 500. In the absence of evidence that dependents are less healthy in some areas than in others, such variation implies a degree of arbitrariness in rates of hospital use. Moreover, just as too low a rate of hospital use may be risky, so also may be too high a rate. Inappropriate admissions and needless surgeries may inadvertently harm patients' health.

Any savings from reducing dependents' hospital use might be offset by the costs of reviewing patients' use of care or of shifting patients to ambulatory settings. In the civilian sector, for example, some practices that restrict hospital admissions--such as preadmission authorization and concurrent review of hospital admissions--have been known to lead to increases in outpatient costs. The Coordinated Care program, however, has the potential to mitigate such a shift by providing medical care in both ambulatory and hospital settings on a consistent and efficient basis.

DEF-35 INCREASE CHARGES FOR DIRECT MILITARY HEALTH CARE SERVICES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	265	260	260	265	265	1,315
Outlays	210	250	255	260	265	1,240

When nonactive-duty beneficiaries receive care in military hospitals and clinics, they pay very little. Hospital stays cost about $9 a day; outpatient visits and prescriptions cost nothing. Such low charges promote greater use of health care services, thus contributing to overcrowding and rising costs.

Higher charges for military health care benefits would both curb excessive use and raise revenue. This option would charge varying amounts for outpatient care in military clinics: outpatients from senior enlisted persons' families (above pay grade E-4) would pay $5 for a visit to a military physician, and outpatients from officers' families would pay $10. Prescriptions filled in military pharmacies would cost $3. Dependents of enlisted personnel below pay grade E-5 and survivors of military personnel--the military's least well-off beneficiaries--would still pay nothing for visits to military physicians or for prescription drugs. To avert a shift of patients to inpatient care, this option would also raise the daily charge for a hospital stay to $25 for all nonactive-duty beneficiaries.

Together, these changes could save the Department of Defense about $260 million a year. Some of these savings would be offset by the cost of modifying existing automated information systems to collect the higher fees. (Savings relative to the Administration's latest budget request and the CBO baseline, which is generally consistent with the Administration's 1991 plan, are equal because of similar assumptions about use of direct military health care services.) Further savings would result if higher charges help to reduce use of outpatient and hospital services (see DEF-34).

Because medical care is a key part of military compensation, military families would view increased charges as an erosion of benefits. Recruitment and especially retention could suffer, although the parallel trend in civilian medicine to wider cost sharing might allay beneficiaries' dissatisfaction. Indeed, increased cost sharing would bring the military health care system somewhat more in line with medical plans offered to civilian employees of the federal government. Nor should rising charges necessarily harm health, a potential concern, because evidence shows that people at ages and incomes typical of military beneficiaries seek needed care even when they share the costs.

DEF-36 CHARGE RETIRED MILITARY PERSONNEL PREMIUMS FOR MILITARY HEALTH CARE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	450	475	500	525	560	2,510
Outlays	360	450	485	515	550	2,360

When military personnel retire from active-duty service, they and their dependents remain eligible to use the military's health care system. They may visit physicians in military clinics, and have any prescriptions filled, for free. As inpatients in military hospitals, retired enlisted personnel pay nothing, retired officers pay about $4 a day, and dependents pay about $9 a day. When this direct military care is not available (or inaccessible because of distance), the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS) will help retirees and their dependents who are less than 65 years old pay for civilian services. (Medicare helps those 65 years of age and older.) After beneficiaries pay a deductible of $150 a person or $300 a family, CHAMPUS covers at least 75 percent of allowable expenses, with a relatively high limit on out-of-pocket expenses of $10,000.

Retirees do not pay premiums for these benefits. Some of them, however, pay premiums for private insurance policies that supplement CHAMPUS. Although such policies offer needed protection against catastrophic expenses, they also insulate beneficiaries from CHAMPUS's requirements for cost sharing and thus undermine CHAMPUS's main instrument for controlling use.

This option would charge nondisabled retirees and their dependents under age 65 a monthly premium of $90 a family. As under the Federal Employees Health Benefits (FEHB) program, they would have an open season in which to enroll in the military health care system. In return for paying the premium--and as an inducement for beneficiaries to drop any supplemental insurance--the annual limit on out-of-pocket expenses would be reduced from $10,000 to $2,500, a level typical of the FEHB. Both premiums and the level of catastrophic protection would be updated annually to reflect the effects of medical inflation.

How many retirees would choose to enroll? The estimate shown in the table above uses an enrollment rate of 60 percent. Based on survey data, a plausible guess might range between 40 percent and 80 percent: the lower figure represents the proportion of retired families who get all or most of their outpatient care directly at military health care facilities; an additional 40 percent get outpatient care from both military and civilian providers, but prefer the civilian system. (The rest never use military treatment facilities.)

If 60 percent of retired families were to enroll, net revenue from the premiums and enhanced catastrophic protection would total more than $2.5 billion over the next five years. Savings are the same compared with either the Administration's current budget request or the CBO baseline, which is generally consistent with the Administration's 1991 plan, because both make similar assumptions about the number of future military retirees. (Though not reflected in this estimate, further savings would result from an expected decrease in use of CHAMPUS.)

In addition to raising revenue, this option would give military health care planners a firm handle on the nature and composition of retirees' demand for health care. At present, the number and location of retirees interested in using the military's health care system are uncertain and can therefore vary from year to year. Once planners have that information, the process of allocating resources should become significantly easier and potentially more cost-effective.

Charging a premium would create a risk of empty waiting rooms and idle active-duty physicians if too few retirees enrolled in the military health care system. More likely, many retirees would resent premiums as an erosion of the military health care benefit. Although $90 represents only about 7 percent of the average nondisabled retiree's monthly pension, and a smaller percentage of total family income, many would view the added cost sharing as a breach of faith. Some families, however, no longer would feel it necessary to pay for supplemental insurance and could therefore offset part of the premium.

Even modest premiums may be burdensome to lower-income retirees. Those families might suffer real financial hardship paying $90 a month, or might forgo military health care. The Department of Defense, however, could link premiums to income by reducing the premium for the lower ranks and raising it for the higher.

DEF-37 CLOSE THE UNIFORMED SERVICES UNIVERSITY OF THE HEALTH SCIENCES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	20	50	80	90	90	330
Outlays	20	50	80	90	90	330

Historically, the Department of Defense has faced shortages in medical personnel, particularly physicians. To alleviate this situation, DoD has developed various programs to provide a supply of these personnel. One such program is the Health Professionals Scholarship Program (HPSP), which pays tuition and a stipend to individuals attending medical school and other health-related programs in return for a military service obligation. Another example is the Uniformed Services University of the Health Sciences, or USUHS, a medical school operated by DoD.

The university was created by the Congress in 1972 to train physicians committed to long-term military careers. At an annual cost of about $80 million, the school provides a full education for its participants, including a stipend to cover room, board, and books. USUHS is the most expensive source of physicians at $144,000 per person, HPSP is $104,000, and volunteers (individuals who had completed medical school, and in some cases practiced medicine for some period, before entering military service), $76,000.

USUHS has met only a small fraction of DoD's need for new physicians. In 1990, for example, USUHS provided less than 9 percent of DoD's new physicians. HPSP was the source of about 67 percent, and the remaining 25 percent were volunteers.

This option assumes that USUHS stops taking in new students in 1993 and closes fully in 1995. If USUHS were eliminated, and other programs for obtaining physicians remained unchanged, net savings would be about $20 million in 1993 and $330 million over five years. These savings include reductions for military and civilian personnel, which would be in addition to planned drawdowns. Savings are measured relative to the CBO baseline, which is generally based on the Administration's 1991 plan, but would be the same measured against the Administration's latest plan.

Based on the 1990 patterns of physician accessions, closing USUHS would reduce the supply of DoD physicians by less than 10 percent. As part of the planned force drawdowns, the military services have already proposed reducing physicians by 5 percent between 1991 and 1995, so the loss of USUHS physicians could be partially absorbed by reduced requirements. Expansion of existing programs could make up the rest of the loss.

This proposal has some drawbacks. Supporters of USUHS claim that its physicians are better trained for the special needs of the services because of the military focus of the institution itself. Some of the higher costs of USUHS are in effect repaid because USUHS-trained physicians have a longer service commitment than physicians from other sources. This tenure enhances stability in the medical corps and lessens demands on the other sources of physicians. Perhaps because of these considerations, the Congress strongly

backed the creation of USUHS and has consistently given the institution full financial support.

A further consideration motivating the Congress in this regard may be its concern about the general state of military medical care. In particular, given past physician shortages, the Congress might be reluctant to reduce the number of medical personnel in line with the force drawdown. Finally, direct cost comparisons between USUHS and other sources of physicians may be unfair to USUHS because of indirect subsidies that the federal government provides to medical schools, which in effect raise the true governmental cost of physicians from sources other than USUHS.

DEF-38 ADOPT SHORT, UNACCOMPANIED TOURS FOR EUROPE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	290	320	350	570	590	2,130
Outlays	260	290	310	530	580	1,970

Under current policy, military personnel in Europe generally remain for tours of three years and may be accompanied by their families. The U.S. government pays for the moving expenses of dependents (spouses and children) and for other costs associated with their stay in Europe. In 1990, about 310,000 military personnel were located in Europe along with some 317,000 dependents. Accompanied tours require that DoD maintain a large support infrastructure in Europe, including schools for dependents, commissaries, hospitals, family centers, and family housing. In countries like Korea, where housing shortages and other factors make it difficult to support families, most personnel are assigned for only one year without their families.

This option assumes adoption of one-year unaccompanied tours in Europe for almost all U.S. military personnel assigned there. Longer, accompanied tours would still be permitted for a few key personnel who need to remain overseas longer to ensure continuity in U.S. operations. This change would be phased in over three years, starting in 1993. When fully in effect, the new policy should permit elimination of all overseas schools for dependents, family centers, family housing, and some commissaries and other support facilities. The added costs associated with moving military personnel more often would be offset by savings in other areas. Together, these actions would reduce overseas support costs by $290 million in 1993 and by a total of $2.1 billion through 1997 compared with costs under the CBO baseline and the Administration's February 1991 plan. Savings relative to the Administration's latest plan would probably be similar in size.

Additional savings not reflected in these estimates might eventually be realized if hospitals and other facilities that cater to dependents can be reduced in size. However, there could be greater costs, also not reflected in the estimates, for federal school Impact Aid at U.S. localities where military dependents would increase in numbers.

This option would primarily affect personnel in the Army and Air Force, who accounted for more than 90 percent of U.S. military personnel in Europe at the end of 1991. Even though many--perhaps as many as half--of the positions in Europe could be filled by unmarried personnel, the shift to short, unaccompanied tours would increase the portion of married Army and Air Force personnel serving without their families from today's level of less than one-tenth to roughly one-sixth, approximately the current level for Navy and Marine Corps personnel.

Coupled with the increased disruptions associated with the ongoing force drawdown, this increase in time away from their families might cause some Army and Air Force personnel to leave the military. Although this would be unlikely to cause shortages of skilled personnel during the current drawdown, lower retention could be a problem in the future. Shorter tours would also increase turnover

among personnel in Europe, which could adversely affect readiness by reducing the amount of time units train together. Finally, some headquarters or support positions could require the continuity provided by longer tours.

Some of the problems associated with shorter tours could be minimized by the force drawdown or policy changes. Because forces in Europe are scheduled to be reduced by 50 percent, compared with the 20 percent decrease in overall forces, fewer military personnel will face the prospect of unaccompanied tours, thus reducing any negative effects on retention. To counter the effect of higher turnover on readiness, entire units rather than individuals could be rotated; in this way, individuals would already be accustomed to operating as a unit. Finally, for those positions that require continuity, longer accompanied tours could be permitted with special provisions for educational and other support.

Adverse effects of unaccompanied tours would be further reduced if U.S. forces in Europe are cut even more. Some military analysts and policymakers have suggested that 50,000 or 75,000 U.S. military personnel in Europe may be adequate in view of the greatly diminished threat to European security posed by the republics of the former Soviet Union. Moreover, if only a small force is stationed in Europe, the per capita cost of maintaining schools, commissaries, and other support facilities would grow sharply, thereby requiring a shift to unaccompanied tours.

Perhaps for these reasons the Army itself may be considering shorter, unaccompanied tours with rotations of entire units. Although the Army has not officially endorsed this policy change, the Secretary of the Army has publicly proposed it as a possible option.

DEF-39 REDUCE OPTEMPO AND UNIT TRAINING COSTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	910	940	910	940	980	4,680
Outlays	720	890	900	930	950	4,390

In fiscal year 1992, the Department of Defense plans to spend about $17 billion for all field-level training worldwide by units of the military services. The cost of this unit-level training depends on the size of military forces (force structure) and the operating tempo (optempo), that is, the number and length of training exercises carried out by these forces. Such training ranges from large-scale exercises (for example, REFORGER, a joint deployment and training exercise by U.S. and North Atlantic Treaty Organization forces in Europe), to smaller battalion-level maneuvers at training ranges in the United States, to individual training sorties by military aircraft. Field-level training contributes to a unit's military readiness--that is, its ability to fight well early in a war.

In response to decreased tensions with the republics of the former Soviet Union, this option would reduce certain unit-level training based on the particular threat, the amount of warning time, and the likelihood of the contingency--a concept referred to as "flexible readiness" in 1990 by the Chairman of the Senate Committee on Armed Services. Two tiers of readiness levels would be adopted--current high training levels for those forces most likely to deploy, and somewhat lower levels for those forces whose deployment is less likely. Just as the Administration recently took strategic bombers off their alert status for the first time in over 30 years, this option assumes that current optempo levels and training schedules for conventional forces could also be reduced because of the decrease in international tensions.

The decision about which units would receive less field-level training would ultimately be made by the military services and the Secretary of Defense. To illustrate potential savings, CBO assumed that optempo levels would be set based on the Administration's allocation of forces in its recently proposed base force plan. Under this plan, forces are assigned to one of four military missions: deterrence of strategic nuclear war, response to worldwide contingencies, or defense of U.S. interests in the Atlantic or in the Pacific. CBO assumed that no changes would be made in the Administration's optempo levels for strategic forces, or for reserve forces whose training is already limited by their availability. Nor would adjustments be made for contingency forces where the likelihood of a threat is least predictable.

Because of the diminution in the former Soviet threat, however, this option assumes that training for active-duty units designated for defense in the Atlantic or Pacific regions could be cut 10 percent below current levels starting in 1993. Active units assigned to the Atlantic and Pacific portions of the base force will constitute about two-thirds of all active-duty military personnel in 1997. For the Navy, a 10 percent cut would mean fewer or shorter deployments to the Atlantic and Pacific and additional time spent at ports in the United States. For the Army and Air Force, certain units would train less frequently, and some pilots would fly fewer hours per month.

With these assumptions, savings compared with the CBO baseline and the Administration's February 1991 plan would total some $900 million in 1993 and $4.7 billion over the 1993-1997 period. Savings relative to the Administration's latest plan would probably be similar in size. Savings would result primarily from reductions in operation and maintenance funds provided to support current optempo or training levels. There would be lower costs not only for the fuel and spare parts used during training but also for maintenance and logistical support (for example, purchase and distribution of supplies, or technical engineering support). This option could also be associated with lower personnel levels, though such savings are not included here. For example, if Navy ships spent more time in port where personnel levels are reduced, military end strength could be lower. As is sometimes already the case, Army and Air Force units could be manned below authorized levels as a matter of policy.

The Administration's plan does not reflect flexible readiness since it continues to fund optempo at current high levels. The Administration might argue that with smaller overall force levels, any reduction in training and readiness of the remaining units would be unacceptable even though the threat of a major war in Europe has declined markedly. Since the risk of other contingencies may be as strong as before the changes in the former Soviet Union, and the precise mix of forces to be deployed is unpredictable, some analysts would argue that all units should maintain high readiness levels. Finally, if military personnel have fewer opportunities to train realistically in peacetime, morale could also be reduced, in turn affecting readiness.

Supporters of flexible readiness would argue that even with reduced training levels for selected units, the military would still retain enough fully ready forces to respond to likely contingencies. In fact, apart from Operation Desert Storm and military buildups based on conscription, the largest deployment of U.S. forces was to Panama in 1990 when approximately 27,000 troops took part in Operation Just Cause. If larger numbers of troops are needed, as was the case in Operation Desert Storm, there would probably be some warning before hostilities began. In that case, fully ready units would be deployed first, and units that had had reduced training would have time to "train up" before deployment.

DEF-40 REDUCE FUNDING FOR CLASSROOM TRAINING

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	240	470	630	660	720	2,720
Outlays	190	420	580	640	700	2,530

In 1993, the Department of Defense will spend $3 billion to train military personnel in military schools. School training provides a variety of skills, including recruit training for new accessions, specialized skill training for midlevel personnel, and professional military education for officers being prepared for leadership positions. Each year, the Congress approves funding for a certain student load, defined as the number of students times the period each is involved in classroom training.

Estimates of student loads should reflect the total size of the force as well as the number of new military personnel, career paths of midlevel personnel, and retraining needed to match skills to anticipated needs. Between 1987 and 1992, however, student loads did not change in proportion to reductions in forces. From its high point in 1987, overall force size decreased by 12 percent through 1992, but total student loads fell by only 8 percent.

To differentiate between various kinds of training, a distinction is made between accession- and career-related training. Even though accession-related training is strongly influenced by the number of new personnel, accessions decreased by 22 percent from 1987 through 1992, but accession-related student loads fell by only 15 percent. During the same period, the career force (defined here as the total force minus accessions) decreased by 10 percent, but loads for career-related training actually increased by 13 percent. Since career training prepares members for new responsibilities, DoD may be training more service members than are likely to be promoted.

The CBO baseline assumes that student loads remain constant at the planned level for 1993. This option reduces student loads to reflect planned changes in forces in 1993 and beyond. Accession-related training would be decreased by the same percentage as accessions, and career training would be cut by the same percentage as the career force. These reductions would save $240 million in 1993 compared with the CBO baseline. If total student loads are to be adjusted beyond 1993 in proportion to reductions in total personnel, then savings compared with the baseline would total $2.7 billion through 1997. The Administration has not announced its detailed plans for student loads beyond 1993, so estimates of savings compared with the Administration's current plan are not provided.

In general, the reductions under this option should ensure that funding for student loads reflects the planned decline in the total number of military personnel as well as in the size of the career force and the number of accessions. Some of the reductions could, however, adversely affect the skill levels of military forces, potentially reducing wartime effectiveness. Training levels, particularly for the career force, may vary not only with force size but also with changes in the types of weapon systems that must be operated. Reducing student loads could limit DoD's ability to

train entering members, and retrain current members, as new weapon systems enter the force. Also, more training may be needed because of increased difficulties in matching skill levels to required jobs during the force drawdown. Finally, a smaller, more flexible force oriented toward new missions may need better-trained personnel.

DEF-41 CONTINUE CIVILIAN HIRING FREEZE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	400	1,400	2,300	2,800	2,800	9,700
Outlays	300	1,150	2,050	2,600	2,750	8,850

At the end of fiscal year 1991, the Department of Defense employed 1,045,000 civilians in a wide variety of support activities ranging from depot maintenance to payroll administration. In September 1991, DoD decided to extend the partial civilian hiring freeze first instituted in January 1990 to reduce total civilian employment. Except for exemptions for specific hiring categories allowed under the freeze (such as positions involving health and safety, or civilians hired to meet special requirements for Operation Desert Shield/Storm), the military services and defense agencies were instructed to replace only two of every five civilians who leave the department. DoD adopted this policy to reduce civilian employment through attrition so as to limit the use of reductions in force (RIFs). DoD may well tighten this freeze because of concern about current personnel levels.

This option reflects the effect of adopting a slightly tighter freeze in 1993 and 1994 and maintaining a more liberal freeze through 1996. Under this approach, DoD could replace one of every three employees who leave in 1993 and 1994, one of every two employees who leave in 1995, and two of every three in 1996, lifting the freeze in 1997. Assuming that current patterns of losses continue, this policy would reduce civilian end strength gradually by about 20 percent from 1990's level--some 230,000 personnel--by 1997, compared with the Administration's planned reduction of 155,000, or about 14 percent. The higher percentage in this option would be close to the decrease planned for military personnel. It would also be roughly proportional to the planned reduction in spending in the operation and maintenance (O&M) appropriations, which fund the activities that employ 80 percent of DoD's civilian work force. Savings would increase from $400 million in 1993 to $2.8 billion by 1997, compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan.

The Administration's budget request for 1993 reduces civilian end strength by about 15,000 each year between 1993 and 1997 compared with last year's budget request. Compared with the Administration's current plan, the option would save $100 million in 1993 and $2.1 billion in 1997. However, these savings may not fully capture the effect of the current hiring freeze. This ongoing freeze could save an additional $350 million in 1993 compared with the request.

The additional reductions under this option would help ensure that reductions in O&M costs are made in a balanced manner. About 40 percent of the O&M appropriations are spent on civilian pay and benefits, with the remainder allocated to nonpay DoD costs such as fuel, spare parts, and purchases of goods and services from private contractors. If civilian personnel are cut by less than O&M funds as a whole, as in the Administration's 1991 plan, then nonpay activities such as training, equipment maintenance, transportation, and medical care would have to be cut disproportionately, which in turn could adversely affect readiness.

Continuing a partial freeze would also maintain pressure on DoD to streamline operations as its force structure decreases. Major companies and state and local governments are reducing white-collar headquarters personnel to ensure that their overhead decreases while they are downsizing their operations. Similarly, DoD may need to continue a partial freeze to help reverse the almost 50 percent growth in administrative and management personnel that has occurred since 1980. Finally, continuing a freeze would limit the size of civilian RIFs, which are disruptive and reduce savings because of separation pay and other costs.

Continuing a partial freeze, however, might cause skill imbalances since attrition tends to be highest in particular fields (clerical workers, for example) rather than spread evenly across the work force. Without careful management to distribute positions where work load needs are most pressing, a long-term freeze could create labor shortages in some O&M programs. Moreover, because junior employees are more likely to leave, the freeze is likely to produce a work force with slightly higher average age and salary. Some of these problems could be alleviated by policies such as encouraging personnel transfers within DoD, retraining, relocation, and selective new hiring, all of which can take place under a partial hiring freeze.

DEF-42 REVAMP MILITARY FAMILY HOUSING

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	470	510	520	540	560	2,600
Outlays	350	470	510	530	550	2,410

The Department of Defense provides family housing to its members either with on-base units or through cash allowances to defray housing expenses in the private market. Members who receive on-base housing forfeit their cash allowances. The amount of these forfeited allowances usually falls short of the full cost of operating and maintaining the housing units, however, so DoD ends up paying the difference. In 1992, this extra cost totaled almost $700 million. The current on-base housing inventory is about 440,000 units, with roughly 310,000 of those located in the United States. The U.S. units provide housing for about 35 percent of military families.

The housing allowances provided to members who live off-base currently cover 80 percent of the average housing costs for a given area, with members expected to pay the remaining 20 percent themselves. Clearly, members have a significant financial incentive to live on-base. Not surprisingly, there are usually waiting lists for on-base housing.

Under this option, all military personnel eligible for DoD family housing would receive the cash housing allowance. In an effort to equalize the families' costs of on-base and off-base housing, rents would be charged for the existing inventory of on-base housing. Initial rents could be determined from a variety of sources: the annual surveys DoD uses to set allowances, information from either the Department of Housing and Urban Development or the National Homeowners Association, and the evaluations of trained appraisers. These initial rents could be adjusted based on the actual demand for the housing units so that there would be no vacancies or waiting lists.

Savings compared with the CBO baseline, which is generally consistent with the Administration's 1991 plan, could amount to $470 million in 1993 and $2.6 billion through 1997. Savings compared with the Administration's latest plan should be similar. Savings are equal to the estimated rental receipts from the on-base houses less the cost of providing housing allowances--at current levels--to the families living in on-base houses. Although the exact rental value of the on-base houses is not yet known, the fact that there are waiting lists of families willing to give up their housing allowances in exchange for on-base housing indicates that the rental value of the on-base houses will exceed the cost of the additional housing allowances. The savings estimates shown here assume that, on average, on-base houses would rent for amounts similar to off-base houses. Personnel living on-base would receive housing allowances, but--as is now the case for those living off-base--their allowances would equal only about 80 percent of the rents they would pay. This approach would result in budgetary savings and would equalize treatment of personnel living on- and off-base.

This system of market-based rents would result in a more rational allocation of the limited stock of DoD housing. Currently, military families that might prefer to live off-base are driven by the financial incentives to seek on-base housing, and other families that would prefer on-base housing may be unable to get it because of waiting lists.

Both the weaker national housing market and planned force drawdowns might help ease implementation of this option. Over the long run, DoD and the Congress could better evaluate DoD's housing program. In those locations where DoD spends more to maintain housing units than military members are willing to pay in rent to live in that housing, the quality of life of military families could be increased by shifting resources away from housing and toward cash payments (either in the form of pay or higher housing allowances). Alternatively, DoD could justify additional housing on bases where the cost of construction and maintenance would be covered by expected rental payments.

A principal drawback of this option is that--unless part of the savings is used to increase pay--morale and retention would be adversely affected, especially for service members living on-base. In fact, some personnel are required to live on-base because of their importance to the base in case of mobilization. If rents for on-base housing proved to be higher than for comparable housing off-base, some adjustment in housing allowances would have to be provided for these personnel as equitable relief. Further, if housing is scarce in particular markets, some families might have to rent in undesirable areas.

Finally, a major change in housing allowances may be inappropriate at a time when the services are conducting a large drawdown and many military personnel are anxious or uncertain about their careers. Although DoD has considered similar proposals, it is not currently considering a change of the sort envisioned in this option.

DEF-43 INCREASE THE STATES' SHARE OF ARMY NATIONAL GUARD COSTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	510	490	490	510	530	2,530
Outlays	460	480	490	500	520	2,450

The 440,000 members of the Army National Guard serve two functions. They are part of the nation's reserve military forces, and the states use them for keeping order when other police and security forces are inadequate, for assistance after natural disasters, for holiday traffic patrols, and for other state purposes. The states pay salary costs only when the Guard is actively performing a state mission; they pay nothing else toward the cost of the insurance role the Guard fulfills.

This option would require the states to pay 10 percent of the operating costs of the Army Guard. Savings compared with the CBO baseline, which is generally based on the Administration's 1991 plan, would amount to about $510 million in 1993 and would total $2.5 billion through 1997. Savings compared with the Administration's latest budget request would be somewhat smaller because the Administration's plans call for a large cut in the reserves.

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

DEF-44 REDUCE SECURITY ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	210	430	670	920	1,190	3,420
Outlays	40	150	330	540	550	1,610

Security assistance, which comprises military aid and economic support funds, is an important means of advancing the interests of U.S. national security or foreign policy. In the Cold War era, security assistance was used to counter the spread of communism.

After assistance to Israel and Egypt, assistance to countries with U.S. military bases is the second largest component of security assistance. Currently, the United States provides nearly $1.1 billion per year in foreign military financing and $300 million per year in economic support funds as grants and loans to four "base-rights" countries: Turkey, Greece, the Philippines, and Portugal. In some cases, the military financing is used to modernize forces and to make the country's weapon systems compatible with those of U.S. forces. In other cases, the funds exceed a country's purchase of U.S. military equipment and services, remain undisbursed, and build up as balances uncommitted to any particular purchase. In a period of tight budgets, assistance to these countries can be cut sharply and gradually eliminated over the next five years. The cuts would reduce budget authority by $210 million in fiscal year 1993 and $3.4 billion through 1997.

Critics have argued that security assistance to base-rights countries amounts to paying a country rent for the privilege of protecting it. In the case of the Philippines, Clark Air Force Base has been closed and Subic Bay is being evacuated, thus eliminating the argument that assistance is needed to maintain a strategic asset. Furthermore, the base-rights countries in the North Atlantic Treaty Organization (NATO) are some of the highest-income recipients of U.S. foreign aid. Greece and Portugal have higher per capita income than South Korea, which last received assistance in 1987.

Recent changes in the world provide the United States with the opportunity to decrease security assistance. The Soviet Union no longer exists as a political entity, and the Warsaw Pact has been dissolved. Indeed, the constituent republics of the former Soviet Union are now potential recipients of economic assistance. Not only has the military threat from the former Soviet Union declined, but the deteriorating economies of the constituent republics have reduced their capacity and will to fund regional powers that have policies contrary to U.S. interests. The diminished threat has permitted the United States to reduce its own forces, leaving the U.S. military with an excess inventory of military equipment. The law implementing the Conventional Forces in Europe Treaty provides for the transfer of tanks, artillery, and armored vehicles to U.S. allies on the southern flank of NATO. The Philippines is also receiving excess military equipment. These countries, therefore, have less need for new funding.

Supporters of security assistance argue that access to military facilities is secured under long-term agreements. An abrupt reduction in assistance could harm relations with the recipient countries, especially those anticipating U.S. assistance to pay for U.S. military equipment already under contract. Furthermore, the chaos arising from the breakup of the Soviet Union creates a new threat, and it

is too early to tell whether the instability within and between the new republics will decrease the long-term military threat from that region. Given this potential threat, critics would argue that base-rights countries need a strong military capability, and, because this defense burden is out of proportion to their economic capacity, that they will need continued U.S. security assistance.

DEF-45 CONSOLIDATE OVERSEAS BROADCASTING

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	80	180	260	270	280	1,070
Outlays	-100	200	310	320	310	1,040

U.S. overseas broadcasting is provided by several entities. Radio Free Europe (RFE) and Radio Liberty (RL) broadcast country-specific news to Eastern Europe and the former Soviet Union, respectively. The United States Information Agency oversees the Voice of America (VOA) radio broadcasts and television broadcasting services that provide news and U.S.-related information to audiences worldwide. Combining the operations of RFE/RL with those of the VOA, and eliminating television broadcasting and unnecessary capital construction, would save approximately $1 billion over the 1993-1997 period.

Some operations of the VOA and RFE/RL currently overlap. Both broadcast to the former Soviet Union and Eastern Europe. This overlap, combined with the recent dramatic changes in that region, suggest that some portions of overseas broadcasting could be consolidated and that others could be scaled back or eliminated. Also, some current projects, such as the construction of a radio transmitter facility in Israel that would broadcast to the former Soviet Union and Asia, could be stopped without affecting current services. Finally, with the advent of private broadcasts such as the Cable News Network, many countries already receive world news on television via satellite, reducing the need for U.S. television broadcasting services.

This option would close RFE/RL and would provide the VOA with additional funds for broadcasting to Eastern Europe and the former Soviet Union, end construction of the radio transmitting facility in Israel, and end U.S. overseas television broadcasting. When measured against the CBO baseline, consolidating RFE/RL with the VOA, which have annual budgets of about $200 million each, would cost about $105 million in 1993 but would save $680 million over the five-year period. Terminating television broadcasting would save $5 million in 1993 and $180 million over the five-year period. Not building the transmitter in Israel would save $1 million in 1993 and $180 million over the five-year period. Savings in 1993 are reduced for all the programs by large termination costs such as severance pay.

Supporters of overseas broadcasting would argue that the current level of radio broadcasting to Eastern Europe and the former Soviet Union should continue because democratization is a slow process that will need nurturing. Supporters also would argue that even if savings could be achieved in existing broadcasting services, those savings should be used to expand broadcasting services in other parts of the world, like China and Africa, which have government-controlled radio stations.

Proponents of satellite television services would argue that they are a powerful communications tool that can reach audiences instantaneously and that private television networks cannot adequately communicate U.S. policy and viewpoints. Supporters of the transmitting facility in Israel argue that it will be a vital link in broadcasts to Southwest Asia, the former Soviet Union, and Eastern Europe.

DEF-46 REDUCE EXIMBANK CREDITS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	210	210	220	230	240	1,100
Outlays	30	90	130	170	200	620

The Export-Import Bank (Eximbank) promotes U.S. exports by providing financing to foreign buyers of U.S. goods. The bank provides direct loans with below-market interest rates and guarantees of private lending without receiving full compensation for the contingent liability of future losses. These subsidies are shared by the U.S. exporter and the foreign buyer. In the 58 years since its creation, Eximbank has lost $7 billion on its operations, practically all in the last 15 years. Baseline projections of new subsidy costs are $600 million per year. Savings could be realized by cutting the bank's projected subsidy by one-third and directing the remainder to the private sector in middle-income, moderate-risk countries with growth potential.

Supporters of Eximbank say that the subsidies it provides offset subsidies provided by foreign governments, and that eliminating them would put U.S. exporters at a disadvantage. These subsidies, they argue, increase U.S. exports, thereby providing jobs to U.S. workers. Finally, supporters argue that the bank's subsidies help increase the output of high-technology industries and allow these industries to achieve economies of scale.

Critics of Eximbank dispute these claims. The bank does not limit credit to exports facing foreign-subsidized competition. Little evidence exists suggesting that the credits create jobs. Finally, since the United States encourages the creation of free-market economies throughout the world, providing subsidies to promote exports is contrary to free-market policies that the United States is advocating.

DEF-47 PHASE OUT SPECIAL DEFENSE ACQUISITION FUND

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	450	260	220	90	30	1,060
Outlays	10	60	90	30	10	200

The Special Defense Acquisition Fund (SDAF) is a revolving fund that finances the acquisition of military equipment and materiel in anticipation of future military sales. The Department of Defense uses SDAF funds to buy military equipment and materiel that it expects to sell to foreign nations. When the equipment or materiel is sold, the proceeds are put back into the SDAF and used to finance subsequent purchases. The SDAF results in faster deliveries once agreements on foreign military sales are signed.

This fund, authorized in 1982 under the Arms Export Control Act, was intended to help DoD meet the urgent demands of U.S. allies without drawing down U.S. service inventories. The fund is capitalized at $1.07 billion. Over the long run, this capital is sufficient to support annual SDAF sales of approximately $280 million. To date, Pakistan, Saudi Arabia, and Bahrain have purchased the largest quantities of military equipment and materiel from the fund, followed by Turkey, Egypt, Greece, the United Kingdom, the Netherlands, Japan, and Thailand. Missiles and ammunition have accounted for 52 percent of total SDAF procurement, and radars and heavy arms for another 19 percent.

This proposal would phase out the SDAF by eliminating its authority to obligate funds beginning in 1993. Military equipment and materiel that the SDAF currently owns or has agreed to purchase would be sold as planned to foreign buyers. Unobligated cash balances within the SDAF would be rescinded, and the proceeds from future sales would be returned to the Treasury as offsetting receipts. Returning the funds to the Treasury is estimated to reduce net budget authority by just over $1 billion during the next five years. Over the same period, net outlays are estimated to be reduced by $200 million as the military equipment and materiel that the SDAF currently owns is sold and not replaced. The SDAF phaseout would be completed by fiscal year 1997, and no additional savings would accrue after that year.

With the current reduction in U.S. force structure, a significant portion of the military equipment and materiel that foreign nations might urgently require can be obtained quickly from excess U.S. inventories, without reducing the readiness of U.S. combat units. In addition, it is DoD policy to use SDAF funds primarily to purchase goods for which there is a reliable foreign demand and then to sell those goods--while still in the production pipeline--on a first-come, first-served basis (rather than to hold goods in the inventory in anticipation of some urgent need). As a result, the SDAF is largely a financing mechanism to meet the routine defense needs of foreign nations. Without the SDAF, both the decision to produce these goods in anticipation of future orders and the cost of financing the production could be left to U.S. industry.

Phasing out the SDAF, however, could eliminate one of the few sources of flexibility in the DoD procurement process. Although the Congress controls the overall size of the SDAF, DoD is free to revise its planned allocation of SDAF funds quickly in response to ongoing events. Proponents of the SDAF point out that it can be used to bridge gaps in production lines and to ensure that equipment is ordered in economically efficient quantities, thereby lowering the cost of the equipment to U.S. forces. Since the price the U.S. government pays for military equipment is frequently negotiated based on production costs, private producers may be unwilling to bridge gaps in production lines by producing in anticipation of foreign sales, even if doing so would lower production costs. The potential increase in procurement costs for U.S. forces resulting from the proposed SDAF phaseout is not reflected in the savings estimates shown above. During the drawdown of U.S. forces, the SDAF might also finance modifications of excess U.S. equipment, making U.S. equipment more attractive to potential foreign buyers.

Proponents of the SDAF also point out that--since SDAF procurements focus on items used both by the United States and by foreign nations--some of the assets in the SDAF pipeline were those urgently needed to enable U.S. and allied forces to operate together during Operations Desert Shield and Desert Storm. This may be less an argument in favor of the SDAF, however, than an argument for a broader change in U.S. policies aimed at purchasing more equipment for U.S. forces that can also be operated by allied forces.

Chapter Three

Domestic Discretionary Spending

Domestic discretionary programs include all those funded through appropriations except programs in defense and international affairs. An extremely varied category results: science and space, transportation, energy, agriculture, environmental protection, housing, education and training, medical research, and law enforcement.

Spending for these programs will total an estimated $214 billion in 1992, about 15 percent of federal outlays. Relative to the nation's gross domestic product (GDP), spending in the domestic discretionary category has remained stable since 1987 at about 3.4 percent. This share is well below the level reached in 1980, when domestic discretionary spending was 5.5 percent of GDP.

Broad clusters of domestic discretionary spending have risen or fallen relative to GDP since the early 1960s (see Figure 4). Individual programs within these groups have fared better or worse than the groups as a whole: many programs have come and gone over this period. The clustering shown in the figure reveals something about how national priorities have shifted.

Human services--comprising such areas as education, training, social services, medical research, subsidized housing, and the administrative costs of many benefit programs--have accounted for the largest share of spending among domestic discretionary programs since the late 1960s. The education, training, and social service programs--budget function 500--dominate the category, and they have accounted for much of the rise and fall observed since 1962.

Sharp increases in funding for programs to aid education and to provide training and employment occurred during the late 1960s. Spending for education and training peaked at more than 1 percent of GDP in 1979 and has since declined to about 0.5 percent. A large part of the decline in the early 1980s stemmed from eliminating funding for public service employment, which had grown during the late 1970s. Federal funding for education also shared in the decline, as state and local governments took over a larger part of that responsibility.

Spending in the areas of science, energy, natural resources, and agriculture since 1962 shows two peak periods. The effort that placed a man on the moon caused the first peak. At their height in 1966, outlays for space and other general science activities reached nearly 1 percent of national income, but rapidly declined to their current level of about 0.25 percent of GDP. Energy programs initiated after the oil price shock of 1973 produced the second peak. Those programs, like many others in the domestic discretionary category, faced cutbacks during the 1980s.

Spending for commerce, transportation, and community and regional development remained roughly constant relative to GDP

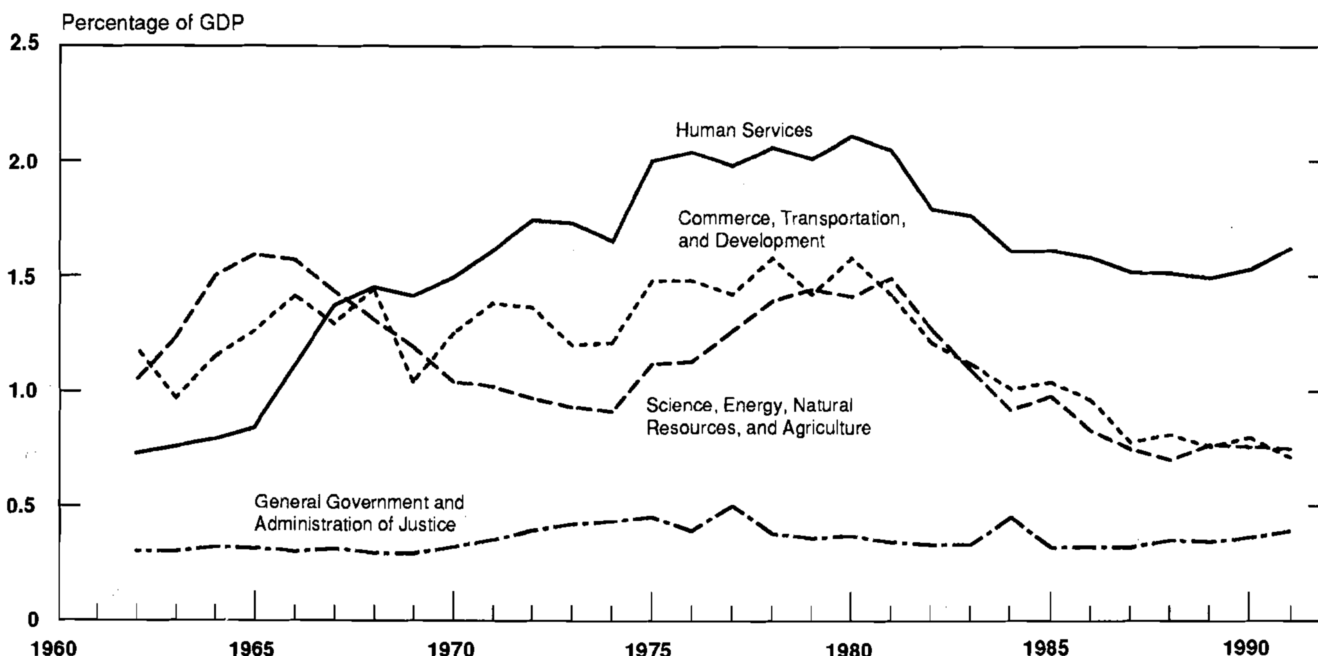
through the 1970s, but it now stands at half the share reached in 1980. Spending for general government activities, the final category shown in the figure, has not fluctuated greatly during the period. Federal law enforcement spending, which now accounts for about half of this total, grew during the 1970s as a share of GDP and did not undergo reductions common to many other discretionary spending programs during the 1980s.

Because all of the options in this chapter affect discretionary spending, action taken in appropriation bills would be required to achieve the budgetary savings. In some cases, however, the options describe changes in the laws establishing the programs, in addition to reductions in the amounts appropriated for them. The appropriation reduction rather than the program change causes spending to decline. This contrasts with options affecting entitlement or mandatory programs, discussed in Chapter 4, in which appropriation actions are generally not needed to effect budgetary savings.

In the options involving authorizing legislation, program goals or the methods of achieving them are changed. An example of such an option is DOM-11, which would reduce the level of cleanup required in the Superfund program. The effect of the program change, combined with reduced appropriations, would be different from what would occur with cuts in appropriations alone. The text accompanying each option contains a description of the programmatic changes, their effects, and arguments for and against the changes.

Several options contained in this chapter would affect spending in both the mandatory and discretionary categories of the Budget Enforcement Act. An example is DOM-09, which would eliminate below-cost timber sales in national forests. In this option, receipts from timber sales, which fall into the mandatory category, would be reduced, but the loss of receipts would be more than offset by lower discretionary funding for Forest Service activities.

Figure 4.
Domestic Discretionary Spending as a Share of GDP



SOURCE: Congressional Budget Office.

The final two options in this chapter, DOM-53 and DOM-54, would change labor contract rules and thereby affect spending in the defense as well as domestic discretionary area.

Federal budget functions define the order of options in this chapter. DOM-01 through DOM-06 address reductions in space and science programs (function 250). DOM-07 through DOM-16 analyze reductions or changes in federal support and management of energy, natural resources and the environment, and agriculture (functions 270, 300, and 350). DOM-17 through DOM-22 cover commerce, housing, and credit (function 370). DOM-23 through DOM-25 describe options for transportation programs (function 400). DOM-26 through DOM-30 deal with community and regional development (function 450). DOM-31 through DOM-41 focus primarily on education and health (functions 500 and 550). DOM-42 through DOM-48 concentrate on housing and income security programs (function 600). DOM-49 and DOM-50 relate to veterans' programs (function 700). DOM-51 and DOM-52 center upon the administration of justice (function 750). DOM-53 and DOM-54 involve labor contract rules and would affect many functional areas.

DOM-01 CANCEL NEW SPACECRAFT DEVELOPMENT PROJECTS IN A MAJOR NASA PROGRAM FOR SPACE SCIENCE AND APPLICATIONS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	190	190	200	210	210	1,000
Outlays	100	180	200	200	210	890

The National Aeronautics and Space Administration's (NASA's) space science and applications program is currently funded at $2.7 billion for eight programs. Three programs--physics and astronomy, planetary exploration, and environmental observation--account for 85 percent of 1992 funding. Canceling new activities in only one of the three could save $1 billion in budget authority and $890 million in resulting outlays over the 1993-1997 period, relative to the CBO baseline. To realize these savings, NASA would have to cancel immediately the Advanced X-Ray Astrophysics Facility (AXAF) in the physics and astronomy program, the Comet Rendezvous Asteroid Flyby/Cassini mission in the planetary exploration program, or the Earth Observation System in the environmental observation program. NASA would also have to refrain from starting any new activities until after 1997 in the program suffering the cancelation.

Canceling development of major new spacecraft in any of these programs need not endanger ongoing scientific work. In fact, the public purpose of gaining scientific knowledge may be better served by allowing intensified efforts in the programs in which new spacecraft development continues. In the physics and astronomy program, existing ground facilities and two orbiting observatories--the Hubble Space Telescope and the Gamma Ray Observatory--will provide the scientific community with new data, even if two additional planned orbiting observatories (the AXAF and the Space Infrared Telescope Facility) are cancelled. In the planetary exploration program, although obtaining samples from other bodies orbiting the sun would require new missions, data from completed missions and those likely to be operating in the near future will be available to planetary scientists. In the environmental observation program, multiple sources of new data will be available whether or not new spacecraft are developed and launched over the next five years.

Significant reductions in one space science program, rather than smaller reductions across all programs, would concentrate resources in those that remain. That reduction strategy would avoid extending projects with no near-term results. Aggressively pursuing international cooperation in the program chosen for cutbacks could also decrease scientific losses.

Canceling new spacecraft development in a major program area, however, would undercut the nation's scientific and technical leadership in that field. National prestige would suffer. Once lost, leadership could be difficult to restore, and U.S. scientists and engineers would be discouraged from entering the field in which the cutbacks were made.

DOM-02 REDUCE THE OVERHEAD RATE ON FEDERALLY SPONSORED UNIVERSITY RESEARCH

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	730	760	790	820	850	3,950
Outlays	330	660	760	800	830	3,400

Under current practice, when federal agencies disburse research and development (R&D) grants to universities, they pay not only the direct costs incurred by the researchers but also indirect costs. Besides administrative overhead, such expenses include library and student services, building and equipment, and operations and maintenance. Of a total of $4 billion in university grants and contracts in 1990, the National Institutes of Health (NIH) paid for $1.2 billion in indirect costs. Concerned by the rise in such costs, the Congress has begun to reduce them by capping the administrative portion at 26 percent of so-called modified direct costs--a subset of all direct costs--for research sponsored by the Department of Health and Human Services (HHS). The department accounted for over half of the $9.2 billion in university R&D sponsored by the federal government in 1991.

The Congress could further reduce indirect costs by capping the administrative portion at 20 percent of modified direct costs for university research sponsored by all nondefense agencies, and capping facilities' indirect costs at 15 percent. Extrapolating from NIH data, CBO estimates that implementing these rules would reduce spending by $330 million in 1993 and $3.4 billion over the 1993-1997 period. In order to save the funds indicated, the appropriations for the relevant agencies would have to be reduced by the amount corresponding to the saved indirect costs. This is because the funding for these indirect costs typically comes within the appropriation ceiling--crowding out direct spending on research itself.

The share of indirect costs has risen since 1970, when they averaged 30 percent of modified direct costs. By 1990, the percentage had risen to 48 percent of these direct costs. (Although this rate seems high, it applies to only a fraction of the direct costs. Consequently, the effective rate actually paid on the entire grant is generally much lower than the nominal rate on modified direct costs.) Despite the recent focus on administrative costs, facilities overhead in fact has accounted for virtually all of the growth in indirect costs since 1982. Analysts usually blame the increase on a policy change in the late 1980s that permitted reimbursement for interest charges and, in the early 1980s, for energy costs. Consequently, a cap on various indirect costs, not just administrative overhead, is warranted. Furthermore, setting these rates back to the level roughly of 1980 should not do substantial harm; until quite recently universities not only survived, but prospered, with those rates of reimbursement. Leaving the rates uncapped only provides incentives to increase overhead at federal expense, resulting in more R&D spending with less actual R&D.

Opposition to such reduction in overhead stems from the need to maintain a healthy university environment. Despite a handful of well-publicized occurrences of university abuse of indirect cost charges, recent audits at HHS have found that questionable charges amount to only about 1 percent of indirect costs. More important, defenders of the current system argue, is the need of the universities to recover the total cost of research, so that the United States can continue to

maintain the world-class system of research universities built up at great cost over a period of decades. Not allowing universities to recover all costs could result in slow decay, as financially strapped institutions might be forced to reduce investments in new facilities, complete library collections, and the like. In addition, the data, at this point, do not exist to allow federal agencies to determine the true total costs of R&D and the pattern of distribution of these costs among universities and spending categories. In these circumstances, a cap could easily be set below the real cost-recovery point.

As an alternative to caps on individual indirect cost components, the Congress could impose an overall indirect cost cap on all institutions. This system would provide those institutions that are above the overall cap with an incentive to become more efficient and cost-conscious. Instituting a flat rate of 40 percent (roughly the average indirect cost rate in 1980) would reduce spending by $290 million in 1993 and $2.9 billion over the 1993-1997 period.

DOM-03 CANCEL THE NASA DEVELOPMENT PROGRAM FOR THE ADVANCED SOLID ROCKET MOTOR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	480	500	510	530	550	2,550
Outlays	250	420	480	510	530	2,200

The National Aeronautics and Space Administration (NASA) is developing the Advanced Solid Rocket Motor (ASRM) to replace the redesigned solid rocket motor currently used to launch the space shuttle. Canceling the ASRM program could save $2.2 billion from 1993 through 1997, relative to the CBO baseline.

NASA initiated the ASRM program to improve the safety of the space shuttle and to increase the weight of the payloads it can carry. But NASA's own Aerospace Safety Advisory Panel points out that the redesigned rocket booster is performing well. According to the panel, investments in other parts of the shuttle system--for example, the turbo pumps providing fuel to the space shuttle's main engines--would enhance the safety of the shuttle more than would investment in the ASRM.

A goal of the ASRM program is to increase the carrying capacity of the space shuttle by 12,000 pounds. Since no other approved payloads require that much lift, only the space station and the Advanced X-Ray Astrophysics Facility (AXAF) programs benefit from the increase in capability. The ASRM would serve the space station program in two ways: the shuttle would be able to deploy the space station in fewer flights, and the risky activity of moving equipment from the shuttle to the space station's modules would be reduced because the modules could be launched more fully equipped. The ASRM's increased lift is also needed to allow the AXAF to carry its planned complement of instruments. If the ASRM were unavailable, additional spending on an inertial upper-stage launch vehicle would be necessary to launch the AXAF.

The ASRM program can be questioned as an investment regardless of its role in the space station and AXAF programs. It is unlikely that the shuttle system will be operated after 2020. If the program's anticipated cost of $3 billion were spread over 200 shuttle flights, a number sufficient to fly the vehicle eight times a year between 1996 and 2020, developing the ASRM would add $15 million to the cost of each flight. Predicted decreases in the acquisition cost of ASRM boosters compared with the cost of redesigned solid rocket boosters could offset part of these increased costs.

A report by the National Research Council on the ASRM program raises other questions. The report indicates that significant design and manufacturing problems may increase the program's cost and delay its introduction; the panel advised NASA to make adequate allowances in its schedule and budget for unanticipated problems in those areas. Indeed, the program's schedule has already slipped. If the booster were developed later than currently planned, it could not be used to deploy the space station unless that program were also delayed. If the booster cost more to develop, its addition to the average cost of a shuttle flight would be even greater.

The case for the ASRM program rests primarily on its ability to support the deployment of the space station. Additional benefits that could accrue from the program include demonstrating the application of advanced manufacturing technology to launch-vehicle production, and the possibility that the booster could be used in the proposed National Launch System to carry very large payloads into orbit.

DOM-04 CANCEL THE SUPERCONDUCTING SUPER COLLIDER

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Savings from CBO Baseline						
Budget Authority	500	520	530	550	570	2,650
Outlays	200	410	520	540	550	2,200
Savings from Administration's Plan						
Budget Authority	640	710	780	730	850	3,700
Outlays	260	540	720	750	790	3,050

The Department of Energy (DOE) is building a 54-mile proton accelerator--the Superconducting Super Collider (SSC)--to investigate the origin of mass and test current theories about the unity of electromagnetism and radioactive decay. DOE currently estimates that this accelerator will cost $8.2 billion, but other estimates are much higher. Canceling the SSC would save the U.S. taxpayer $200 million in 1993 and $2.2 billion over the 1993-1997 time frame relative to the CBO baseline. Relative to the Administration's plan the savings would be greater.

The SSC is consuming a disproportionate share of U.S. science resources--according to the official DOE projection, 6 percent of all federal basic research spending over the next five years. And SSC costs are entering the high-growth stage: the increase in 1993 equals roughly one-quarter of the entire increase in the section of the budget reserved for general science. Both the share and the absolute amount of federal funds devoted to this project are out of proportion to the likelihood of the SSC's producing usable science or technology in the near future, if ever. Nor is the SSC project likely to be the source of training for as many science graduate students as a project of its size would warrant. In short, in terms of the output that federal policy typically seeks from science--useful knowledge, useful technology, and training for students--the SSC is not likely to be an investment that provides society with a good rate of return.

In addition, there are large discrepancies in the cost estimates. DOE claims that the accelerator will cost $8.2 billion, up from an earlier $5.3 billion. By contrast, the independent cost-estimate office within DOE calculates that the cost may exceed $11.8 billion. The independent estimate is greater, in large part, because the official estimate excludes some items--such as spare magnets and costs of operating the SSC laboratory--that are essential if the SSC is to run properly.

Furthermore, DOE has been largely unsuccessful in attracting commitments for substantial amounts of foreign funds as it promised. Only India has committed itself--in the amount of $50 million--although scientists from other nations have expressed interest in providing other components for the SSC. The Japanese government remains uncommitted, having only promised to study the matter for another year.

Proponents of the SSC claim that the project will be the centerpiece of high-energy physics research in the United States. Many of

the magnet problems that lay behind much of the first cost increase have been solved. Two full-length prototype superconducting magnets have been tested, each showing a 10 percent to 12 percent margin beyond the operating requirements; the design panel had recommended a 10 percent to 15 percent margin. (Whether industry can economically build 8,600 of these magnets to specification remains unclear.)

Proponents would also argue that most of the cost increases have already occurred: the SSC to date has experienced the average level of cost increase associated with DOE accelerators throughout their entire construction.

DOM-05 CANCEL SPENDING FOR THE SPACE EXPLORATION INITIATIVE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	90	95	95	100	100	480
Outlays	45	80	95	95	100	420

Under the umbrella of the Space Exploration Initiative, the National Aeronautics and Space Administration (NASA) proposes to expand its research and technology development program for the ultimate purposes of establishing a U.S. base on the Moon and carrying out a manned mission to Mars. The Department of Defense and the Department of Energy also fund part of this activity. Not expanding the nation's space program in this direction could save $480 million in budget authority and $420 million in resulting outlays over five years, relative to the CBO baseline.

Human exploration of the solar system is a long-standing goal of space enthusiasts and, implicitly, of the NASA program. Since the earliest days of the U.S. space program, its supporters have foreseen progress toward manned space flight from Earth's orbit to the Moon and interplanetary space travel to Mars. In 1989, President Bush proposed a policy of carrying out manned space flights over the next 30 years--specifically, returning to the Moon around the year 2000 and carrying out a manned mission to Mars sometime after 2010. Congressional action, however, has substantially reduced the Administration's 1991 and 1992 budget requests for these purposes.

The President's 1992 request included $256 million for space exploration, but the Congress reduced this amount to around $90 million. The Department of Energy will spend about $45 million, NASA about $35 million, and the Department of Defense the remainder. Over half of this spending will support a collaborative effort among the three agencies to develop the SP-100, a nuclear reactor for use in space.

In addition, NASA's current exploration program proposes a set of precursor missions to survey the Moon and Mars. Each mission would cost around $100 million and be independent of the others, allowing useful results to be produced even if no additional activities were undertaken. A decision to move forward with these missions would increase spending by as much as $500 million above the CBO baseline for the 1993-1997 period.

The main disadvantage of proceeding with a program for manned space flight beyond Earth's orbit is the cost. Preliminary estimates from NASA indicate that the entire Moon/Mars initiative could cost as much as $400 billion. Even if radical and less expensive options were considered--many proposals abound in the space policy community--the justification for significant expenditures at any level rests upon returning U.S. citizens to the Moon or visiting Mars for the first time, benefits that are both controversial and difficult to quantify.

Many of the subsidiary benefits of the Moon/Mars initiative could be more certainly and less expensively realized by pursuing alternative federal science programs. The space science program itself could pursue alternative projects that are far less costly yet as productive. In a broader context, equivalent federal spending on a variety of science and tech-

nology areas would have many of the same beneficial effects on technology, education, and the competitive strength of U.S. industry as does manned exploration of the solar system. In the presence of technical uncertainty, the expected return from a more diversified national science portfolio would arguably be even greater than that expected from a program with a narrower focus.

Successful exploration of the solar system, however, could offer some unique benefits. Such an enterprise would offer the American people a tangible symbol of national achievement. An aggressive program for manned space flight may be particularly effective in attracting young people to careers in science and technology. Finally, the technical capability of the United States may be uniquely suited to human exploration of the solar system; thus, pursuing this objective has an advantage over other science and technology options.

DOM-06 CANCEL THE NASA SPACE STATION PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	2,100	2,150	2,250	2,300	2,400	11,200
Outlays	1,050	1,850	2,200	2,250	2,350	9,700

In March 1991, the National Aeronautics and Space Administration (NASA) submitted to the Congress its plan for a restructured space station program--the latest in a program that, through 1992, will have spent over $7 billion. The current plan reduces the size of the laboratory and habitation modules and the truss on which they are to be mounted. It also delays by several years the onset of sustained manned operations. By some estimates, these changes will reduce the total cost of the program--including development, transportation, operations, and ground facilities--from $38 billion to $30 billion during the 1990s. Canceling--rather than reducing--the program could save $11.2 billion in budget authority and $9.7 billion in outlays from 1993 to 1997, relative to the CBO baseline.

Advocates of canceling the space station point out that many of the traditional objectives of U.S. space policy will not be furthered by the current program. No significant national security purpose will be served, because the Department of Defense has expressed very limited interest in using the NASA station. Many civilian scientific goals could be met earlier, and at less cost, with a more modest program. Some scientists argue that the station will absorb funds that would be better spent on space science and exploration, which involve greater known returns.

Arguments for the current program emphasize its possibilities, both known and unknown, and U.S. commitments to cooperating countries. Manned exploration of the solar system requires the type of long-duration flight provided by the current program; more modest alternatives do not. Advocates contend that significant uses for a space station will be discovered once it is operational. Cancellation of the current program would force the United States to renege on agreements recently signed with European nations, Japan, and Canada. That would hurt the prospects for future international cooperative agreements in space, science, and other areas.

DOM-07 ELIMINATE FURTHER FUNDING FOR THE CLEAN COAL TECHNOLOGY PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	275	230	230	240	250	1,200
Outlays	0	5	60	90	120	270

The Clean Coal Technology Program (CCTP) was created in 1984 to assist private industry in developing commercial technologies that would use coal in environmentally sound ways. The program was initially funded with $750 million originally intended for the Synthetic Fuels Corporation. After four rounds of bid solicitations, the Department of Energy (DOE) will spend nearly $2.2 billion to fund and administer selected CCTP projects. The government's spending on these demonstration projects is limited to 50 percent of total costs.

An initial goal of the CCTP was to reduce acid rain by supporting technologies that can lower the emissions of sulfur dioxide (SO_2) and nitrogen oxides (NO_x) that result from coal combustion. The President has declared that his Administration will honor an agreement with Canada to spend $2.5 billion on clean coal technologies aimed at helping curb acid rain in Canada. Another important goal of the program has been to promote the use of coal. That has two purposes: to contribute to national energy security (since greater use of domestic coal can reduce imports of crude oil); and to bolster the economies of coal-producing regions. Concerns about global warming and emissions of carbon dioxide have recently whetted policymakers' interest in increasing the efficiency of coal use.

Current practices that reduce SO_2 and NO_x emissions include cleaning the coal before burning, scrubbing combustion gases to remove sulfur, switching to types of coal with a lower sulfur content, and switching to other fuels altogether. The new technologies that the CCTP supports fall into three general categories:

- Retrofit technologies that lower harmful emissions from existing coal-fired plants by cleaning the coal before combustion, by reducing the level of gases emitted during combustion, or by removing (or scrubbing) the gases emitted from combustion;
- Repowering technologies that replace all or part of existing boilers with advanced combustion systems that both reduce emissions and increase power output; and
- Conversion technologies that change coal into a liquid or gas.

Most of the CCTP-funded projects will demonstrate technologies that will be used to retrofit or repower coal-burning electricity generating plants.

This option would complete projects already selected in rounds one through four of CCTP bid solicitations, but rescind the $600 million appropriation for round five (which has yet to select projects) and eliminate any future project funding. Savings would total about $270 million in projected outlays over the 1993-1997 period.

Federal support for new clean-coal technologies may no longer be necessary. In the past, supporters of the CCTP viewed it as an alternative to legislation controlling acid rain: enactment of ill-timed controls could force industry to invest in current, high-cost abatement technologies when new, low-cost ones may be just around the corner. Since the passage of the Clean Air Act Amendments of 1990, however, the private sector has faced a clear legislative mandate for lowering coal emissions. Electric utilities and large industrial users of coal now have a clear economic motive for selecting among current practices and new technologies to find the lowest-cost options for reducing emissions. DOE efforts may also be redundant in light of independent research efforts by utilities themselves and by states that produce high-sulfur coal and want to maintain the product's sales.

Alternatively, continued CCTP funding could hasten the deployment of control and abatement technologies that will provide social benefits beyond what electric utilities would be willing to pay for under the Clean Air Act Amendments. Those benefits could come in the form of enhanced energy security, cleaner air, and economic support for electricity consumers in general and coal-producing regions in particular.

DOM-08 REDUCE DEPARTMENT OF ENERGY ACQUISITIONS OF CRUDE OIL FOR THE STRATEGIC PETROLEUM RESERVE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	60	60	60	60	60	300
Outlays	70	160	160	210	220	820

The Strategic Petroleum Reserve (SPR) was authorized in 1975 by the Energy Policy and Conservation Act to reduce the vulnerability of the United States to interruptions in oil supplies. Under plans developed in the 1970s, the SPR is a government-owned crude oil inventory stored in salt caverns in Texas and Louisiana. Current law establishes a fill target for the SPR of 1 billion barrels. Through fiscal year 1990, 590 million barrels of crude oil were stored in the SPR. No additional oil was obtained in 1991; in fact, the Department of Energy (DOE) sold approximately 20 million barrels from the SPR as part of a coordinated international response to the United Nations' embargo of oil from Iraq and occupied Kuwait.

DOE now has approximately $800 million in unspent funds for purchasing oil for the SPR, including a little over $200 million in new appropriations for fiscal year 1992 plus receipts from SPR sales during the Persian Gulf War. Using these funds and additional appropriations assumed in the CBO baseline (equal to the 1992 appropriation in inflation-adjusted terms) would support oil acquisitions of nearly 40,000 barrels per day over the 1993-1997 period.

This option would limit the SPR fill rate to only 20,000 barrels per day--half the average rate supportable by the funding levels assumed in the CBO baseline. Limiting SPR oil acquisitions to 20,000 barrels per day would save $70 million in 1993 and $820 million over the 1993-1997 period.

The principal advantage of this option is the short-term cost savings to the government. In addition, the nation's readiness to meet energy emergencies would not be greatly diminished. With acquisitions of 40,000 barrels per day, the SPR would contain 650 million barrels by the end of 1997; with acquisitions halved, it would still have 615 million barrels by that time.

A disadvantage of the option is that the final bill for filling the SPR may be greater as a consequence of delaying acquisitions. (DOE's forecasts for oil prices in the long term--that is, beyond CBO's five-year projections--indicate significant increases.) And although the total amount of oil in the SPR at the end of 1997 under this option is not too different from the baseline, it is still that much shorter of the target of 1 billion barrels.

DOM-09 ELIMINATE BELOW-COST TIMBER SALES FROM NATIONAL FORESTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	25	40	50	65	80	260
Outlays	20	30	45	60	75	230

NOTE: Savings include changes in both direct spending and discretionary appropriations.

The Forest Service (FS) manages federal timber sales from 119 national forests in the national system. In 1991, the FS sold roughly 6.4 billion board feet of public timber under contract to private lumber companies. The total 1991 harvest, approximately 8.5 billion board feet providing about $1.1 billion in federal timber receipts, represented a sharp decline in volume from previous years. In 1991, the FS spent approximately $900 million on timber management, reforestation, construction of logging roads, payments to states, and other timber program costs, resulting in net federal timber receipts of $200 million.

In seven of the nine National Forest System regions, however, annual cash receipts from federal timber sales have consistently failed to cover the FS's annual cash expenditures. These so-called "below-cost" timber sale regions include the Rocky Mountain, Northeastern, and Intermountain. On average over the past decade, cash expenditures in these three regions have exceeded cash receipts by a ratio of 3 to 1. (Annual timber program costs in the three still exceed annual timber receipts if FS expenditures for road construction are excluded.) The FS does not maintain the data needed to estimate annual timber receipts and expenditures associated with each separate timber sale; it is therefore hard to determine precisely the budgetary savings that could be achieved by phasing out all below-cost timber sales in the National Forest System. As an illustration of the potential savings, however, eliminating all future timber sales from the three regions mentioned above would reduce FS outlays by $110 million annually by 1997, including savings in the timber road budget. Annual timber receipts would be reduced by about $35 million. Net savings in federal budget outlays over the 1993-1997 period would be about $230 million.

Below-cost timber sales have several potential disadvantages. They may lead to an increase in the federal deficit, wasteful depletion of federal timber resources through uneconomic harvests, unwarranted destruction of roadless forests valued by many recreational visitors, and government interference with private timber markets.

One advantage of the sales, however, is that the FS timber program generates other-than-financial benefits to the government. Among these is community stability in areas dependent on the federal timber industry for logging and other related jobs. The risk of economic hardship from eliminating the federal timber program in these areas could be reduced by gradually lowering the level of below-cost timber sales, by providing federal job replacement skill programs, and by encouraging greater development of other activities--such as tourism and recreation--in the national forests.

DOM-10 ELIMINATE FEDERAL GRANTS FOR CONSTRUCTION OF WASTEWATER TREATMENT PLANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	2,500	2,550	2,650	2,750	2,850	13,250
Outlays	90	530	1,250	1,850	2,150	5,900

Construction grants for wastewater treatment plants were first authorized in 1972 under the Title II categorical grants program of the Clean Water Act. The federal share under Title II was 55 percent of project costs, with localities not obligated to repay the money. Title VI, which was added to the act as part of the 1987 amendments, initiated a program of grants--still in effect--to capitalize state revolving funds. These SRFs make low-interest loans to local public agencies to construct municipal wastewater treatment facilities that help attain and maintain high water-quality standards. For each dollar of Title VI funds it receives, a state contributes 20 cents to its SRF. In 1991, nearly 95 percent of all money for construction of wastewater treatment plants under the Clean Water Act was appropriated to the SRFs. The remaining money went to fund the categorical grant program.

According to CBO baseline assumptions, federal support for the construction of local wastewater treatment facilities is projected to continue at the 1992 level of $2.4 billion, adjusted for inflation. The projected amounts for 1993 through 1997 exceed those actually authorized in the Water Quality Act of 1987. CBO estimates that the government would save approximately $90 million in 1993 and $5.9 billion through 1997 if all funding of new wastewater projects were ended after 1992.

Federal wastewater treatment grants were originally intended to be temporary. Ending all new funding after 1992 would have little effect on water pollution--because the grants have done little to stimulate spending on wastewater treatment. In some cases, the grants may have even encouraged inefficient treatment decisions by state and local governments:

- Studies indicate that those governments reduce their own wastewater treatment expenditures by 40 to 70 cents for every dollar they receive from the federal government. Most of the federal grants have thus replaced, rather than supplemented, state and local spending.

- The prospect of a federal grant has apparently caused some communities to wait until federal assistance was available rather than to clean up water problems promptly--thus delaying compliance with the Clean Water Act.

- Grants provided for construction, but not for operation and maintenance, have reduced incentives for local governments to find less capital-intensive and costly alternatives for controlling water pollution.

Opponents of such cuts make two rebuttal arguments. First, states and localities would find it more difficult to meet the Clean Water Act's treatment deadlines without continued federal contributions because repayments to the SRFs are insufficient to fund new projects and because states are unable to shoulder the additional cost of increased contributions to the SRFs. Second, the Title VI capitalization grant program may be more efficient than the old Title II categorical grant program because, under Title VI, states have some ability to tailor the terms of SRF loans to the particular circumstances of the agency receiving them.

DOM-11 DE-EMPHASIZE PERMANENCE IN SUPERFUND CLEANUPS; EMPHASIZE LAND-USE CONTROLS AND CONTAINMENT METHODS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	860	890	920	830	800	4,300
Outlays	160	380	600	660	740	2,550

NOTE: Savings include changes in both direct spending and discretionary appropriations.

Estimates of the size of the nation's hazardous waste problem and of the resources required to resolve it have grown substantially since the Superfund program was established in 1980. The Environmental Protection Agency (EPA) expects to spend a total of $25.5 billion on cleaning up the first 1,223 sites on the National Priorities List (NPL), including $16.4 billion in fiscal years 1993 and beyond. Substantial related expenditures will be required by the Energy and Defense Departments and by other agencies responsible for federally owned hazardous waste sites. Moreover, new sites continue to be added to the NPL: EPA projects 2,100 Superfund sites by the end of the century, and researchers at the University of Tennessee recently chose 6,000 sites as a plausible upper-end figure for the ultimate size of the "nonfederal" problem. Crude extrapolation suggests that the remaining Superfund liability for nonfederal sites may therefore be between $35 billion and $125 billion.

One way to reduce these large costs is to change the mix of methods used to protect health and the environment at Superfund sites. The present statutory preference for permanent treatment technologies could be dropped in favor of an emphasis on institutional controls (such as deed and access restrictions, monitoring, and provision of alternate water supplies) and containment methods (including caps, slurry walls, and surface water diversion). The University of Tennessee study estimated that a judicious shift toward these interim measures could reduce remediation costs by 80 percent, without sacrificing health or environmental protection. Such a shift would reduce federal expenditures on enforcement, as well as on direct cleanup, since it would decrease the incentive for private parties to contest their hazardous waste liabilities. Given a reasonable transition period, Superfund outlays could be cut by almost $2.6 billion over five years; total budgetary savings would be higher if the new standards were applied to federally owned waste sites, or lower if Superfund taxes were reduced.

Proponents of this option argue that it is wasteful to spend more on Superfund cleanups than is necessary to protect health and the environment, and that use of more permanent remedies (such as incineration, bioremediation, and vitrification) can be deferred until land-use needs are clearer and treatment technologies are better developed. Opponents argue that the option may not provide as much protection as supporters claim, and that invoking it would be unfair to local communities (which would bear the disruptive effects of the land-use restrictions) and to future generations (which would bear any costs of replacing interim cleanups with more permanent measures). Some opponents also assert that the lion's share of cost savings from any significant reduction in remediation requirements should take the form of cuts in the taxes that provide the primary financing for the Superfund trust account; modifying the proposal in that way would substantially reduce the net benefit to the federal budget.

DOM-12 ELIMINATE HEALTH ASSESSMENTS DONE AT SUPERFUND SITES BY THE AGENCY FOR TOXIC SUBSTANCES AND DISEASE REGISTRY

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	15	15	15	15	15	80
Outlays	15	15	15	15	15	75

One of the present statutory responsibilities of the Agency for Toxic Substances and Disease Registry (ATSDR) is to conduct health assessments at each site on the Superfund program's National Priorities List. These assessments consider the nature and extent of contamination, potential pathways of human exposure, size and susceptibility of the potentially affected community, and short- and long-term health effects associated with observed or projected levels of exposure to the relevant contaminants. The stated purpose of the studies is to help determine the need for action to reduce the exposure risk (by provision of alternative water supplies, relocation, or other means) or to obtain further information on exposure levels and health effects. Eliminating the assessments, including both ATSDR's own studies and its funding and support for cooperating state agencies, would save $75 million over five years.

An August 1991 report by the General Accounting Office (GAO) criticized the ATSDR health assessments as incomplete and of questionable value. The report found that managers of the Environmental Protection Agency's (EPA's) Superfund projects generally consider ATSDR assessments redundant, duplicating information in EPA's own risk assessments and recommending actions already planned or required by EPA policy. In only one of 15 cases examined by GAO did the EPA manager report that the ATSDR assessment provided any new information. Moreover, the director of ATSDR's Division of Health Studies told GAO that the health assessments do not provide enough information for decisions about whether to conduct detailed follow-up health studies.

The argument for not eliminating the health assessments is that the Superfund program needs more, not less, information about the health risks posed by individual hazardous waste sites, and that ATSDR should therefore be given an opportunity to improve the assessments' completeness and usefulness. The National Research Council of the National Academy of Sciences recently called for increased efforts to study the public health problems associated with hazardous wastes; the report argued that "Existing data on exposures and health effects are inadequate...for decisions on the management of hazardous-waste sites." ATSDR plans several changes to improve its health assessments, such as incorporating surveys of local health statistics and increasing its contact with local health officials and communities.

DOM-13 SUBSTITUTE PRIVATE FINANCING FOR GOVERNMENT FINANCING OF THE SUPERFUND PROGRAM TO THE MAXIMUM EXTENT POSSIBLE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	450	470	500	370	320	2,100
Outlays	75	190	310	270	280	1,100

NOTE: Savings include changes in both direct spending and discretionary appropriations.

The Superfund program to clean up the nation's worst hazardous waste sites makes four groups of "potentially responsible parties" (PRPs) liable for cleanup costs, damages to natural resources, and the costs of health-impact studies. The PRPs include a site's past and present owners and operators, the generators of its hazardous substances, and any transporters who selected the site as a disposal location.

This proposal would minimize the use of money from the Superfund trust fund for cleanup work; the fund would be drawn on only when the collective resources of a site's PRPs are insufficient to cover the total costs. Specifically, the Environmental Protection Agency (EPA) would forgo the option of funding a cleanup and then seeking reimbursement, and it would avoid PRP settlements that covered less than 100 percent of cleanup work and past costs. In some respects, the proposal merely extends EPA's current "enforcement first" Superfund strategy by placing even more emphasis on leveraging private-sector dollars; however, it uses increased private spending as an opportunity to reduce federal expenditures rather than to increase the pace of the Superfund program.

The strongest version of this proposal includes short-term and emergency removal actions, as well as long-term remedial responses and their associated studies, in the definition of cleanup work. This variant would save $1.1 billion over five years, assuming that Superfund tax rates remain unchanged, 30 percent of the sites have no financially viable PRPs, and the enforcement budget rises by 20 percent. (Increased expenditures on negotiation, litigation, and searches for PRPs would be offset to some extent by reduced efforts to recover costs.) Focusing more narrowly on remedial actions and their preliminary studies would reduce the five-year savings to $700 million.

Proponents of this approach argue that it would better reflect the "polluter pays" conception of fairness that is a guiding principle of the Superfund law, and that it would reduce the overall cost of hazardous waste cleanup by taking fuller advantage of the efficiency of the private sector. Opponents counter that further emphasis on leveraging private dollars is likely to be inefficient, given the impact on enforcement costs, and to raise the risks to health and the environment by delaying cleanup; that prohibiting the use of joint Superfund and PRP financing is unfair, given that sites may involve "orphan shares" associated with parties that are insolvent or cannot be found; and that increases in private-party contributions should continue to be used to increase the pace of the program.

DOM-14 REDUCE FEDERAL SUPPORT FOR AGRICULTURAL RESEARCH AND EXTENSION ACTIVITIES

Savings from CBO Baseline	1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Annual Savings (Millions of dollars)					
Budget Authority	170	180	180	190	200	910
Outlays	110	180	180	190	190	850

The Department of Agriculture (USDA) has three agencies that conduct and support agricultural research and education. The Agricultural Research Service (ARS), the USDA's internal research arm, operates at locations throughout the country; its research 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 Service (CSRS) supports agricultural research conducted at land-grant universities and other state institutions. The Extension Service (ES) introduces farmers to new technology and educates low-income families in good nutrition; the ES provides some services to urban residents.

The 1992 appropriations for these three agencies totaled $1.64 billion. Reducing funding levels by 10 percent below the baseline would save $850 million during the 1993-1997 period.

As it now stands, ARS and CSRS research grants may, in some cases, be replacing funding from the private sector. If, in those cases, the ARS and CSRS grants were eliminated, the private sector would be forced to finance more of its own research. A reduction in federal funding for ES activities would have a relatively minor direct impact on farmers. For example, both the Expanded Food and Nutrition Education Program and money earmarked for urban gardening projects could be deleted without undercutting the ES's basic mission of educating and assisting farmers.

Research and extension activities have long played important roles in the development of an efficient farm sector. A reduction in federal funding could compromise the sector's future development as well as its competitiveness in world markets. If the burden of funding is transferred to the private sector, agricultural research could be seriously reduced. In addition, agricultural research helps provide U.S. consumers with an abundant and relatively inexpensive food supply. In a recent report, the Board on Agriculture of the National Research Council proposed an increase in funding for agricultural research. The board argued for more research to maintain the competitive position of U.S. agriculture in world markets, develop more convenient and nutritious foods that contribute to human health, and create more environmentally sound farming practices to combat the degradation of water, air, and soil resources.

DOM-15 REDUCE USDA SPENDING FOR EXPORT MARKETING AND INTERNATIONAL ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	10	10	10	10	10	60
Outlays	5	10	10	10	10	55

The Department of Agriculture runs programs to promote exports and international activities through the Foreign Agriculture Service (FAS) and the Organization for International Cooperation and Development (OICD). FAS develops foreign markets by jointly funding--with U.S. trade and commodity organizations called "cooperators"--overseas advertising campaigns, trade show exhibits, and promotional materials. OICD collaborates on a variety of ventures, one of which provides training to foreign nationals with the objective of improving commercial relationships that will benefit U.S. agriculture.

Reducing funding levels for these programs by about one-third could save $55 million over the 1993-1997 period. FAS could significantly reduce its aid to the cooperator program, to which it currently contributes the bulk of direct and overseas costs (cooperator contributions tend to be in the form of services). In its other activities, FAS provides commodity analysis and information on access to foreign markets to U.S. producers and traders.

Although the cooperator program has served a useful purpose, it may be ready to revert to private enterprise, with minimal financial assistance from FAS. The program has tended to promote basic commodities, such as grains, oilseeds, and cotton. It is uncertain how much return in terms of market development the cooperator program is generating. In addition, private, brand-name advertising is sponsored in this program, and many people object to spending taxpayer money on such activities.

The OICD Middle-Income Country Training Program affords a select group of foreign midlevel managers a visit to the United States and training in agriculture and agribusiness. The benefits to U.S. agriculture are unknown, and although the program is popular among the recipients and their sponsors, it may be of marginal value to taxpayers.

Some observers maintain that U.S. agriculture, processors, and traders would suffer from less business abroad, especially over the long run, if funding for these activities were cut.

DOM-16 STREAMLINE THE OPERATION OF FARM AGENCIES' FIELD OFFICES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	35	75	130	140	140	530
Outlays	25	65	120	140	140	480

The Department of Agriculture (USDA) has four agencies that use extensive networks of local field offices to administer farm programs. The Agricultural Stabilization and Conservation Service (ASCS) administers commodity and land-use programs. The Soil Conservation Service (SCS) directs the national soil and water conservation program. The Farmers Home Administration furnishes credit to farmers and other rural residents. The Extension Service provides a diverse range of educational services, including introducing farmers to new technology and to improvements in farming practices.

A 1991 report by the General Accounting Office (GAO) found that the ASCS and SCS have offices in more than 85 percent of the 3,150 counties in the United States, the Farmers Home Administration has offices in over 60 percent of the counties, and the Extension Service has offices in nearly all of the counties. Each agency employs state-level managers to oversee local operations. The GAO report concluded that this highly decentralized operational structure is inefficient and costly. The report recommended extensive administrative streamlining. It suggested that the USDA could improve efficiency and save money through the collocation and consolidation of field offices and through improvements in sharing resources. (Collocation involves two or more agencies sharing a common operating site; consolidation involves merging two or more field offices of a single agency into a single office.) Cost savings are realized when integrated field offices share administrative resources, structural facilities, personnel, equipment, and services.

The savings estimated for this option assume that consolidating or collocating agency offices could allow administrative funding to be cut by 5 percent, resulting in savings of $480 million over the 1993-1997 period. The large majority of these savings come from office consolidations. Because the budgets of these offices are dominated by personnel costs, office consolidations would entail a reduction in federal employment in rural areas. The amount that could be saved without seriously hurting services to farmers is uncertain.

The USDA, in its response to the GAO report, claimed it would be difficult to realize substantial cost savings. The department said that many opportunities for sharing field office resources have already been realized, that many field offices have already been collocated or consolidated, and that full collocation is not always possible. If the USDA could not reduce its administrative costs through organizational streamlining, a reduction in federal funding would lead to a reduction in services.

DOM-17 END SMALL BUSINESS ADMINISTRATION LOANS AND LOAN GUARANTEES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			End All Credit Programs			
Budget Authority	600	620	640	670	690	3,250
Outlays	450	600	620	650	670	3,000
			Keep Minority and Disaster Programs			
Budget Authority	310	320	330	340	350	1,650
Outlays	230	280	290	300	310	1,400

The Small Business Administration (SBA) provides both direct loans and loan guarantees to qualified small businesses. The SBA's lending objectives are to promote business development generally, to aid economically disadvantaged groups, and to assist small businesses and homeowners in recovering from disasters. SBA outlays could be reduced by $3 billion over the 1993-1997 period by eliminating all SBA loan and loan guarantee programs. An alternative to eliminating all loans would be to retain only those that provide assistance to minorities and disaster victims. Continuation of those programs could be justified as aid to the socially or economically disadvantaged because of factors beyond their control. Following that course could reduce SBA outlays by $1.4 billion over the 1993-1997 period.

Under the loan guarantee program, the federal government guarantees 90 percent of the principal for business loans up to $155,000 and between 70 percent and 85 percent for larger ones. The interest rate on guaranteed loans is about 2.5 percentage points above the prime rate; in addition, the SBA guarantee has a charge equal to 2 percent of the amount guaranteed. In 1991, SBA guaranteed 23,200 loans totaling nearly $4.2 billion; the SBA share of the guaranteed loans was roughly $3.5 billion. Holders of about 4,000 guaranteed loans defaulted, and the loans were subsequently purchased by the SBA. The SBA share of the outstanding balances of those loans exceeded $650 million.

Under the direct loan program, the SBA provides loans to businesses located in high-unemployment or low-income areas and to businesses owned by minorities, handicapped individuals, and Vietnam veterans or disabled veterans. It also offers direct loans to homeowners recovering from natural disasters. Direct loans generally do not exceed $150,000, although some disaster loans run as high as $500,000. In 1991, the SBA disbursed 29,300 direct loans, totaling $562 million and bringing the total direct loan portfolio to nearly $4.2 billion. In both the direct loan and loan guarantee programs, the SBA extends credit for up to 25 years--significantly longer than would otherwise be available to small businesses.

SBA assistance is favored by those who view it as a way of aiding small businesses, which, they argue, generally create more jobs, improve technology more rapidly, and satisfy some markets more efficiently than do large

firms. When banks and other traditional sources of loans to small businesses tighten credit standards or become more conservative in their lending practices, SBA assistance can help fill a financing gap.

But others claim that SBA assistance tends to flow to the firms least likely to create stable employment, improve technology, or enhance national productivity. SBA loans and loan guarantees go primarily to businesses that have been rejected by conventional providers of financing. Perhaps as a result, they have a high default rate. It can also be argued that financial markets are now more efficient and less susceptible to the types of market failure that justified the SBA program when it first began.

DOM-18 DISCONTINUE POSTAL SUBSIDIES FOR NOT-FOR-PROFIT ORGANIZATIONS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	350	360	380	390	400	1,900
Outlays	350	360	380	390	400	1,900

The Postal Reorganization Act of 1970, which replaced the federal Post Office Department with the independent U.S. Postal Service, intended that the mail system operate as a largely self-sufficient enterprise, with mail users paying the full costs of service. However, certain bulk mailers--notably charitable organizations as well as state and national political committees--receive favored statutory treatment. These favored mailers pay reduced postage rates that, on average, cover only about 75 percent of the cost of service received. The taxpayer subsidizes the remaining costs through annual federal payments made by the Congress, referred to as revenue-forgone appropriations. In 1991, the appropriation for not-for-profit bulk mailers totaled about $370 million. Almost $1.9 billion could be saved through 1997 if such payments were discontinued and most subsidized postage rates eliminated. (Subsidies supporting reduced rates for blind and otherwise-handicapped persons, libraries, and others could be continued.)

Abolishing subsidies to certain mailers would simplify postage-rate administration and further the goal of requiring mail users to pay for the costs of the service they receive. The overuse of mail services that reduced rates encourage would be lessened. Such overuse directs a steady stream of solicitations to many households, especially those with higher incomes. The Philanthropic Advisory Service, a branch of the Better Business Bureau that monitors the activities of charitable organizations, reports frequent complaints from citizens about the volume of solicitations, in particular multiple solicitations from the same not-for-profit groups. Further, the Advisory Service has found that, for some not-for-profit organizations, fundraising costs consume too high a percentage of the contributions received from the direct mail campaigns. (President Bush's budget proposes a ceiling on revenue-forgone appropriations as well as restrictions on eligibility for reduced rates for third-class and other not-for-profit mailers. Combined savings in 1993, according to the budget, would total $360 million.)

Although discontinuing reduced rates could cause financial difficulties for some groups, the subsidy represents only a small part of federal assistance to not-for-profit organizations. In 1991, such organizations received about $4 billion in federal grants. Support in the form of tax deductions for charitable contributions cost the government, through forgone tax revenues, an additional $15 billion. Finally, subsidized postage in effect represents an additional "donation" by taxpayers who already contributed about $100 billion to charitable organizations in 1990.

Eliminating this postal subsidy, however, could reduce the flow of educational, cultural, charitable, and other information of genuine public interest. It could raise mailing rates for not-for-profit organizations by an average of about 30 percent. (If the Congress reduces appropriations below required levels, the Postal Service is required to increase postage

rates paid by subsidized mailers.) Such rate hikes could pose severe financial difficulties for some organizations, especially those that depend heavily on mail solicitation for fund-raising. The impact would be particularly heavy when added to the recession and other recent rate increases.

DOM-19 SCALE BACK THE RURAL RENTAL HOUSING ASSISTANCE PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			Stop Expansion			
Budget Authority	390	410	420	430	450	2,100
Outlays	30	220	280	330	360	1,200
			Increase Developers' Interest Rate to 5 Percent			
Budget Authority	75	80	80	85	90	410
Outlays	10	60	75	80	85	320

NOTE: Excludes savings in administrative costs.

The Section 515 housing program, administered by the Farmers Home Administration (FmHA), provides low-interest, 50-year mortgage loans to developers of multifamily rental projects in rural areas. These mortgages have interest 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 contribute toward their housing expenses the greater of 30 percent of adjusted income or the minimum project rent. The minimum project rent for each unit includes a proportionate share of the amortization costs of the 1 percent mortgage and of the project's operating expenses. The developer keeps the minimum rent, and the FmHA collects any payments above this minimum and treats them as additional interest payments to reduce the program's cost. Additional subsidies are provided through the Rural Rental Assistance Payments (RRAP) program to many of the poorest tenants to reduce their rent payments to 30 percent of their incomes. During 1991, the Section 515 program made $576 million worth of new loans to finance about 15,400 new rental units.

Stopping all new commitments for assistance under the Section 515 program would reduce federal outlays by about $1.2 billion over the 1993-1997 period, including $180 million for RRAP payments that would otherwise have been made. (See DOM-43 for a similar option for housing programs administered by the Department of Housing and Urban Development.) Additional savings would be realized eventually as the cost of administering a shrinking loan portfolio decreased.

An argument in favor of this option is that expanding rural rental assistance is inappropriate at a time when many other federal programs are being cut. Also, turnover among current residents of existing projects would ensure that some new income-eligible families would be assisted each year. However, this option would reduce the proportion of rural families being assisted as the number of eligible families continued to grow. Moreover, growth in the supply of standard-quality, low-income rental projects in rural areas would slow down.

Savings in outlays could also be realized by increasing tenant rental payments. This

result could be achieved by raising the interest rate on loans to project developers, who would pass along the increased interest costs in the form of higher minimum project rents. Raising interest rates to 5 percent would save $320 million over the 1993-1997 period. Alternatively, tenants could be required to pay at least 35 percent of their incomes instead of the current 30 percent. This policy change would apply to tenants in all projects in the inventory as opposed to the former change, which would affect only tenants in newly built projects. The latter approach might be of particular interest if a similar increase were enacted for subsidized urban renters (see DOM-42). Data are not available, however, to estimate the savings from this alternative.

Although raising tenants' rents would increase the share of their incomes spent on housing above 30 percent, they would still be better off than the typical unassisted but equally poor renter, who pays nearly 50 percent. Arguing against raising the interest rates (and thus the minimum project rent) is the fact that this approach would affect primarily those poorer tenants who do not receive RRAP subsidies and who must pay the minimum project rent because it exceeds 30 percent of their income.

In contrast, raising the minimum contribution toward rent to 35 percent would affect households in the higher-income brackets and those receiving RRAP subsidies. A disadvantage of the 35 percent approach is that it might prompt some stable, higher-income households to move out of assisted housing projects, changing the economic mix of the projects and possibly reducing their viability.

DOM-20 SCALE BACK THE HOUSING LOAN PROGRAM FOR RURAL HOMEOWNERS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Eliminate New Lending					
Budget Authority	290	300	310	320	330	1,550
Outlays	240	300	310	320	330	1,500
	Reduce New Lending by 50 Percent					
Budget Authority	150	150	160	160	170	780
Outlays	120	150	150	160	160	750
	Increase Borrowers' Payments to 30 Percent of Income					
Budget Authority	310	370	430	480	540	2,150
Outlays	260	360	420	480	540	2,050

NOTE: Excludes savings in administrative costs.

The Section 502 housing program, administered by the Farmers Home Administration (FmHA), provides mortgages to rural, low-income borrowers, many of whom live in areas with shortages of private mortgage credit. The FmHA's costs for this program include the costs associated with any future defaults on the loans and with the subsidies arising from the difference between the interest rates it pays to finance the program and the rates borrowers pay to obtain the FmHA mortgages. The latter rates can be as low as 1 percent. During 1991, in the continental United States, more than 23,000 rural households with incomes averaging about $16,750 purchased single-family homes with loans at reduced interest rates from the FmHA. The total value of all new Section 502 loans in 1991 was nearly $1.3 billion.

Through this program, eligible borrowers can purchase homes by spending a portion of their income--generally 20 percent--on principal, interest, property taxes, and insurance (PITI) throughout the full mortgage term, usually 33 years. Eligible borrowers with relatively low incomes, however, have to pay somewhat more than 20 percent to amortize the loan at 1 percent. Incomes are recertified annually, and payments are adjusted as necessary. In contrast, almost two-fifths of all low-income homeowners in both metropolitan and nonmetropolitan areas spent more than 30 percent of income on housing in 1989.

The costs of this program could be cut by eliminating or reducing new lending or by increasing borrowers' payments. Those options would reduce the present value of the mortgage-interest subsidies and the cost of future defaults, which under credit reform are scored as outlays when the loans are originated. Because cash flows associated with making new loans are no longer counted as outlays, however, short-term savings realized from eliminating or reducing new lending would be smaller than they appeared before enactment of credit reform.

Eliminate or Reduce New Lending by 50 Percent. If new lending under the Section 502 program were eliminated, federal outlays

would be reduced by $240 million in 1993 and about $1.5 billion over the 1993-1997 period. Alternatively, if new lending were reduced by half, federal outlays would fall by $750 million over the same five-year period. Additional savings would be realized over time as the cost of administering a shrinking portfolio decreased.

The current program may not be the best use of scarce federal resources. It makes rather sizable payments to relatively few households that, though not rich, are better off than many that receive no housing assistance of any kind. Yet, if either option were enacted, rural, low-income households would probably experience greater difficulty becoming homeowners, both because the cost of home ownership would rise and because shortages of private mortgage credit exist in some areas where the program operates.

Increase Borrowers' Payments to 30 Percent of Income. If these rural housing loans were continued at the current volume and borrowers' payments were increased to 30 percent of income, federal outlays would be reduced by $260 million in 1993 and about $2.1 billion in the 1993-1997 period. This option assumes that the increase in payments would be effective immediately for new borrowers and would be phased in over 10 years--at 1 percentage point per year--for current borrowers.

Increasing the percentage of income that borrowers pay for FmHA loans would eliminate disparities between the FmHA Section 502 program and home ownership programs sponsored by the Department of Housing and Urban Development (HUD). Under the recently authorized Homeownership and Opportunity for People Everywhere program, homebuyers will pay 30 percent of their income for PITI and up to 35 percent for total housing costs, including utilities. This option would also reduce unequal treatment of assisted homeowners and renters, who generally pay 30 percent of their adjusted income for housing (and who would pay 35 percent under options described in DOM-19 and DOM-42).

Increasing the percentage of income that rural households pay toward home ownership, however, would result in a shift in the composition of borrowers away from households with the lowest incomes. In addition, higher costs relative to income might raise default rates among borrowers; historically, the foreclosure rate has been around 2.5 percent.

DOM-21 REDUCE THE BUDGET OF THE EXPORT ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	10	10	10	10	10	55
Outlays	10	10	10	10	10	55

The Export Administration (EA) enforces U.S. export laws to promote national security and foreign policy objectives. Its activities include ensuring availability of industrial resources for U.S. defense, licensing exports, and detecting and preventing foreign distribution of U.S. goods and technical data that are controlled for reasons of national security or foreign policy. Reducing the budget of the Export Administration by 25 percent would save $10 million in 1993 and $55 million over five years.

The enforcement activities of the EA reduce U.S. exports and thereby create economic inefficiencies that reduce U.S. gross national product. To the extent that they keep defense-related goods and technology out of the hands of potential adversaries, however, they promote U.S. security and foreign policy. The activities to ensure availability of industrial resources (such as restricting foreign ownership of U.S. firms that are deemed to be defense-related) also have their economic efficiency costs and corresponding national security and foreign policy benefits.

The EA's budget has been cut recently and may be able to absorb further cuts because of the demise of the former Soviet bloc and the elimination of sanctions against South Africa. Proponents may argue, however, that recent disclosures of Iraq's progress in developing the technology for nuclear, chemical, and biological weapons, and in obtaining the materials necessary for their construction, demonstrate a need for increased monitoring and enforcement. Further, the EA's work load is largely determined by laws, regulations, and agreements with other countries that specify the commodities to be controlled, the degree of control, and the recipient countries to which the controls apply. If the EA is to perform its job adequately with a reduced budget, it might be necessary to alter some of those laws, regulations, or agreements to reduce the number of commodities controlled and the stringency of the controls. Negotiations to revise the list of commodities controlled by the Coordinating Committee for Multilateral Export Controls were completed in the past year, so attempting further revisions could be awkward.

DOM-22 ELIMINATE THE TRADE PROMOTION ACTIVITIES OF THE INTERNATIONAL TRADE ADMINISTRATION OR CHARGE THE BENEFICIARIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	160	170	180	190	190	890
Outlays	110	170	180	180	190	860

The International Trade Administration (ITA) has four direct program activities: the Import Administration, which investigates antidumping and countervailing-duty cases; the trade development program, which assesses the competitiveness of various U.S. industries and runs various export promotion programs; the international economic policy program, which develops policy, provides marketing services, and identifies and develops remedies for long-range trade and investment problems; and the U.S. and foreign commercial services, which counsel U.S. businesses on exporting. The latter three also help fight foreign barriers to U.S. exports. That effort, and the efforts against dumping and foreign subsidies, are probably necessary to maintain public support for free-trade policies, and some of their elements can be defended on economic grounds. ITA export promotion, marketing, and counseling could be eliminated, however, or the beneficiaries could be charged fees to pay more of the costs.

Eliminating or charging firms for the cost of those ITA activities would reduce outlays or increase receipts by $110 million in 1993 and by $860 million over five years.

One might argue that the activities are best left to the firms and industries involved rather than to the ITA. Alternatively, one might argue that there may be some economies of scale to these activities, 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 could make sense. In that case, net federal spending could be reduced by charging the full cost of these activities when possible to their beneficiaries.

To the extent that beneficiaries are not charged the full cost, the ITA's activities effectively subsidize the exports of the industries involved. These implicit subsidies are inefficient means of helping the industries because they are partially dissipated 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 ITA's activities do not improve the current-account balance and do not necessarily increase total exports. As a result of changes they cause in exchange rates and other variables, all increases in exports due to ITA activities are completely offset by some mix of reduced exports of other industries and increased imports. Thus other firms are hurt by the export promotion activities.

DOM-23 REDUCE FEDERAL AID FOR MASS TRANSIT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	1,750	1,800	1,850	1,900	2,000	9,300
Outlays	530	920	1,250	1,500	1,700	5,900

In 1992, the principal federal transit assistance programs will provide about $2.4 billion in capital grants and about $0.8 billion in operating assistance to local mass transit agencies. Federal grants generally pay 80 percent of the costs of qualifying capital projects and up to 50 percent of local transit system operating deficits. In 1990, federal capital grants accounted for about 60 percent of all public capital spending for mass transit, and federal operating subsidies offset roughly 5 percent of the operating costs of transit systems nationwide (and about 9 percent of the systems' operating deficits). Reducing the federal share of qualifying investment costs for mass transit to 50 percent, and eliminating operating assistance, would save $530 million in 1993 and $5.9 billion over the 1993-1997 period.

The high federal shares of investment spending and the subsidies for operating assistance appear to have had little effect on either transit productivity or the use of mass transit services. Despite modernization of transit systems, only 6.5 percent of journeys to or from work are made by mass transit. Transit agencies serve mainly downtown areas, whereas most of the growth in urban travel has been in the suburbs. At the same time, inflation-adjusted labor costs per mile of transit travel rose by 60 percent during the 1970s, when overall assistance levels were highest. Reducing the federal share of capital costs for mass transit might improve local investment choices, as a similar reduction seems to have done with federal subsidies for construction of local wastewater treatment plants. Similarly, ending operating assistance could encourage local authorities to make better use of existing capital by improving services, by using more cost-effective smaller vehicles, or by taking other steps to lower the operating costs of transit services.

Reducing federal transit subsidies, however, could harm some local transit services. The burden of diminished services would be borne disproportionately by people especially dependent on public transportation: the poor, the young, the elderly, and the handicapped. A lower level of transit services also could harm efforts to reduce congestion and air pollution in metropolitan areas. And an across-the-board cut in transit subsidies would be less efficient than targeted reductions, since certain transit investments, such as the rehabilitation of rail transit in older cities, could have a high payoff.

DOM-24 ELIMINATE AIRPORT GRANTS-IN-AID

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	1,950	2,050	2,100	2,150	2,250	10,500
Outlays	300	750	1,600	1,850	2,050	6,550

Each year, the Federal Aviation Administration (FAA) provides airports with grants for expanding capacity and improving terminals. The grants are allocated by formula. Up to 49.5 percent is reserved for primary, commercial service airports; another 12 percent goes to the states for distribution to general aviation airports; and the remainder is allocated among all airports on a discretionary basis. Eliminating these grants would reduce the deficit by $300 million in 1993 and about $6.6 billion over the 1993-1997 period.

Recent trends in aviation have increased the importance of larger airports (as measured by the number of embarking passengers). These airports would have little trouble financing capital improvements from the fees collected or additional bonds issued if airport grants were eliminated. In 1991, the Congress passed legislation allowing airports to levy passenger facility charges (up to $3 per passenger). Those charges will supplement the revenues received from concessionaire rents, landing fees, and airline lease payments. In addition, revenues from the passenger facility charges, unlike federal grants, can be used to pay the interest on bonds issued by the airport. Passenger facility charges alone are estimated to bring in total annual revenues of about $1 billion to the 30 busiest airports. This revenue could be leveraged to support over $12 billion in borrowing.

Small "reliever" airports, financed by the FAA with the expectation that they would draw general aviation aircraft away from major airports, have not done so. Thus some would argue against federal subsidies to these airports.

Supporters of the current program argue that the benefits provided by the system of airports are nationwide in scope. They also argue that more assistance is needed to overcome airport congestion and to allow airports to construct new gates and terminals that will promote competition among airlines, with benefits accruing to passengers.

DOM-25 ELIMINATE REGULATION OF MOTOR CARRIERS AND ABOLISH THE INTERSTATE COMMERCE COMMISSION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	25	25	25	25	30	130
Outlays	20	25	25	25	30	125

The Interstate Commerce Commission (ICC) regulates rates, operating rights, and mergers and acquisitions of interstate motor carriers and railroads. It also rules on rail abandonments and construction of new rail lines. The ICC's powers have diminished since the passage in 1980 of the Motor Carrier Act and the Staggers Rail Act, and its staff and budget have decreased accordingly. But the vestiges of regulation remain, including a large number of routine applications for ICC approval of operating rights, rates, and other business decisions.

Taking the final step of the motor-carrier deregulation process begun a decade ago--eliminating all remaining ICC regulation of trucking and intercity bus companies--could save the federal government about $25 million to $30 million annually. Deregulation would apply only to economic regulation; motor carrier safety would continue to be regulated by the Federal Highway Administration.

Current regulations impose costs not only on the federal government but also--and in much greater magnitude--on carriers and shippers. In 1990, motor carriers filed 20,000 applications for operating authority, nearly 1,000 applications for approval to merge with or acquire other motor carriers, and more than one million tariffs; railroads filed 185,000 tariffs. Estimates of deregulation savings to the private sector run as high as $28 billion a year.

Proponents of deregulation note that the trucking industry is highly competitive and that competition can reduce costs and increase productivity far more efficiently than can regulation. Opponents contend that the remaining regulation is not burdensome and that the open filing of tariffs and applications for operating rights, rate changes, and mergers protects carriers and shippers.

As with motor carriers, eliminating requirements for railroads to file applications for routine matters could reduce costs to the federal government as well as to the industry. There is considerable debate, however, over whether the rail industry is sufficiently competitive to protect the interests of shippers. For instance, some shippers have access to only one rail line, and some communities depend on rail service for their economic vitality. Authority to handle cases involving market power could be shifted to the Department of Transportation if the ICC were abolished. Advocates of more extensive deregulation of railroads argue that the ability of shippers to enter into long-term contracts with railroads diminishes the railroads' market power. They also note that communities dependent on rail can provide subsidies or other incentives to keep rail operations in business.

DOM-26 ELIMINATE CERTAIN RURAL DEVELOPMENT PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Eliminate Direct Loans and Loan Guarantees					
Budget Authority	130	130	140	140	150	690
Outlays	10	35	75	100	120	350
	Eliminate Grants					
Budget Authority	400	410	430	440	460	2,150
Outlays	10	85	190	300	380	960

NOTES: Programs include direct loans for rural development; direct loans and loan guarantees for water and waste disposal and for community facilities; loan guarantees for business and industry; and grants for water and waste disposal, rural development, fire protection, solid waste management, and emergency community water assistance.

Excludes savings in administrative costs.

The Farmers Home Administration (FmHA) assists rural development through a variety of programs. In general, they provide loans, loan guarantees, and grants for rural water and waste disposal projects, community facilities, rural development, and fire protection. Funds are generally allocated among states based on their rural populations and their number of rural families with incomes below the poverty threshold. Within each state, funds are awarded competitively to eligible applicants, including state and local agencies, nonprofit entities, and (in the case of loan guarantees for business and industry) for-profit organizations.

The amount of interest that loan applicants pay varies with the type of aid they receive and, in some programs, the economic condition of the area. For example, for rural water and waste disposal loans, interest rates average 5.6 percent but can range from 5 percent to market rates, depending on the median family income of the service area. If repayment of a loan would impose an undue financial burden on their residents, relatively poor areas may receive grants instead.

For 1992, the Congress appropriated a total of $125 million in budget authority to support the costs of $893 million in combined direct loans and loan guarantees. Under credit reform, those costs include the present value of interest subsidies and the cost of loans that go into default. In addition, a total of $387 million was appropriated for grants, of which $350 million is for water and waste disposal. Eliminating these programs would reduce federal outlays for subsidizing direct loans and loan guarantees by a total of $350 million over the 1993-1997 period. Additional savings would be realized gradually as the costs of administering a shrinking portfolio decreased. Savings in outlays for grants would amount to $960 million over the same period.

One argument for terminating these programs is that federal funds should be targeted toward activities whose benefits are national in scope, with state and local governments funding rural development. Moreover, recent research by the Center for Community Change found that two of the largest programs--the water and waste disposal program,

and the business and industry program--are not well targeted toward low-income or distressed communities. Higher-income rural communities, the study found, were more likely to receive assistance--including higher subsidies--than low-income ones.

Supporters of federal funding of rural development programs argue that, by sparking economic growth, the programs help to increase rural incomes. Compared with urban areas, rural ones have higher rates of unemployment, poverty, and infant mortality and thus are more in need of assistance. Eliminating these funding sources would probably reduce economic development activities because private credit may simply not be available in some areas, and many fiscally distressed states and localities would be unable to offset the loss of federal grants and interest subsidies.

DOM-27 END FUNDING FOR THE ECONOMIC DEVELOPMENT ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	270	270	280	290	300	1,400
Outlays	50	130	210	260	280	930

The Economic Development Administration (EDA) provides grants to state and local governments for public works, technical assistance, and job programs, as well as direct loans and loan guarantees to firms for business development. In 1992, appropriations for EDA programs totaled $257 million. Disbanding the EDA would reduce federal outlays by about $50 million in 1993 and $930 million over the 1993-1997 period.

One criticism of EDA programs is that federal assistance should not be provided for activities whose benefits are primarily local and, therefore, whose responsibility should be that of state and local governments. In addition, EDA programs have been criticized for substituting federal credit for private credit and for facilitating the relocation of businesses from one distressed area to another through competition among communities for federal funds. The EDA has also been criticized for its broad eligibility criteria, which allow areas containing 80 percent of the U.S. population to compete for benefits, and for providing aid with little proven effect compared with other programs having similar goals. Furthermore, because of the competitive nature of EDA programs, local governments do not incorporate this type of aid into their budget plans; hence, eliminating future EDA funding would not impose unexpected hardships on communities.

Some of the reduction in aid associated with this option would, however, curtail economic development activities in financially distressed communities that have no other available resources. This cutback could result in deterioration of infrastructure, loss of prospective jobs, and decreases in local tax receipts in these areas, which are likely to be among the last to recover from the current recession.

DOM-28 ELIMINATE THE APPALACHIAN REGIONAL COMMISSION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	200	200	210	220	220	1,050
Outlays	10	60	120	160	190	540

The federal government appropriates about $200 million annually for the Appalachian Regional Commission (ARC) to fund activities that promote economic growth in the Appalachian counties of 13 states. The states are responsible for filing development plans and for recommending specific projects for federal funding. The commission distributes the funds competitively, based on 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.

The ARC supports a variety of programs, including the Appalachian Development Highway System, to open up areas with development potential; the Community Development Program, generally to create jobs; the Human Development Program, to improve rural education and health; and the Research and Local Development District Programs, to provide planning and technical assistance to multicounty organizations. Federal funds also support 50 percent of the salaries and expenses of the ARC staff. For 1992, the Congress appropriated $190 million for these programs. Discontinuing the programs funded through the ARC would reduce federal outlays by $10 million in 1993 and by $540 million over the 1993-1997 period.

Those in favor of termination argue that the programs duplicate activities funded by other federal agencies, such as the Department of Transportation's federal highways program and the Department of Housing and Urban Development's Community Development Block Grant program. Critics of the ARC also contend that, although it allocates resources to poor rural communities, those areas are no worse off than many others outside the Appalachian region and therefore no more deserving of special federal attention.

Nevertheless, eliminating federal funding of the ARC programs would reduce economic development activities in the region, because the fiscal distress of many states and localities would probably preclude them from offsetting this loss of resources. Thus, fewer jobs might be created and rural infrastructure, education, and health care conditions might deteriorate in a region that is likely to recover slowly from the current recession.

DOM-29 ELIMINATE OR RESTRICT COMMUNITY DEVELOPMENT BLOCK GRANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Eliminate CDBG Program			
Budget Authority	3,500	3,600	3,750	3,850	4,000	18,750
Outlays	140	1,600	3,050	3,650	3,800	12,250
			Restrict Eligibility and Reduce Funding			
Budget Authority	490	500	520	540	560	2,600
Outlays	20	220	430	510	530	1,700

The Community Development Block Grant (CDBG) program provides annual grants, by formula, to all metropolitan cities and urban counties under its entitlement component. Under the formula, jurisdictions with greater needs (as measured by factors such as population, poverty levels, and housing conditions) receive larger grants than those with lesser needs. The program also allocates funds, by formula, to each state. The latter funds are distributed among nonentitlement areas, typically through a competitive process. Nonentitlement areas generally are units of local government that have populations under 50,000 and that are not metropolitan cities or parts of urban counties.

Community Development Block Grants in general must be used to aid low- and moderate-income households, to eliminate slums and blight, or to meet emergency needs. In accomplishing these goals, they may be used for a wide range of community development activities, including rehabilitation of housing, improvement of infrastructure, and economic development. Funds from the entitlement component may also be used to repay principal and interest on obligations that are issued by local governments to finance certain activities--such as the acquisition or rehabilitation of public property--and that are guaranteed by the federal government under the Section 108 loan guarantee program.

For 1992, the appropriation for the CDBG program amounts to $3.4 billion. Of this total, about $2.3 billion is allocated to metropolitan cities and urban counties and about $1 billion to nonentitlement government units, with the remainder earmarked for specific purposes described in the appropriation act. Substantial federal savings could be realized either by terminating the CDBG program or by restricting eligibility for the entitlement component to exclude the least needy jurisdictions while reducing funding levels. Least needy jurisdictions could be defined by measuring relative economic well-being and fiscal capacity using factors such as number and percentage of families below the poverty level and per capita income.

Eliminate CDBG Program. If the CDBG program were eliminated, savings in federal outlays would amount to $140 million in 1993 and a total of about $12.3 billion over the 1993-1997 period. One argument for terminating the program is that federal funds should be targeted toward programs whose benefits are national rather than local. Accordingly, programs such as CDBG, which generate primarily local benefits, should be funded by state and local governments. Moreover, to the extent that local jurisdictions use CDBG funds to attract business by competing against each other, benefits are shifted away from local jurisdictions to private firms.

Without the CDBG program, however, a number of its activities would not be undertaken by most local governments--particularly the rehabilitation of low-income housing and, to some extent, economic development. Since the CDBG program is the largest source of federal aid for many cities, fewer resources would benefit low-income households. Furthermore, CDBG funding has presumably been figured into the budgets of entitlement recipients. Ending that support could impose at least temporary stress on many governments, some of which will experience fiscal difficulties even after the recovery is well under way.

Restrict Eligibility and Reduce Funding. If the entitlement component were cut 20 percent by eliminating funding for the least needy jurisdictions, federal outlays could be reduced by $20 million in 1993 and $1.7 billion over the 1993-1997 period. Such a cutback would increase the proportion of funds going to the nonentitlement component from 30 percent to 35 percent, but the typically competitive nature of the distribution process would presumably ensure that these funds would be targeted toward the neediest areas. Carrying out this option would require both changing the authorizing legislation and cutting the program's annual appropriation.

Proponents argue that no pressing interest is served by supporting jurisdictions that have above-average ability to fund projects themselves. For example, seven of the 10 counties that had the highest per capita income in the nation in 1985 currently receive funds under the CDBG entitlement component. Eliminating funding for such jurisdictions, rather than reducing grants across the board, would ensure that the most distressed jurisdictions retained the same level of aid. A reduction in federal funds for affluent jurisdictions would, however, probably curtail activities designed to aid low- and moderate-income households in any pockets of poverty in those areas, because local governments would probably not completely offset the reduction.

DOM-30 REDUCE FEDERAL SUPPORT FOR TENNESSEE VALLEY AUTHORITY ACTIVITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	140	150	150	160	160	760
Outlays	40	120	140	150	160	600

The annual appropriation for the Tennessee Valley Authority (TVA) provides federal support for the TVA's stewardship of its lands, facilities, and natural resources and for other activities. Stewardship includes maintaining a system of dams and reservoirs and managing TVA-held land. In addition, the TVA provides recreational programs, promotes public use of its land and water resources, and operates a national fertilizer and environmental research center. In fiscal year 1992, the TVA received appropriations for these activities of $135 million and also received revenues from fees. Eliminating many of the activities supported by appropriations and increasing the funding from nonfederal sources could reduce federal outlays by about $40 million in fiscal year 1993 and $600 million for the 1993-1997 period.

Because many of TVA's stewardship activities are necessary to maintain its power system, their costs would more appropriately be borne by users of the power. Each year, the TVA allocates about $90 million to stewardship activities, of which about $14 million is derived from sales of power. Other stewardship activities not related to the power system could be discontinued, or their costs could be recovered from the beneficiaries. Direct costs to the federal government could be reduced by about $70 million annually if the TVA were to increase power rates or fees to cover costs of all stewardship activities, or if the activities were eliminated.

Some critics claim that certain TVA activities, such as providing recreational facilities, are beyond the scope of the TVA and should not be federally supported. They could be underwritten by state or local governments, or by fee-for-service mechanisms. Critics also argue that most activities of the national fertilizer and environmental research center benefit the private sector and should be supported by private funds. By discontinuing its support of the center, the federal government could save about $30 million annually.

Supporters of continued federal funding argue that its removal would damage the TVA's ability to meet its federally mandated mission. That mission includes aiding the proper use, conservation, and development of the region's natural resources, as well as promoting its economic well-being.

DOM-31 ELIMINATE ANCILLARY VOCATIONAL EDUCATION PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Eliminate Community-Based Organizations Programs					
Budget Authority	10	15	15	15	15	65
Outlays	a	10	10	15	15	50
	Eliminate Consumer and Homemaking Education Program					
Budget Authority	35	35	40	40	40	190
Outlays	5	30	35	40	40	150

a. Less than $2.5 million.

Vocational education--occupationally specific instruction in such areas as business math, industrial arts, electronics, and office management--is widely offered in U.S. secondary schools. Federal legislation in the form of the Carl D. Perkins Vocational Education Act of 1984, as amended, is intended to help states ensure equal vocational education opportunities for traditionally underserved populations. The act also funds qualitative improvements in vocational education programs in order to increase work-force productivity and promote economic growth. In addition to its core programs, this legislation established others that are ancillary to its larger purposes. Two of these are the Community-Based Organizations programs and the Consumer and Homemaking Education program. Eliminating them would probably not affect the accomplishment of the central purposes of the legislation and could save about $200 million over the 1993-1997 period.

Community-Based Organizations Programs. These programs fund projects that include outreach efforts to locate likely recipients of vocational education; prevocational basic-skills training, guidance, and counseling; and career intern programs. In 1990, 57 grants were made to states and outlying areas for $11 million, with competitive grants then used by most states to fund local recipients. Eliminating these programs could save about $50 million in outlays over the 1993-1997 period.

People who argue for eliminating these programs have several criticisms. The services the programs fund are ancillary to vocational education in that they do not address the allocation or quality of occupationally specific instruction. In some cases the services only supplement those funded by other sources. States tend to distribute funds among a large number of organizations located in different parts of the state, and many awards appear to be too small to make a significant difference. Most states do not conduct formal evaluations of projects they fund.

Proponents of the programs argue that they complement the efforts of the core Vocational Education Basic Grant program. For example, they fund efforts to inform disadvantaged individuals who may not be served by regular vocational education programs; these people include school dropouts, substance abusers, teenage parents, and immigrants with limited language skills. The services provided through community-based organizations can also provide beneficiaries with

the attitudes and basic skills they need to succeed in mainstream vocational education programs.

Consumer and Homemaking Education Program. This program provides grants to states to prepare youths and adults to be homemakers. Federal funds are allocated according to a state's per capita income and population; one-third of each state's allotment must go to economically depressed areas. These funds can be used for instruction in family living and parenthood, food preparation and nutrition, child development and guidance, home management, and the like. In 1990, about $34 million was appropriated for this program, and grants were made to 50 states, the District of Columbia, and six outlying areas. Eliminating the program would reduce federal outlays by about $150 million over the 1993-1997 period.

Critics of the Consumer and Homemaking Education program argue both that there is no essential federal role in educating people to be homemakers and that federal funds are not necessary to support these particular activities. They generally supplement state and local programs for elementary and secondary schools, where state and local dollars exceed federal dollars by more than 20 to 1. If they chose, states and localities could also use funds from their Basic Grants to States to continue these services.

Proponents of the program see it as an important supplement to efforts to reduce sex bias and stereotyping in family life. It also provides funds for ancillary services (including outreach) to ensure the quality and effectiveness of local programs. Without federal support, local consumer and homemaking educational services might be restricted or reduced in quality.

DOM-32 ELIMINATE EDUCATION PROGRAMS THAT HAVE LARGELY ACHIEVED THEIR PURPOSE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Public Library Construction			
Budget Authority	15	20	20	20	20	90
Outlays	a	10	20	20	20	65
			Follow Through			
Budget Authority	10	10	10	10	10	45
Outlays	a	5	10	10	10	35
			Law-Related Education			
Budget Authority	5	5	5	5	5	15
Outlays	a	5	5	5	5	10
			Law School Clinical Experience			
Budget Authority	10	10	10	10	10	45
Outlays	a	5	10	10	10	35
			Total Savings			
Budget Authority	35	40	40	40	45	200
Outlays	5	25	40	40	40	150

a. Less than $2.5 million.

The Department of Education funds more than 130 programs that address a range of problems at all levels of education. Four of the programs continue to be funded even though they have largely or completely achieved their original purposes or could be supported by other funding sources. The annual cost of these four programs ranges from about $5 million to $20 million each. Eliminating all of them would save about $150 million over the 1993-1997 period.

Public Library Construction. This program is intended to fund facilities so that all people have access to local public library services. Eliminating it would reduce federal outlays by about $65 million over the 1993-1997 period.

The argument for elimination is that access to public libraries is now virtually universal, making continued federal funding for new library facilities unnecessary. Opponents of elimination argue that the program provides assistance that is still needed in building or modifying libraries, including alterations necessary to meet federal guidelines for access by the disabled.

Follow Through. This program's purpose is to develop educational practices that help low-income children in the early elementary grades fulfill their potential. Eliminating this program would reduce federal outlays by about $35 million over the 1993-1997 period.

Those who would eliminate Follow Through note that it was initiated in 1968 as a short-term experimental program. It generated many ideas, but the Chapter 1 Basic Grant Program is now the appropriate vehicle for funding state and local educational agencies to develop as well as to implement services for disadvantaged children in preschool and elementary-school grades. The counterargument is that Follow Through grants, now awarded competitively, are still being used to fund innovative projects to help disadvantaged children retain the cognitive gains made in preschool programs in the early elementary-school grades.

Law-Related Education. This program aims to provide children, youth, and adults with knowledge and skills pertaining to the law and to the legal principles and values on which it is based. Eliminating the program would reduce federal outlays by about $10 million over the 1993-1997 period.

The argument for eliminating this program, which was first funded in 1980 and supported 36 projects in 1990, is that it has successfully supported the institutionalization of law-related education, including teacher training. Past recipients of grants should be able to continue without federal assistance. Those who want to maintain the program argue that many of the funded projects support outreach efforts to disabled and minority youth. Without federal funding, these efforts could collapse.

Law School Clinical Experience Program. This program is intended to establish or expand law school programs to provide clinical experience in the practice of law, especially the preparation and trial of actual cases. Eliminating this program, which supported some 1,600 law students in 75 institutions in 1991, would save about $35 million over the 1993-1997 period.

Program critics argue that it should be eliminated because it was established to demonstrate the concept of clinical legal education, not to support it as a permanent federal responsibility. Most law schools now offer clinical education and would continue to do so in the absence of federal support. Program supporters argue that some law schools still only make a marginal commitment to clinical education in their budgets. If the program were eliminated, those law schools might drop their clinical education programs, depriving their students of this experience.

DOM-33 ELIMINATE STATE STUDENT INCENTIVE GRANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	75	75	80	80	85	400
Outlays	35	75	80	80	85	350

The State Student Incentive Grant (SSIG) program helps states provide financially needy postsecondary students with grant and work-study assistance. States must match federal funds at least dollar for dollar, while also meeting 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 SSIG program. In 1991, the federal government appropriated $64 million, which was matched by 50 states and seven outlying areas, with the money distributed to an estimated 200,000 students.

Eliminating SSIGs would save the Treasury about $350 million during the 1993-1997 period. If a portion of the resulting savings from eliminating this program were redirected to the Pell Grant program, which assists financially needy undergraduates, some of the adverse effects of eliminating SSIG could be alleviated. In either case, the extent of the actual reduction in assistance would depend on the responses of states, some of which would probably make up 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 SSIG program was authorized in 1972, only 31 states had student grant programs. Furthermore, state need-based aid for undergraduates increased from $870 million (in 1990 dollars) in academic year 1973-1974 to $1.6 billion in academic year 1989-1990, when about 1.4 million students received such aid.

Opponents of eliminating SSIGs argue that not all states would increase their student aid appropriations to make up for the lost federal funding, and some might even reduce them. Eight states just met the SSIG matching provision in 1989-1990. In addition, many other states are now having financial problems and might not be able to make up the loss of SSIG funds.

DOM-34 ELIMINATE OR REDUCE FUNDING TO SCHOOL DISTRICTS FOR IMPACT AID

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			Eliminate All Impact Aid			
Budget Authority	800	820	850	880	900	4,250
Outlays	630	780	840	870	900	4,000
			Eliminate All But Half of Aid for "a" Children			
Budget Authority	490	510	520	540	560	2,600
Outlays	380	480	520	540	550	2,450
			Eliminate Impact Aid for "b" Children			
Budget Authority	140	150	150	160	160	750
Outlays	120	140	150	150	160	720

School Assistance in Federally Affected Areas--also known as Impact Aid--is intended to compensate school districts that have children who are enrolled because their parents live or work on federally owned or subsidized property. Since property of that type is tax-exempt, Impact Aid compensates school districts for the forgone property tax revenues that would have supported the schools.

Impact Aid goes to school districts for two categories of children: "a" children, whose parents both live and work on federal property; and "b" children, whose parents either live or work on federal property. A minimum of 3 percent of the children enrolled in a school district (or at least 400 children) must be federally connected for a district to be eligible. In 1990, Impact Aid went to approximately 2,500 school districts spread across all states. Payments for "a" children--at an average of $1,572 per child in 1990--have been found to go disproportionately to school districts with high expenditures per pupil and to school districts with low average property values. Payments for "b" children--at an average of $65 per child in 1990--have been found to be relatively evenly distributed across school districts with high and low expenditures per pupil. School districts in at least six of the 10 richest counties in the United States are among the beneficiaries of the Impact Aid program.

Eliminating all funding for Impact Aid would reduce federal outlays by $4 billion in the 1993-1997 period. Opponents of the program argue that the economic benefits from federal installations outweigh the demands placed on the schools, making the program unnecessary. These economic benefits are considered so substantial that local jurisdictions compete vigorously for new federal installations and lobby intensely to forestall closing existing ones.

Proponents of the program counter that the presence of federal installations does not adequately compensate local governments and school districts for losses in property tax revenues. Additional revenues resulting from federal installations are collected primarily by the state through income and sales taxes. Moreover, many school districts--especially isolated ones having military installations with large numbers of "a" children--would face

severe financial hardship if such funding were eliminated.

A second option would eliminate all Impact Aid except for half of the "a" payments. The remaining Impact Aid funds would be targeted toward school districts enrolling large numbers of "a" children. This alternative, which would require changes in authorizing legislation, would reduce federal spending by $2.5 billion over the 1993-1997 period; it would also ensure that scarce federal funds go only to the school districts most affected by federal activities. School districts with only "b" children or relatively few "a" children, however, would have somewhat less funding unless state or local resources were increased.

A third option would eliminate Impact Aid only for "b" children, thereby reducing federal outlays by $720 million over the 1993-1997 period. This alternative would significantly limit any negative effects on school districts compared with ending larger portions of Impact Aid. Proponents of this alternative note that school district operations do not generally depend on "b" payments, which constitute less than one-half of one percent of total expenditures in more than half of the districts receiving them. The parents of "b" children also pay state and local taxes, which fund educational expenditures, at almost the same rate as the parents of children who are not federally connected. Opponents of this option argue that "b" payments are important for a few school districts--for example, where large numbers of military families live in the community but shop at military exchanges, which do not collect state and local sales taxes.

DOM-35 ELIMINATE UNTARGETED FUNDING FOR MATHEMATICS AND SCIENCE EDUCATION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	120	130	130	140	140	660
Outlays	15	100	130	130	140	510

Most federal aid for elementary and secondary education is targeted toward students with special needs. Federal funds for compensatory education under Chapter 1 of the Elementary and Secondary Education Act of 1965, for example, are intended for low-achieving students in schools with many poor children. Federal funds are also provided to help educate children with disabilities.

Substantial amounts of federal money, however, are provided with no federal requirement for targeting funds toward students with special needs or toward the teachers who serve them. An example is the portion of the mathematics and science education grants not targeted toward students with special needs. Ending funding for this portion would reduce budget authority by about $660 million, and outlays by about $510 million, over the 1993-1997 period.

On the one hand, this option would generate significant federal savings and affect total spending for elementary and secondary education only minimally because the reduction would constitute considerably less than 1 percent of total local, state, and federal expenditures on education. Moreover, districts might offset part or all of the reduction in federal funding for the activities of special concern to them.

On the other hand, this program has a purpose other than increasing services to students with special needs--namely, to support several of the national education goals agreed to by the President and the governors of the states. The reductions could pose hardships for some jurisdictions trying to meet those goals. In particular, the progress of students in mathematics and science might improve more slowly if federal funding were ended.

DOM-36 REDUCE PELL GRANT FUNDING BY TIGHTENING THE DEFINITION OF INDEPENDENT STUDENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	340	360	370	390	410	1,850
Outlays	70	340	360	380	390	1,550

The Pell Grant program provides grants to undergraduate students on the basis of financial need and, among federal student aid programs, is the most directly targeted toward low-income students. Since 1987, Pell Grants have been somewhat easier to obtain for many students because the Higher Education Amendments of 1986 eased the definition of independent students (that is, students for whom only their own financial situation--not that of their parents--is considered in determining the need for financial aid). Just under 60 percent of the recipients are now classified as independent, compared with about 40 percent in the early 1980s. Currently, about 95 percent of independent recipients have incomes below $25,000, and about 75 percent of dependent recipients have family incomes below the same level.

An independent student is one meeting any of the following criteria: at least 24 years old; a veteran; married and not declared a dependent on the parents' federal income tax return; or having legal dependents other than a spouse. Also defined as independent are single students who were not claimed as dependents by their parents for income tax purposes in the previous two years and who had incomes of at least $4,000 in each of those years. The last provision has apparently enabled some families to obtain more financial aid by not declaring their children as dependents on their income tax returns, thereby enabling the children to qualify as independent students.

Outlays could be reduced by nearly $1.6 billion during the 1993-1997 period by removing the last alternative from the definition of independent students and simultaneously cutting the federal appropriation by the same amount. Of the roughly 300,000 independent students who would be affected each year, an estimated 25 percent would receive awards as dependent students; the others, it is estimated, would not receive Pell Grants at all because their parents' financial resources are too large for them to qualify.

Of the students affected, those whose parents have few financial resources would receive awards similar to their current ones and so would not be expected to change their education plans. Moreover, the effect of this change on the enrollment of students who would no longer qualify for awards would probably be small because their parents have the resources to help them finance their educations. Other types of federal aid, notably Stafford Loans, would also be available to some affected students. (The costs of the other programs would then increase, but these indirect costs are not reflected in the estimated savings for this option.)

Some students whose awards would be cut or eliminated, however, would not receive additional financial support from their parents. They might have to attend less costly schools, and some might not finish their educations. In addition, some students who are truly financially independent of their parents would receive less aid.

DOM-37 ELIMINATE FEDERAL FUNDING FOR CAMPUS-BASED STUDENT AID

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Eliminate Campus-Based Aid						
Budget Authority	1,400	1,450	1,500	1,550	1,600	7,450
Outlays	140	1,350	1,450	1,500	1,550	5,950
Eliminate Campus-Based Aid and Redirect Half of the Savings to Pell Grants						
Budget Authority	700	720	740	770	790	3,700
Outlays	70	680	720	740	770	3,000

The federal government provides campus-based student aid through three programs: Supplemental Educational Opportunity Grants, Perkins Loans (formerly National Direct Student Loans), and Work-Study. Financial aid administrators at postsecondary institutions determine which eligible students receive aid under general federal guidelines. In 1992, the federal government provided $1.3 billion in campus-based aid, which will go to approximately 1.5 million students.

Eliminating federal funding of these programs would lower outlays by about $6 billion during the 1993-1997 period. Alternatively, half of the savings from eliminating these programs could be redirected to the Pell Grant program, which provides grants for undergraduate students on the basis of national standards of financial need. Accordingly, the Pell Grant program is more closely targeted toward low-income students. The extent of the reduction in total student aid would depend on the responses of postsecondary institutions, some of which would make up part or all of the lost federal funds. Moreover, since postsecondary institutions retain $5.4 billion in revolving funds under the Perkins Loan program, an estimated 690,000 students would receive loans, averaging about $1,250 in 1992, even if the federal government did not fund any new campus-based aid.

The primary justification for this option reflects the view that the main goal of federal student aid is to provide access to postsecondary education for those with low incomes. In contrast, campus-based aid is less closely targeted toward low-income students than is other federal student aid. In addition, campus-based aid is tied to specific institutions so students with greater need at poorly funded schools may receive less than those with less need at well-funded institutions.

Postsecondary institutions object to this option, however, because it would reduce their discretion in packaging aid to address the special situations of some students, while also reducing total available aid. Moreover, these programs disproportionately help students at private nonprofit institutions (whose students get over 40 percent of this aid, compared with 20 percent of Pell Grant aid). Thus, cutting campus-based aid would make this type of school less accessible to needy students.

Redirecting half of the savings from eliminating campus-based aid to the Pell Grant program would mitigate the effects of less total aid on lower-income students. The Pell Grant appropriation provides for a maximum award of $2,400 in the 1992-1993 academic year. Redirected funds from campus-based

programs could be used by the appropriations committees to increase the maximum Pell Grant. Pell Grants allow students to choose freely among postsecondary institutions rather than be limited to institutions that offer them campus-based aid. Redirecting funds to the Pell Grant program would result, however, in only half the reduction in the federal deficit that could otherwise be accomplished by eliminating campus-based aid.

DOM-38 ELIMINATE OR REDUCE FUNDING FOR THE ARTS AND HUMANITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Eliminate Funding			
Budget Authority	1,100	1,100	1,100	1,150	1,200	5,650
Outlays	780	990	1,100	1,150	1,200	5,200
			Reduce Funding by 50 Percent			
Budget Authority	550	540	560	580	600	2,850
Outlays	390	500	550	580	590	2,600

The federal government subsidizes various arts and humanities activities. In 1992, federal outlays for the Corporation for Public Broadcasting, the Smithsonian Institution, the National Gallery of Art, the National Endowment for the Arts, and the National Endowment for the Humanities will total $1.1 billion.

Eliminating funding for these programs would reduce federal outlays by $5.2 billion in the 1993-1997 period, and cutting funding in half would save $2.6 billion during that period. The final effect of either option on arts and humanities activities would depend on the extent to which other funding sources--states, private individuals, firms, and foundations--increased their contributions and on whether admission fees to these activities were used to make up for reduced federal funding.

Proponents of this option argue that federal funding for the arts and humanities is not affordable in a time of fiscal stringency, especially as programs addressing central federal concerns are not fully funded. Moreover, because many arts and humanities programs benefit predominantly higher-income people, instituting or raising admission fees could substitute for federal aid in many cases. In many cities here and abroad, for example, museums charge fees.

Reducing or eliminating federal appropriations for the arts and humanities would probably result in fewer of these activities, however, because other funding sources would not be likely to offset fully the loss in federal subsidies. In fact, a substantial increase in private contributions is less likely now that tax reform has reduced the extent to which taxpayers benefit (through reduced tax liabilities) from their charitable contributions. As a result, activities that preserve and advance the nation's cultural heritage would be likely to decline.

DOM-39 CONSOLIDATE SOCIAL SERVICE PROGRAMS AND REDUCE THEIR BUDGETS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	a	270	270	270	280	1,100
Outlays	a	220	270	270	280	1,050

NOTE: Savings include reductions in both direct spending and discretionary appropriations.

a. The option would not take effect until 1994.

Social services are provided to many individuals and families through an array of programs, each with its own rules and regulations. These programs may be administered at both the federal and state levels by separate agencies, even though they serve the same or very similar clientele. In recent years, the number of separate programs has proliferated, particularly in child care, which has seen five new ones enacted since 1988.

This option would consolidate a number of the social service programs into one or several block grants. For example, one grant could be for families with children and another for the elderly. A large array of programs could be consolidated. For purposes of this estimate, the consolidation brings together the Social Services Block Grant (SSBG), Community Services Block Grant, Title IV-A "At-Risk" Child Care, Child Care and Development Block Grant, and two Human Development Services (HDS) initiatives--Title III services and meals for the aging, and Dependent Care Planning and Development Grants. (Two of these programs are mandatory--SSBG and "At-Risk" Child Care--and the remainder are discretionary.) Needy individuals and families could be protected by greater targeting of the funds toward states and areas with the lowest incomes or fiscal capacities.

Consolidating these programs and reducing their new budget by 5 percent would reduce federal government outlays by $220 million in 1994 and about $1 billion over the 1994-1997 period. (Implementation would be delayed until 1994 to allow time for consolidation options to be designed and evaluated.) With consolidation, localities could provide social services more efficiently. Duplicate services could be eliminated, and administrative costs would decline because of simpler rules and regulations plus a reduction in administrative personnel. States and localities would have more freedom to tailor programs to local needs. Moreover, different services provided to the same individual or family could be integrated more easily, improving service delivery from the client's perspective.

There are, however, some risks. Despite improved administrative efficiency, a 5 percent cut in funding could lead to a reduction in services. Several of the HDS programs have state matching requirements, and state spending might decline with their removal. In addition, consolidation would diminish federal control over the spending.

DOM-40 REDUCE THE MATERNAL AND CHILD HEALTH CARE BLOCK GRANT AND THE PREVENTIVE HEALTH SERVICES BLOCK GRANT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	400	420	430	450	460	2,150
Outlays	230	360	420	440	450	1,900

In its appropriations for 1991, the Congress provided about $680 million in block grants for programs in maternal and child health and preventive health services. Almost all of these funds are distributed to the states, with a small amount being used for federal initiatives. The block grants, which are funded through the Public Health Service, allow states considerable flexibility in choosing the programs to fund within the specified areas. These grants do not generally restrict benefits to categories of recipients, such as low-income families.

Each block grant supports a wide range of programs. The Maternal and Child Health Care Block Grant subsidizes programs that provide such services as preventive care, prenatal care, health assessments for children, rehabilitation services for blind and disabled children, and community-based services for children with special health care needs. The 1991 funding for this block grant was $587 million. The Preventive Health Services Block Grant supports programs in areas such as immunization, hypertension control, dental health, environmental health, and injury protection. Funding for 1991 was $93 million.

If funding for each of these block grants were reduced by half, the savings in outlays for the 1993-1997 period would be about $1.9 billion. The principal justification for this reduction is that the federal commitment to other programs directed at maternal and child health and preventive health services has increased substantially in recent years. For example, Medicaid's coverage of low-income women and young children has expanded in several ways. States are now required to provide Medicaid coverage to pregnant women and children under age six in families with incomes below 133 percent of the federal poverty level, and to children under age 19 and born after September 30, 1983, with family incomes below the poverty line. Thus the block grants are not essential for ensuring access to health services for these individuals. In addition, states have the option of providing Medicaid coverage for pregnant women and infants in families with incomes up to 185 percent of the poverty line. By July 1991, 28 states and the District of Columbia had set income thresholds above 133 percent of the poverty line for this population. Similarly, between 1988 and 1991, funding for the Centers for Disease Control's immunization program was increased by $120 million.

The major disadvantage of cutting the block grants is that, in the current fiscal environment, many states might be unable to assume a greater share of the financial responsibility for the affected programs. Cuts in the block grants could adversely affect the health of people--especially those in low-income families--who receive assistance from these programs.

DOM-41 REDUCE FUNDING FOR RESEARCH SUPPORTED BY THE NATIONAL INSTITUTES OF HEALTH

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	870	900	930	960	1,000	4,650
Outlays	370	800	910	940	980	4,000

The federal government provided $7.5 billion in 1991 for research funded through the National Institutes of Health (NIH). About 75 percent of the NIH research budget is awarded to universities and other nonprofit institutions through research grants and contracts. The rest is spent on research within the institutes, research contracts with industrial firms, research by state and local governments, foreign research, and administration.

A reduction in funding for NIH research could be justified by its rapid growth in recent years. Between 1981 and 1991, NIH expenditures increased by about 128 percent, or approximately 84 percent after adjusting for inflation. If funds for NIH research were reduced by 10 percent, the 1993-1997 savings in outlays would be about $4 billion.

The NIH could respond by limiting its overhead reimbursements for research grants and by funding research projects at a reduced proportion of their costs, thereby encouraging researchers to find additional sources of support (see DOM-2 for a related option). Alternatively, the NIH could cut the number of grants awarded. Since funding of projects is based on a rating system, proposals with the highest ratings would still be supported.

A reduction in NIH funding could, however, have adverse effects on biomedical research and might cause some researchers to leave the field. The NIH cannot currently fund the majority of grants that it approves, and funding is insufficient to support some important areas of research. In addition, the NIH has had difficulties recruiting and retaining scientific personnel because federal salaries are lower than those in the private sector.

DOM-42 REDUCE FEDERAL RENTAL SUBSIDIES BY SHIFTING SOME COSTS TO THE STATES OR TENANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Reduce Section 8 Subsidies						
Budget Authority	10	15	30	35	45	130
Outlays	190	410	650	920	1,200	3,400
Reduce Public Housing Operating Subsidies						
Budget Authority	100	210	330	460	600	1,700
Outlays	50	150	260	390	520	1,350

Most lower-income renters who receive federal rental assistance are aided through the Section 8 programs or the public housing program, which are administered by the Department of Housing and Urban Development (HUD). These federal programs usually pay the difference between 30 percent of a household's adjusted income and either the actual cost of the dwelling or, under the voucher program, a payment standard. In 1991, average federal expenditures per household for all of HUD's rental housing programs combined were roughly $3,700. This amount includes both housing subsidies and fees paid to administering agencies.

Savings in outlays could be achieved by reducing federal payments on behalf of recipients. To diminish or eliminate the impact of this change on assisted tenants, state governments--which currently contribute no funds toward these federal rental assistance programs--could be required to make up some or all of the decrease as a condition of receiving assistance commitments from newly appropriated funds. This option would increase combined tenant and state rental contributions over a five-year period from 30 percent to 35 percent of a tenant's adjusted income. It would save $190 million in federal outlays for the Section 8 programs in 1993 and a total of $3.4 billion over the 1993-1997 period. Savings in outlays for public housing would amount to $50 million in 1993 and almost $1.4 billion over the five-year period. Realizing these savings, however, would require changing the authorizing legislation for these programs as well as cutting the annual appropriations for vouchers and public housing operating subsidies.

One rationale for involving states in housing assistance is that these programs generate substantial local benefits, such as improved quality of the housing stock. If all states paid 5 percent of the adjusted incomes of those receiving assistance, housing costs for assisted families would not rise. Moreover, since eligibility for housing assistance 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 rental payments by its households increased to 35 percent of their adjusted incomes, these out-of-pocket costs would still be well below the nearly 50 percent of income that the typical nonassisted renter who is eligible for assistance now pays.

Absorbing part of the costs of housing assistance would be difficult for the states that are experiencing fiscal distress, however. Un-

less all states made up the reduction in federal assistance, this strategy would increase housing costs for some current recipients of aid, who are generally poor. Moreover, raising rental payments could prompt some stable, slightly higher-income households to leave assisted housing projects in areas of the country where unassisted housing of the same quality would now be cheaper. This outcome would change the economic mix of households in these projects, reduce the projects' viability, and increase the average cost of subsidizing them.

DOM-43 MAINTAIN THE CURRENT NUMBER OF HOUSING ASSISTANCE COMMITMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	2,400	1,250	3,400	3,700	3,850	14,650
Outlays	70	250	490	810	1,850	3,450

Each year since 1975, the Department of Housing and Urban Development (HUD) has made new commitments under the Section 8 and public housing programs. These new commitments, which cover periods ranging from five to 20 years, provide housing assistance for additional lower-income households, thereby increasing the total number receiving aid. At the end of fiscal year 1991, about 4.6 million commitments for housing assistance were outstanding for all housing programs combined.

Outlays for all rental assistance programs combined totaled almost $17 billion in fiscal year 1991. If those programs are funded for 1993 and thereafter at the rate assumed in CBO's baseline, total outlays will increase to more than $24 billion by 1997. Even if no budget authority is appropriated for 1993 and later years for commitments to assist additional households, outlays will rise to more than $22 billion by 1997. That increase will take place because some outstanding commitments have not yet resulted in actual assistance; because subsidies per household increase annually as a result of inflation; and because costs will continue to meet such goals as restoring the public housing stock to standard condition and providing incentives to owners of certain housing projects to preserve them for low-income use.

Savings could be realized if the total number of commitments were frozen at the current level. Under this option, enough budget authority would still have to be appropriated to renew all expiring commitments and to fund enough additional ones in each of the next five years to replace commitments that would be lost for other reasons. Incentives to owners to preserve certain rental projects for low-income use would be funded each year at levels estimated by HUD. Modernization of public housing projects would be funded at the 1992 level, adjusted in later years for inflation. This option would reduce outlays by $70 million in 1993 and almost $3.5 billion over the 1993-1997 period; additional savings would accrue for up to 20 years thereafter, when all contracts associated with 1993-1997 budget authority would have expired.

One argument in favor of this option is that expanding rental assistance programs is inappropriate in light of present cutbacks in other areas. Furthermore, existing commitments would continue to assist many new income-eligible households each year because of turnover among assisted renters. Finally, no current recipients would lose their housing assistance as a result of this option.

One argument against the option is that the upward trend in the proportion of eligible renters actually receiving assistance has almost leveled off at about 35 percent because the number of new commitments funded annually dropped significantly during the 1980s. If the number of commitments were frozen, the proportion of eligible renters receiving assistance would fall because of continued growth in the number of eligible households. As a result, the problem of homelessness might worsen.

DOM-44 SHIFT HOUSING ASSISTANCE FROM NEW CONSTRUCTION TO VOUCHERS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			Replace New Construction with Vouchers			
Sections 202 and 811						
Budget authority	680	700	720	750	770	3,600
Outlays	a	-60	5	70	260	270
Public Housing[b]						
Budget authority	380	390	410	420	430	2,050
Outlays	a	-15	140	310	440	870
			Partially Replace New Construction with Vouchers			
Sections 202 and 811						
Budget authority	340	350	360	370	390	1,800
Outlays	a	-30	5	35	130	140
Public Housing[b]						
Budget authority	190	200	200	210	210	1,000
Outlays	a	-5	70	150	220	440

a. Increase in outlays of less than $2.5 million.

b. Does not include savings that could be realized if annual appropriations for operating subsidies were decreased in accordance with the reduced number of new units.

A number of federal programs administered by the Department of Housing and Urban Development (HUD) subsidize the housing costs of lower-income households. The programs provide rental assistance through two basic approaches: subsidies that are tied to projects specifically constructed for lower-income households and subsidies that enable renters to choose standard housing units from existing private housing. In recent years, construction of low-income housing has been sharply curtailed in favor of using less costly existing housing. The only construction programs under which new commitments are still being made are the Section 202 and Section 811 programs (for the elderly and disabled, respectively) and the public housing program. For 1992, less than 30 percent of additional assistance commitments are for construction of new dwellings, and the remaining ones are provided through the Section 8 existing-housing certificate and voucher programs.

Appreciable savings in the costs of housing programs could be realized by substituting vouchers for new construction. Total savings over the long run are evident when the cost of using vouchers is compared with the cost of new construction in terms of their present values, but not necessarily when they are compared in terms of year-by-year outlays as reflected in the budget. (Present values indicate the amounts of money that would have to be put in the bank today in order to cover the future streams of costs.) This apparent contradiction occurs because of differences in the patterns of outlays for the two approaches. Construction programs require large up-front federal outlays for building the projects, with relatively low annual outlays for operating

subsidies thereafter. In contrast, annual outlays for vouchers are more constant over time but exceed those for annual operating subsidies.

The options shown here would eliminate new commitments for construction, or make only half as many, and in each case replace the eliminated commitments with vouchers on a one-for-one basis. The savings shown in the table are not measured in terms of present values, however, because of budgetary conventions. Nevertheless, the budget would show net savings in outlays over the 1993-1997 period for each of the options considered. Under the first option, outlays would decrease by $270 million for the Section 202 and Section 811 programs and by $870 million for the public housing program. Net savings under the second option would be half of those amounts. These savings reflect the elimination of up-front construction expenses. Under both options, savings in outlays would continue to occur for some time after 1997, but eventually the budget would reflect the higher annual outlays of vouchers compared with operating subsidies.

Substantially greater savings in budget authority would occur over the five-year period but, again, these short-term savings do not represent the complete picture. For example, in the Section 202 and Section 811 programs, the savings would derive partially from the shorter contract term of vouchers (five years) compared with rental assistance in the newly constructed projects (20 years). Consequently, they would be offset by higher budget authority after 1997, if expiring vouchers were renewed for 15 more years. (In the calculations of present values, on which the earlier discussion was based, this difficulty was avoided by using the same period of time for both types of aid.)

Proponents of these options see little need for subsidizing new construction. The overwhelming housing problem today, they argue, is not a shortage of rental units but the inability of poor households to afford existing units. For example, nationwide vacancy rates have consistently exceeded 7 percent since 1986, the highest levels since 1968. Furthermore, even if there are shortages, subsidizing new construction may merely displace private activity rather than add to the total housing stock. Also, the construction of subsidized housing is generally a slow process that, at best, has an impact only after a long lag. Vouchers could help the poor more quickly and at a much lower cost to the federal government than new construction. In addition, vouchers would give the poor greater flexibility in choosing where to live.

National statistics on the supply of rental units, however, may mask local shortages in certain types of units that rent within HUD's guidelines for vouchers. Many elderly and disabled households, in particular, need housing that can provide special social and physical services not available in their current residences. Supporters of subsidized construction of units for elderly and disabled households contend that the private sector does not respond adequately to these demands because it produces units that those with low incomes typically cannot afford, even when vouchers subsidize rents.

Similarly, a relatively large proportion of lower-income families with children live in crowded conditions. Many of them need units with three or more bedrooms. A number of the nation's large public housing authorities report that their jurisdictions have shortages of these large units with rents within the HUD guidelines.

DOM-45 ELIMINATE HOPE GRANTS FOR LOW-INCOME HOME OWNERSHIP

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	370	380	400	410	430	2,000
Outlays	90	270	370	390	400	1,500

The Homeownership and Opportunity for People Everywhere (HOPE) grants program, authorized in 1990, provides grants on a competitive basis to resident groups, private nonprofit organizations, local governments, and public housing agencies to enable them to undertake low-income home ownership programs. The eligible housing stock consists of public and Indian housing units, as well as multifamily rental projects and single-family units that are owned (or whose mortgages are now held) by the Department of Housing and Urban Development (HUD) or other federal, state, or local government agencies, including the Resolution Trust Corporation.

Grant recipients may use the funds to help pay for a variety of activities, including the costs of acquiring and rehabilitating these properties for the purpose of transferring ownership to eligible families. These families include current occupants of the units being purchased and others with incomes up to 80 percent of the median income in the area. To ensure affordability, the units must be priced so that monthly payments for principal, interest, taxes, and insurance do not exceed 30 percent of the purchasers' income after certain adjustments. Grants may also be used to provide operating subsidies for up to five years so that total monthly housing costs, which include utilities and maintenance expenditures, do not exceed 35 percent of the purchasers' adjusted incomes.

For fiscal year 1992, the Congress provided a total of $351 million for HOPE grants. Eliminating these grants would reduce federal outlays by $90 million in 1993 and by $1.5 billion over the 1993-1997 period.

One argument against low-income home ownership assistance is that it does not target scarce resources toward the poorest families. To serve them, purchase prices would have to be reduced nearly to zero, and additional subsidies would need to be provided--perhaps indefinitely--to cover operating costs. Thus per-unit costs would be relatively high, making it unlikely that such projects would be selected under the competitive funding procedures. Another argument is that low-income families might have to default on their mortgages and face foreclosure if they encountered unexpected repair bills or reductions of income. Finally, some observers have raised concerns about converting public housing units to home ownership, which would reduce a readily available supply of rental units that has traditionally housed the poorest of the poor.

Supporters of direct federal home ownership aid argue that it should be available to families whose incomes are too low to benefit from tax expenditures for housing. The current tax code effectively encourages home ownership only for middle- and upper-income families, many of whom would choose to own rather than rent even without added incentives. Supporters also argue that home ownership empowers low-income families to take control of their lives by potentially gaining financial equity in an asset that can be passed

on to the next generation. Home ownership is also believed to strengthen communities by giving families a greater stake in them and by encouraging better maintenance of properties. Finally, home ownership opportunities in currently unassisted housing (such as that owned by the Resolution Trust Corporation) would give residents of assisted housing projects incentives to improve their economic circumstances, enabling them to leave the projects and making their units available for families on waiting lists for rental assistance.

DOM-46 ELIMINATE SPECIAL-PURPOSE HUD GRANTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	120	120	130	130	140	640
Outlays	0	55	120	130	130	430

As part of the 1992 appropriation for the Department of Housing and Urban Development (HUD), the Congress funded 133 special-purpose grants. The conference report accompanying the appropriation act specifies the activities funded by each grant, as well as the communities and organizations receiving them. Although the grants are part of the appropriation for rental housing assistance for low-income households, the overwhelming majority of them are aimed at community and economic development, infrastructure, and public service activities. Specific endeavors include art centers and recreation and health care facilities.

Eliminating these grants would save $430 million over the 1993-1997 period. One argument for not funding them is that their benefits are strictly local and should be funded at the local level. Moreover, in last year's budget request, the Administration stated that this type of grant violates the principles of open and fair distribution of HUD program resources that were adopted by the Congress in the 1989 HUD Reform Act. The Administration further maintained that these grants were being awarded without authorization and without published selection criteria or competitive application procedures. Finally, they are not well-targeted toward states with low per capita incomes. In fact, in 1992, the 10 states with the highest per capita income in 1989 (and with 29 percent of the U.S. population) will receive 33 percent of the total amount, and the 10 poorest states (with 10 percent of the population) will receive only 17 percent; the rest of the states, with moderate incomes, will get 50 percent of the funds.

Without these grants, however, fewer such development and service activities probably will be undertaken because fiscally distressed states and localities will have difficulty offsetting lost federal funds. Depending on the nature of the particular activity, therefore, fewer jobs might be created; various community development projects might not take place; some needed public services might not be provided; and infrastructure might not be developed or might deteriorate. To the extent that these activities would have benefited low-income households, this option would reduce resources available to these households.

DOM-47 MODIFY THE FEE STRUCTURE FOR LOCAL AND STATE AGENCIES THAT ADMINISTER FEDERAL HOUSING PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	50	50	50	55	90	290
Outlays	180	190	210	240	270	1,100

The Department of Housing and Urban Development (HUD) pays fees to local and state public housing agencies (PHAs) for administering the Section 8 existing-housing certificate and voucher programs. For each assisted household, PHAs receive an ongoing annual fee, as well as a one-time fixed fee when the new assistance commitment from HUD is first issued. Under current policy, the annual fee for commitments funded from pre-1989 appropriations ranges from 6.5 percent (for vouchers) to 7.65 percent (for certificates) of the local two-bedroom Fair Market Rent (FMR). The fee for commitments funded from appropriations since 1989 is set at 8.2 percent for both programs. The ceiling for the one-time fee is now typically $275 for each new commitment.

A 1988 study based on data from a sample of large urban PHAs estimated that annual administrative costs for both the existing-housing certificate and voucher programs averaged about 5 percent of the two-bedroom FMR. The average start-up costs, however, amounted to about $590 per household. Changing the current fee structure to reflect these estimated costs would reduce federal outlays by $180 million in 1993 and by $1.1 billion over the 1993-1997 period. In general, realizing these savings would require changing the authorizing legislation as well as cutting the appropriations for vouchers to reflect the lower fee payments. Even greater savings might be realized if other private or public entities were allowed to compete with the PHAs for the administration of the programs.

Such a fee structure would more accurately reflect the best available information about the costs of providing these types of housing assistance. Moreover, this option would equalize fees for programs that appear to have similar administrative costs and would eliminate the disparity among fees that now vary according to the year the commitment was first funded. In doing so, the fees would also be easier to administer. Allowing other organizations to compete to administer these programs might lead to increased efficiency.

This option could, however, impose financial difficulties on some PHAs. For example, in areas where FMRs are low relative to the overall cost of living, reduced fees might not cover actual administrative costs. Also, some PHAs may now use their excess reimbursements to cover shortfalls in the funds for other subsidized housing programs that they administer. (Such problems would be exacerbated if the administration of certificates and vouchers were taken over by other organizations.) Moreover, it is unclear whether the study on which these estimated costs are based can be generalized. Smaller urban and rural PHAs may have patterns in their administrative costs that differ from those of the large urban PHAs covered by the study. Thus some further modifications in the fee structure might be necessary, and that could change the ultimate federal savings.

DOM-48 ELIMINATE OR SCALE BACK LOW-INCOME HOME ENERGY ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Eliminate Program			
Budget Authority	1,550	1,600	1,650	1,700	1,750	8,300
Outlays	1,450	1,600	1,650	1,700	1,750	8,150
			Scale Back Program			
Budget Authority	770	800	830	850	880	4,150
Outlays	730	800	830	850	880	4,100

The Low Income Home Energy Assistance Program (LIHEAP) helps pay the home energy costs of some low-income households. Authorized by the Omnibus Budget Reconciliation Act of 1981 and administered by the Department of Health and Human Services, the LIHEAP provides about $1.5 billion annually in block grants to states. They may use them to help eligible households pay their home heating or cooling bills, meet energy-related emergencies, or fund low-cost weatherization projects.

Households may be eligible if they receive assistance from certain other programs, such as Aid to Families with Dependent Children or Supplemental Security Income, or if their incomes are low. In addition, federal law requires that states give preference to households with the highest energy costs (relative to income) when disbursing LIHEAP funds. Only about one-third of eligible households actually receive assistance.

Eliminating the LIHEAP would save almost $8.2 billion in federal outlays during the 1993-1997 period. Reducing future appropriations by 50 percent would lower outlays by about half that amount.

The LIHEAP and its predecessor energy assistance programs were created in response to the rapid 1970s' price increases in energy used in the home (notably fuel oil). Since then, real energy prices have dropped sharply. Those lower real prices could now justify either eliminating or reducing the LIHEAP. In addition, 28 states transferred up to 10 percent of their LIHEAP funds during fiscal year 1990 to supplement spending on five other social and community services block grant programs; the transfers indicate that some states believe spending for energy assistance does not have as high a priority as other spending.

If LIHEAP appropriations were reduced or eliminated, however, some low-income households in states with severe winter or summer weather could be forced to choose between paying for energy or for other household necessities. Moreover, retaining the LIHEAP at some level would provide the flexibility needed to respond quickly to a future spurt in energy prices.

DOM-49 CLOSE OR CONVERT INEFFICIENT OR UNDERUSED FACILITIES IN VETERANS' HOSPITALS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	75	150	240	330	340	1,150
Outlays	65	140	230	320	340	1,100

The Department of Veterans Affairs (VA) operates a nationwide medical care system that in 1991 included 172 medical centers with 66,000 inpatient beds, 119 nursing homes, and 339 outpatient clinics. Most of the hospitals are large, modern, and well staffed, providing access to high-quality care for eligible veterans. Although many of the hospitals are treating increasing numbers of patients, other facilities have experienced a declining demand for services, such as major surgery or common acute-care procedures. In response, the VA in 1992 plans to open 390 nursing home beds that have been converted from hospital beds.

The VA could achieve greater efficiency by closing small hospitals or underused units within hospitals or by converting them into facilities that offer services in greater demand. The criteria for closure could include the existence of adequate alternative sources of care, as well as low numbers of veterans using the VA facilities. Carrying out this option would require changes in both the program's authorization and its appropriation.

The level of savings achieved would depend on several factors: whether complete hospitals or merely wings within hospitals were closed or converted; whether conversions substituted for construction of new nursing homes that would otherwise have occurred; and the extent to which gross savings from closure or conversion would be absorbed by the increased costs for transportation or private care incurred for some veterans under the restructured arrangements. If overall savings were equal to those from the gradual closing of 4 percent of VA hospital beds, federal savings would total about $1.1 billion from 1993 through 1997.

This option would reduce the number of expensive surgical and other acute-care medical facilities with low average caseloads or occupancy rates. Closing or converting these facilities would not eliminate VA care for veterans--patients would be transferred to other VA hospitals or appropriate private facilities--but needed care would be provided more economically. To the extent that veterans were transferred to facilities that have greater professional resources or that undertake relevant surgical procedures more frequently, closure or conversion would also improve the quality of the care veterans receive.

This option could have the effect, however, of reducing access to health services for some veterans who receive care on a space-available basis within underused VA facilities. Some veterans might also find care more difficult to obtain if closures were in rural areas without other facilities.

DOM-50 PROMOTE MORE EFFICIENT MANAGEMENT AND DELIVERY OF HEALTH CARE FOR VETERANS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	0	200	410	650	900	2,150
Outlays	0	170	380	610	870	2,050

The Department of Veterans Affairs (VA) operates a nationwide medical care system that in 1991 included 172 medical centers, 119 nursing homes, and 339 outpatient clinics. The VA spent $7.1 billion in 1991 on inpatient health care services in VA hospitals. Evidence exists, however, that one-quarter or more of inpatient days in these hospitals have been inappropriate or unnecessary. The excessive use has been attributed to inappropriate admissions and unnecessarily long stays. The latter stemmed both from inefficient management practices (such as performing certain diagnostic tests after, rather than before, admission) and from the lack of less costly levels of care (including nursing home care that could facilitate timely discharges). Moreover, the availability of empty or underused beds in some VA hospitals reduces the pressure to avoid unnecessary inpatient days.

The VA adopted a system known as the Resource Allocation Methodology (RAM) in 1985 to promote more efficient resource use, although its impact on the allocation of VA funds proved to be limited. Use of the RAM to adjust VA hospital budgets was suspended in 1991 for one year while technical problems were addressed, and a new system known as Resource Planning and Management (RPM) is now being developed for implementation in 1993. It is unclear, however, whether RPM will lead to more efficient use of resources within the VA hospital system.

The Congress could require the VA to allocate resources for hospital care using a prospective payment system (PPS) similar but not identical to Medicare's system, while increasing the VA's freedom to allocate resources more efficiently. In essence, under a PPS, each patient would be classified in a diagnosis-related group (DRG), which would entitle the hospital to a fixed payment designed to reflect the average cost of efficient care for such a patient. In turn, the VA health care system would receive an overall level of operational funding related to the sum of these amounts. For this option to be effective, however, the VA would also have to be given considerably greater control over the nature and location of VA facilities, the total number of its health care beds, and its total staffing levels. If a PPS were introduced to the VA hospital system between 1994 and 1997 with a rate structure, for instance, that assumed gains in efficiency of 10 percent after full implementation, federal savings would total about $2 billion through 1997. Carrying out this option would require changes in both the program's authorization and its appropriation.

PPS-based funding for VA hospitals would strengthen their incentives to use resources efficiently. In the first year after PPS was introduced within Medicare, estimated gains in efficiency averaged about 5 percent. Because the government cannot walk away from operating deficits, government health care

facilities cannot be placed fully at risk. Nevertheless, this option would identify inefficiently managed hospitals, thereby providing strong incentives for better performance; it would also identify hospitals that would be better converted to other uses (for example, nursing homes) or closed entirely (see DOM-49). Finally, this option would promote efficient use of resources in the next century as the declining number but increasing age of World War II veterans alters the demand for veterans' health care.

One disadvantage of this option is that hospitals serving rural areas that have few alternative facilities might be among the underused hospitals on which a PPS would place the greatest financial pressure. Furthermore, implementing a PPS would be complex. For example, doing so would require defining patient categories covering a broader range of conditions than Medicare's PPS system covers, especially for psychiatric care, which accounts for about 30 percent of inpatient days in VA hospitals but only 20 percent of their costs. Improved review procedures would also be necessary to avoid inappropriate admissions and to ensure that quality of care remained satisfactory. Finally, under this option, the legislative branch would have less control over the nature and location of VA facilities.

DOM-51 REDUCE FUNDING FOR LAW ENFORCEMENT CONTROL OF ILLEGAL DRUGS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	710	730	760	790	820	3,800
Outlays	420	610	710	750	790	3,250

The federal government currently allocates $10.7 billion for the war on drugs (excluding prisons), with $6.7 billion for controlling their influx and $4 billion for research and development, treatment, and education. Over the last five years alone, federal resources for criminal justice activities aimed at controlling the supply of illegal drugs have increased, after inflation, by 85 percent. Cumulative amounts over the 1987-1992 period total $30 billion (in 1992 dollars).

The results of this formidable effort have been mixed, and some critics argue that federal resources could be reduced without much long-term impact on drug use. A 10 percent cutback in annual appropriations would save $3.3 billion in outlays over five years; the amount remaining for drug-enforcement activities would still be two-thirds greater, in today's dollars, than the 1987 level.

Instead of an arbitrary, across-the-board cut, more tailored reductions could be made. For example, the entire reduction could be made in the two areas where critics find the most questionable results: interdiction and international activities. A 25 percent cut in these resources (allocated mainly to the Department of Defense, the Coast Guard, the Customs Service, the Drug Enforcement Agency, and the Agency for International Development) would still represent over a 10 percent increase compared with the 1987 level, in today's dollars. Treatment and education funding would be left unchanged.

Proponents of reducing federal spending for interdiction and international activities argue that those activities have had little lasting effect on either availability or demand. Although enforcement has undoubtedly made it more difficult and more costly to grow, process, import, and distribute illegal drugs, no hard evidence exists that intensified efforts have kept them away from users or pushed prices up to levels that, in the long run, appreciably reduced the amount of drugs purchased. The difficulty in effectively controlling street supply and price stems from competition among producers and distributors, the large markup from wholesale to retail prices, and the ability to maintain an affordable end price by diluting the drug. Those conditions, critics argue, make it almost impossible to curb drugs by means of supply controls and related activities. In their view, the problem should be addressed through efforts to reduce the market for drugs. (Simply shifting funds from enforcement to drug education and treatment programs would, of course, not produce immediate savings; but the effects in the long run might be immensely beneficial.)

Advocates of reduced funding for drug enforcement maintain that trends in drug use bear little relation to law enforcement activities. They claim, for example, that perceptions of health risks and societal attitudes, not enforcement efforts, probably reduced demand among casual users. They also argue that past increases in the number of people

with serious drug problems could not have been controlled by beefed-up enforcement, because hard-core users tend, in time, to become immune to such efforts. The advocates also point out that the most recent data show a reversal of past trends--that is, increases rather than decreases in hard-core drug use. Other data, they note, suggest that young people, despite vigorous enforcement, still do not fully recognize the risks associated with drug use. Instead of more enforcement, critics have argued for an expansion or reshaping of existing drug education programs and for more attention to societal problems, such as dysfunctional families, that contribute to the overall problem.

Opponents of cutting funds for drug enforcement and related efforts point to the arrest of major traffickers and to the large quantities of illegal crops and drugs that have been destroyed or seized. Law enforcement planners believe they can take some credit for reduced drug use in 1990; they argue that street prices would have been much lower, and the availability of drugs much greater, were it not for extensive funding for criminal justice. Given recent signs that drug use in some categories is again increasing and that overall use remains at unacceptable levels, they contend that it would be premature and irresponsible to reduce or shift current resources. They point out, moreover, that criminal justice efforts are needed as much to keep some control over illegal drug activity as to roll it back, and that many programs are hard pressed to maintain existing levels of effort even with current funding. Proponents of law enforcement resources also argue that the message of enforcement--drug trafficking does not pay--is itself an essential educational element of any war on drugs.

DOM-52 END FUNDING FOR THE LEGAL SERVICES CORPORATION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	360	370	390	400	410	1,950
Outlays	320	370	380	400	410	1,900

The Legal Services Corporation (LSC), an independent, not-for-profit organization, supports free legal aid to the poor in civil matters. About 300 state and local programs receive LSC grants from federally appropriated funds. In 1991, more than 1 million of the nation's poor received assistance under such funding. The Congress continued to support the LSC despite repeated attempts by the Reagan Administration to abolish the program. (President Bush's budget proposes freezing funds for LSC at the 1992 level.) Terminating federal appropriations to LSC would save about $1.9 billion in outlays for the period 1993 through 1997.

From its inception in 1974, the LSC has been the subject of much controversy. Critics charge that the activities of legal aid lawyers focus too often on the advancement of social causes rather than on the needs of poor people with routine legal problems. The Reagan Administration and others argued that the responsibility for legal aid to the poor should rest not with the federal government but with states and localities. From this perspective, support obtained from other federal grants and expanded support from private sources, including donated services, could help to meet local needs for legal aid. Federal funds for social services block grants totaled $2.8 billion in 1991, about nine times the funding level for LSC. Such an approach would give localities more control over legal aid programs and therefore would make services more responsive to local needs.

Proponents of the LSC argue that relying on uncertain and indirect forms of support, rather than on a specifically targeted federal assistance program, cannot ensure that legal aid is available to the poor; the inadequacy of local and private support was one of the factors that led to direct federal financing in the first place. The decline in the percentage of attorneys participating in the American Bar Association's pro bono programs, from about 19 percent in 1989 to 16 percent in 1990, suggests the difficulty in generating strong and sustained private support for legal aid. Supporters point out that a strong federal program also allows for oversight and national direction. Instead of eliminating the program, the Congress could continue to curtail activities some observers find objectionable. Some analysts even argue that the level of federal support should be increased. In that regard, critics attacked the Administration's recent report on civil justice reform for not addressing what they viewed as a major problem--inadequate access for the poor.

DOM-53 MODIFY THE DAVIS-BACON ACT BY ALLOWING UNRESTRICTED USE OF HELPERS AND RAISING THE CONTRACT THRESHOLD

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	510	530	540	560	580	2,700
Outlays	230	570	760	870	960	3,400

Since 1935, the Davis-Bacon Act has required that "prevailing wages" be paid on all federally funded or federally assisted construction projects of $2,000 or more. Procedures for determining prevailing wages in the area of a construction project, as well as the classifications of workers receiving them, favor union wage rates in some cases. Recent changes in regulations, however, have lessened this effect. The act also restricts use of lower-wage, less-skilled workers such as "helpers." Under current regulations, wages for helpers are usually not determined separately, with the result that most helpers on covered projects are paid at the higher journeymen's rates.

Federal outlays for construction could be reduced by allowing unrestricted use of helpers, by raising the threshold for determining the projects to be covered by Davis-Bacon, or by doing both. The specific option depicted in the table would allow unrestricted use of helpers and would raise the threshold from $2,000 to $250,000, thus excluding about 7 percent of the value of all contracts currently covered by the act. These measures would reduce outlays by about $230 million in 1993 and by about $3.4 billion over the 1993-1997 period. These estimates assume that federal agency appropriations would be reduced to reflect the anticipated reduction in costs.

Most of the savings would result from the increased use of helpers. Allowing unrestricted use of helpers without changing the project threshold would reduce outlays by about $3.1 billion over the 1993-1997 period. Allowing unrestricted use of helpers and raising the project threshold to $100,000 or to $1 million would reduce outlays by about $3.2 billion or $4 billion, respectively, over this period. Setting the threshold at $100,000 would exclude less than 2 percent of the value of contracts currently covered; setting it at $1 million would exclude about 30 percent.

Relaxing Davis-Bacon requirements would help reduce the cost of federal construction projects. In addition, easing restrictions on the use of helpers would probably increase employment opportunities for less-skilled workers on federal projects. Such changes would, however, lower the earnings of some construction workers. In addition, opponents of this option argue that relaxing Davis-Bacon requirements could jeopardize the quality of federally funded or federally assisted construction projects.

DOM-54 MODIFY THE SERVICE CONTRACT ACT BY ELIMINATING THE SUCCESSORSHIP PROVISION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	180	190	190	200	210	980
Outlays	170	190	190	200	210	960

The McNamara-O'Hara Service Contract Act of 1965 sets basic labor standards for employees on government contracts whose principal purpose is to furnish labor, such as laundry, custodial, and guard services. Contractors covered by this act generally must provide these employees with wages and fringe benefits that are at least equal to those prevailing in their locality or those contained in a collective bargaining agreement of the previous contractor. The latter provision applies to successor contractors, regardless of whether their employees are covered by a collective bargaining agreement.

The cost of services procured by the federal government could be reduced by permitting successor contractors to pay lower wage rates or to provide less costly fringe benefits than their predecessors. Under this option, successor contractors would still be subject to the rules on prevailing wages and fringe benefits. This change in requirements would reduce outlays by about $170 million in 1993 and by about $960 million over the 1993-1997 period. These estimates assume that federal agency appropriations would be reduced to reflect the anticipated reduction in costs.

Federal procurement costs would fall because this option would promote greater competition among contractors. The current rule discourages potential successors from bidding on contracts in which the existing provider has a collective bargaining agreement, unless they have similar agreements.

The provision for successor contractors is intended, however, to prevent bidders from undermining existing collective bargaining agreements. Eliminating this provision would reduce the compensation of workers in some firms that provide services to the government. Some supporters of the provision argue that a reduction in compensation would, in turn, reduce the quality of such services.

Chapter Four

Entitlements and Other Mandatory Spending

Entitlement programs provide benefits to all who are eligible to receive aid and choose to participate. Major federal entitlements include Social Security, Medicare, Medicaid, food stamps, and farm price supports. Spending on these and other so-called mandatory programs (other than deposit insurance) account for nearly half of all federal outlays. In 1992, this category is expected to cost more than $700 billion, or about 12 percent of gross domestic product (GDP).

Spending in entitlement programs is largely determined, not by the annual appropriation process, but by the extent of participation, the benefit levels, the program rules that govern eligibility, and the cost of providing noncash benefits. A variety of other factors also cause outlays for entitlements to rise or fall, including demographic shifts, changes in providers' practices, and rates of inflation. Entitlement spending is, therefore, only partly under the direct control of the Congress.

Total spending on entitlements has grown rapidly since the early 1960s. As a share of GDP, however, most of the increase occurred by about 1975. Steadily increasing spending for retirement and disability programs, plus the creation of Medicare and Medicaid in 1965, spurred the growth of federal entitlement outlays from less than 6 percent of GDP in the early 1960s to almost 11 percent in 1975. Since then, the share of national production committed to these programs has hovered around 11 percent. Federal health care spending has climbed alarmingly during this period but has been offset in part by a relative decline in certain non-means-tested entitlements. Federal spending on mandatory programs other than deposit insurance is expected to keep pace roughly with GDP over the next few years.

The Budget Enforcement Act of 1990 (BEA) links future changes in federal spending on entitlements and other mandatory programs with changes in governmental receipts. It requires that the combined legislative changes in mandatory spending programs and federal receipts must not increase the deficit in any year between now and 1995. Thus, an entitlement program can be increased only if another entitlement is cut or taxes or fees are raised. Similarly, a tax can be cut only if another is increased or if entitlement spending is reduced. This requirement, which is called pay-as-you-go, applies not to each new law individually, but to the total impact of all laws affecting a fiscal year.

This BEA rule is qualified in several ways. For instance, spending for designated emergencies is exempt from the requirement. In addition, the BEA excludes the receipts and outlays of the Social Security retirement and disability trust funds from all calculations under the act, including the pay-as-you-go requirements. (Social Security is subject to its own set of rules, however, which are designed to protect the balances in these trust funds.)

If a violation of the rule occurs, a targeted sequestration--automatic cutbacks applying only to selected mandatory programs--must occur. But many of the major benefit programs, such as Social Security, federal employees' retirement, and most means-tested programs, are wholly exempt from the automatic cuts. In addition, other programs (including Medicare and Stafford student loans) are subject to limited cuts. This leaves just a few programs to bear the brunt of any serious violation of the pay-as-you-go rule.

Program Trends and Options

Mandatory federal spending can be grouped according to its purposes and programs. The level of and recent trend in outlays for each category provide a budgetary perspective on its changing importance over time, and future outlay projections indicate the likely spending paths if the programs remain unaltered. Within this context, options can be identified that would curb the amount of federal resources going to each area.

Social Security and Other Retirement and Disability Programs

Social Security, the largest entitlement program, is expected to provide benefits of $285 billion to more than 40 million elderly and disabled workers and members of their families in 1992 (see Table 4). Outlays for benefits have grown over the years as a result of increases in the number of elderly and disabled recipients, expansions in program coverage, benefit increases to account for rises in the cost of living, and the higher real earnings of newly retired workers. The Social Security Amendments of 1983 made major changes in the program to improve its financial standing. While most changes involved program financing and coverage, benefit changes were also enacted that delayed annual cost-of-living increases to recipients and made some program benefits subject to taxation. The amendments also increased the age of eligibility for full retirement benefits from 65 to 67, with the change phased in during the first quarter of the next century.

Baseline projections for Social Security spending reflect the influence of the above factors on the program through 1997. The growth of the beneficiary population will level off over the next few years, however, as the relatively small group of people born during the depression becomes eligible. Although the Social Security program has special rules under the BEA and is not included in the pay-as-you-go budget discipline, it nonetheless represents a major component of federal spending and cutting its spending would reduce the total budget deficit. Options to alter the program's benefit structure are considered in ENT-60 through ENT-63. In addition, restraint on the annual cost-of-living adjustment for Social Security is a major component of ENT-59, which considers all non-means-tested retirement and disability entitlements.

Other retirement and disability programs--which will cost $68 billion in 1992, or almost 10 percent of entitlement spending--are dominated by the government's civilian and military retirement programs. Spending on these programs and Social Security are affected by similar factors, and outlays are expected to increase at like rates in the Congressional Budget Office's (CBO's) baseline. Also included in this category are the government's fast-growing contributions for health benefits for civil service annuity recipients. ENT-31 and ENT-51 contain options that would modify benefits for former federal workers, as would ENT-59.

Medicare

Medicare was among the fastest-growing of the major spending programs during the 1980s, outpacing defense and Social Security and second only to net interest payments. It

Table 4.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1991	1992	1993	1994	1995	1996	1997
	Means-Tested Programs						
Medicaid	53	68	80	89	100	112	126
Food Stamps[a]	20	22	22	22	23	24	25
Supplemental Security Income	15	16	18	21	22	21	25
Family Support	14	16	17	17	18	19	19
Veterans' Pensions	4	4	4	4	4	4	4
Child Nutrition	6	6	6	7	7	8	8
Earned Income Tax Credit	5	7	8	8	11	12	12
Stafford Loans[b]	5	1	3	3	3	3	3
Other	2	3	3	3	4	4	5
Total, Means-Tested Programs	122	142	160	175	192	206	227
	Non-Means-Tested Programs						
Social Security	267	285	301	318	336	354	374
Medicare	114	128	142	158	176	196	218
Subtotal	381	413	443	476	511	550	592
Other Retirement and Disability							
Federal civilian[c]	37	38	40	42	45	50	55
Military	23	24	26	27	28	30	32
Other	4	5	5	5	5	5	5
Subtotal	64	68	70	74	78	85	91
Unemployment Compensation	25	33	26	25	26	26	27
Other Programs							
Veterans' benefits[d]	14	15	16	18	17	16	18
Farm price supports	10	10	12	11	10	10	10
Social services	6	5	6	5	5	5	5
Credit reform liquidating accounts	0	10	7	4	1	-5	-3
Other	13	11	12	10	8	9	10
Subtotal	43	53	54	47	41	35	41
Total, Non-Means-Tested Programs	514	566	593	622	657	697	750
		Total					
All Mandatory Spending, Excluding Deposit Insurance	636	708	752	798	848	903	977

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as nondefense discretionary spending, and Medicare premium collections as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Formerly known as guaranteed student loans.

c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

includes two related programs: the Hospital Insurance (HI) program, which covers certain costs of hospital stays and other institutional services used by elderly and disabled enrollees, and the Supplementary Medical Insurance (SMI) program, which primarily pays for services by physicians and other providers of ambulatory health care. Spending has been fueled in recent years by growth in the eligible population, by inflation in the medical sector that far outstrips general inflation, and by increases in the volume and complexity of medical care used by enrollees. But the patterns of growth for the HI and SMI programs have been quite different. After averaging 7 percent a year from 1975 to 1985, the real annual growth rate in spending per enrollee for HI dropped to less than 1 percent between 1985 and 1990. By contrast, real spending per SMI enrollee grew about 10 percent a year between 1975 and 1980, and continued at about 8 percent a year between 1980 and 1990. Growth in Medicare spending has persisted despite repeated legislative efforts to constrain it.

CBO's baseline spending for Medicare projects HI outlays rising at an inflation-adjusted rate of about 7 percent a year between 1992 and 1997, and SMI costs increasing at a real rate of 9 percent a year. ENT-33 through ENT-42 consider a variety of options to reduce payments to providers of medical services, and ENT-43 through ENT-48 discuss several ways to increase beneficiaries' payments.

Medicaid

Medicaid is a joint federal and state program that provides medical assistance for certain people with low incomes. Primarily, it covers participants in such income support programs as Supplemental Security Income (SSI) and Aid to Families with Dependent Children (AFDC), other participants who have somewhat greater incomes and high medical expenses, and selected groups targeted by recent program expansions, such as low-income children and pregnant women. Almost three-fourths of Medicaid spending goes to the aged and disabled, although they represent less than one-third of participants. Much of this money pays the costs of long-term care in nursing homes.

With projected federal outlays of $68 billion in 1992, Medicaid spending dominates other means-tested entitlement programs. Program outlays rose rapidly in the 1980s as a result of rising costs of medical care, greater use of covered services, and growth in the size of the eligible population. Under CBO's baseline, federal costs are expected to continue their rapid growth over the next five years. After rising in real terms by a staggering 26 percent between 1991 and 1992, federal Medicaid costs are estimated to reach $126 billion in 1997, an annual real increase of more than 9 percent between 1992 and 1997. At the same time, the states' share of Medicaid outlays are expected to climb from $51 billion to $95 billion, evidence of the strain the program places on these governments. ENT-29 and ENT-30 describe options that would reduce federal spending on Medicaid.

Means-Tested Entitlement Programs Other Than Medicaid

In addition to Medicaid, means-tested entitlement programs include Food Stamps; SSI for the aged, blind, and disabled; family support payments (primarily AFDC); pensions for needy veterans who are aged or disabled; child nutrition (such as the school lunch program); and the earned income tax credit (EITC). At more than $70 billion in 1992, spending on these programs represents about 10 percent of entitlement spending. In recent years, caseloads in the AFDC and Food Stamp programs have increased significantly while real AFDC benefit levels have declined. Federal spending for the refundable portion of the EITC--a federal program that benefits low-income working families with children--has risen from more than $1 billion in the early 1980s to almost $7 billion in 1992.

ENT-53 through ENT-58 and ENT-30 would reduce federal spending on certain means-tested programs by more narrowly targeting benefits and limiting federal payments for program administration.

Another means-tested entitlement is the Stafford Loan program, which subsidizes loans for students attending postsecondary educational institutions. While it is means-tested, this aid is not as sharply focused on those with low incomes as other means-tested entitlements. It is also less targeted than Pell Grants, the main discretionary program providing aid to postsecondary students. The apparent cost of Stafford Loans fell sharply between 1991 and 1992 as a result of a change in accounting practices brought about by credit reform. Henceforth, the annual budgetary cost of Stafford Loans--as well as that of other federal loan and loan guarantee programs--will consist of the present value of current and expected future subsidies on the loans that originate in a specific year.

After the 1992 drop, CBO's baseline projections for Stafford Loans show relatively steady program costs of about $3 billion through 1997. Expected costs are the result of relatively low projected interest rates and slow growth in the number of new borrowers. ENT-24 through ENT-26 would reduce the federal cost of Stafford Loans by reallocating a part of it to students and schools. ENT-27 would replace the present loan guarantee program with a direct loan plan.

Aid to Jobless Workers

Two entitlement programs that provide assistance specifically to unemployed workers are the federal/state Unemployment Compensation (UC) program and the federal Trade Adjustment Assistance (TAA) program. Spending on UC declined in the mid- and late 1980s but rose significantly in 1990 and 1991 because of the economic slowdown; spending will rise further in 1992 because of continued high claims and enactment of the temporary Emergency Unemployment Compensation program in November 1991. Federal TAA spending on income support and training for workers adversely affected by foreign trade is expected to be about $200 million in 1992.

CBO's baseline for the UC program projects relatively constant spending between 1993 and 1997. While lower unemployment is expected to reduce the demand for UC, increases in average benefits will tend to offset it. Federal spending on TAA is expected to decline slightly over the forecast period. Although Unemployment Compensation is included in the federal budget, most of the benefit and tax provisions in the regular state programs, which provide the vast majority of benefits, are set by state laws. Thus, states generally can offset federal options that would reduce regular UC spending, and permanent budgetary savings cannot usually be attributed to federal changes in regular UC rules. As a result, this chapter does not include federal options to limit regular UC benefits. ENT-52, however, does consider a reduction in the TAA program.

Farm Price Supports

Spending for farm price and income support programs administered by the Department of Agriculture's Commodity Credit Corporation (CCC) is projected to be $10 billion in 1992, down sharply from its peak of $26 billion in 1986. Reduced federal spending since 1986 reflects cuts in support rates and reductions in the amount of land on which payments are based. Rising commodity prices also contributed to the decline in spending.

CBO's baseline for these programs projects further reductions in spending after 1993. By 1997, CCC outlays are expected to be $1.6 billion below 1993 levels. Target prices are assumed to remain constant during this period; outlays decline mostly because commodity prices are projected to rise gradually. ENT-06 through ENT-12, ENT-16, and ENT-17 consider ways to reduce federal spending by lowering outlays for commodity programs and the crop insurance program. ENT-13

through ENT-15 would lower federal spending by cutting programs that subsidize or promote exports of farm commodities.

Non-Means-Tested Veterans' Programs

Veterans' benefits constitute another substantial category of federal entitlement spending. Non-means-tested spending for veterans' compensation, readjustment benefits, life insurance, and housing programs is estimated to total about $15 billion in 1992. Relatively slow growth in spending is projected between 1992 and 1997 under CBO's baseline. ENT-64 through ENT-66 would restrict federal spending on veterans' benefits by limiting eligibility for certain programs and raising costs to participants. In addition, ENT-63 would reduce Social Security disability payments for some of those also receiving veterans' compensation.

User Fees and Other Changes in Direct Spending

Fees can be charged to users of facilities or services provided by the federal government to raise funds to help pay for the facilities or services and to promote their more efficient use. Options describing new or increased fees in a variety of areas are included in this chapter (ENT-03, ENT-05, ENT-18 through ENT-23, ENT-40, ENT-57, ENT-58, and ENT-65). Receipts from fees would be treated under the Budget Enforcement Act like spending changes in entitlements or mandatory programs if, as is normally true for the latter programs, the legislation changing the fees originated in an authorizing committee. In this case, the added receipts from fees would be credited against the pay-as-you-go scorecard.

Some changes in fees in recent years, however, have been enacted through legislation originating in appropriations committees. If options in this volume were to be enacted in this way, the resulting spending changes for the budget year would be credited against the discretionary spending cap.

Options affecting two other programs--ENT-01, which would reduce subsidies provided by the Rural Electrification Administration, and ENT-02, which would effectively raise rates on federally provided hydroelectric power--are included in this chapter because the activities affected by the options stem from mandatory spending authority.

ENT-01 REDUCE SUBSIDIES PROVIDED BY THE RURAL ELECTRIFICATION ADMINISTRATION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	200	210	210	220	230	1,050
Outlays	30	70	130	170	200	590

The Rural Electrification Administration (REA), an agency within the Department of Agriculture, provides financial assistance to electric and telephone utilities that serve rural areas. To qualify initially for an REA loan, a borrower's service area could not contain more than 1,500 inhabitants. Most of the REA's borrowers that are electric utilities were established in the 1930s and 1940s, and most of the borrowers that are telephone companies were established in the 1950s. Many of the communities originally identified by the REA as rural areas are now much larger, but any utility that met the original service-area requirement can continue to receive REA assistance. The agency's borrowers serve about 10 percent of the nation's electricity consumers and about 4 percent of its telephone customers.

The federal government provides three major types of assistance to rural electric and telephone borrowers: direct loans by the REA at a statutory 5 percent rate of interest (2 percent before 1973); direct loans by the Rural Telephone Bank (RTB), which charges an RTB cost-of-money rate (currently about 6 percent); and guarantees by the REA for loans that are provided by such other lenders as the Treasury's Federal Financing Bank, which charges a government cost-of-money rate (currently about 7.5 percent).

In 1991, the REA approved direct loans of $672 million at the 5 percent rate, $177 million in RTB loans, and $850 million in new loan guarantees. The government incurs large budgetary costs from such lending activities. There are two reasons for that: the government's cost of money is significantly higher than the interest rates charged on direct RTB and REA loans; and there have been a few large defaults on REA-guaranteed loans. Under the credit reform procedures enacted in 1990, the budget now shows the estimated subsidy costs of federal loans and loan guarantees. For fiscal year 1992, the Congress enacted appropriations totaling $178 million to cover the estimated subsidies of REA financial assistance.

This option includes two possible actions. The first, increasing the interest rate on REA 5 percent loans and on RTB loans, would achieve budgetary savings by eliminating the need for subsidy appropriations for direct loans. The second, charging an origination fee for new loan guarantees to cover the risk of defaults on guaranteed loans, would achieve additional savings. Collecting such fees would eliminate the need for subsidy appropriations to the REA guarantee program.

Raise Interest Rates to Cover Treasury Cost of Borrowing. Eliminating the interest rate subsidy on direct loans, by raising rates to reflect the government's cost of borrowing for debt of comparable maturity, would save about $30 million in 1993 and $575 million over the 1993-1997 period. These savings would be realized only in the event that loan amounts are not increased dramatically--to a point at which defaults become more likely. (There have been very few defaults on REA 5 percent loans and RTB loans.)

Charge an Origination Fee on Loan Guarantees. Charging a fee of 1 percent on the amount of new loan guarantees provided by REA probably would be sufficient to cover the risk of defaults on such guarantees. The Congress could thereby avoid providing some $80 million in subsidy appropriations over the 1993-1997 period. Savings on outlays over that period would be about $15 million.

Carrying out both these actions would reduce outlays for the REA loan programs by about $590 million between 1993 and 1997.

The REA has largely fulfilled its original goal of making electric and telephone service available in rural communities. Yet many borrowers still depend on the low-interest REA loans to maintain and expand electric services to rural communities. Increasing the interest rate on those loans would raise the utility rates charged by REA borrowers, especially for the rural regions most affected. REA borrowers argue that they need interest rate subsidies to keep their service and utility rates comparable with those provided in urban regions. Raising the interest rate on new loans alone, however, would have little effect on the utility rates most borrowers charge their customers, since interest costs account for only a small percentage of the typical utility customer's bill.

With more than $16 billion in outstanding REA loans at rates of 5 percent and 2 percent, the additional interest cost for new loans of less than $1 billion a year would have only a small impact on customer rates. Similarly, although charging an origination fee on REA guarantees would eventually result in higher utility rates, the impact on individual customers would be small.

ENT-02 REQUIRE DEPARTMENT OF ENERGY TO RAISE RATES FOR FEDERAL HYDROELECTRIC POWER TO SPEED DEBT REPAYMENT

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	0	260	250	240	220	970

Hydroelectric power, generated at 129 plants owned and operated by the federal government, is sold by the Department of Energy (DOE) at wholesale rates to utilities for delivery to their customers and to certain large industrial electricity users in the Pacific Northwest. In 1990 these plants generated about 6 percent of the electricity sold in the United States, and DOE collected $2.9 billion from consumers. The cost of operating these systems was $2.2 billion in 1990. By law, the rate charged for electricity thus generated must be sufficient to recover the government's cost of operating and maintaining the facilities, as well as recouping the plants' construction cost plus interest. Under current regulations, however, DOE has great flexibility in determining when to collect power revenues to repay the outstanding debt on existing plants.

From the 1930s until 1990, the government appropriated $18 billion for the construction of hydroelectric projects and related facilities. The interest rate charged for the use of this appropriated construction money varied over the years, but averaged about 3 percent. Since 1933, the sale of federal hydroelectric power has generated $8 billion in interest and $4 billion in principal for the Treasury. The remaining debt of these federal hydroelectric projects is $14 billion.

Current regulations generally require that the cost of constructing federal power projects be repaid to the Treasury by the end of the project's useful life. DOE defers making any principal payments to the Treasury on many hydroelectric projects until 50 years after they have gone into service. By deferring principal payments on the debt of these federal hydroelectric facilities, the DOE increases the federal budget deficit.

Requiring DOE to repay the current hydroelectric debt of $14 billion (as well as future debt) with fixed annual principal and interest payments would increase Treasury receipts by about $1 billion over the 1993-1997 period. Regular annual principal payments would cause DOE to increase its electricity rates. CBO estimates that it would take DOE about 12 months to put into effect the electricity rate increases required under this proposal. Additional budget receipts would therefore start in 1994.

Even though applying a fixed repayment schedule as described would increase electricity prices for the consumers involved, rates in the Pacific Northwest would still rank among the nation's lowest. It has been argued that DOE needs the ability to defer principal payments to the Treasury because of the fluctuations in the water supply available for hydroelectric generation. Contingency funds or other mechanisms could be used to reduce the risk of revenue shortfalls. It should be noted that the Tennessee Valley Authority is also heavily dependent on hydroelectric power, but it has made annual principal payments on its outstanding Treasury debt since 1960. Granted, a fixed repayment schedule for DOE's debt to the Treasury would conflict with DOE's mandate to encourage the widest possible use of federal hydroelectric power at

the lowest possible cost. But the current policy of deferring debt until the end of a project's lifetime may lead to large "balloon" payments, and much higher electricity prices, in the future. In addition, today's lower electricity rates at federal hydroelectric projects--made possible, in part, by deferring principal costs--are inconsistent with the government's energy conservation objectives.

ENT-03 IMPROVE PRICING FOR COMMERCIAL AND RECREATIONAL USES OF PUBLIC LANDS

Addition to CBO Baseline	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Raise Fees on Hardrock Mining Claims	a	60	60	60	60	240
Raise Grazing Fees	10	15	30	30	30	120
Raise Charges for Federal Water	15	15	15	20	20	85
Raise Recreation Fees at Federal Facilities	170	180	190	200	210	950

a. Fees are not imposed until 1994.

The federal government owns and manages more than 700 million acres of land in the United States. These lands have a wide range of uses, including mining, grazing, and recreational activities. For most commercial and some recreational uses, the government is compensated by fees, royalties, and bonuses. Several of these compensation schemes may not provide the government with a fair return, and underpricing may lead to overuse. Better pricing could increase federal receipts, and alleviate overuse by limiting commercial and recreational activity.

Hardrock Mining Claims. Private access to public domain lands for hardrock mining (for example, the mining of gold, copper, and molybdenum) is controlled by the Bureau of Land Management (BLM). Under the Mining Law of 1872, the discovery of a "valuable mineral deposit" and the staking of a mining claim gives a prospector the right to mine and sell public domain minerals without paying fees or royalties to the federal government. The only condition is an annual expenditure of at least $100--a "diligence requirement"--to develop the claim. Moreover, under current provisions, public hardrock mining lands can be patented and allowed to pass into private hands for a fee of $2.50 to $5 an acre and, it is argued, without a thorough assessment of their alternative uses.

A bill has been referred to the Senate Energy Committee (S. 433) that would impose a holding fee on all inactive claims and, in the case of active mineral production, would substitute a federal royalty of not less than 5 percent of the gross income from the production of locatable minerals (and not less than the applicable holding fee). In the absence of active production, each claimant would pay a holding fee of $5 an acre during years one through five, $10 an acre in years six through 10, $15 an acre in years 11 through 15, and $20 an acre in each year thereafter.

A House bill (H.R. 918), referred to the House Committee on Interior and Insular Affairs, specifies a minimum expenditure schedule for the "diligent development" of each claim: $20 an acre in each of years one through five, $40 an acre in each of years six through 10, $80 an acre in each of years 11 through 15, and $160 an acre in each year thereafter. After the fifth full "diligence year," the claimant may elect to make direct annual payments in lieu of "diligent development," with the payment schedule beginning at $20 an acre in the sixth year and reaching a maximum of $80 an acre in the 16th year. The House bill includes a rental fee of not less than $1.50 a year, before the approval of a plan of operation, and not less than $5 a year

in all years following the approval of such a plan.

Although the budgetary effects of S. 433 and H.R. 918 have not been evaluated, the savings resulting from several changes in the current mining law have been estimated. The following amendments would free public lands of inactive claims and would raise an estimated $60 million annually, beginning in 1994. The fee schedules proposed in S. 433 and H.R. 918 could be increased to a flat rate of $1,000 a year (roughly the equivalent of the diligence requirement of $100 imposed in 1872). This fee would be paid directly to the Treasury beginning two years after a claim is staked. The patenting provision could also be revoked to prevent a rush of patent applications, which may occur under an imposed annual fee, although this revocation might raise certain legal questions. This revenue would partially compensate the federal government for the value of the minerals extracted and the cost of reclaiming abandoned sites.

Opposition to these amendments stems from arguments that any change in the current law reducing the prospector's expected return would significantly decrease overall prospecting, including that for strategic minerals important to national security. Although a $1,000 yearly fee would probably reduce prospecting and possibly some current mining, the effects might be somewhat offset by clearing inactive claims and opening the land they include to economically productive activities. In S. 433, a production royalty is proposed as a way for the government to extract a fair share of the rents from mining on federal land. A royalty system would be administratively expensive, however, since the BLM would have to estimate ore content and processing costs for approximately 150,000 active claims. In addition, the royalty may distort the claimant's production decisions. Because the royalty acts as a tax on production, it may lead to a reduction in output. H.R. 918 proposes a rental fee. The fee does not act as a tax on production, and its administration may be less costly than that of the royalty scheme.

Grazing Fees. The Forest Service and the BLM administer livestock grazing on approximately 268 million acres of public rangelands in the West. These lands provide ranchers with approximately 31,000 grazing allotments and, at current leasing rates, over 17.5 million animal unit months (AUMs) of grazing each year. In 1990, the appraised value of public rangeland in six western regions varied between $5.41 and $9.88 per AUM. The Forest Service spends, on average, $3.86 per AUM to manage its rangelands. By contrast, the 1991 permit fee was set at $1.97 per AUM under the fee formula established by the Congress. Thus the current fee structure may represent a large subsidy for many of the ranchers who participate in the program.

Various proposals have been introduced in the Congress recently to increase the grazing fee. These proposals would either adjust the fee-setting indexes to reflect livestock markets and private rangeland leasing rates, or replace the existing fee structure with a new modified market value. The increase in federal receipts resulting from either of these measures depends on the degree to which ranchers reduce the size of their grazing stock as a result of the increased fees.

The Regula amendment to H.R. 1096, the BLM authorization bill, as adopted by the House in July 1991, calls for an annual increase in the grazing fee not to exceed 33.3 percent a year, with the fee reaching fair market value over a period of four years. (The Senate did not adopt the House proposal, and it was not included in the final law.) The amendment calculates the fair market value using the appraised value of grazing lands in the lowest valued of the six western regions. If passed into law in 1992, the amendment would lead to an increase in federal receipts, measured against the baseline, of approximately $120 million over the 1993-1997 period. This figure is the amount that would be left in the Treasury after deducting the additional receipts that would be paid to states and counties as a result of the amendment, but it does not reflect any additional appro-

priations for range improvements that could result from the added receipts.

Increased fees for grazing on public lands may overstate the value of those lands when compared with private properties that might be in better condition or offer more favorable lease terms. In addition, low fees may encourage permit holders to invest in range improvements and to practice good stewardship over the land by grazing only at permitted levels. A potential disadvantage of increased fees is that they would cut ranchers' profit margins and thus might encourage them to break the grazing limits and forgo range improvements. Between 1979 and 1983, however, ranchers spent, on average, only 16 cents per AUM per year for range improvements. Increased funding from the Range Betterment Fund would offset any decrease in private range improvements. Providing ranchers with longer-term leasing agreements, regardless of their fee level, could promote efforts to combat overgrazing.

As an alternative to setting fees, grazing rights could be allocated through a competitive bid process similar to the system used by the Bureau of Indian Affairs. Disadvantages of this approach are high administrative costs and limited competition. In many cases, only the owners of private lands adjacent to federal lease tracts would be willing to bid for grazing rights. Permit holders do not normally have complete control over third-party access to the permit area. Thus, permit holders may hope to maintain control by owning and regulating the private lands that surround the lease tract. (In addition, current law requires permit holders to own a base property near the federal lease tracts.)

Water Sales. The Bureau of Reclamation provides water resources for industrial and agricultural uses in the western states and also supplies municipal water systems. This water is made available through long-term contracts with water-district commissions that are composed of individual private users. Water prices charged under these contracts generally run much lower than the true market value of the water. For many agricultural users, the charges rarely cover the federal costs associated with water projects. Federal water is often provided at less than its full costs for agricultural commodities, such as rice, that are subject to price support programs.

In recent years, the Congress has considered several reforms aimed at reducing the subsidy to agricultural users of federal water and at increasing receipts to the Treasury. One reform would require that all farms of more than 960 acres be charged the full cost of federal irrigation water. (Current law contains this requirement but is often circumvented because of the vague definition of the term "farm.") Another reform would allow those who grow agricultural commodities that are in surplus to receive only one of the federal subsidies currently provided: either crop price support payments or federally subsidized water. These two reforms illustrate changes in the current system that could increase federal receipts from water sales. Taken together, they could lead to increased receipts of $85 million over the 1993-1997 period.

Recreation Fees. All major federal landholding agencies allow recreational access and provide some visitor services. The services range from maintaining rough hiking trails to operating fully developed recreational facilities, such as campsites and marinas. Entrance and user fees are charged at some locations, but the fees generally cover only a small portion of the direct service costs. For example, in 1992, the National Park Service will spend an estimated $220 million on visitor services and will recover only $60 million in fees. Requiring land management agencies to charge fees to cover these direct costs would shift the cost burden to the beneficiaries of the services and would result in improved pricing of public land use. Such fees would lower net federal costs by $170 million in 1993 and by $950 million over five years.

Arguments against increased fees reflect the notion that the national parks and public lands are a vital and public part of our na-

tional heritage. The social benefits of visits to the parks--especially for the elderly and the poor--far exceed the government costs. Visits should thus be encouraged, not discouraged by increasing fees.

Under an increased fee structure, however, taxpayers would not have to bear costs for police protection and other similar services that benefit only the users. The overcrowding that is now a problem at many parks could be alleviated by an appropriate fee structure. And visits by the poor and the elderly could be encouraged by free-access days or the cross-subsidization of urban parks, by which fees collected at some parks would be used to offset the costs of maintaining others that have lower charges or none at all.

ENT-04 CHANGE REVENUE-SHARING FORMULA FROM A GROSS- TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	200	200	210	210	220	1,050
Outlays	190	200	210	210	220	1,050

The federal government owns more than 700 million acres of public lands--nearly one-third of the U.S. land mass. These public lands contain a rich supply of renewable and non-renewable natural resources: timber, coal, forage for livestock, oil and natural gas, and many nonfuel minerals. Private interests are given access to much of the federal land to develop the resources found there. Generally, private parties pay fees to the federal government based 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 forgone from the federal lands within their boundaries.

The government typically calculates the allotments to states and counties on a gross-receipt basis before taking account of its program costs. This practice has an important disadvantage: providing federal receipts-sharing on a gross--rather than a net basis--sometimes causes the federal government's program costs to exceed its share of receipts.

By law, the U.S. Forest Service allots 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, about 12.5 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the Department of the Interior, specifically the 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 these administrative costs.) On certain federal lands, specifically the Oregon and California grant lands, gross federal receipts from all commercial activities, primarily timber sales, are shared with the states and counties on a 50/50 basis.

Federal savings would be substantial if the Congress required these agencies to deduct their full program costs from their gross receipts before making payments to states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and would accrue receipt shares totaling about $700 million in 1993.

Certain federal costs would increase, however, under the federal Payment in Lieu of Taxes (PILT) program, which was established in 1976 to offset the effects of nontaxable federal lands on the budgets of local governments. These PILT payments to the states are partially reduced by the amount of revenue-sharing payments from federal agencies. Costs to the federal government under the PILT program would increase if the option to share the net program receipts was implemented. These costs have been netted out of the projected savings. Changing the revenue-sharing formula from a gross-receipt basis to a net-receipt basis would reduce net

federal outlays by $1.05 billion over the 1993-1997 period.

Changing the revenue-sharing formula to a net-receipt basis would, in all probability, have a negative impact on the economies of the respective states and counties. A significant source of revenue for some states and counties would be reduced. That reduction in revenues might lead to serious cuts in state and county spending. To help mitigate that hardship, the federal agencies could switch gradually to the net-receipt basis over a period of several years.

ENT-05 INDEX NUCLEAR WASTE DISPOSAL FEES FOR INFLATION

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	20	40	60	80	100	300

Electric utilities pay one mill (one-tenth of a cent) into the Nuclear Waste Fund for each kilowatt hour of electricity sold from a nuclear power plant. The fund finances the development of storage and permanent disposal facilities for high-level radioactive wastes; the first permanent repository is scheduled to open in 2010. The fee has remained constant since its inception in 1983, although the price level (measured by the gross national product deflator) has risen 33 percent since then. Based on current CBO projections, indexing the fee for inflation would raise $300 million over five years.

The primary arguments in favor of this proposal are that the current fee may be insufficient to finance the necessary disposal facilities, especially because its value is eroded over time by inflation; and that indexing equitably allocates the costs between present and future operators of nuclear power plants. A June 1990 study by the General Accounting Office argued that historically plausible inflation and real interest rates (4 percent and 3 percent, respectively) could produce a present-value shortfall of $2.4 billion in 1988 dollars--roughly 10 percent of total system costs--if the fee remains fixed.

Against automatic indexing, the Energy Department argued in a November 1990 report that recent revenue estimates show the fund roughly in balance; that given present levels of uncertainty, the fund may in fact be collecting too much money; and that occasional "step" adjustments in the fee, introduced as new information is acquired, would be a better way to avoid any problems of under- or overfunding.

ENT-06 REDUCE DEFICIENCY PAYMENTS TO FARMERS PARTICIPATING IN USDA COMMODITY PROGRAMS BY LOWERING TARGET PRICES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	440	1,550	2,150	3,200	5,950	13,250
Outlays	440	1,550	2,150	3,200	5,950	13,250

Producers of wheat, corn and other feed grains, rice, and cotton who participate in federal commodity programs receive a deficiency payment, the primary form of direct government payment to farmers. The size of the deficiency payment is calculated in part from the difference between the market price of a crop and a target price. The table on the next page shows the target prices set by current law through the 1995 crop year. The CBO baseline assumes that target prices are maintained at these levels for the 1996 and 1997 crop years.

Budgetary savings could be achieved by reducing target prices in the years after 1992. The greater the rate of reduction, the greater would be the savings. One alternative, shown in Table 5, would be to reduce target prices by 3 percent per year starting with the 1993 crops. Outlay savings would be an estimated $13.3 billion over the 1993-1997 period.

An advantage of reducing target prices is that it would increase the degree to which farmers respond to market prices, rather than to government program benefits, in making their production decisions. U.S. competitors and trading partners view deficiency payments as trade-distorting. Target price reductions would be seen as evidence of an intention to reduce the effects of domestic farm policies on world trade in agricultural commodities, a goal of the United States in the General Agreement on Tariffs and Trade talks.

Lower target prices would reduce farm income by reducing direct government payments. Farm income would not fall as much as government outlays because some farmers would choose not to participate in the commodity programs. Although these farmers would give up all of their government payments, they would not be required to idle part of their acreage and thus would generate income from additional production. With additional grain production, livestock producers might benefit from lower feed costs.

Despite an improved outlook for agricultural markets, many farmers are still facing financial difficulties. In some cases, financial problems were worsened by droughts in recent years. Further reductions in target prices would intensify these difficulties. Providing financial assistance directly to needy farmers might, however, be more appropriate and would certainly be more cost-effective because the bulk of deficiency payments go to larger, usually wealthier, farmers.

Table 5.
Target Prices Under CBO Baseline Assumptions and Under 3 Percent Annual Reductions (By crop year)

	1992	1993	1994	1995	1996	1997
			CBO Baseline Assumptions			
Wheat	4.00	4.00	4.00	4.00	4.00	4.00
Corn	2.75	2.75	2.75	2.75	2.75	2.75
Rice	10.71	10.71	10.71	10.71	10.71	10.71
Cotton	0.729	0.729	0.729	0.729	0.729	0.729
			3 Percent Annual Reductions			
Wheat	4.00	3.88	3.76	3.65	3.54	3.43
Corn	2.75	2.67	2.59	2.51	2.43	2.36
Rice	10.71	10.39	10.08	9.77	9.48	9.20
Cotton	0.729	0.707	0.686	0.665	0.645	0.626

SOURCE: Congressional Budget Office.

NOTE: Wheat and corn in dollars per bushel; rice in dollars per hundredweight; cotton in dollars per pound.

ENT-07 ELIMINATE THE 0/92 AND 50/92 PROGRAMS FOR PARTICIPANTS IN USDA COMMODITY PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	190	490	400	270	370	1,700
Outlays	190	490	400	270	370	1,700

Current law allows participants in U.S. Department of Agriculture (USDA) price and income support programs to receive 92 percent of their deficiency payments, even though they may plant as little as 50 percent of their eligible acreage in the program crop (the 50/92 program available to cotton and rice producers), or even though they do not plant any of the program crop (the 0/92 program available for wheat and feed grain producers). Producers must leave the land idle or, under certain conditions, may plant minor oilseeds such as sunflower, flaxseed, and canola. This option would eliminate these programs. Producers would have to plant the program crop to receive deficiency payments. In the 1991 crop year, about 12.1 million acres that went unplanted to the program crops received payments under the 0/92 or 50/92 programs.

Eliminating these programs would save $1.7 billion over the 1993-1997 period. This estimate assumes that the Secretary of Agriculture would increase the acreage reduction program requirement for each supported crop if it was anticipated that eliminating the 0/92 and 50/92 programs would increase plantings. Participation in the acreage reduction program, in which producers agree not to plant a portion of their eligible land in the supported crop, is voluntary and unpaid. Producers must participate, however, to receive deficiency payments and other program benefits.

Eliminating these programs (and maintaining production at a given level by increasing the acreage reduction programs) would in effect substitute unpaid acreage reduction for paid acreage reduction. The Secretary of Agriculture has considerable discretion to increase unpaid acreage reduction requirements under the current outlook for program commodities, and proponents of this option would argue that there is no need to pay farmers to cut acreage. The 0/92 and 50/92 programs were introduced at a time when unpaid acreage reduction requirements were high, and the Secretary had little discretion to increase them.

Those who are against eliminating these programs would argue that such a move would constitute "recoupling" program benefits with planting decisions, encouraging farmers to plant some land that might better be left idle from the perspective of market returns alone. Others would point out that these programs are a safety net for farmers who cannot plant their program crops because of poor weather conditions during planting time. Sign-up periods for the 0/92 and 50/92 programs extend well past normal planting times. Other forms of disaster assistance may be more appropriate in these cases, however.

ENT-08 REPLACE DEFICIENCY PAYMENTS IN THE WHEAT, FEED GRAINS, COTTON, AND RICE PROGRAMS WITH DECLINING DIRECT PAYMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	110	280	240	260	250	1,150
Outlays	110	280	240	260	250	1,150

In recent years, a number of proposals have been offered that would "decouple" or separate farm support payments from the volume of crop production. The ultimate goal of decoupling is to reduce government influence on production decisions and to increase the responsiveness of farmers to market signals. Current farm programs incorporate some aspects of decoupling.

One way of decoupling income support from production decisions would be to make direct payments to producers based on their production histories. In such a program, payments would be made to participants irrespective of current market prices. Anyone now participating in the commodity programs could opt to participate in the new direct farm income support program. The actual payment rate would be expressed per unit of historical output and could be set at any level. The rates assumed in this option were chosen so that total annual payments are 4 percent less than annual direct payments projected in the CBO baseline for crop years 1993 through 1997. This assumption, of course, assures savings relative to the current baseline. Price supports, as currently provided by the Commodity Credit Corporation's nonrecourse loans, would no longer exist in a decoupled program. (A low-cost recourse loan might be considered to facilitate farmers' marketing decisions.) Likewise, acreage controls other than the Conservation Reserve Program would be phased out. Export programs could be maintained as a bargaining tool for negotiations to liberalize international trade.

The direct farm income support program would have several advantages. This decoupled program would avoid the excess production and inequities across crop types characteristic of the current program. U.S. farm policy would thus move toward conformity with this country's negotiating position in the General Agreement on Tariffs and Trade talks. In addition, most studies indicate that a decoupled agricultural policy would produce a relatively small but significant improvement in the overall performance of the U.S. economy. This improvement is considered to be the result of a more efficient use of resources than now takes place in farming. Finally, a decoupled program increases the predictability of agricultural budget costs.

Decoupling would not be without its disadvantages. Many farm groups have voiced hostility to decoupling, which they characterize as farm welfare. Further, a decoupling program like the one discussed in this option would simply lock in the current distribution of benefits, which has been criticized as inequitable. Also, the impact that decoupling would have on agriculture is not clear. While decoupling might make more land available for production as well as increase efficiency and output, it would probably result in a net outflow of resources from agriculture, leading to lower production and higher prices. Most analysts feel that aggregate farm income would fall under a decoupling program and that landowners could experience losses on the value of their property.

ENT-09 RAISE THE PROPORTION OF EACH FARMER'S BASE ACREAGE INELIGIBLE FOR DEFICIENCY PAYMENTS FROM 15 PERCENT TO 25 PERCENT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	410	960	910	810	890	4,000
Outlays	410	960	910	810	890	4,000

Outlays of the Commodity Credit Corporation would be reduced by cutting the number of acres eligible for deficiency payments. Currently, wheat, feed grains, cotton, and rice producers who participate in commodity programs receive a deficiency payment. The size of the deficiency payment is generally equal to the difference between the target price for the commodity and its market price times the program yield assigned to the farm, times "payment acres." Payment acres equal 85 percent of the farm's crop acreage base, less land idled to comply with the acreage reduction program that is in effect for the crop during that crop year.

This option would expand the changes made in the Omnibus Budget Reconciliation Act of 1990 by decreasing the amount of land eligible to receive deficiency payments from 85 percent of base acreage to 75 percent of base acreage. Producers would be permitted to plant any program crop or oilseed on this additional unpaid acreage without losing eligibility for future program benefits. These changes would be introduced both to reduce program spending and to increase the flexibility that farmers have to make planting decisions in response to the needs of the market rather than the rules of the farm programs.

A disadvantage of this option is that it would decrease farm income for most participants of commodity programs and for people raising crops that do not directly receive federal support. Program participants would generally shift production away from program crops on land no longer earning subsidies and toward alternative crops. As a result of these changing production patterns, incomes of growers of nonprogram crops would be hurt by the new competition.

ENT-10 RESTRICT ELIGIBILITY FOR BENEFITS FROM PRICE SUPPORT PROGRAMS AND REDUCE THE PAYMENT LIMITATION

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Limit Payments to $50,000 per Person					
Budget Authority	70	170	150	160	160	710
Outlays	70	170	150	160	160	710
	Limit Payments to $40,000 per Person					
Budget Authority	130	320	270	300	290	1,300
Outlays	130	320	270	300	290	1,300
	Disqualify People Whose Adjusted Gross Income Exceeds $100,000					
Budget Authority	30	80	70	80	70	330
Outlays	30	80	70	80	70	330
	Disqualify People Whose Gross Revenue from Commodity Sales Exceeds $500,000					
Budget Authority	70	180	150	170	160	730
Outlays	70	180	150	170	160	730

Current law limits participants in crop price support programs to no more than $100,000 in deficiency payment benefits from the Commodity Credit Corporation during any crop year. The maximum in deficiency payments that can be received is $50,000 for an individual, plus $25,000 as a shareholder in a maximum of two corporate farms (each of which is entitled to a maximum payment of $50,000). The maximum of $100,000 can be achieved only by those who are actively engaged in the operations of relatively large farms and who have organized their farm businesses to maximize government payments.

Government costs could be reduced by allowing each farm operator to receive only the individual payment and eliminating the two corporate farm payments. This option would reduce spending by an estimated $710 million during the 1993-1997 period. Outlays could be cut further by reducing the maximum direct payment from $50,000 to $40,000, with estimated savings totaling $1.3 billion over the 1993-1997 period.

Eligibility for payments could also be limited on the basis of income or gross sales. Disqualifying people with adjusted gross income from all sources over $100,000 would save an estimated $330 million over the five-year period. Disqualifying people with gross revenues from commodity sales over $500,000 would save an estimated $730 million over the period.

Support for these changes could be based on the belief that current payment limits are too high. If reductions in program spending are required, they should come from relatively large farming operations rather than relatively small ones. In addition, reducing the limit on direct government payments would reduce their influence on the production decisions of operators of large farms, causing them to be more responsive to market returns. Operators of smaller farms, who are more likely to need government assistance, would continue to receive program benefits as before.

This change could harm relatively efficient-sized farm operations. In addition, until operating and price subsidies are reduced for producers in foreign countries, increasing the exposure of the most efficient U.S. farmers to market forces could hurt long-term prospects for the farm sector. Finally, the ability of farmers to reorganize their holdings to avoid the payment limitations increases the uncertainty of the estimated budgetary savings as well as the effect on farmers.

ENT-11 ELIMINATE THE PRICE SUPPORT PROGRAM FOR WOOL AND MOHAIR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	0	0	190	190	200	570
Outlays	0	190	190	200	200	760

The federal government makes direct support payments to U.S. producers of wool and mohair. The support price for shorn wool produced in 1990 was $1.82 a pound, and the market price averaged about $0.80 a pound. Total payments to wool producers for 1990 production, which were made in the spring of 1991, amounted to $100 million. Total payments to mohair producers for 1990 production, which are calculated like wool payments, were about $59 million. This option would eliminate these programs beginning with the 1993 marketings, resulting in savings of $760 million over the 1993-1997 period.

Critics of the wool and mohair program claim that it is no longer needed. Originally this program was meant to encourage increased production of wool, which was considered a strategic material when direct payments were first authorized in 1954. Wool is no longer a strategic material. Moreover, in a March 1990 study, the General Accounting Office (GAO) found that the program does not greatly encourage production of wool or improve its quality. Wool payments supplement the market returns of wool producers and help stabilize their incomes. Consumers benefit little. Even if the program encouraged greater domestic production, domestic prices would not change substantially because they are largely determined by the world market.

The GAO study was critical of the mohair program primarily because it has no clear legislative objectives. Only in the past several years have payments become significant enough to attract attention to the program. Mohair payments were infrequent and relatively small before 1981. They were made in only eight years during the 1955-1980 period. But a combination of higher support prices and weakening market prices have made payments significant from the mid-1980s to the present.

Mohair is a specialty fiber, of very little significance in relation to all U.S. fiber use, and has never been considered strategically important. By contrast with wool, 90 percent or more of U.S. mohair production is exported. Like wool program payments, mohair payments supplement producers' incomes. Unlike wool, however, if program payments encouraged an increase in mohair output, mohair prices could fall because U.S. production is important in world markets.

The distribution of program payments is also an issue raised by critics of both programs. In a 1989 study, the Congressional Research Service reported that 41 percent of the program payments went to only 1.5 percent of sheep growers. Mohair payments show a similar pattern.

Defenders of the wool and mohair programs argue that the payments are necessary to maintain a healthy domestic industry. They also argue that the payments contribute significantly to the economic survival of some rural areas and to the incomes of many farmers and ranchers, including Native Americans. Moreover, the program encourages lamb production, thus lowering meat prices for consumers.

ENT-12 ELIMINATE THE HONEY PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	20	20	a	a	a	35
Outlays	20	20	a	a	a	35

a. Less than $2.5 million.

The federal government supports honey producers by subsidizing the price of honey. Under a marketing loan program, producers pledge their honey as collateral for a federal loan at the rate of 53.8 cents per pound. The loan can be repaid, and the collateral redeemed, at the market price or the loan rate, whichever is lower. The loan repayment rate for the 1991 marketing year is estimated to average 45 cents a pound, which means that U.S. production is subsidized by an average of about 8.8 cents a pound for the year. This option would eliminate the honey program, yielding savings of $40 million over the 1993-1997 period.

Critics of the program, including the General Accounting Office, claim that price supports are no longer necessary to provide crop pollination services, one of the original motivations for the program. Critics also point to the relatively small number of beneficiaries; there are only 2,000 commercial beekeepers in the United States.

Supporters of the honey program claim that it is vital to the economic survival of many beekeepers, and that many types of crops, including commercial cash crops, would suffer if the number of bee colonies dropped significantly.

ENT-13 REDUCE LOAN GUARANTEES MADE UNDER THE USDA'S EXPORT CREDIT PROGRAMS, AND ELIMINATE LOANS TO ESPECIALLY RISKY BORROWERS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	-45	410	420	450	400	1,650
Outlays	-45	410	420	450	400	1,650

The U.S. government guarantees short- and intermediate-term loans made by commercial banks to finance foreign purchases of U.S. agricultural commodities and products. Legislation requires that a minimum of $5.5 billion in loan guarantees be made annually, although actual levels of guarantees have been lower. There is no limit on the total amount of guarantees, but there is a requirement that borrowers be creditworthy. The purpose of these programs is to encourage exports of U.S. goods. Credit terms, in addition to price, are an important element of competition in world markets.

When a foreign buyer misses a loan payment, the bank making the original loan submits a claim to the U.S. Department of Agriculture. The USDA reimburses the bank, takes over the loan, and attempts collection. The U.S. government guarantees 98 percent of the principal of the loan, except loans to the former Soviet Union. In these loans, the government guarantees 100 percent of the principal. During one credit offering in 1990, no U.S. bank was willing to extend credit to the Soviet Union with less than a 100 percent guarantee because of the high risk of default.

This option would limit annual guarantees to $4.5 billion--about $1 billion less than assumed in the baseline. The estimate of savings assumes that the entire reduction would derive from lowering the value of loan guarantees for sales to the former Soviet Union, which is now considered to be the world's most risky borrower receiving guarantees. This change would reduce outlays by more than $1.6 billion over the 1993-1997 period.

Proponents of reducing guarantees of credit would argue that they are overused and potentially extremely costly. The benefits of the first several billion dollars in guarantees--in terms of export promotion--may be substantial, but the net benefit diminishes, particularly since the additional guarantees are extended to countries that are at high risk of default.

Opponents of reducing credit guarantees argue that they are vital in retaining the U.S. share of competitive world markets. Opponents also argue that these guarantees are an important part of necessary aid to the republics of the former Soviet Union; during 1991 they are expected to receive $2.5 billion in guaranteed credit. Some supporters of more aid to these republics, however, would prefer that they be given grain, rather than sold it with money loaned at high risk of default. In addition, wheat and corn producer groups believe that total exports and prices that they receive for their crops would be sharply lower without these credits.

ENT-14 ELIMINATE THE EXPORT ENHANCEMENT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	310	740	670	640	610	2,950
Outlays	310	740	670	640	610	2,950

The U.S. Department of Agriculture (USDA) subsidizes the export of agricultural commodities through the Export Enhancement Program (EEP). U.S. exporters participating in EEP negotiate directly with buyers in a targeted country, then submit bids to the USDA for cash bonuses. The bids include the sale price, tentatively agreed to with the buyer, and the amount of the subsidy or bonus requested by the exporter.

Since its inception in 1985, more than $4.4 billion in EEP bonus payments have been made, mostly to assist wheat exports. The CBO baseline assumes that $4.5 billion in additional subsidy payments will be made during the 1993-1997 period. Eliminating the program would save nearly $3 billion during this period.

One disadvantage of eliminating the program is that it has been somewhat effective in increasing U.S. exports above the level they would otherwise have reached. In addition, one of the underlying motivations for the EEP has been to encourage competitors, particularly the European Community, to negotiate reduced subsidies in trade negotiations currently being conducted under the General Agreement on Tariffs and Trade (GATT). Unilateral elimination of the EEP would deprive U.S. negotiators of a bargaining chip in the GATT negotiations.

It is not clear, however, how much the program has increased U.S. grain sales. It has depressed world commodity prices. Competitors such as Australia and Argentina, which do not subsidize their exports, have been adversely affected by lower world prices even though they did not cause the United States to resort to export subsidies. The two biggest recipients of subsidized grain sales under EEP are the People's Republic of China and the republics of the former Soviet Union. Finally, many critics question the usefulness of EEP in advancing the agricultural trade negotiations in GATT.

ENT-15 ELIMINATE THE MARKET PROMOTION PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	100	200	200	200	200	900
Outlays	100	200	200	200	200	900

The Market Promotion Program (MPP) was authorized under the 1990 Food, Agriculture, Conservation, and Trade Act to assist U.S. agricultural exporters, particularly when they face unfair trading practices abroad. Payments are made to offset partially the costs of market building and commodity promotion undertaken by state-related, private nonprofit, and private profit-making firms. The MPP continues the Targeted Export Program, which was aimed mainly at specialty crops such as fruits and nuts, but has also targeted wine, plywood, tobacco, feed grains, meat, eggs, and several other agricultural products for promotion. The current CBO baseline assumes that $200 million would be obligated annually for the program in the 1993-1997 period. Eliminating this program would reduce outlays by $900 million over the next five years.

An argument for reducing MPP funding is that the assisted groups benefit directly from the market development activities and thus should bear the full costs. In addition, marketing funds are provided through other Department of Agriculture activities, such as the Cooperator Program of the Foreign Agricultural Service. Activities promoting exports of nonagricultural goods do not receive similar support. Therefore, why should agribusiness be singled out for this type of federal aid?

Eliminating the MPP could place U.S. exporters at a disadvantage in international markets. Those concerned about U.S. exports of high-valued agricultural products consider the program to be a useful tool for developing markets for these products.

ENT-16 REDUCE COSTS FOR THE DAIRY PRICE SUPPORT PROGRAM BY REQUIRING PRODUCER CONTRIBUTIONS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	140	230	250	270	280	1,150
Outlays	140	230	250	270	280	1,150

The incomes of dairy producers are protected and increased through the purchase of storable dairy products by the U.S. Department of Agriculture's (USDA's) dairy price support program. Their incomes are further supported by marketing orders, which set minimum prices for milk going to various uses. The dairy industry is also protected from foreign competition by quotas on imports of dairy products.

Consumers may benefit because the dairy price support program helps to stabilize prices of milk and milk products. Some needy families, schools, and other institutions gain through the free distribution of dairy products that are purchased by the USDA. The program raises the prices of dairy products, however, and thus consumer costs, above the levels they would reach without government intervention.

One method of reducing the costs of dairy programs would be to increase the assessments levied on dairy farmers' production. During calendar year 1991, farmers were assessed $0.05 per hundredweight. By law, this assessment rose to $0.1125 per hundredweight in January 1992. Increasing assessments to $0.25 per hundredweight starting in January 1993 would save an estimated $1.2 billion over the 1993-1997 period.

This method of reducing dairy program costs would be straightforward and relatively easy to administer. Many dairy producers would favor this approach to cutting program costs over alternatives such as reductions in federal price supports. A cut in the price support level for milk would cause a drop in the price that both consumers and the government pay for milk and milk products. Government purchases account for a relatively small portion of the total dairy market. Thus, in order to generate a significant amount of savings, the price cut would have to be relatively large. By contrast, an assessment would apply to the marketing of all milk. Therefore, a relatively small assessment would generate significant savings. As a result, the income of dairy farmers would be reduced less by the assessment than by a cut in support prices generating similar budgetary savings.

Raising these assessments, however, would reduce the net incomes of dairy farmers. Furthermore, the dairy industry would be paying part of the costs of federal government purchases of dairy products, much of which are used in domestic food assistance programs. Some would argue that this assistance should be paid for by the taxpayer rather than the dairy industry.

ENT-17 END THE FEDERAL CROP INSURANCE PROGRAM AND REPLACE IT WITH STANDING AUTHORITY FOR DISASTER ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	890	630	640	650	670	3,500
Outlays	270	620	640	650	660	2,850

NOTE: Savings include reductions in both direct spending and discretionary appropriations.

The federal government has offered crop insurance through the Federal Crop Insurance Corporation (FCIC) to farmers for many years to protect them against losses caused by natural disasters. This insurance is heavily subsidized. The government pays all administrative costs, subsidizes farmers' premium payments, and covers losses in excess of premiums. Even with this program in place, the government in recent years has reacted to crop shortfalls caused by drought and other natural factors by providing cash or in-kind disaster assistance. The Congress enacted legislation providing such assistance in 1986, 1988, 1989, and 1991.

Participation in the federal crop insurance program has grown in the past few years, but it still covers less than half of the nation's eligible acres. Consistently low participation rates have, in part, encouraged enactment of the laws providing disaster assistance because so many farmers had no other protection. Some farmers may not have participated in the insurance program because they believed they would be covered by disaster assistance. And in fact, outlays for disaster assistance exceeded indemnity payments under the crop insurance program during the 1980s. Between crop years 1981 and 1989, the federal government paid $6 billion for ad hoc disaster assistance and $3.1 billion for FCIC net indemnity payments.

This option would end federally subsidized crop insurance offered through the FCIC and replace it with federal disaster assistance. Under this program, the Commodity Credit Corporation would make disaster payments to producers operating in counties with actual average harvested yields below 65 percent of the county's normal yield. Once a county was declared eligible, individual farmers would receive disaster payments for any shortfall in their own harvested yield below 60 percent of that county's normal yield.

Such a program structure would reduce expected federal outlays, compared with the current crop insurance program, primarily because it would provide benefits only in the case of sharp losses, and then only if the county, rather than just the individual, suffered significant losses as well. The program could be structured to save more or less with stricter or more lenient eligibility rules. A disadvantage of this option is that individual producers who use the current crop insurance program to control the risks they face in farming would no longer have that option.

The figures in the table contain both direct spending and discretionary savings. The crop insurance fund, which makes payments to satisfy farmers' crop loss claims, is categorized as direct spending because it is governed by

law rather than by annual appropriations. The administrative expenses of the crop insurance program are categorized as discretionary spending because they are controlled by annual appropriations.

The estimates of savings under this option assume that the crop insurance program ends with the 1993 crops. Savings from eliminating the crop insurance program are partly offset by costs of disaster assistance, which is estimated at $300 million per crop year.

ENT-18 AUCTION LICENSES TO USE THE RADIO SPECTRUM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	1,700	1,800	0	0	0	3,500

The Federal Communications Commission (FCC) is responsible for assigning licenses to private parties that use the radio spectrum. Recently, both the Congress and the Administration have considered making available additional licenses to provide land-mobile communications services. If enough appropriate spectrum--a band of 30 megahertz (MHz) to 50 MHz below 2200 MHz--were made available to create two additional licenses, a spectrum auction is estimated to generate $3.5 billion over the 1993-1997 period. This estimate is subject to considerable uncertainty; actual revenues could vary by $2 billion or more. The receipts would be scored as revenues or offsetting receipts, depending on how the option was applied. Depending on the specific frequencies allocated for private use, applying the policy could require new federal expenditures to relocate displaced federal users of the reallocated spectrum.

Currently, holders of licenses who use the radio spectrum do not pay (beyond an application fee) for the right to exploit the spectrum. Uses include traditional radio and television broadcasting as well as newer commercial areas, such as cable television, satellite and microwave communications, and cellular telephone and paging services. Technical progress continues to make possible a greater variety of spectrum uses. These uses require more spectrum than can be accommodated by current allocations (the designation of frequencies for a class of service) and assignments or licenses (the designation of specific frequencies for use by particular parties). Making available new allocations for land-mobile communications services, which would allow licensees to emulate the success of cellular telephone providers, is widely recognized as a high-value use of the spectrum. Many private firms would be likely to bid for these new licenses. How much they would bid is less certain, since major questions about the way bidders perceive technology, competition, and regulation can only be answered in an actual auction. The uncertainty about these factors accounts for the wide range from which the $3.5 billion estimate is drawn.

Until 1982, the FCC allocated the spectrum through an administrative hearing process that compared the relative merits of contending applicants. In 1982, responding to criticisms that the hearing process was too long and too costly for the government and did not demonstrably serve the public interest, the Congress permitted the FCC to experiment with assigning portions of the spectrum by lottery to all participants capable of meeting minimum eligibility criteria. Currently, the FCC employs both comparative hearings and lotteries for allocating non-mass-media licenses.

Initiating an auction process to assign new licenses for the radio spectrum, analogous to that used for oil-drilling rights on the Outer Continental Shelf, offers advantages in addition to federal revenues. Under most circumstances an auction would ensure that new licenses would go to the users that value them most. An auction process would decrease the

cost to the government of assigning licenses and assign them more quickly than either the comparative hearing or lottery alternatives. Since an auction process need not include changes in licensee requirements or in the rights of the licensee, the FCC's role in guarding the public interest would not be compromised.

According to critics, the principal disadvantage of an auction process is that it may preclude small, less wealthy applicants--for example, local telephone cooperatives--from expanding their use of the spectrum. The financial strength of large firms, however, is already a determining factor in the hearing process (given regulatory and legal expenses) and also in the lottery process (given the secondary market for spectrum allocation that it creates). Public-sector users--such as police, fire, and other emergency providers--have expressed concern that an auction process, with its revenue-raising potential, would lead the Congress to transfer too much of the public spectrum to private use and ultimately leave the public with too small an allocation.

A disadvantage of an auction process as a deficit reduction measure is that it would not provide a stable, continuous inflow of revenues, since conditions in the telecommunications market do not require that new allocations and assignments be made on an annual basis. Some future revenues could be expected, however, if technological change created profitable uses for other parts of the spectrum or if the Congress made available to the private sector those portions of the spectrum currently reserved for public use.

ENT-19 IMPOSE A ROYALTY PAYMENT ON COMMUNICATIONS USERS OF THE RADIO SPECTRUM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	1,500	1,600	1,800	1,900	2,000	8,800

This option would institute royalty payments on scarce portions of the radio spectrum used for private communications. To retain their licenses, private users of the electromagnetic spectrum who earn revenues from generating or relaying a signal would be charged an annual royalty payment equal to 4 percent of their gross revenues. Royalty payments by major communications users of the electromagnetic spectrum could raise $8.8 billion between 1993 and 1997. This estimate does not take into account reductions in income tax revenues. The receipts from these royalty payments could be considered tax revenues or offsetting collections, depending on the form of the enacting legislation.

The Communications Act of 1934 established the public nature of the radio frequency spectrum. The Federal Communications Commission (FCC) allocates frequencies to private users through a variety of licensing procedures. Although the FCC already charges user fees to cover the cost of the application and licensing process, license holders have profited from using this scarce public resource without compensating the public. Establishing a royalty payment would be consistent with federal policy in other areas--for example, petroleum production on the Outer Continental Shelf.

Since 1979, proposals have been made in the Congress to charge users of the radio spectrum. These legislative proposals would charge a royalty payment based on a market's population and number of license holders. This payment structure was designed to reflect the size and competition level of local markets. Basing the payment on gross revenues, however, would also reflect these conditions. Some experts have advocated charging license holders on the basis of the amount of spectrum they are assigned in relation to the intensity with which they use their portion. This approach is conceptually more effective in encouraging spectrum conservation than a gross royalties fee, but it is more difficult to implement.

Arguments for a royalty payment emphasize the public nature of the radio spectrum and its role as a key unpriced factor in the production of communications services. The prices paid for licenses in the private market are indicative of the value of this public resource. Many holders of FCC licenses producing communication services earn higher-than-average profits, or economic rents, through their use of this public resource. In these circumstances, royalty payments to the government would leave the economic efficiency of service providers unaffected. Combining a spectrum fee with policies that allow license holders increased flexibility in choosing which services to provide to consumers could increase economic efficiency.

Arguments against a royalty payment note that the radio spectrum had little or no value at the time most spectrum licenses were issued. The economic value of the resource was created only by the efforts of spectrum users and, thus, the public should not benefit. Regarding economic rents, the federal income tax already secures a portion for the govern-

ment. In addition, in the many cases where licenses have been sold by one private party to another, the buyer has already paid the original licensee for expected rents. Moreover, a royalty payment based on a formula is likely to capture only the average level of rents in the affected industries, permitting some licensees to continue to earn above-average profits. A final general objection to a royalty payment is that license holders in some markets will increase their prices and pass the payment along to consumers.

ENT-20 CHARGE FOR EXAMINATIONS OF STATE-CHARTERED BANKS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	200	280	280	290	300	1,350

State-chartered banks regulated by the Federal Deposit Insurance Corporation (FDIC) could be charged to cover the cost of examining them. Such other depository institutions as thrifts, credit unions, and nationally chartered banks currently pay these costs. Charging the roughly 7,000 state-chartered banks to recover the full supervisory costs of the FDIC would increase offsetting collections to the FDIC, thereby reducing outlays by as much as $300 million each year when fully implemented. Savings from this option would not be counted in meeting the implementation requirements of the Budget Enforcement Act because spending related to meeting current deposit insurance commitments is excluded from those requirements.

Bank supervision consists of monitoring an institution's behavior and exerting informal pressure, often through the examination process, to modify behavior in a manner conducive to regulatory standards of safe operation. Examiners evaluate a bank's financial condition, review its compliance with laws and regulations, and survey its soundness of operation. As a part of its supervisory function performed in relation to insured state banks that are not members of the Federal Reserve, the FDIC examines such banks regularly to determine their condition for insurance purposes.

The Federal Deposit Insurance Corporation Improvement Act of 1991 authorizes, but does not require, the FDIC to charge for examination expenses. Currently, the FDIC charges all insured banks a uniform insurance assessment. Its member institutions are assessed an annual insurance premium of 23 cents per $100 of qualifying deposits. Insurance assessments are paid semiannually. With an administration already in place to handle them, it would be relatively easy to add a provision to recover examination costs. Implementation by January 1993 should be feasible.

A disadvantage of this option is that it may force marginal banks to fail. The banking industry has been weakened by structural change as well as the deleterious effects of an economic recession. Such additional costs as examination charges could bring more bank failures and, by extension, increase losses to the Bank Insurance Fund. How much additional costs would influence bank failures depends, in part, on the ability of banks to pass these costs along to customers.

Imposing new charges might encourage some state-chartered banks to apply for membership with the Federal Reserve or to apply for a national charter, depending on the costs of meeting requirements for other agencies, the relative costs of membership, and services provided. These estimates assume that the number of state-chartered banks examined by the FDIC is relatively constant over the period. The figure does not account for bank failures or a change in the supervisory responsibilities of the three federal agencies.

ENT-21 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	300	300	300	300	300	1,500

The Congress considered imposing charges in fiscal year 1990 for the use of slots for taking off or landing at the four airports where the Federal Aviation Administration (FAA) has established capacity controls: Kennedy International and La Guardia in New York; O'Hare International in Chicago; and Washington National in the District of Columbia. That proposal would have required the FAA to raise $239 million through these charges for fiscal year 1990. An alternative measure would be to establish similar slot charges at the FAA-controlled airports on a permanent basis with a target of $300 million in annual receipts. These receipts could be generated by auctioning the slots among the commercial airlines that use the airports. Receipts could be greater if this option were extended to other airports or if slots now reserved for commuter carriers and general aviation were also included in the auction.

Takeoff and landing slots were instituted in 1968 to control capacity and were allocated without charge by the FAA. A total of about 3,600 air carrier slots exist, with an additional 1,400 commuter and general aviation slots at the four FAA-controlled airports. Airlines are currently allowed to buy and sell slots among themselves, with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules on their use at any time. These slots have value because the demand for flights exceeds the capacity of the airports and of the air traffic control system at certain times.

The main argument in favor of establishing charges for slots is that since the slots reflect the right to use scarce public airspace, airports, and air traffic control capacity, private firms and individuals should not receive all the benefits of this scarcity. They should share it instead with the public owners of these rights. Further, the charges would serve as incentives to put these scarce resources to their best use.

The main argument against this proposal is that the scarcity of slots at these airports arises principally from a lack of land and runway space; these fees are not intended to provide increased capacity. Further, if the current prices paid by airlines in the private sale of slots already accurately reflect their value, then a better allocation of these scarce resources might not occur as a result of this proposal. Only a redistribution of the benefits from their use between the private sector and the public would result.

A further argument against implementing the proposal at this time is that new fees would worsen the already bleak financial condition of the airline industry. The airlines have had to contend recently with both rising fuel prices and a decline in passenger demand. In addition, aviation taxes were increased by 25 percent in fiscal year 1991.

ENT-22 ESTABLISH USER FEES FOR AIR TRAFFIC CONTROL SERVICES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	700	1,450	1,550	1,650	1,700	7,050

The Federal Aviation Administration (FAA) manages the air traffic control system (ATC), which serves commercial air carriers, military planes, and such smaller users as air taxis and private planes. Services provided include air traffic control towers that assist planes in takeoff and landing, air route traffic control centers that guide planes through the nation's airspace, and flight service stations that assist smaller users. The FAA has more than 16,000 air traffic controllers as well as sophisticated software to perform these tasks. The total cost of operating, maintaining, and upgrading the ATC system was about $4.7 billion in 1991.

Currently, about half of FAA operations are financed through annual appropriations from the general fund, whereas revenues from aviation excise taxes are used for a variety of purposes: facilities and equipment, research engineering and development, and such non-ATC activities as airport improvement.

If users paid the marginal costs the ATC incurs on their behalf, the deficit would be reduced by about $700 million in 1993 and $7 billion over the 1993-1997 period. This assumes that the new charges would be levied in the middle of fiscal year 1993.

Users would be charged according to the number of facilities they used on a flight and the marginal costs of their usage at each facility. The various classes of users would be affected differently. Smaller users, such as general aviation users, would experience comparatively greater increases in the cost of flying than larger users, such as commercial airlines.

Levying efficient fees presumably would oblige users to moderate their demands. Small users who are required to pay these costs would cut back on their consumption of ATC services, freeing controllers for other tasks and increasing the overall capacity of the system. An additional benefit of efficient fees is that, on the basis of user response, planners can judge how much new capacity is needed and where it should be located.

The main argument against this option is that flying could become too costly for some general aviation users, causing demand for small airplanes produced in the United States to decline.

ENT-23 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	350	360	380	390	410	1,900

The Corps of Engineers spent about $800 million on the nation's system of inland waterways in 1991, according to CBO estimates. Expenditures for operation and maintenance (O&M) totaled about $300 million; construction outlays, about $500 million. 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. Revenues from the tax currently fund about 20 percent of federal outlays for inland waterway construction. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover the cost of O&M outlays for inland waterways would reduce the federal deficit by $350 million in 1993 and $1.9 billion during the 1993-1997 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

The advantage of this option is the beneficial effect of user fees on efficiency. Reducing subsidies to water transportation should improve resource allocation by leading 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 in large measure on whether the fees were set at the same rate for all waterways or according to the cost of each segment. Since costs vary dramatically among the segments, systemwide fees would offer far weaker incentives for cost-effective O&M spending. In 1988, for example, O&M costs on the inland waterways ranged from less than 50 cents per 1,000 ton-miles on the lower Mississippi River (between the Ohio River and Baton Rouge) to about $140 per 1,000 ton-miles on the Allegheny River. A systemwide fee of $1.69 per 1,000 ton-miles would recover all O&M outlays but would do little to ration use of the system. Fees set for specific segments, by contrast, could substantially change waterway use. A Department of Transportation study found that fees to recover even 50 percent of all federal outlays (both O&M and construction) would close four out of 12 waterway segments for lack of traffic.

An argument in favor of federal subsidies is that they may promote regional economic development. Assessing user fees would limit

this promotional tool. Reducing inland waterway subsidies would also lower the income of barge operators and grain producers in some regions, but these losses would be small in the context of overall regional economies.

ENT-24 REDUCE INTEREST SUBSIDIES FOR STAFFORD LOANS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Require Students to Pay In-School Interest					
Outlays	600	890	910	930	930	4,250
	Raise Students' Interest Rates After They Leave School					
Outlays	60	95	95	95	95	440
	Raise Students' Interest Rates and Accrue Interest During the After-School Grace Period					
Outlays	210	330	340	360	360	1,600
	Reduce Lenders' Subsidies by 1 Percentage Point					
Outlays	160	270	310	330	340	1,400

The Stafford Loan program authorizes the federal government to guarantee loans for postsecondary students against default. The program pays the interest while students are enrolled in school plus a portion of the interest after students begin repaying their loans. Lenders receive a rate of return that varies with market interest rates and is equal to 3.25 percentage points plus the rate of interest on 91-day Treasury bills. Because students do not begin repayments on Stafford Loans until after they leave school, and because they repay loans at fixed interest rates that are generally below market rates, they receive a substantial subsidy from the federal government. Lenders are also subsidized because the rate they are guaranteed exceeds the lowest rate at which most would probably be willing to lend in the program. (See ENT-27 for a proposal to achieve savings by replacing Stafford Loans with direct loans.)

In 1990, interest payments on loans to students attending school (net of a 5 percent student-paid origination fee) plus special allowance payments on outstanding loans (which pay lenders the difference between the interest rates students pay and current market interest rates) accounted for 70 percent of the cost of the Stafford Loan program. Default payments net of collections equaled 27 percent, and other costs equaled 3 percent. In recent years, interest payments have fluctuated as interest rates changed, and default costs have grown substantially. The options presented below suggest ways subsidies for students and lenders could be reduced.

Require Students to Pay In-School Interest or Raise Students' Interest Rates After They Leave School. Federal subsidies could be reduced by requiring students to repay larger amounts than they do under current law. Charging interest on loans to new borrowers while they are in school, but deferring actual payments until they leave school, would reduce federal outlays by $4.3 billion between 1993 and 1997 if the 5 percent student-paid origination fee, which is used to offset federal interest subsidies, were eliminated at the same time.

Alternatively, raising the interest rates of new borrowers after they leave school to the

full amount of interest the government now pays to lenders, but continuing the interest subsidy to students while they are in school (which would include the current six-month grace period during which students can defer repaying), would reduce federal spending by $440 million during the 1993-1997 period and by considerably more in future years. A variation of this option would also require new borrowers to begin accruing interest on their loans immediately after leaving school, but would allow a grace period of six months before the first payment is due. This approach would save about $1.6 billion over the 1993-1997 period.

These measures would not cause cash flow problems for students while they are in school because students would be allowed to defer interest payments during that period. With the added costs generally occurring only after leaving school--when borrowers would be better able to afford them--most students would still be able to continue their educations. The larger repayments that would result from these changes might, however, cause some students not to attend school or to limit their choices to lower-priced institutions.

Reduce Lenders' Subsidies. A reduction of 1 percentage point in the yield on loans (currently 3.25 percentage points greater than the 91-day Treasury bill rate) would lower federal spending by a total of $1.4 billion during the next five years and by substantially more in future years.

Reducing lenders' subsidies would lower federal expenditures without increasing students' costs. Moreover, although some people argue that reducing the special allowance to lenders while borrowers are in school would limit the availability of loans for many students, this fear is probably overstated. During 1989, the 100 largest lenders--making up fewer than 1 percent of all lenders--disbursed about 75 percent of all loans. Although a few small lenders might leave the program if the special allowance were reduced, large lenders currently receive a subsidy worth significantly more than the costs they incur (including the small risk they bear related to defaults on loans), and they would remain in the program. However, if this option made most loans unprofitable for lenders in a few locations, students in those areas could have more difficulty arranging the financing of their educations.

Reducing lenders' subsidies could also be done in conjunction with raising the interest rate paid by borrowers. Cutting the interest paid to lenders by half a percentage point and requiring students to pay half of their in-school interest, for example, would lead to substantial savings while distributing the impact between students and lenders.

ENT-25 REQUIRE POSTSECONDARY INSTITUTIONS TO SHARE THE RISK OF DEFAULTS ON STAFFORD LOANS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Define the Allowable Default Rate as a One-Year Rate						
Outlays	150	160	160	160	160	770
Lower the Allowable Default Rate to 20 Percent Over Three Years						
Outlays	190	200	200	190	180	950
Lower the Allowable Default Rate to a One-Year Rate of 20 Percent						
Outlays	310	310	310	310	310	1,550
Require Postsecondary Institutions to Pay a Loan Default Fee						
Outlays	140	190	180	170	140	800

In recent years, the volume of defaults in the Stafford Loan program has grown as the number of borrowers in repayment has increased dramatically. In 1990, default payments net of collections equaled $1.0 billion, or about 27 percent of the total cost of the program, up from 18 percent of the total cost in 1980. To reduce these costs, the Stafford Loan program no longer allows students attending schools that have default rates of 35 percent or more in each of the three previous years to take out loans. This cutoff will be reduced to 30 percent beginning in 1993. Historically black colleges and universities and tribally controlled community colleges are exempt from the requirements until July 1994. The options presented below suggest ways to lower the federal costs of defaults by further reducing the allowable default rate and by having postsecondary institutions share the financial risk of defaults on Stafford Loans.

Further Restrict the Allowable Default Rates for Schools. One way to tighten these standards would be to define the default rate cutoff as only the previous year's default rate, as is done in the Supplemental Loans for Students program, rather than use the default rate in each of the three previous years. Doing so would save an estimated $150 million in 1993. A second approach would be to decrease the threshold--to 20 percent, for example--without changing its calculation. This option would save an estimated $190 million in 1993. Combining these options would save about $310 million in 1993. The savings over the 1993-1997 period from the three approaches would be $770 million, $950 million, and $1.6 billion, respectively. (These estimates are contingent on preventing operators of disqualified schools from regaining eligibility by a name change or similar device.)

Proponents of these approaches argue that the current restrictions still allow schools with excessive default rates to remain in the program, leading to higher federal costs and poor educations for their students. Opponents argue that schools with high default rates are often those that serve a disproportionate number of low-income students--students who are more likely to default, even when the program is of high quality--and that the default rate is a poor measure of which schools are pro-

viding inferior programs. In this case, these options would unfairly penalize some schools that offer useful programs.

Require Postsecondary Institutions to Pay a Loan Default Fee. Another option would be to charge postsecondary institutions a sliding annual fee related to the percentage of loans entering repayment on which their students default. In this option, institutions with default rates above 10 percent would have to pay a fee set at 25 percent of the value of defaults of their former students in excess of the first 10 percent of defaults. This alternative would raise an estimated $800 million over the 1993-1997 period.

An advantage of this option is that it would provide institutions with strong incentives not to overstate the economic benefits that students will derive from their educations and to ensure that their students are aware of their obligation to repay loans. A disadvantage is that this approach could create financial stress or lower profits for some postsecondary institutions having high default rates--for example, proprietary schools, many of whose disadvantaged students take out loans.

ENT-26 REQUIRE POSTSECONDARY INSTITUTIONS TO PAY A CO-ORIGINATION FEE ON STAFFORD LOANS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	330	490	500	510	510	2,300

The federal government pays the interest on Stafford Loans while the borrowers are enrolled in school. In addition, it pays a portion of the interest after students leave school and begin repaying their loans. To help pay for the interest costs, 5 percent of the value of the loans is deducted as an "origination fee" from the amounts the students receive. This amount is remitted to the federal government. Requiring postsecondary institutions to pay the federal government a 5 percent co-origination fee on the amount of loans taken out by their students would raise an estimated $2.3 billion in the 1993-1997 period.

The primary argument for sharing in the costs of the program is that postsecondary institutions benefit directly from these loans, which enable students to attend schools costing more than they could otherwise afford. Some schools with limited financial resources might, however, shift these costs to students by reducing the amount of financial aid they provide or increasing their tuitions.

ENT-27 REPLACE STAFFORD AND SLS LOANS WITH DIRECT LOANS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	1,300	1,350	1,450	1,450	1,500	7,050
Outlays	900	1,350	1,400	1,450	1,500	6,600

NOTE: The savings include the present value of the special allowance paid to lenders, which would be eliminated in a direct loan program, offset by the present value of the long-term administrative costs that the federal government would incur in administering a direct loan program. Current law does not allow long-term federal administrative costs to be included on a present-value basis in official cost estimates. In addition, official cost estimates must report pay-as-you-go savings (for example, from eliminating the special allowance) separately from discretionary spending (for example, from increased administrative costs).

Under the Stafford Loan program and the Supplemental Loans for Students (SLS) program, the federal government guarantees lenders against loan defaults by postsecondary students. These federal loan programs are complex and involve more than 8,000 postsecondary institutions, about 9,000 lenders, 46 state or nonprofit guaranty agencies, and 35 institutions in the secondary market.

Students generally apply through their schools to borrow from commercial banks. Lenders must obtain prior approval for loans from guaranty agencies, which guarantee the loans against default and monitor lenders and schools for compliance with program rules. The Department of Education reinsures guaranty agencies for loan defaults if program requirements are followed. Lenders may retain loans until repaid, or sell them in secondary markets to others to hold and service.

A significant portion of the federal cost of these guaranteed student loans comes from subsidies paid to lenders over the life of the loan. Other major costs include loan default claims and interest paid in behalf of students while they are in school. The subsidy paid to lenders--known as the special allowance--is intended to encourage their participation in the program and ensures that they earn a rate of return equal to 3.25 percentage points above the rate of interest on 91-day Treasury bills (before administrative costs are deducted). (See ENT-24 for a proposal to achieve savings in the current guaranteed student loan program by reducing the special allowance.)

The option presented here would replace these guaranteed loans with direct federal loans. Savings would be achieved primarily as a result of not paying the special allowance, offset by the added cost of having the federal government (rather than banks and other organizations) service the loans. An estimated $900 million would be saved in 1993, assuming that all other features of the programs affecting students were retained. The savings could be larger (or smaller) if interest rates rose above (or fell below) currently projected levels.

Savings achieved by replacing guaranteed loans with direct loans would appear in the federal budget because the Federal Credit Reform Act of 1990 has improved the budgetary accounting, control, and management of federal credit programs, allowing more consistent treatment of guaranteed and direct loans. This law requires that the costs of loan subsidies be separated from the unsubsidized cash flows entailed in making loans, and that only the subsidies be included in the federal

budget. The entire subsidy for a given loan is included on a present-value basis in the year the loan is made. The law also stipulates that long-term federal administrative costs are not to be included on a present-value basis in budget estimates. The net savings reported in the table, however, include the present-value estimates of these long-term administrative costs to facilitate comparison with the guaranteed student loan program.

Under this option, acting as agents of the Department of Education, postsecondary institutions would originate and disburse student loans using federal capital raised by issuing Treasury securities. The department would contract with private firms to service and collect the loans. Commercial lenders, guaranty agencies, and secondary markets would not be needed for new loans, but because more than $50 billion in loans made under existing legislation are outstanding, parts of the current system would have to remain in operation until currently outstanding loans were repaid.

Advocates of a direct student loan program argue that it would involve fewer participants and be easier to manage. The primary parties would be the Department of Education and postsecondary institutions. It would thus be easier to oversee the program. In addition, a direct loan program would be simpler for students and parents to deal with. An application for a loan could be handled on the same form as an application for a Pell Grant. Collections could be made through a single agent, and loans would not be resold on the secondary market, as they are now, which sometimes causes students to lose track of whom they must repay.

Opponents of a direct loan program think that the Department of Education is not capable of administering such an enterprise. They say that the department has neither the expertise nor the staff needed to ensure that the roughly 3.5 million students who borrow annually would continue to get their loans without disruption. In addition, direct lending would impose significantly greater administrative burdens and responsibilities on postsecondary institutions. Many schools do not want these responsibilities, and others are not capable of exercising them. Opponents also fear that a direct loan program would foster more fraud.

ENT-28 LIMIT THE GROWTH OF FOSTER CARE ADMINISTRATIVE COSTS TO 10 PERCENT PER YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Budget Authority	85	170	260	380	520	1,400
Outlays	65	150	240	350	480	1,300

The federal foster care program, authorized under Title IV-E of the Social Security Act, is an open-ended entitlement program that provides federal matching funds to assist states in providing foster care to children who meet certain eligibility requirements. In 1993, the program is expected to serve about 250,000 children on average each month at a federal cost of $2.9 billion. Administration will account for about 45 percent of that total. Each state administers its own program within the federal mandates established in Title IV. The federal government reimburses states for one-half of certain administrative costs, including those for determining eligibility, certain preplacement services, and child placement services, as well as administrative overhead.

Policymakers have been concerned about the rapidly escalating costs for administration. Such costs (adjusted for inflation) increased from less than $50 million in 1981 to more than $450 million in 1989.

This option would limit annual increases in payments to each state for administrative costs to 10 percent a year, reducing federal outlays, measured against the CBO baseline, by $65 million in 1993 and by about $1.3 billion in the 1993-1997 period. During the 1980s, costs increased much more rapidly than caseloads. At some point in the past decade, many states' administrative costs increased sharply. In about one-half of the states, the annual increase in such costs per child exceeded 1,000 percent in at least one year, supporting the theory that much of the growth resulted from changes in states' methods for claiming funds rather than from expanded services to children.

It might not be advisable to slow the growth in federal funding to child welfare agencies now, however, when these agencies are struggling to deal with rising reports of child abuse and neglect. A 10 percent limit, given projected annual growth in total administrative costs averaging 14 percent, would represent a significant cut. If states responded to the restriction by cutting back services, children in need of foster care could be harmed. Limiting the percentage increase that each state could receive would also lock in the current differences in costs per child. In 1989, average federal costs per child for Title IV-E administration ranged from less than $100 a month in eight states to more than $500 a month in five states and the District of Columbia.

ENT-29 TIGHTEN MEDICAID'S ESTATE-RECOVERY PROCESSES AND RULES FOR LONG-TERM CARE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	75	150	250	400	450	1,350
Outlays	75	150	250	400	450	1,350

Federal Medicaid spending in 1991 included $11.8 billion for nursing facility care. People cannot qualify for such assistance unless they satisfy Medicaid's income- and asset-test provisions, which are meant to ensure that people use their own resources to purchase care before qualifying for Medicaid assistance. Subject to certain restrictions, states have the authority, and sometimes the obligation, to take into account the asset transfers undertaken to achieve Medicaid eligibility; to place liens on the property of institutionalized Medicaid beneficiaries so that Medicaid payments on their behalf can be recovered; and to recover the costs of care from the estates of deceased recipients.

If prospective Medicaid beneficiaries dispose of their assets for less than fair market value, they are ineligible for nursing home care financed by Medicaid for the time (up to 30 months) during which the uncompensated value of the transferred assets would have covered the average cost of private nursing home care. The disqualification does not apply in certain circumstances, including transfer of the applicant's home or other resources to specific categories of close relatives. In addition, people may keep sufficient private assets to pay for 30 months of nursing home care, transfer the balance of their assets to others, and qualify for Medicaid-financed nursing home care 30 months later.

Partly in response to attempts to circumvent the policy governing transfers of assets and partly in order to recover more of Medicaid's current costs for nursing home care, the Inspector General of the Department of Health and Human Services proposed several changes in Medicaid's rules regarding estate recoveries and processes. (See Department of Health and Human Services, Office of Inspector General, *Medicaid Estate Recoveries*, June 1988.) These changes would reduce Medicaid's ultimate liability for the costs of nursing home care while, in certain circumstances, enabling close relatives of someone admitted to Medicaid-financed nursing home care to continue using assets, such as a house, that they had shared with the admitted person.

Based primarily on the Inspector General's recommendations, this option would strengthen transfer-of-asset rules to restrict further the giving away of property to qualify for Medicaid. It would also encourage state Medicaid programs to protect dependent or incompetent recipients and their property from financial exploitation by relatives. In addition, this option would require, as a condition of Medicaid eligibility, a legal instrument to secure property owned by recipients for later recovery, and it would allow a lien to be placed on the home of a Medicaid recipient if the state determined, subject to a fair hearing, that the person could not reasonably be expected to be discharged from the medical institution and to return home. The option would also require states to operate Medicaid estate-recovery programs and would allow states to recover from an individual's estate the amount of benefits that had been received before age 65. Furthermore, it

would allow recoveries from the estates of a spouse or dependent adult child who had inherited or received assets from a Medicaid beneficiary or who retained assets that the beneficiary and his or her relatives had owned jointly. Carrying out the option would save $75 million in 1993 and $1.3 billion over the 1993-1997 period, and substantially more in the future.

Changing the estate-recovery processes and rules would have two main advantages. First, it would reduce Medicaid spending as more people used private resources to defray their nursing home costs, and as Medicaid payments for long-term care services were recovered from the estates of beneficiaries. Second, lien programs could enable relatives who might otherwise have sold a beneficiary's home to pay for long-term care to buy this care instead at Medicaid rates and still retain use of the house during their lifetimes.

One disadvantage of this option, for those who do not support a welfare approach to public financing of long-term care, is that it would make means-testing more, rather than less, stringent. In doing so, it would selectively curtail the inheritance of wealth, affecting only the heirs of people who develop a need for long-term care. In addition, more effective estate-recovery processes and rules might make it financially appealing for relatives of a person needing nursing home care to discourage that person from seeking it. Also, carrying out this option might prove difficult because of differences among states in laws governing liens, estates, and inheritance.

ENT-30 COMBINE FUNDING TO STATES FOR THE COSTS OF ADMINISTERING AFDC, MEDICAID, AND FOOD STAMPS INTO A SINGLE INDEXED GRANT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	500	830	1,200	1,600	2,050	6,150
Outlays	500	830	1,200	1,600	2,050	6,150

The Aid to Families with Dependent Children (AFDC) program provides cash assistance to low-income families with children in which one parent is absent or incapacitated, or to families in which the primary earner is unemployed. The Medicaid program provides medical assistance to low-income people who are recipients of Supplemental Security Income (SSI), current or recent recipients of AFDC, and certain other low-income people. The Food Stamp program provides coupons redeemable for food to low-income households to enable them to buy a nutritionally adequate low-cost diet.

The federal government pays half of most administrative costs in all three programs; state and local governments pay the remaining share. Higher matching rates have been instituted for some types of expenses as an incentive for local administrators to undertake more of a particular administrative activity than they would if such expenses were matched at 50 percent. For example, enhanced matching rates are applied in all of these programs to the costs of some computer operations and some antifraud activities.

The administrative activities matched at higher rates currently represent a relatively small proportion of all administrative costs in the Food Stamp and AFDC programs, but constitute a larger share of Medicaid administrative costs. In the Food Stamp and AFDC programs, administration mainly consists of determining eligibility and benefit amounts. In the Medicaid program, however, determining eligibility represents a relatively small share of administration, since the AFDC and SSI programs largely carry out this function. Consequently, activities that are matched at higher rates--including the costs of automated claims processing, reviewing medical and health care use, and establishing and operating a fraud control unit--constitute a much higher percentage of Medicaid's administrative costs.

This option would set all administrative matching rates for AFDC, Food Stamps, and Medicaid at 50 percent in 1993; thereafter, it would combine the administrative funding for the three programs into a single grant whose growth would be indexed by the fixed-weighted gross national product deflator. Federal outlays would be reduced by $500 million in 1993 and by $6.1 billion over the 1993-1997 period. About 87 percent of the savings would be in Medicaid, 9 percent would be in AFDC, and the remaining 4 percent would be in the Food Stamp program.

Reducing the higher matching rates to 50 percent might be appropriate to the extent that the need to provide special incentives for these activities no longer exists. For example, all state Medicaid programs already have established computer systems and are currently operating units to control fraud and abuse. Providing the administrative funds as a block grant would also enable states to manage these funds more effectively.

States might respond to this option by reducing their administrative efforts, however, and might thereby raise program costs and offset some of the federal savings. Specifically, AFDC and Food Stamp benefits might increase if errors or fraud occurred more often in spite of the penalties states already face when errors exceed a certain rate. States might also make less effort to eliminate waste and abuse in payments to providers under Medicaid. In addition, this proposal might harm recipients by encouraging states to slow the growth of benefits over time or to limit services provided under Medicaid in order to constrain total state costs.

ENT-31 PREFUND THE GOVERNMENT'S SHARE OF FEDERAL RETIREES' HEALTH INSURANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	a	2,950	4,300	4,350	4,350	15,950

a. The option takes affect in 1994.

Upon retirement, more than 80 percent of federal workers elect to continue their employer-provided health insurance coverage under the Federal Employees Health Benefits (FEHB) program. The federal cost of continued protection, averaging 69 percent of annual premiums, is not recognized until a worker retires, when it is financed on a pay-as-you-go basis. Instead, the government could fund its share of annuitants' premiums in advance by annually investing a scheduled amount to cover, with interest, the cost of future benefits earned for work performed during the year (current service charge) and a portion (one-twentieth per year) of the cost of earned benefits that have already accumulated as a result of the prior service of active and retired employees. The scheduled amounts would be paid by individual employing agencies and deposited into the governmentwide FEHB fund. (Instead of prefunding, the President's budget proposes certain upward adjustments in the pay-as-you-go charges required of the Postal Service under the Omnibus Budget Reconciliation Act of 1990.)

The changes this option poses resemble changes emerging in the private sector's financial management of health care benefits. The Financial Accounting Standards Board (FASB), the private body that sets financial reporting standards, now recommends that statements of corporations recognize liability for postretirement health care. Moreover, nearly 70 percent of the large firms in a 1991 survey had adopted some form of prefunding or may do so in the future. As in the private sector, prefunding health care for annuitants and their dependents would shift recognition of employer costs for such deferred compensation from the years of retirement to the years of active employment. The accrual accounting under this option, like that for deferred compensation earned under the Federal Employees' Retirement System, would allow better management of human resources and improve the recognition of government operating costs.

In general, the recorded deficit would not be changed by adopting this proposal, because the increased agency payments would simply represent transactions from one account to another within the budget; they would neither increase or decrease net federal spending nor generate offsetting income from the public. But the option's coverage of government enterprises (like the Postal Service, the Tennessee Valley Authority, and various public power administrations) would reduce federal budget deficits in the near term. These agencies would incur higher current costs; assuming the higher cost of current operations was recouped through increases in postage and utility rates, the deposits to the health benefits fund would decrease the budget deficit.

Estimated decreases over five years from this option could total nearly $16 billion. Almost all of the savings would derive from the U.S. Postal Service, which is highly labor intensive and which would need to incorporate the new costs into the next postage rate hike, assumed to occur in February 1994. For estimating purposes, the new scheme would apply to other agencies at the beginning of

1994, and appropriate adjustments would need to be made in amounts requested for appropriation.

Critics point out that calculating future liabilities for annuitant health insurance is highly complex and uncertain. Because FEHB costs and benefits are currently under intensive review by the Administration and the Congress, it also seems ill-advised and premature to enact financing reform at this time. The accounting practices in the private sector, moreover, need not apply unambiguously to most governmental operations that, unlike the mail service, are not self-financing.

In addition, postal and public utility customers would probably claim that prefunding places an unfair burden on users of mail and power service simply to improve the near-term cash flow of the U.S. Treasury. Such burdens have already been levied as a result of recent enactment of various changes, including annuitant health care financing on a pay-as-you-go basis. The prefunding option could increase postage rates for letters by nearly 3 cents on top of forthcoming increases. It would also, because of the high price, initially reduce total demand for all types of mail service by about 2 percent from projected volume. This loss of business would come at a time when the Postal Service is experiencing financial difficulty brought on by other cost requirements and a softening of demand for its services because of the nation's economic troubles.

The FASB rules for "pay-as-you-earn" accrual costing do not apply to firms participating in a multiemployer plan. In these cases, the participating employer simply pays the amount billed by the plan each year. The Postal Service claims the FEHBP is akin to such a plan and thus the current pay-as-you-go scheme is the appropriate approach. Others feel that individual agencies are related employers under the central policy direction of the federal government. As such, the government should assign annuitant health care costs on an "as earned" basis (including interest and transition obligations) to the subsidiary entities that deliver services, especially those with operations, such as delivery of the mail, that are intended to be largely self supporting. Postal Service managers, however, believe such treatment would place their organization at a great disadvantage because, unlike other single-employer plans, it would not have control over the costs and benefits for annuitant care. Some accountants argue, however, that "pay as-you-earn" charges could be appropriately applied whether the FEHB is a single or multiemployer plan. Failure to do so subsidizes today's operations at the expense of future customers and possibly taxpayers.

Finally, it should be noted that this proposal--although it would reduce the deficit in the initial years--would not save the federal government much money over the long term. For one thing, the total costs for annuitants' health benefits would not change. In the case of the Postal Service, moreover, the proposal would change only the timing of certain receipts, forcing current postage ratepayers, rather than future ones, to pay the full costs of services received. In the case of utilities, however, the shift would result in some small savings to taxpayers because public utility ratepayers currently cover none of the cost of health benefits for retired utility workers.

ENT-32 REFORM THE FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM BY MODIFYING HOSPITAL REIMBURSEMENT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	0	120	300	560	710	1,700
Outlays	0	120	300	560	710	1,700

The Federal Employees Health Benefits (FEHB) program provides health insurance coverage for about 4 million federal employees, retirees, and their survivors at a yearly cost to the government of about $7 billion. Reforming hospital reimbursement, as described below, would reduce such costs and thus lower federal outlays through 1997 by an estimated $1.7 billion. The savings result from a gradual reduction in the rate of increase allowed for hospital costs. To realize the budgetary savings, more than one-fourth of which would come from national defense functions, the Congress must reduce agency funding accordingly. (In order to allow time for carrying it out, this estimate assumes that the new reimbursement system would begin to take effect for the FEHB contract year beginning January 1994. Savings would be realized from a 5 percent reduction in hospital payment rates in 1994, a 10 percent reduction in 1995, and a 15 percent reduction from baseline rates thereafter. The estimates exclude amounts paid by the U.S. Postal Service because such costs are paid by mail users instead of taxpayers.)

FEHB insurance carriers pay hospitals in two principal ways: some on the basis of actual charges, and others on the basis of predetermined rates that have been negotiated with the hospitals and reflect certain discounts. An alternative reimbursement system could require carriers to use a prospective payment system patterned after the one instituted in 1987 by the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS) for military dependents and retirees. The military program modified the diagnosis-related group (DRG) payment schedules used by Medicare to reflect the health care needs of younger patients. Under a modified DRG system, hospitals receive a fixed payment per case based primarily on a patient's diagnosis and adjusted for certain hospital characteristics that affect the costs of treating him or her on the basis of that assessment. The size and timing of premium reductions would depend on rate negotiations with more than 400 FEHB insurance carriers. Savings realized under this prospective payment system eventually would allow for lower premium payments by both the federal government and enrollees. The reductions realized from 1994 through 1997 could save postal and nonpostal enrollees about $600 million.

In 1990, the Congress required preset payment limits for insured hospital stays for the relatively small group of federal retirees who are over age 65 but who are not covered by Medicare. The President's budget proposes legislation to extend predetermined rates for physician and related services under Medicare Part B. For enrollees with Medicare, the budget also anticipates certain new cost-sharing arrangements, such as copayments for prescription drugs, that can be adopted under current law.

With few exceptions, such as the Washington, D.C., area, FEHB enrollees represent a relatively small portion of hospital cases.

An expanded DRG reimbursement system should save the government money without adverse financial effects on most hospitals. The few states that have instituted DRG-type systems had mixed results in early years. Early impacts aside, the information generated by a DRG approach could provide a valuable management tool for long-term cost control. Its management improvement attributes and its potential for long-term savings make the option an important ingredient in considering other FEHB reforms. (Most reform packages contain some cost-control measures, but produce overall net costs as a result of benefit restructuring and of adjustments in premiums and risk assignment.)

This proposal would raise some of the same concerns about jeopardizing the quality of health care that arise in debate on the DRG scheme for Medicare and CHAMPUS. The DRG payment system has not yet been refined to the point where it recognizes all of the appropriate cost variations for treating different patients with the same diagnosis, nor can it identify all of the relevant cost variations among alternative hospitals. As a result, some hospitals might realize a profit from cases for which an identical diagnosis in a different hospital could represent a financial loss. Such economic forces might cause hospitals, especially in localities with significant numbers of FEHB patients, to shift care to a local competitor or to limit the amount of care provided. (In fact, a recent study of DRG experience, through mid-1986, suggests a somewhat increased mortality risk due to early discharge and recommended intensified monitoring. On the plus side, the study found that the DRG scheme did not interrupt the trend toward better in-hospital services.) In other cases, hospitals might try to collect excess expenses directly from FEHB patients or to shift some costs and procedures to outpatient services not covered by the DRG fees.

Conversely, the longer the federal government waits to adopt a DRG hospital payment scheme for FEHB, the more vulnerable it becomes to cost shifts directed at its enrollees by hospitals faced with controls placed on them by other plans. Accordingly, FEHB may be the last large insurer not incorporating a DRG payment scheme, and the estimated long-term savings may be understated. (Payment rates, of course, can be set to achieve whatever savings policymakers deem acceptable.)

ENT-33 ELIMINATE THE DISPROPORTIONATE SHARE ADJUSTMENT FOR MOST HOSPITALS IN MEDICARE'S PROSPECTIVE PAYMENT SYSTEM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Immediately Eliminate the Disproportionate Share Adjustment					
Outlays	1,900	2,400	2,600	2,800	3,000	12,700
	Gradually Eliminate the Disproportionate Share Adjustment					
Outlays	250	760	1,400	2,100	2,950	7,450

NOTE: The disproportionate share adjustment is based on an index that is the sum of two ratios: the proportion of all Medicare patient days that are attributable to Medicare patients receiving benefits from the means-tested Supplemental Security Income program, and the proportion of all patient days for which Medicaid is the primary payer.

Under Medicare's prospective payment system (PPS), higher rates are paid to hospitals with a disproportionately large share of low-income patients. In 1985, the Congress added this "disproportionate share" adjustment to account for the presumed higher costs of treating Medicare beneficiaries at these hospitals. One rationale for the adjustment is that low-income Medicare patients may be sicker and, therefore, more expensive to treat than other Medicare patients. Another rationale is that hospitals with large numbers of low-income patients--regardless of whether they are Medicare enrollees--may provide additional staffing, facilities, and services (such as social workers and translators) in response to such patients' needs. In 1993, disproportionate share payments are expected to total about $2.4 billion, or 4.1 percent of all PPS payments. Large urban hospitals--those with 100 or more beds--will receive over 95 percent of the disproportionate share payments, compared with approximately 82 percent of all PPS payments.

Data on hospitals' costs provide very limited support for any disproportionate share adjustment. Although more than 1,500 hospitals receive disproportionate share payments, the only group for which such an adjustment would be supported by the data is large urban hospitals that have extremely high values of the disproportionate share index. This group contains roughly 150 hospitals and accounts for about one-fourth of all disproportionate share payments.

If the disproportionate share adjustment were eliminated, outlays would fall by $12.7 billion over the 1993-1997 period. Alternatively, phasing out the disproportionate share adjustment by the end of 1997 would reduce outlays by about $7.5 billion over the same five years. Alternatively, the adjustment could be eliminated for all hospitals except for those with the highest disproportionate share indices. If the adjustment were restricted to that group and set at 5 percent--the level suggested by the cost data--annual savings would be about $100 million less under the first option and about $50 million less under the second one.

Even without the disproportionate share adjustment, Medicare's payments to these hospitals would, on average, be sufficient to cover their costs for treating Medicare beneficiaries. Hospitals currently receiving the adjustment would, on average, be adequately reimbursed for their higher-than-average costs through other aspects of the PPS--namely, the adjustments for differences in case mix, wage

level, location, and the presence of teaching programs. Nevertheless, many disproportionate share hospitals are in poor financial condition. If this option led some of them to reduce their provision of charity care or if some were forced to close, the access to and quality of care could fall for residents of the areas they serve. Phasing out the adjustment over several years would provide time for affected hospitals to adjust, but would significantly lower federal savings.

ENT-34 REDUCE MEDICARE'S PAYMENTS FOR THE INDIRECT COSTS OF PATIENT CARE THAT ARE RELATED TO HOSPITALS' TEACHING PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	Reduce the Teaching Adjustment to 6 Percent					
Outlays	550	680	740	800	860	3,650
	Reduce the Teaching Adjustment to 3 Percent					
Outlays	1,550	1,900	2,100	2,250	2,450	10,250

The Social Security Amendments of 1983 established the current prospective payment system (PPS) under which Medicare reimburses hospitals for inpatient services provided to beneficiaries. Higher rates are paid to hospitals with teaching programs to cover their additional costs of caring for Medicare patients. In particular, payments to these hospitals are raised by approximately 7.7 percent for each 0.1 increase in the hospital's ratio of full-time equivalent interns and residents to its number of beds. This adjustment was included both to compensate hospitals for their 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 a variety of factors that are not otherwise accounted for in setting the PPS rates. These factors include severity of illness within diagnosis-related groups, location in inner cities, and a more costly mix of staffing and facilities--all of which are associated with large teaching programs.

Estimates of the indirect teaching adjustment based on data from the 1984-1989 period suggest that the teaching adjustment could be lowered to a value in the range of 2 percent to 7 percent, depending on which year's data are used and which of many possible estimating assumptions are chosen. If the teaching adjustment were lowered to 6 percent, outlays would fall by about $3.6 billion over the 1993-1997 period. Alternatively, if the teaching adjustment were lowered to 3 percent, outlays would fall by about $10.3 billion over that period.

This option would better align payments with the actual costs incurred by teaching institutions; between 1981 and 1984, these costs fell substantially in real terms relative to those of nonteaching hospitals. It would, however, considerably reduce payments to teaching hospitals. If these hospitals now use some or all of the excess payments to fund activities such as charity care, access to and quality of care could diminish for some people.

ENT-35 REDUCE MEDICARE'S DIRECT PAYMENTS FOR MEDICAL EDUCATION

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	160	180	190	200	200	930

Medicare's prospective payment system does not include payments to hospitals for the direct costs they incur in providing graduate medical education (GME), that is, residents' salaries and fringe benefits, teaching costs, and institutional overhead costs. Instead, these payments are made separately, but also prospectively, based on Medicare's share of the hospital's 1984 cost per resident indexed for subsequent increases in the level of consumer prices. Medicare's GME payments, which are received by about one-fifth of hospitals, totaled $1 billion in 1991.

This option would reduce teaching and overhead payments for nonprimary care residents in their initial residency period and eliminate these payments for nonprimary care residents beyond their initial residency period. Hospitals' GME payments would be based on the national average salary paid to residents in 1987, updated annually by the consumer price index for urban areas. Reimbursement for primary care residents would be based on 175 percent of the national average salary. This weighting provides a payment amount close to the average that Medicare pays per resident under the current system. The corresponding weights for nonprimary care residents in their initial residency period and nonprimary care residents beyond their initial residency period would be 145 percent and 120 percent, respectively. The savings over the 1993-1997 period would total about $0.9 billion.

Unlike the current system, in which GME payments vary considerably from hospital to hospital, this option would pay every hospital the same amount for the same type of resident. Efficient hospitals would be rewarded by being able to keep any excess reimbursement over the cost of training, and inefficient hospitals would be penalized. The overall reduction in the level of subsidies might be warranted since the United States as a whole is facing a projected surplus of physicians. Moreover, since physicians earn much higher incomes as a result of graduate training, they might reasonably contribute more to these costs themselves. This reallocation would occur if hospitals responded to the reimbursement changes by cutting residents' salaries or fringe benefits.

Reducing Medicare's GME payments could have some drawbacks, however. Some physicians incur substantial debts during their medical education, which they must pay off when they begin to practice. Requiring physicians to contribute to their residency costs might further discourage physicians from entering primary care or locating their practices in low-income areas. Decreasing GME reimbursement could force some hospitals to reduce the resources they commit to training, jeopardizing the quality of their medical education programs.

ENT-36 ELIMINATE MEDICARE'S ADDITIONAL PAYMENTS TO SOLE COMMUNITY HOSPITALS AND MEDICARE-DEPENDENT HOSPITALS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	180	220	240	260	280	1,200

Under Medicare's prospective payment system (PPS) for inpatient hospital services, special rules apply to providers designated as sole community hospitals (SCHs) or Medicare-dependent hospitals (MDHs). At present, there are about 600 SCHs, more than 95 percent of which are located in rural areas, and about 540 MDHs, which are small rural hospitals. Thus, nearly 45 percent of rural hospitals qualify for SCH or MDH status. In 1991, about half of SCHs and MDHs received higher payments as a result of being in these categories.

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, many SCHs have been permitted to continue that status regardless of whether they meet the current sole provider criteria. The MDH classification, scheduled to be phased out during 1993, assists rural hospitals that have 100 or fewer beds and treat relatively high proportions of Medicare patients. Because MDHs are small and rely on Medicare for a large share of inpatient revenues, it is thought that they might be especially vulnerable to financial risk under the PPS.

Payments to SCHs and MDHs 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. In addition, rural SCHs receive a higher "disproportionate share" adjustment--that is, a higher PPS adjustment for hospitals that treat a disproportionately large share of low-income patients--than other rural hospitals. As a result of the special rules, total PPS payments to SCHs and MDHs for 1991 are estimated to have been about 9.5 percent higher than they would have been otherwise. If the special payment rules for SCHs and MDHs were eliminated, total PPS payments would be $180 million less in 1993 and $1.2 billion less for the 1993-1997 period. More than 95 percent of the savings would be attributable to the elimination of the special rules for SCHs, because under current law the special provisions for MDHs will be phased out in 1993.

A primary objective of the SCH and MDH rules is to assist hospitals whose closings would threaten access to hospital care in rural areas, but the support is not well targeted toward essential providers. The group of hospitals qualifying for SCH payments, for example, includes many hospitals located in areas with other nearby providers. Moreover, whether an SCH or MDH 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, but not on its current financial condition.

If the special payment rules were eliminated, however, revenues of many SCHs and MDHs would be lower, which might cause financial stress for some hospitals and might lead others to close. Because many SCHs are the sole provider of hospital services in their geographic area, quality or access to care might be reduced in some rural locations.

ENT-37 ELIMINATE RETURN-ON-EQUITY PAYMENTS FOR PROPRIETARY SKILLED NURSING FACILITIES

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	55	60	65	70	75	320

Medicare pays for care in skilled nursing facilities (SNFs) for eligible people who need skilled nursing or rehabilitative care services after discharge from an acute care hospital. Following annual growth averaging about 5 percent between 1984 and 1987, Medicare's payments to SNFs grew by 11 percent in 1988, 214 percent in 1989, and 23 percent in 1990, and then shrank by 12 percent in 1991. The pattern of growth in the 1988-1991 period reflected the combined impact of administrative changes that were designed to clarify eligibility for benefits and the temporary expansion of eligibility under the Medicare Catastrophic Coverage Act of 1988. CBO expects that, during the 1992-1997 period, annual growth in total outlays for SNFs will average 8.6 percent.

For-profit SNFs receive payments designed to provide a rate of return on equity capital that is equal to the average interest rate paid on securities issued for purchase by the Federal Hospital Insurance Trust Fund. Equity capital is generally the difference between assets and liabilities after excluding certain specified items. In addition, a for-profit SNF that is certified by Medicare may depreciate capital investments over a specified period.

In 1992, CBO expects Medicare payments to for-profit SNFs for return on equity (ROE) to be $50 million. If these payments were eliminated, Medicare outlays would be about $55 million lower in 1993 and about $320 million lower over the 1993-1997 period.

Eliminating ROE payments for proprietary SNFs would result in more consistent treatment of return on capital across the Medicare program. Currently, for-profit SNFs are the only providers to which Medicare makes ROE payments. This option would also result in more consistent handling of Medicare-certified SNFs because it would eliminate the different treatment of ROE for not-for-profit and for-profit SNFs.

By reducing the overall return on capital invested in SNFs, however, this option would reduce the incentive for private investment in the nursing home industry at a time when the demand for nursing home use is increasing rapidly. In addition, if for-profit SNFs responded to eliminating ROE payments by restructuring their capital to emphasize debt rather than equity, they would incur additional interest costs. These costs might be deemed allowable by Medicare and might partly offset the savings to Medicare from nonpayment of ROE. Finally, the Omnibus Budget Reconciliation Act of 1990 requires the Secretary of Health and Human Services to submit a proposal for prospective reimbursement of SNFs. Some people think it would be more appropriate to integrate changes in ROE payments with any move to pay SNFs prospectively.

ENT-38 FREEZE MEDICARE'S PROSPECTIVE PAYMENT SYSTEM RATES FOR ONE YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	1,600	2,150	2,400	2,600	2,850	11,600

Medicare's payment rates for hospital services are usually increased every year. Rates for inpatient hospital services that are paid for under Medicare's prospective payment system (PPS) are set to increase on October 1, 1992.

Under the PPS, payments for the operating costs of inpatient hospital services provided to Medicare beneficiaries are determined on a per-case basis, according to preset rates that vary with the patient's diagnosis and certain characteristics of the hospital. Separate rates apply to hospitals in three types of location: urban areas with populations of more than 1 million, other urban areas, and rural areas. The annual percentage increase in these rates, called the update factor, is usually based on the increase in an index of hospitals' costs known as the hospital market-basket index (MBI). For fiscal year 1993, under the Omnibus Budget Reconciliation Act of 1990, the amount of the urban update factor (which applies to rates for both types of urban areas) will equal the percentage increase in the MBI minus 1.55 percentage points, and the rural update factor will equal the percentage increase in the MBI minus 0.55 percentage points. Based on CBO's current estimate of a 5.3 percent growth in the MBI, the urban update factor will be 3.75 percent and the rural update factor will be 4.75 percent for fiscal year 1993. The estimated average PPS update factor will be about 3.9 percent.

Under this option, Medicare would freeze PPS hospital rates for 1993 at their 1992 levels by setting the update factors to zero, thereby saving $1.6 billion in 1993 and $11.6 billion over the 1993-1997 period. In response to the freeze, some hospitals could increase their efficiency. In addition, data on hospitals' revenues and costs during the past several years suggest that some hospitals could absorb the reductions even if they were unable to increase efficiency--in particular, estimates by the Prospective Payment Assessment Commission indicate that the overall margin for hospitals (defined as the difference between the total revenues of hospitals from all sources and their total costs, expressed as a percentage of total revenues) increased from 3.5 percent in 1987 to 3.9 percent in 1990. It increased even though total PPS payments declined during this period in relation to the costs of treating Medicare beneficiaries and were actually less than those costs for the last two years of the period.

The reduction in payments might, however, be difficult for other hospitals to absorb. As a result, some Medicare beneficiaries might encounter reduced access to hospital services or lower-quality care, and hospitals might cut back on providing uncompensated care.

ENT-39 CONTINUE MEDICARE'S TRANSITION TO PROSPECTIVE RATES FOR FACILITY COSTS IN HOSPITAL OUTPATIENT DEPARTMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
Outlays	180	580	780	930	1,100	3,550

The Medicare program pays for services provided in hospital outpatient departments with separate payments to the facility and to the physician. The facility component includes reimbursement for the services of nonphysician personnel, drugs and biological products, other health services, rent, and utilities. Medicare used to reimburse hospital outpatient departments on a reasonable-cost basis for most services. The Omnibus Budget Reconciliation Act of 1986, however, changed Medicare's payment method for most surgical procedures performed in hospital outpatient departments. The reimbursement that hospitals receive for these procedures is now based on the lesser of reasonable costs or charges, or a blend of reasonable costs or charges and the prospective rate received by free-standing ambulatory surgical centers (ASCs) in the area. In 1987, a similar change was enacted for paying facility costs associated with outpatient radiology and diagnostic services. In both cases, the hospital-specific share is currently 42 percent and the prospective rate share is 58 percent.

Outpatient payments are one of the fastest growing components of Medicare expenditures, accounting for a projected 21 percent of Supplementary Medical Insurance (SMI) payments in 1992. Between 1993 and 1997, SMI outlays for hospital outpatient services are expected to increase at an average annual rate of about 18 percent. A major factor in this increase is technological progress that allows hospitals and physicians to substitute outpatient surgical procedures and technologies for inpatient surgical procedures.

Under this option, the hospital-specific portion of the blended reimbursement rate for the facility costs of outpatient surgery, radiology, and diagnostic services would be phased out in 1994, with a transitional blend for 1993 of 25 percent of costs and 75 percent of the prospective rate. Savings to the Medicare program would be $180 million in 1993 and $3.6 billion over the 1993-1997 period.

In addition to reducing Medicare's costs, this option would result in the same payment system for hospital outpatient departments and ASCs. Thus, it would reduce the greater incentive and ability of hospitals to compete for patients through costly capital acquisitions. Hospitals would also have stronger incentives to control the costs of outpatient surgery, radiology, and diagnostic services since they could no longer automatically pass through part of these costs to Medicare. Nonetheless, experience with the partially prospective rates for outpatient departments is limited, and it is not yet known whether the current blended rate is sufficient to ensure continued access for Medicare beneficiaries. In addition, if patients at risk of complications are advised to receive treatment in hospital outpatient departments rather than ASCs because of the ready availability of advanced support systems in hospitals, then paying higher rates to hospitals than to ASCs might be appropriate.

ENT-40 CHARGE A FEE FOR SMI CLAIMS THAT ARE NOT BILLED ELECTRONICALLY

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	230	260	220	170	100	980

NOTE: Savings include reductions in both direct spending and discretionary appropriations.

About 45 percent of all claims under the Supplementary Medical Insurance (SMI) program are billed electronically; the rest are submitted on paper. In 1991, about 500 million claims were processed, with an average of two items per claim.

Medicare could create an incentive for providers to switch to an electronic system for submitting claims. Under this option, Medicare would reduce reimbursements by $1 for each item not billed electronically. (Medicare could provide electronic billing software to physicians at cost.) Net savings to Medicare would be $230 million for 1993 and $980 million over the 1993-1997 period. Net SMI outlays would be reduced by about 0.3 percent over the five-year period. Nearly 20 percent of those savings would be on administration, and appropriations would have to be reduced to obtain them.

This option would cut Medicare's costs, not only as a result of the fee charged for paper billing, but also because processing costs for Medicare's administrative agents would be lower on claims that were switched from paper to electronic billing. Manual entry of data by clerical personnel would no longer be necessary. It would also reduce the chances of entering data incorrectly. Physicians could benefit as well because the software used for electronic submittal of claims automatically checks for missing or inconsistent entries, thereby helping to prevent problems that can delay Medicare payments.

Physicians would bear the additional costs of buying the equipment and software for submitting bills electronically, however. They might also incur additional costs to train office personnel to use the new equipment. Although these additional costs would be small compared with revenues for most physicians, they could be a hardship for physicians who provide a lot of charity care.

ENT-41 REDUCE MEDICARE'S PAYMENT FOR INTRAOCULAR LENSES TO $100

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	120	190	200	200	200	900

Medicare pays for nine-tenths of all surgical procedures for treating cataracts in the United States. During this surgery, the natural lens of the eye is removed and, in most cases, an intraocular lens (IOL) is implanted. Currently, for each IOL used, Medicare pays a flat fee of $200 to ambulatory surgical centers and an average of $215 to hospital outpatient departments. Total payments under Medicare for IOLs were about $205 million in 1991.

Some people argue that Medicare pays more than necessary for IOLs, often citing Canadian prices to justify reducing Medicare's payment. If Medicare's payment at all sites were reduced to $100 as of January 1, 1993, savings to Medicare would total $120 million for fiscal year 1993. If the payment rate were indexed to the consumer price index in subsequent years, savings over the 1993-1997 period would be $900 million, and net outlays under the Supplementary Medical Insurance program would be reduced by 0.3 percent.

This option would give providers an incentive to negotiate lower prices from companies that manufacture and sell IOLs. Whether or not providers were successful at negotiating lower wholesale prices, enrollees would benefit from Medicare's lower payment rate because patients pay 20 percent coinsurance on IOLs, and balance-billing for this service is rare.

If providers were unable to negotiate reductions in the prices they pay for IOLs, however, they would find it less profitable to perform cataract surgery. This fact, together with recent reductions in Medicare's payments to physicians performing the surgery, might reduce access to this procedure in some areas. Even if access did not become a general problem, the flat rate of $100 for IOLs might induce some providers to substitute lower-quality IOLs for the ones they now use, perhaps necessitating later replacement, with all the attendant costs of a second surgery.

ENT-42 FREEZE MEDICARE'S SMI REIMBURSEMENT RATES FOR ONE YEAR

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	350	580	640	790	920	3,300

Payment rates under Medicare's Supplementary Medical Insurance (SMI) program are generally increased every year. Rates are scheduled to rise next on January 1, 1993.

A new Medicare fee schedule for physician services became effective January 1, 1992. Under current law, the update for 1993 will be equal to the percentage increase in the Medicare Economic Index less an adjustment based on the difference between actual growth in spending for 1991 compared with the 7.3 percent target rate of growth. Under CBO's current projections, physicians' fees will rise by 0.2 percent in 1993.

Payment rates for clinical laboratory services and durable medical equipment are normally updated on the basis of the consumer price index. Under the Omnibus Budget Reconciliation Act of 1990, however, the 1993 update for clinical laboratory services is set at 2 percent.

Legislation could be passed directing that Medicare instead freeze the rates for these SMI services at 1992 levels by setting all these updates to zero. This one-year freeze would save $350 million in 1993 and $3.3 billion over the 1993-1997 period.

The freeze would reduce total SMI expenditures by 0.8 percent in 1993 and 1.1 percent over the 1993-1997 period. The reduction in payments might, however, be difficult for some providers to absorb. As a result, some Medicare beneficiaries might face a decrease in access to or quality of services.

ENT-43 COLLECT 20 PERCENT COINSURANCE ON ALL HOME HEALTH AND SKILLED NURSING FACILITY SERVICES UNDER MEDICARE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays for Home Health	1,850	2,450	2,700	3,000	3,300	13,300
Outlays for Nursing	-220	-280	-300	-320	-350	-1,450
Total	1,600	2,150	2,400	2,700	2,950	11,850

Currently, no copayments are required from enrollees for home health services under Medicare. Copayments for skilled nursing facility (SNF) services are required for each day after the first 20 days of care; the coinsurance amount per day is equal to one-eighth of the deductible amount for hospital care and is unrelated to SNF costs.

If enrollees were required to pay coinsurance amounts equal to 20 percent of the projected average cost for each home health visit and each SNF day, the net savings to Medicare would be $1.6 billion in fiscal year 1993, with higher Medicare costs for SNF services more than offset by savings for home health services. Over the five-year projection period, savings would total $11.9 billion.

This option, together with the laboratory coinsurance requirement discussed in ENT-46, would establish a uniform coinsurance rate of 20 percent on almost all Medicare services. This uniform rate would make Medicare's copayment requirements easier for providers and patients to understand. Further, because coinsurance amounts would be based on the cost of services, it would encourage enrollees without supplementary insurance coverage to consider relative costs appropriately when choosing among alternative treatments. As a result, the use of home health services might fall and the use of SNF services might increase. Only hospital inpatient services would have no copayment requirement (for most stays) except for the deductible amount. But under the prospective payment system, patients are unlikely to remain hospitalized longer than necessary because hospitals have strong incentives to discharge them quickly.

However, many enrollees have supplementary insurance coverage that eliminates their Medicare copayment costs, and this option would have no effect on the use of services by those enrollees. Moreover, this option would increase the risk of very large out-of-pocket costs for the 20 percent to 25 percent of enrollees without any supplementary coverage, and would probably increase medigap premiums for about 30 percent of enrollees who purchase that kind of supplementary insurance.

ENT-44 INCREASE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO 30 PERCENT OF PROGRAM COSTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	1,360	1,950	2,920	4,920	7,170	18,300

Benefits under Medicare's Supplementary Medical Insurance (SMI) program are partially funded by monthly premiums paid by enrollees, with the remainder paid from general revenues. Although the SMI premium was initially intended to cover 50 percent of the cost of benefits, between 1975 and 1983 premium receipts covered a declining share of SMI costs--falling from 50 percent to less than 25 percent. This 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 increased faster. Since 1984, premiums have been set to cover 25 percent of average benefits for an aged enrollee, although under current law the COLA will again limit the premium beginning with the 1996 increase.

If the premium were set to cover 30 percent of benefits for 1993 and for all years thereafter, there would be savings of $1.4 billion in fiscal year 1993 and $18.3 billion over the 1993-1997 period. Net outlays for SMI would be reduced by about 6 percent over this period. The premium for 1993 would be $41.40 a month, instead of $36.60. These estimates assume a continuation of the current hold-harmless provision, which ensures that no enrollee's monthly Social Security check will fall as a result of the Social Security cost-of-living adjustment (which is based on the whole benefit) being smaller than the SMI premium increase.

Under this option, all SMI enrollees would pay a little more, in contrast to proposals--such as increasing copayments--that could substantially increase the out-of-pocket costs of those who become seriously ill. This option need not affect enrollees with incomes below the federal poverty threshold because all of them are eligible to have Medicaid pay their Medicare premiums, although some who are eligible for Medicaid do not apply for benefits.

Low-income enrollees who are not eligible for Medicaid, however, 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 the nearly 20 percent of Medicare enrollees who are also eligible for Medicaid.

ENT-45 INCREASE AND INDEX MEDICARE'S DEDUCTIBLE FOR PHYSICIANS' SERVICES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	900	1,700	2,260	3,000	3,980	11,850

One way to achieve appreciable 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. The deductible has fallen relative to average annual per capita charges under the SMI program from 45 percent in 1967 to about 5 percent in 1991. Relative to the average annual Social Security benefit, the deductible has dropped from 5 percent in 1967 to 1.4 percent in 1991.

Increasing the SMI deductible to $150 on January 1, 1993, would save $900 million in fiscal year 1993. If the new deductible were indexed to the rate of growth in SMI charges per enrollee for 1994 and later years, savings would be $11.9 billion over the 1993-1997 period, and net outlays for SMI would be reduced by 4 percent. By 1997, the deductible amount would be $230.

An increase in the deductible amount would enhance the economic incentives for prudent consumption of medical care by enrollees, while spreading the burden among most enrollees. No enrollee's out-of-pocket costs would rise by more than $50 in 1993.

The additional out-of-pocket costs under this option might, however, 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 deductible amounts for Medicare enrollees who also receive Medicaid benefits.

ENT-46 COLLECT 20 PERCENT COINSURANCE ON CLINICAL LABORATORY SERVICES UNDER MEDICARE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	600	1,020	1,170	1,340	1,540	5,650

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. Beneficiaries pay coinsurance of 20 percent for most other services provided under Medicare's Supplementary Medical Insurance (SMI) program (as they did for clinical laboratory services before July 1984, when a fee schedule that reduced payment rates was put in place).

Reimposing the coinsurance requirement for laboratory services could yield appreciable savings to Medicare. If coinsurance of 20 percent of laboratory fees were imposed beginning January 1, 1993, federal savings would be $600 million in fiscal year 1993. Savings would total $5.7 billion over the 1993-1997 period, reducing net SMI outlays by about 2 percent.

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 have laboratory tests with little expected benefit if they paid part of the costs.

Cost sharing probably would not substantially affect the use of laboratory services by enrollees, however, because decisions about what tests are appropriate are generally left to physicians, whose decisions do not appear to depend on enrollees' cost sharing. Hence, although a small part of the savings under this option might be the result of more prudent use of laboratory services, most of the expected savings would reflect the transfer to enrollees of costs now paid by Medicare. Further, billing costs for some providers, such as independent laboratories, could be greatly increased 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.

ENT-47 RELATE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO ENROLLEES' INCOMES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
50 Percent Ceiling	290	1,200	1,200	2,500	4,450	9,600
100 Percent Ceiling	260	1,150	1,150	2,400	4,300	9,300

Instead of increasing the premium for all enrollees under the Supplementary Medical Insurance (SMI) program, this option would collect relatively more from higher-income people. For individuals with modified adjusted gross incomes of less than $50,000 and couples with incomes lower than $65,000, premiums would be set at 25 percent of SMI costs per enrollee. Premiums would rise progressively for higher-income enrollees, however, and would be set to cover 50 percent of costs for individuals with incomes exceeding $60,000 and for couples with incomes exceeding $80,000. Alternatively, nearly the same five-year savings could be achieved by setting the premium to cover 100 percent of costs for individuals with incomes exceeding $125,000 and for couples with incomes over $150,000.

Under this option, income-related premiums would begin at $100,000 for individuals and $125,000 for couples. These 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 the 50 percent option were carried out for 1993, savings would total $290 million in fiscal year 1993 and $9.6 billion over the 1993-1997 period. Under the 100 percent option, savings would total $9.3 billion over the five-year period. These estimates assume that the current hold-harmless provisions would continue only for those subject to the basic 25 percent premium. (The hold-harmless provisions ensure that no enrollee's Social Security check would decrease because an increase in the SMI premium exceeded the cost-of-living adjustment.)

Most enrollees would be unaffected by this approach. Under the 50 percent option, roughly 93 percent of enrollees would face the basic 25 percent premium, about 5 percent would pay the maximum premium, and 2 percent would pay a premium somewhere in between. Under the 100 percent option, only about 2 percent of enrollees would be subject to the income-related premium.

Enrollees subject to the income-related premium would pay substantially more, however. Under the 50 percent option, the maximum monthly premium for 1993 would be $69 instead of the $36.60 premium set by current law. Under the 100 percent option, the maximum monthly premium would be $138. This might lead some enrollees to drop out, although it is estimated that fewer than 0.5 percent of all enrollees would do so. Those with retirement health plans that do not require Medicare enrollment (largely retired government employees) would be most likely to drop out, but some healthy enrollees who have no other source of health insurance might do so as well.

ENT-48 INCREASE THE SMI COINSURANCE RATE TO 25 PERCENT

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	2,010	2,910	3,030	3,500	4,000	15,450

Currently, the coinsurance rate on most services provided under the Supplementary Medical Insurance (SMI) program is 20 percent. One exception is outpatient psychiatric services, for which the coinsurance rate is 50 percent. The other exceptions are clinical laboratory services and home health care, which have no coinsurance requirements.

If enrollees were required to pay coinsurance rates of 25 percent on all services that are currently subject to a coinsurance rate of 20 percent, savings to Medicare would be $2 billion in fiscal year 1993. Over the 1993-1997 period, savings would exceed $15 billion, reducing net SMI outlays by 5.3 percent.

This option would reduce Medicare's costs for two reasons. First, the higher coinsurance rate would reduce use of services by Medicare enrollees who do not have supplemental insurance coverage. Second, Medicare would be responsible for a smaller share of the costs of the services that enrollees use.

This option would increase the risk of very large out-of-pocket costs for the 20 percent of enrollees who have no supplementary coverage, however, and would probably increase medigap premiums for the 30 percent of enrollees who purchase that kind of supplementary insurance. Moreover, it would increase states' Medicaid costs for the nearly 20 percent of enrollees who are eligible for full or qualified Medicaid benefits.

ENT-49 TAX A PORTION OF THE INSURANCE VALUE OF MEDICARE BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
			Without Income Threshold			
Hospital Insurance Only	1.3	4.4	4.9	5.5	6.1	22.3
Supplementary Medical Insurance Only	1.4	4.9	5.6	6.5	7.6	26.0
Both	2.9	10.0	11.2	12.7	14.5	51.4
			With Income Threshold			
Hospital Insurance Only	0.8	2.2	2.6	3.2	3.8	12.6
Supplementary Medical Insurance Only	0.9	2.5	2.9	3.5	4.3	14.1
Both	1.8	4.7	5.6	6.7	8.0	26.8

SOURCE: Joint Committee on Taxation.

Eligibility for Hospital Insurance (HI) benefits is based on working-year tax contributions, half of which are paid by employees from after-tax income and half by employers from pretax income. Hence, 50 percent of the insurance value of HI benefits might be treated as taxable income for all Medicare enrollees, reflecting the portion of contributions that was not originally subject to income tax. This proposal is analogous to taxing part of Social Security benefits, which is already in effect for higher-income beneficiaries whose modified adjusted gross income plus half of Social Security benefits exceeds $25,000 (for individuals) or $32,000 (for couples). In addition, that portion of the insurance value of benefits under the Supplementary Medical Insurance (SMI) program that is not covered by enrollees' premiums (currently about 75 percent) could be added to their taxable income.

If no income thresholds were used to limit the application of the tax, additional revenues from the HI tax alone would be $1.3 billion in 1993 and $22.3 billion over the 1993-1997 period. Revenues from the SMI tax alone would be $26.0 billion over the five-year period. If both the HI and the SMI tax were imposed, revenues would be $51.4 billion over the five-year period. The combined tax would generate more revenues than the sum of the HI and SMI taxes because some enrollees would become subject to higher tax rates.

Alternatively, the current income thresholds for the tax on Social Security benefits could be used to limit the application of the tax on Medicare benefits. In this case, 50 percent of the HI insurance value and/or that portion of the SMI insurance value not covered by premiums would be added to modified adjusted gross income plus half of Social Security benefits to compare with the threshold. Taxing HI benefits alone would then yield additional revenues of $0.8 billion in 1993 and $12.6 billion over the 1993-1997 period. Taxing SMI benefits alone would yield additional revenues of $14.1 billion over the five-year period, while a combined tax would yield $26.8 billion. In this instance, the combined tax would generate more revenues than the sum of separate HI and SMI taxes not only because of progressive tax rates, but also because more enrollees would exceed the threshold.

A tax on HI benefits would reduce the federal deficit and strengthen the HI trust fund if the proceeds were placed there. A tax on SMI benefits would shift some SMI costs from taxpayers to enrollees. If income thresholds were used, low- and middle-income enrollees would not be affected. In fact, fewer than 60 percent of enrolled tax units in 1993 would be affected by this proposal even if no income thresholds were used. Furthermore, since this option would use the mechanism already in place for taxing Social Security benefits, it would present no additional administrative difficulties.

Unlike the tax on Social Security benefits, however, this tax would be imposed on the insurance value of in-kind benefits rather than on the dollar benefits actually received, thereby modifying current tax policy. (There would be little to recommend basing the tax on actual benefits received because it would then be directly related to enrollees' health care costs. Such a tax would reduce the insurance protection Medicare is intended to provide.) Some might object to this option unless enrollees could alter their tax liability by renouncing benefits not only under the SMI program, but also under the HI program, a choice that might be particularly important to enrollees for whom Medicare is a secondary payer to their employment-based coverage. For the approximately 10 percent of enrollees in or above the 28 percent tax bracket, the additional tax liability would be substantial--$730 in 1993 for individuals and $1,460 for couples, assuming the combined tax was imposed with no income thresholds.

ENT-50 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Tax Some Employer-Paid Health Insurance						
Income Tax	5.9	9.6	11.3	13.2	15.4	55.5
Payroll Tax	4.0	6.5	7.7	9.0	10.5	37.7
Total	9.9	16.1	19.0	22.2	25.8	93.2
Tax All Employer-Paid Health Insurance, but Allow a Credit for Some Employer and Individual Contributions						
Income Tax	19.6	2.6	4.1	5.7	7.6	39.6
Payroll Tax	26.4	28.9	31.3	34.0	36.9	157.5
Total	46.0	31.5	35.4	39.7	44.5	197.1

SOURCE: Joint Committee on Taxation.

Employees do not pay taxes on income received in the form of employer-paid health care coverage. This exclusion will reduce income tax revenues and Social Security payroll tax revenues by a total of about $65 billion in fiscal year 1993.

Tax Some Employer-Paid Health Insurance. One way to limit the exclusion would be to treat as taxable income for employees any employer contributions (including those in cafeteria plans and flexible spending accounts) that exceed $335 a month for family coverage and $135 a month for individual coverage (in 1993 dollars); these amounts would be indexed to reflect future increases in the general level of prices. This option would raise income tax revenues by about $56 billion and payroll tax revenues by about $38 billion over the 1993-1997 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on benefit payments that would offset most of the added payroll tax revenues from this option over the long run. The option would also raise the state income tax liabilities of individuals in those states with tax bases linked to the federal tax base, unless those states took offsetting actions.

An advantage of this approach is that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling. Without such coverage, there would be stronger incentives to economize in the medical marketplace, thereby reducing upward pressure on medical care prices. Over the long run, indexing the ceilings would limit their erosion by general inflation. Finally, the Congress has already limited the exclusion for employer-paid, group term life insurance in a similar way.

One disadvantage of limiting the tax subsidy is the difficulty of determining just when extensive coverage becomes excessive. Moreover, a uniform ceiling would have uneven effects, since a given employer's contribution purchases different levels of coverage depending on such factors as geographic location and the demographic characteristics of the firm's work force. Finally, if health insurance costs continue to rise faster than the general level of prices, the indexing provision of this option

would gradually reduce subsidies for employer-paid health insurance. This effect is especially of concern to people who argue that current subsidies for private-sector benefits help avoid the need for public provision of similar benefits.

Tax All Employer-Paid Health Insurance, but Allow a Credit for Some Employer and Individual Contributions. Another option would be to treat all employer-paid health insurance premiums as taxable income, but offer a refundable, individual income tax credit of 20 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers regardless of whether an employer paid for or sponsored the coverage. At this percentage of credit and with these ceilings on premiums, the proposal would increase income tax revenues by about $40 billion over the 1993-1997 period--the net result of $230 billion in revenues if there were no credit less $190 billion in new income tax credits. Payroll tax revenues would also rise substantially, by about $160 billion over the same period. As under the first option, however, in the long run increases in Social Security outlays would offset most of the added payroll tax revenues. This alternative would substantially raise the state income tax liabilities of individuals in states with tax bases linked to the federal tax base, unless these states took offsetting actions.

In addition to eliminating the tax incentive to purchase health insurance above the limits, as under the first alternative, an added advantage of this option is that the subsidy would be made available to all taxpayers having health insurance, without regard to their employment status. Moreover, the subsidy per dollar's worth of eligible health insurance would no longer be higher for taxpayers with higher marginal tax rates (and higher incomes). As with the first option, though, opponents of this one have several concerns: it would be difficult to determine at what level health insurance coverage becomes excessive, effects would vary among geographic areas, and the subsidy for health insurance would probably decline over time.

ENT-51 REDUCE FEDERAL EMPLOYEE RETIREMENT BENEFITS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Defer COLAs for Retirees Until Age 62			
Military Retirement	310	800	1,300	1,900	2,500	6,850
Civilian Retirement	80	160	230	280	310	1,050
			Limit Some COLAs Below Inflation			
Military Retirement	180	430	700	1,000	1,350	3,600
Civilian Retirement	100	230	370	520	680	1,900
			Add One Year to Salary Average Used to Set Initial Pensions			
Military Retirement	30	60	100	140	190	520
Civilian Retirement	10	50	100	150	220	530
			Restrict Agency Match on Thrift Plan Contributions to 50 Percent			
Civilian Retirement	290	350	410	480	550	2,100
			Total: All Changes Combined			
Military Retirement	420	1,050	1,700	2,450	3,200	8,800
Civilian Retirement	470	770	1,050	1,400	1,700	5,350

About 4.3 million employees are covered by federal civilian and military retirement programs. The Federal Employees' Retirement System (FERS) covers civilian employees hired since January 1984 and others who elected to join. Most civilian employees not covered by FERS have coverage under its predecessor, the Civil Service Retirement System (CSRS). Uniformed military personnel are covered by the Military Retirement System (MRS). This system was last revised for personnel entering the service after July 31, 1986, and military personnel will continue retiring under the plan through the next century.

Alignment with the practices of private employers is a long-standing objective of federal personnel policy. Cutting selected federal retirement benefits, especially in light of recently enacted pay reform, would further this objective by producing a mix of current and deferred compensation more in line with that found in the private sector. Even with the cuts described below, however, federal retirees would still receive benefits that exceed those typically received by employees retiring from private firms. In addition to better alignment with private-sector practice, the proposed changes could, in some cases, improve the ability of government to retain high-quality workers.

Opponents of changing the current system would point out that alignment with private-sector practice has not been the only policy standard for federal compensation. In the past, generous retirement benefits have been maintained as an incentive for keeping an experienced corps of career employees. Re-

forms in the last two decades have moderated certain benefit provisions, especially for new employees, while keeping a retirement package that competes with the best private-sector plans. Moreover, some of the options would produce substantial savings only if they applied to both current and future retirees. Currently, about one million nondisabled retirees under age 62 receive benefits under CSRS and MRS. These retirees, who would bear about 70 percent of the burden of proposed cuts in cost-of-living adjustments (COLAs), view their relatively generous pensions as recompense for working long years at below-market federal salaries that should now move toward parity as federal pay reforms are phased in over the remainder of the decade. Applying retirement cuts to military personnel would also meet with criticism. The lower benefits would cause some individuals to delay retirement--a counterproductive outcome in view of efforts to reduce the size of the armed forces.

Taken together, the measures described below would generate 1997 savings of about $4.9 billion if applied to all former federal workers. The savings for the entire five-year period would amount to $14.2 billion. Exempting current retirees from the COLA proposals would shrink five-year savings to $1.5 billion. (The estimates exclude savings realized by the Postal Service because it is now off-budget and because its operating cost reductions eventually benefit only mail users.)

Defer Cost-of-Living Adjustments Until Age 62. CSRS and the pre-reform MRS (covering new recruits before August 1, 1986) provide full cost-of-living protection to employees who retire before reaching age 62. Such protection is expensive when compared with that available under the largest and most generous private pensions. Deferring COLAs until age 62 for all nondisabled employees who retire before that age would yield five-year savings of $7.9 billion. (Nearly 90 percent of the estimated savings would derive from MRS because over half of its annuitants are nondisabled retirees under age 62.)

Deferring COLAs would moderate the government's cost for early retirement, consistent with selected reform features enacted for new federal employees covered by FERS and in 1984 for personnel covered by MRS. (Consistent with the MRS reforms, this option allows a catch-up adjustment at age 62 for partial inflation protection since the date of retirement. Retirees under FERS receive neither protection nor catch-up at age 62.) Deferring COLAs would also enhance federal efforts to keep experienced workers by discouraging early retirement. But changing the rules of retirement could cause significant hardships for some individuals--especially MRS employees who usually retire at a relatively young age. Many retirees targeted by this option, however, should be in a position to supplement their pensions by working--as most military retirees already do.

Limit Some COLAs Below Inflation. Current indexing of COLAs is expensive and generous when compared with private-sector practice. Most private pension plans adjust postretirement benefits on an ad hoc basis that, over time, may cover about 30 percent of the erosion that would otherwise occur because of inflation. Inflation protection for other sources of retirement income, such as Social Security and employer-sponsored thrift plans, could boost the overall inflation coverage typically found in the private sector to as much as 70 percent. CSRS and the old MRS, by contrast, provide 100 percent automatic protection from inflation.

This option would limit COLAs to 1 percentage point below the rate of inflation for the old MRS and to one-half point below inflation for CSRS. (The smaller half-point limitation for CSRS would apply to a more comprehensive benefit that, unlike the defined benefits under FERS and MRS, substitutes for both Social Security and employer-sponsored benefits. Therefore, the smaller cut would produce a reduction comparable with the one-point limit for MRS employees.) These changes would conform to the postretirement COLAs (1 percentage point below the rate of

inflation) for employees under FERS and the revised MRS. This option, however, would hurt low-income retirees most. It would also renege on an understanding that workers in the CSRS, who had a chance to switch systems, would retain their full protection against inflation. Savings would amount to $5.5 billion through 1997. (Savings would decrease to $3.2 billion if this option were coupled with the preceding one that would defer COLAs until age 62.)

Add a Year to the Average Salary Used to Set Initial Pensions. Under current law, the CSRS and FERS provide initial benefits based on an average of the employee's three highest salaried years. The MRS uses a different salary base for personnel hired before September 1980; benefits are calculated using the salary at the date of retirement. If, instead, a four-year average were adopted for CSRS and FERS and a 12-month average were adopted for MRS, initial benefits for most new retirees would decline by about 2 percent to 3 percent, producing annual savings through 1997 of $1.0 billion. This option would align federal practice more closely with practice in the private sector, where five-year averages are commonly used. Moreover, it could encourage some employees to stay on another year in order to take full advantage, when calculating retirement benefits, of the higher salary under pay reform. (To discourage workers from accelerating their planned date of retirement to avoid the new formula, the change in base salary would have to be phased in. The estimates here use 12 months.)

Restrict Matching Contributions to Thrift Savings. On behalf of any worker covered by FERS, federal agencies automatically contribute 1 percent of individual earnings to the Thrift Savings Plan. In addition, the employing agency matches any voluntary employee deposits up to 5 percent of earnings, with dollar-for-dollar matching for the first 3 percent of pay and 50 cents for each dollar thereafter. The entire federal contribution, including the automatic contribution, for employees putting aside a full 5 percent amounts to a sum equal to 5 percent of pay. If the government limited matching contributions to a uniform 50 percent rate (50 cents on the dollar), savings over five years would total $2.1 billion. Private employers typically match an individual's voluntary thrift deposits up to 6 percent of pay at a 50 percent rate. As modified, the government's approach would still remain superior because of the automatic 1 percent contribution. The cut in matching would hit higher-salaried professional and administrative workers hardest because they use the thrift plan the most.

ENT-52 END OR SCALE BACK TRADE ADJUSTMENT ASSISTANCE

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			End Trade Adjustment Assistance			
Budget Authority	220	220	210	200	200	1,050
Outlays	220	220	210	200	200	1,050
			Eliminate Trade Adjustment Assistance Cash Benefits			
Budget Authority	140	140	130	130	120	660
Outlays	140	140	130	130	120	660

The Trade Adjustment Assistance (TAA) program offers income replacement benefits, training, and related services to workers unemployed because 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.

Ending the TAA program would reduce federal outlays by $220 million in 1993 and by $1.1 billion during the 1993-1997 period. Affected workers could apply for benefits under Title III of the Job Training Partnership Act (JTPA), which authorizes a broad range of employment and training services for displaced workers regardless of the cause of their job loss. Given that funding for Title III is limited, however, another alternative would be to eliminate only TAA cash benefits and shift the remaining TAA funds for training and related services to Title III. Savings under this option would total $660 million during the 1993-1997 period.

The rationale for these options is to secure more equivalent treatment under federal programs of workers who are permanently displaced as a result of changing economic conditions. Since Title III of JTPA 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 argue, therefore, that eliminating TAA benefits could lessen political support for free trade, which economists generally view as beneficial to the overall economy.

ENT-53 INCREASE TARGETING OF CHILD NUTRITION SUBSIDIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	400	900	970	1,050	1,100	4,450
Outlays	340	830	960	1,050	1,100	4,300

Federal child nutrition programs were developed to improve the health and well-being of children by providing them with nutritious meals. The programs provide cash and commodity assistance to schools, child care centers, and family day care homes that serve meals to children.

Although most of the funds are targeted toward low-income children, some of the aid benefits middle- and upper-income children as well. For example, in the National School Lunch Program (the largest of the child nutrition programs), most schools receive $1.66 in cash reimbursement for each meal served to children from households with incomes at or below 130 percent of the poverty line; a smaller subsidy of $1.26 for each meal served to children from households with incomes from 131 percent to 185 percent of poverty; and a subsidy of 16 cents per meal for children with household incomes above 185 percent of poverty. Schools are also given approximately 14 cents' worth of commodities for each lunch served, regardless of the household income of the child. Comparable reimbursement structures are used in the School Breakfast Program and in the portion of the Child Care Food Program devoted to child care centers.

This option, which was included in the Administration's budgetary proposals for fiscal year 1991, would make three changes: Cash and commodity subsidies for school lunches served to children with incomes above 350 percent of the poverty level would be eliminated. Subsidies for lunches served to children from families with incomes above 185 percent of the poverty level in family day care homes would be made comparable with those in child care centers, resulting in a sharply reduced 24 cent subsidy per lunch. School lunch subsidies for children from families with incomes from 131 percent to 185 percent of the poverty level would be increased by 20 cents.

Together, these changes would reduce federal expenditures by about $4.3 billion during the 1993-1997 period. Eliminating the cash and commodity subsidies for all lunches served to children from households with incomes above 350 percent of the poverty line ($46,900 per year for a family of four in 1991) would reduce federal expenditures by $60 million in 1993, by $540 million in 1994, and by $2.6 billion during the 1993-1997 period. (These estimates assume that the changes would be effective on July 1, 1993, except for the change in subsidies to family day care homes, which would have an October 1, 1992, effective date.) Reducing the subsidies for the children in family day care homes would lower federal expenditures by $300 million in 1993 and by $2.1 billion during the 1993-1997 period. The higher subsidies called for in the third part of the option would increase federal expenditures by $470 million during the five-year period.

In these estimates, CBO assumes that the reduction in federal subsidies would lead a small number of schools--those serving rela-

tively few meals to children from families with low incomes--to discontinue the program for all students. The savings resulting from schools dropping out of the program are an estimated $230 million over five years.

Although most of the federal funds are targeted toward low-income children, about one-fifth of the children who participate in the school lunch program have household incomes above 350 percent of the poverty line and about three-quarters of the participating children in family day care homes have household incomes above 185 percent of the poverty line. These children are less in need of federal subsidies, and the targeting of this assistance would be improved by limiting it to those from households with the lowest incomes. Increases in the subsidies for meals served to children in households with incomes from 131 percent to 185 percent of poverty would, in effect, redistribute some of the child nutrition subsidies from higher-income students to this group.

Such changes would probably result in lower participation among nonpoor children because participation falls when prices are raised. Participating schools and child care centers would probably increase the price charged to nonpoor children to make up the loss in reimbursements unless state and local governments provided additional support. Children who dropped out of the program could receive meals of lower quality, since the meals qualifying for reimbursement are nutritionally adequate, whereas those from alternative sources might not be. Moreover, if the decline in participation were substantial, low-income children could become the main recipients of the meals and thus would be identifiable as poor by their peers. Finally, a few schools where nonpoor children provide a large share of the total revenue for the meal program would probably drop out when participation fell, thereby eliminating federally subsidized meals for the low-income children attending them.

ENT-54 ELIMINATE SMALL FOOD STAMP BENEFITS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	80	80	80	80	80	400
Outlays	80	80	80	80	80	400

The Food Stamp program provides coupons that enable low-income householders to buy a low-cost but nutritionally adequate diet. Among all programs providing assistance to low-income people, its reach is the greatest, encompassing all types of households, from the elderly living alone to two-parent families with children.

Because the benefits to which a household is entitled decline as its income rises, some households can receive only small amounts of food coupons each month. For one- and two-person households, a special rule increases the food coupons they receive to $10 a month even if their net income indicates a smaller coupon amount.

This option would eliminate the special rule that ensures a $10 minimum benefit for eligible households with one or two persons, and would also eliminate any food stamp benefits of less than $10 a month for all households, thereby reducing federal expenditures by $80 million in 1993 and by $400 million during the 1993-1997 period. These savings include an estimated $10 million a year from lower administrative costs. Approximately 600,000 households, of which two-thirds are composed of elderly people, would lose their food stamp benefits.

Carrying out this option would make administration in the Food Stamp program more cost-effective because a large number of households that receive small monthly benefits would no longer have to be served. It would also eliminate the special treatment of one- and two-person households. Finally, such a change would foster consistency between the Food Stamp program and the Aid to Families with Dependent Children program, which has not paid benefits of less than $10 a month for the past decade.

At the same time, this option would reduce by as much as $120 a year the effective incomes of households whose incomes are already low. Even though the households that would be affected are those with the highest incomes among food stamp recipients, their incomes are usually close to the poverty threshold.

ENT-55 ELIMINATE THE $50 CHILD SUPPORT PAYMENT TO AFDC FAMILIES

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	170	180	180	190	200	920
Outlays	170	180	180	190	200	920

The Child Support Enforcement program collects child support payments from absent parents on behalf of families receiving Aid to Families with Dependent Children (AFDC). These payments are largely used to offset federal and state costs for AFDC. Amounts up to the first $50 in monthly child support collected, however, are paid to the AFDC family, with no effect on the level of AFDC benefits. In essence, this policy means that AFDC families for whom absent parents contribute child support get as much as $50 more per month than do otherwise identical families for whom such contributions are not made.

Eliminating the $50 child support payment to AFDC families would save the federal government $170 million in fiscal year 1993 and $920 million through 1997. Stopping such payments would end the differential treatment of AFDC families that depends on whether the absent parent pays child support. Administrative complexity would also be reduced.

Nevertheless, the child support payment continues to provide incentives for custodial parents to make an effort to obtain support. If the payment were eliminated, AFDC recipients would be no better off when absent parents paid child support than when they did not, perhaps reducing recipients' cooperation in seeking such payments. Absent parents also might reduce their child support payments if this option were enacted, although new enforcement tools such as wage withholding would make it difficult for many to do so. In either case, the well-being of the children in these families would be adversely affected.

ENT-56 REDUCE THE $20 EXCLUSION FROM INCOME IN SUPPLEMENTAL SECURITY INCOME

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	150	160	170	170	180	830
Outlays	150	160	170	170	180	830

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments, based on uniform, nationwide eligibility rules, to needy aged, blind, or severely disabled persons. As a means-tested program, SSI benefits are reduced by recipients' outside incomes, subject to certain exclusions. For unearned income, most of it from Social Security payments, the first $20 a month is excluded and any additional amounts reduce benefits dollar for dollar. Earned income is excluded more liberally, and any of the $20 exclusion not applied to unearned income is applied to earned income.

Reducing the $20 exclusion to $15 would save $150 million in 1993 and $830 million over the 1993-1997 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, as illustrated by the absence of any standard exclusions for unearned income (other than child support) in the Aid to Families with Dependent Children program.

Nevertheless, reducing the $20 exclusion would decrease by as much as $60 a year the incomes of the roughly 2.3 million low-income people--50 percent of all federal SSI recipients--who now benefit from the exclusion. Even with the full $20 exclusion, incomes of most SSI recipients fall below the poverty threshold.

ENT-57 REDUCE THE FEDERAL MATCHING RATE AND INCREASE FEES IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Reduce the Federal Matching Rate			
Budget Authority	a	a	a	520	560	1,050
Outlays	a	a	a	520	560	1,050
			Charge Fees for Services			
Budget Authority	a	a	a	55	65	120
Outlays	a	a	a	55	65	120

NOTE: These estimates do not take into consideration the interaction between the two options, which is noted in the discussion.

a. The options would not take effect until 1996.

Enacted in 1975, the Child Support Enforcement (CSE) program provides administrative tools and funding that states can use to improve the payment of child support by absent parents. The federal government helps states finance their CSE efforts by paying 66 percent of the costs and making incentive payments. Because of this federal funding and because they keep a portion of child support collections, states saved an estimated $380 million in 1991. In contrast, the federal government incurred costs in 1991 of about $590 million, after accounting for its share of child support collections.

To improve the performance of the program, the Family Support Act of 1988 required several complex changes in child support practices, some of which need not be implemented until 1994 and 1995. In order to allow sufficient time for states and localities to implement these changes without disruption, the options presented here would not take effect until 1996.

Reduce the Federal Matching Rate to 50 Percent. Lowering the federal matching rate from 66 percent to 50 percent in 1996 and subsequent years is estimated to save $520 million in 1996 and $560 million in 1997, although the amount of savings could vary, depending on how states reacted to the change.

Reducing the federal share of CSE costs would alter the balance of costs and savings between the federal and state governments, decreasing both federal costs and state savings. Although a higher matching rate may have been needed in the past to induce states to set up CSE programs, such programs are now operating and cannot be dismantled without financial penalty. Even with a 50 percent matching rate, states would continue to save money. Finally, this option would encourage states to improve the efficiency of their CSE efforts, since they would pay a larger share of the costs of inefficiencies, and could thus lead to even lower program costs overall.

Lowering the matching rate would entail some risks, however. Because states probably could not improve efficiency enough to offset fully the reduction in federal payments, they might cut CSE services, thereby reducing child support collections. The lower CSE collections for AFDC families would decrease state revenues from that source, but some states still might be better off financially if

they cut CSE services, since those with low per capita incomes may receive only a small share--as low as 20 percent--of child support collected. Further, states receive only small financial benefits from child support collections for non-AFDC families. They might, therefore, be even more likely to cut back on efforts for those families, thereby lowering the children's living standards.

Charge Fees to Some Families Receiving Services. Although states are required to charge application fees for furnishing child support services to non-AFDC families, many states charge only nominal amounts. In 1990, child support enforcement agencies collected fees amounting to $22 million, or 1 percent of total program costs. This option would require states to charge non-AFDC families fees of $25 at the time they applied for services and $25 each year in which child support was collected for them. Some flexibility could be given to states by allowing them to charge the annual user fee to either the custodial parent or the absent parent, to exempt low-income families but charge more to higher-income families, or to pay the fee directly to the federal government without charging families.

If the fee requirement were imposed beginning in 1996, the federal government would save $55 million that year and $65 million in 1997 at the current 66 percent federal matching rate. With a matching rate of 50 percent, as discussed above, savings would decline to $45 million in 1996 and $50 million in 1997.

Considering the substantial services many families receive from the child support enforcement agencies, these fees would be a modest contribution toward meeting their costs. Charging fees could discourage some custodial parents from seeking assistance, however, potentially reducing collections of child support. The families most likely to be discouraged would probably be those most in need of the income, unless states chose to exempt low-income families from paying the fees. In addition, states have often complained about the costs of collecting fees, particularly when they do not have adequate computerized systems. Under those circumstances, it is particularly desirable to delay the effective date for any fee requirements until after the enhanced automated systems required by the Family Support Act are in place.

ENT-58 IMPOSE A FEE FOR FEDERAL ADMINISTRATION OF SSI STATE SUPPLEMENTARY PAYMENTS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	140	150	150	160	170	770

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments to needy aged, blind, or severely disabled persons. Established by the 1972 amendments to the Social Security Act and begun in 1974, SSI replaced the federal/state programs for Old-Age Assistance, Aid to the Blind, and Aid to the Permanently and Totally Disabled. The maximum federal payment is $422 a month for an individual and $633 a month for a couple. States may supplement the federal payment and choose to have the Social Security Administration (SSA) administer these supplements; the SSA does that--at no charge--for 27 states and the District of Columbia. This option would impose a fee for the service.

Fees could be levied in several ways: for example, per recipient of state supplements, or as a percentage of a state's total supplementary payments. This option sets a flat fee of $5 monthly for each recipient. CBO estimates that the SSA would collect $140 million in fees in 1993 and $770 million in the 1993-1997 period. (About 40 percent of the money would be collected from California.)

Imposing an administrative fee would reimburse the federal government for a service it is providing to some states. If the states involved determined that they could administer their supplements at lower cost, they would be free to do so.

The increase in cost that the states would incur could, however, discourage some of them from supplementing the federal SSI payments; it could also result in smaller amounts being provided, although most states cannot reduce their nominal payments because of certain provisions of federal law. Opponents also note that the federal payments alone are insufficient to raise the incomes of SSI recipients to the poverty line and that state supplements help fill the gap; the federal government should therefore encourage them. Moreover, the two states that have chosen to substitute additional SSI payments for food stamps--California and Wisconsin--are saving the federal government its share of the costs of administering food stamp benefits for their SSI recipients.

ENT-59 RESTRICT COST-OF-LIVING ADJUSTMENTS IN NON-MEANS-TESTED BENEFIT PROGRAMS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Eliminate COLAs for One Year						
Social Security/ Railroad Retirement	6,450	8,850	8,850	8,750	8,450	41,350
Other Non-Means-Tested Programs	1,750	2,400	2,450	2,500	2,600	11,700
Offsets in Means-Tested Programs and Medicare Premiums	-230	-320	-330	-340	-350	-1,550
Total	8,000	10,950	10,950	10,900	10,750	51,500
Limit COLAs to Two-Thirds of the CPI Increase for Five Years						
Social Security/ Railroad Retirement	2,150	5,550	9,150	12,900	16,650	46,350
Other Non-Means-Tested Programs	590	1,500	2,500	3,450	4,600	12,650
Offsets in Means-Tested Programs and Medicare Premiums	-75	-200	-330	-660	-1,050	-2,300
Total	2,650	6,850	11,250	15,700	20,200	56,700
Limit COLAs to the CPI Increase Minus 2 Percentage Points for Five Years						
Social Security/ Railroad Retirement	4,050	9,700	15,550	21,550	27,600	78,400
Other Non-Means-Tested Programs	1,100	2,650	4,200	5,800	7,700	21,450
Offsets in Means-Tested Programs and Medicare Premiums	-150	-350	-570	-1,100	-1,750	-3,900
Total	5,000	12,000	19,200	26,250	33,500	96,000
Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years						
Social Security/ Railroad Retirement	0	920	2,150	3,450	4,700	11,250

Under current policies, outlays for Social Security and other non-means-tested cash transfer programs whose benefits are indexed to the consumer price index (CPI) are expected to total $350 billion in 1993 and to rise to $430 billion by 1997. Reducing the automatic cost-of-living adjustment (COLA) for these programs is commonly proposed as one way to slow the growth in entitlement spending. Four strategies for reducing COLAs and the savings in outlays resulting from each are shown in the preceding table. The programs in which COLAs would be reduced under the first three options are Social Security Old-Age, Survivors, and Disability Insurance; Railroad Retirement; Civil Service Retirement; Military Retirement; Federal Employees Workers' Compensation; Veterans' Compensation; and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. The fourth option would affect only Social Security and Railroad Retirement Tier I COLAs. (Other options for achieving savings in Social Security are given in ENT-60, ENT-61, ENT-62, and REV-13.)

COLA restrictions would achieve considerable savings by exacting small reductions in benefits from a large number of people, in contrast to other budget options that would impose large reductions in benefits on smaller groups of recipients. Moreover, limiting these options to the non-means-tested cash benefit programs would protect many of the poorest beneficiaries of entitlements--for example, recipients of Supplemental Security Income--from losses of income. Finally, because the benefit levels would be permanently lowered for those eligible when the COLA limitation was established, significant reductions in outlays would persist beyond the five-year projection period. The savings would eventually disappear, however, as beneficiaries died or stopped receiving payments for other reasons, unless the COLA limitation was accompanied by a permanent reduction in the initial benefits of newly eligible workers (see ENT-60).

Budget reduction strategies that institute less-than-complete price indexing would, however, result in financial difficulties for some recipients--particularly if COLAs were restricted for an extended period. Restrictions on COLAs also encounter opposition from those who fear that changes made to reduce budget deficits would undermine the entire structure of retirement income policy. For example, because private pension plans generally do not offer complete indexing, restricting Social Security COLAs would further reduce protection for beneficiaries against inflation. Some people also think that, because Social Security and other retirement programs represent long-term commitments to both current retirees and today's workers, these programs should be altered only gradually and then only for programmatic reasons. According to this view, any changes in benefits should be announced well in advance to allow people to adjust their long-run plans.

Unless restrictions on COLAs were accompanied by commensurate changes in determining initial benefits for new recipients, disparities in benefit levels would develop among different cohorts of retirees. This situation is particularly relevant for Social Security, where benefits for newly eligible individuals are based on an indexed benefit formula and on indexed earnings histories. For example, if prices rose by 4 percent in a year and the wage index used to compute benefits for newly eligible recipients increased by 5 percent, eliminating that year's COLA without any change in the calculation of initial benefits would result in benefits for new beneficiaries that were about 5 percent higher than for recent retirees; under current law, benefits would be only about 1 percent higher for the new retirees. To mitigate this problem and to achieve additional savings, efforts to slow the growth in benefits through COLA limitations might be extended to the formulas for determining initial benefits (see ENT-60).

Several options that would restrict COLAs for current beneficiaries are examined below. Except for the option to limit COLAs to 2 percentage points less than the increase in the CPI, the magnitude of the savings in each case--as well as the impact on beneficiaries--would be very sensitive to the level of

inflation in the years in which the COLAs would be reduced. If prices were to rise faster than currently assumed, savings would be greater than shown, and recipients would bear larger costs. If prices were to rise less quickly, both budgetary savings and the effect on recipients would be smaller.

The following sections describe the savings from specific versions of COLA restrictions and discuss any effects unique to the individual version.

Eliminate COLAs for One Year. One option would be to eliminate COLAs in fiscal year 1993 for non-means-tested benefit programs, while allowing them to be paid in subsequent years, but with no provision for making up the lost adjustment. If this approach were taken, federal outlays would be reduced by about $8.0 billion in 1993 and $51.5 billion over five years, with Social Security and Railroad Retirement accounting for most of the total.

Limit COLAs to Two-Thirds of the CPI Increase for Five Years. Under this approach, recipients would be compensated for only a certain proportion of inflation, such as two-thirds of the annual CPI increase. Under current CBO economic assumptions, applying this restriction for five years would save about $2.7 billion next year and $56.7 billion over the 1993-1997 period. As a result, benefits for people who received payments throughout the five-year period would be about 5 percent less in 1997 than they would have been under full price indexing. Furthermore, the effects of this option would grow over time, reducing the real income of beneficiaries at the same time that they were becoming less able to supplement their income by working.

Limit COLAs to the CPI Increase Minus 2 Percentage Points for Five Years. An approach similar to the proportionate COLA reduction would be to reduce the adjustment by a fixed number of percentage points--for example, set the adjustment at the CPI increase less 2 percentage points. Unlike other options to restrict COLAs, however, both savings and effects on beneficiaries would be roughly the same regardless of the level of inflation--about $96.0 billion over the next five years, if extended for the full period. As in the last option, this approach would be cumulative and would therefore significantly reduce the real incomes of beneficiaries at the same time that their ability to supplement their incomes by working declined.

Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years. Another alternative would tie the COLA reductions to beneficiaries' payment levels, starting in 1994. The example discussed here--based only on Social Security and Railroad Retirement Tier I benefits--would award the full COLA for benefits based on the first $600 of a retiree's monthly Primary Insurance Amount (PIA) and 50 percent of the COLA on benefits above this level. The $600 per month threshold is about equal to the projected 1994 poverty threshold for an elderly person and would be indexed to maintain its value over time.

This approach would save about $0.9 billion in 1994 and $11.2 billion over the 1994-1997 period. Because of the time needed to implement this proposal, these estimates assume that it would be in place by January 1994. For comparison with other options--which could be carried out earlier--the 1993-1997 budget savings would be $16.2 billion if this option were effective for the January 1993 COLA.

Because the full COLA would be paid to beneficiaries with low PIAs, this option would ensure that low-income recipients would not be adversely affected. Moreover, its percentage impact would be greater for recipients with higher benefits. Nonetheless, benefit levels are not always good indicators of total income. Some families with high benefits have little other income, while some with low benefits have substantial income from other sources. Furthermore, many people object to any changes in retirement programs that

might be construed as introducing a means test for benefits, even if the test is limited only to the COLA.

A variation would extend this approach to the other non-means-tested benefit programs besides Social Security; this variation is not shown in the table. Such an option would spread the effects among a wider group of recipients, although it might be somewhat more complicated to design because the different benefit structure in each program could require separate determinations of the appropriate benefit levels on which to pay reduced COLAs.

Eliminating COLAs for recipients whose benefits are based on PIAs above a certain level is another option. Because this reduction would affect the entire benefit of each recipient above the threshold, not just the portion of the benefit above that level, both the savings and the impacts on beneficiaries would be considerably greater. Unless adjustments were made at the threshold, however, recipients with benefits just below the threshold could be made better off than those with benefits just above the threshold. Still another approach that would address some of the administrative problems of these two options would involve increased taxation of Social Security benefits (see REV-13).

ENT-60 REDUCE THE REPLACEMENT RATE WITHIN EACH BRACKET OF THE SOCIAL SECURITY BENEFIT FORMULA

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	100	420	840	1,350	2,000	4,700

Under current law, the basic Social Security benefit is determined by a formula that provides workers with 90 percent of their Average Indexed Monthly Earnings (AIME) up to the first bend point (which defines the first earnings bracket), plus 32 percent of the AIME in the second bracket, plus 15 percent of the AIME above the second bend point. One method of reducing initial Social Security benefits would be to lower these three rates by a uniform percentage.

Lowering the three rates in the benefit formula from 90, 32, and 15 to 87.3, 31.0, and 14.6, respectively, would achieve an essentially uniform 3 percent reduction in the benefits of newly eligible workers starting in 1993. Thus, a 62-year-old retiree who has always earned the average wage would receive initial benefits in 1993 of about 33.4 percent of preretirement earnings, compared with 34.5 percent if no change were made.

This reduction in the replacement rates would lower Social Security outlays by about $4.7 billion over the 1993-1997 period and by more in later years. Moreover, this option would reduce the benefits of all future retirees by essentially the same percentage. Furthermore, the option could be combined with a cut in the cost-of-living adjustment to ensure that benefits for both current and future recipients would be reduced to a similar extent (see ENT-59). The combination would generate substantial budgetary savings, while having a relatively small impact on both current and future beneficiaries.

Opponents contend that the Social Security Amendments of 1983 have already sharply reduced the benefits of future retirees and that further reductions would be unfair. In particular, the age at which unreduced Social Security retirement benefits are first available will rise in stages from 65 to 67 for workers turning 62 between the years 2000 and 2022. As a consequence, benefits for workers retiring after the turn of the century will be less than what would have been received had the full retirement age not been increased. For example, a worker who retires at age 62 in 2022 will receive 70 percent of the Primary Insurance Amount, compared with 80 percent for a worker who retires at age 62 in 1992.

An alternative method of reducing Social Security benefits would leave replacement rates unchanged but narrow the AIME brackets over which those rates apply, perhaps by reducing the pace at which the brackets are indexed for inflation. This approach would exempt beneficiaries with the lowest AIMEs from the cut, but would impose benefit reductions unevenly among other recipients.

ENT-61 ELIMINATE SOCIAL SECURITY BENEFITS FOR CHILDREN OF RETIREES AGED 62-64

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	85	260	480	600	620	2,050

Unmarried children of retired workers are eligible for Social Security benefits as long as they are under age 18, or attend elementary or secondary schools and are under age 19, or become disabled before age 22. A child's benefit is equal to one-half of the parent's basic benefit, subject to a dollar limit on the maximum amount receivable by any one family. If such benefits were eliminated for the children of retirees aged 62 through 64, beginning with retirees reaching age 62 in October 1992, the savings would total $2.0 billion over the next five years.

This option might encourage some early retirees to stay in the labor force longer. At present, though benefits for retired workers and their spouses are actuarially reduced if retirement occurs before age 65, children's benefits are not. Further, the younger the workers are, the more likely they are to have children under age 18. Thus, workers under age 65 now have an incentive to retire while their children are still eligible for benefits. This incentive is quite small, however, for families in which spouses are also entitled to dependents' benefits. For these families, the increase in total benefits attributable to all eligible children cannot exceed 38 percent of the worker's Primary Insurance Amount.

However, for families with workers whose retirement was not voluntary--because of poor health or unemployment, for example--the loss in family income might cause some hardship. Moreover, since spouses under age 62 receive benefits only if their children under age 16 also receive benefits, eliminating children's benefits for families of early retirees would also result in the loss of entire benefits for spouses in some families. In such cases, the total loss of income would generally be large.

A different approach would apply the same actuarial reduction to children's benefits that is applied to the benefits of the worker on whom those benefits depend. Thus, for example, the child of a worker retiring at age 62 would receive a maximum of 40 percent of the parent's basic benefit, instead of the 50 percent that is currently allowed. Such an approach would avoid large losses in benefits for workers with young children, but would save less.

ENT-62 LENGTHEN THE SOCIAL SECURITY BENEFIT COMPUTATION PERIOD BY THREE YEARS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Outlays	35	150	360	670	1,050	2,250

Social Security retirement benefits are based on the Average Indexed Monthly Earnings (AIME) of workers in employment covered by the system. The present formula computes AIME based on workers' best 35 years of employment. Lengthening the averaging period would generally lower benefits slightly by requiring more years of lower earnings to be factored into the benefit computation. This option would increase the AIME computation period gradually until it reached 38 years for people turning age 62 in 1995 or beyond. This approach would save $2.3 billion over the next five years and more in later years.

One argument for a longer computation period is that people are now living longer and the normal retirement age for the Social Security program will be raised beginning in the year 2000. Using more years to calculate the AIME would reduce incentives for early retirement. In addition, lengthening the averaging period would reduce the advantage that workers who postpone entering the labor force have over those who get jobs at younger ages. Because many years of low or no earnings can be ignored in calculating AIME, the former group currently experiences little or no loss of benefits for its additional years spent not working and thus not paying Social Security taxes.

Because some beneficiaries elect early retirement for such reasons as poor health or unemployment, an argument against this proposal is that a longer computation period would reduce benefits for recipients who are least able to continue working. Other workers who would be disproportionately affected include those with significant periods outside the Social Security system, such as parents--usually women--who interrupted their careers to rear children, and workers who experienced long periods of unemployment or employment not covered by Social Security.

ENT-63 CONSIDER VETERANS' COMPENSATION WHEN DETERMINING SOCIAL SECURITY DISABILITY INCOME PAYMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
			Coordinate Benefits for All Veterans Receiving Compensation			
Outlays	80	110	120	130	140	580
			Coordinate Benefits for Veterans Newly Awarded Compensation			
Outlays	10	20	30	40	55	150

People with disabilities may qualify for cash payments from more than one source, including the Social Security Disability Insurance (DI) program, veterans' compensation, workers' compensation, means-tested programs like the Supplemental Security Income program, and private disability insurance. If they are younger than 65 and covered under Social Security, workers who are unable to work because they are physically or mentally impaired may qualify for DI payments.

When Social Security beneficiaries are eligible for multiple disability benefits, ceiling arrangements limit the combined disability benefit to 80 percent of the workers' average current earnings before they were disabled. The combined payment after the reduction is adjusted periodically for changes in the cost of living and in national average wage levels. Veterans' compensation payments for disabilities, however--as well as needs-tested benefits and benefits based on public employment covered by Social Security--are not included when applying the ceiling.

Approximately 2.2 million veterans--about 1.2 million of whom are under age 65--receive compensation for service-connected disabilities. The amount of compensation is based on a rating of an impairment's average effect on a person's ability to earn wages in civilian occupations. Additional allowances are paid to veterans whose disabilities are rated 30 percent or higher and who have dependent spouses, children, or parents. An estimated 140,000 veterans who receive compensation also receive DI payments from the Social Security program.

This option, which has two variations, would include veterans' compensation within the scope of the ceiling. (The combined payment, however, would never be less than either the DI benefit or the veterans' compensation payment.) Under both versions, compensation would be totaled when determining how much the DI benefit of an individual under 65 would be reduced to keep the combined benefit from exceeding the ceiling. One version of the option would apply this change to all current and future recipients of veterans' disability compensation. The other version would limit application of the option to veterans newly qualifying for disability compensation in the future.

Applying the change to both current and future recipients of veterans' compensation would affect an estimated 30,000 recipients in 1993 and would save an estimated $580 million over the 1993-1997 period. Applying the

change only to veterans newly awarded compensation payments in the future would affect an estimated 15,000 recipients by 1997 and would save an estimated $150 million over the 1993-1997 period.

These options would mean that an explicit policy would determine the total amount of public compensation for veterans with service-connected disabilities. Thus, the federal government would treat in a more consistent way people who receive cash disability payments from multiple programs that are not needs-tested. Both versions of the option could, however, be seen as subjecting veterans' compensation benefits to a form of income testing. Moreover, under the variation of this option that would apply to current recipients of disability compensation, the incomes of some disabled veterans would drop.

ENT-64 RESTRICT ELIGIBILITY FOR VETERANS' COMPENSATION PAYMENTS

Savings from CBO Baseline	Annual Savings (Millions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Savings
	End Compensation Payments for All Veterans with Low-Rated Disabilities and for New Veterans with Disabilities Unrelated to Military Duties[a]					
Budget Authority	1,350	1,500	1,700	1,900	2,100	8,550
Outlays	1,700	2,100	2,100	2,050	2,350	10,300
	End Disability Benefits for Low-Rated Disabilities					
Budget Authority	1,600	1,650	1,700	1,750	1,850	8,550
Outlays	1,450	1,750	1,700	1,650	1,850	8,400
	End Dependents' Allowances for Veterans with Low-Rated Disabilities					
Budget Authority	240	250	250	260	260	1,250
Outlays	220	260	250	240	260	1,250
	End Disability and Death Compensation Awards in Future Cases When a Disability is Unrelated to Military Duties					
Budget Authority	-500	-380	-230	-85	75	-1115
Outlays	20	85	150	200	320	780

a. This option combines the three measures shown separately below. Total savings would be less than the sum of the savings from carrying out each specific measure on its own because some new disabilities will be both low-rated and unrelated to military duties and because reducing the number of new compensation awards would reduce the number of dependents receiving allowances.

Approximately 2.2 million veterans with service-connected disabilities receive veterans' disability compensation benefits. Service-connected disabilities are currently defined as those resulting from diseases, injuries, or other physical or mental impairments that occurred or were aggravated during military service, excluding those resulting from willful misconduct. Disabilities need not be incurred or aggravated while performing military duties to be considered service connected; for example, disabilities incurred while on leave also qualify.

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. Demonstrated loss of income, however, is not a requirement for eligibility. Veterans' disability ratings range from 0 percent to 100 percent (most severe). Veterans unable to maintain gainful employment 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. Receiving veterans' disability compensation does not affect the level of Social Security disability benefits to which an individual may be entitled (see ENT-63).

Currently, 1.2 million veterans have disability ratings below 30 percent and they receive benefits of between $68 and $157 per month. Of the 660,000 veterans receiving dependents' allowances, about 410,000 have disability ratings of 30 percent, 40 percent, or 50 percent; their dependents' allowances average $47 monthly. According to a 1989 survey by the Department of Veterans Affairs (VA), compensable injuries or diseases were unrelated to the performance of military duties for about 50 percent of veterans receiving compensation payments, while the relationship to military duties was uncertain for a further 5 percent. Nearly half the veterans compensated for disabilities unrelated to military duties, however, would be eligible for military retirement benefits if their veterans' compensation claims were denied. (This offset is reflected in the table.)

Federal outlays could be reduced by $10.3 billion during the 1993-1997 period by adopting three measures that would target veterans' compensation payments toward those with higher-rated disabilities and, for new veterans, toward those with disabilities related to military duties. Ending disability benefits for low-rated disabilities would, on its own, achieve more than three-quarters of these savings. None of these measures would affect veterans' eligibility for Social Security disability benefits.

Eliminating compensation benefits for those with disability allowances below 30 percent would target spending toward the most impaired veterans. Because performance in civilian jobs depends less on physical labor than when the disability ratings were originally set, and because improved reconstructive and rehabilitative techniques are now available, physical impairments rated below 30 percent may not reduce veterans' earnings. Low-rated disabilities 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.

Similarly, eliminating dependents' benefits for veterans with disability ratings of 30 percent to 50 percent would target compensation toward the families of disabled veterans who are most impaired. In addition, the continuing increase in the proportion of households where both spouses work means that dependents' allowances for veterans with disability ratings below 60 percent may not be necessary to maintain adequate family incomes.

Ending disability and death compensation awards in future cases in which a disability is neither incurred nor aggravated while performing military duties would make disability compensation of military personnel comparable with disability compensation of federal civilian employees under workers' compensation arrangements. In both cases, diseases, injuries, or impairments unrelated to employment tasks would not create an entitlement to compensation. The VA's formal appeals system could be extended to cover rulings that disabling conditions were unrelated to military duties.

Some disabled veterans--especially older ones who have retired--might, however, find it difficult to increase their working hours or otherwise make up the loss in compensation payments. Moreover, removing dependents' allowances because a spouse may have income could be interpreted as an indirect means test on veterans' family income--a test that uses a poor proxy for this income. One objection to the last measure is that, because military personnel are assigned to particular geographic locations where situations may sometimes be volatile, they have less control than civilians over where they spend their off-duty hours.

ENT-65 RAISE THE LOAN FEE FOR HOUSING LOANS GUARANTEED BY THE DEPARTMENT OF VETERANS AFFAIRS

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Budget Authority	260	270	280	290	300	1,400
Outlays	260	270	280	290	300	1,400

The Department of Veterans Affairs (VA) supports home ownership by veterans through the home loan guaranty program, which allows veterans to obtain mortgage credit from private lenders on more favorable terms than usual, such as without a down payment. In the event of foreclosure, the federal guarantee reduces the lender's potential loss. The amount and proportion of the loan principal that are guaranteed vary with the size of the loan. In 1991, net federal outlays for the program were $98 million.

Since 1982, one-time loan fees have been assessed on borrowers. Currently, the fee is 1.25 percent of the mortgage amount for loans with down payments of less than 5 percent, 0.75 percent for loans with down payments of 5 percent up to 10 percent, and 0.5 percent for loans with down payments of 10 percent or more.

Even allowing for an additional 1 percent loan-origination fee that the private lender may charge the veteran for such loans, the maximum fee of 1.25 percent is appreciably below mortgage insurance costs for private loans with small down payments and without government guarantees. Program participants therefore receive a substantial benefit relative to borrowers obtaining private mortgage insurance.

This option would reduce net federal outlays for the VA mortgage guaranty program by increasing the fees paid by veterans (see ENT-66). Raising the maximum loan fee to 3 percent for borrowers with down payments under 5 percent would raise borrowers' costs closer to those prevailing in the private market. (Under the option, the loan fee would be raised to 2 percent for loans with down payments of 5 percent up to 10 percent, and to 1.5 percent for loans with down payments of at least 10 percent.) If this option were in place by October 1, 1992, it would reduce federal outlays by $1.4 billion over the next five years.

The primary justification for this option is that the amount paid by new participants in the VA program to obtain a mortgage guarantee would become closer to the costs of private mortgage insurance. The primary disadvantage of these measures is that increased charges might discourage participation by some low-income potential homebuyers who are targeted for housing assistance.

ENT-66 ELIMINATE "SUNSET" DATES ON PROVISIONS FOR VETERANS IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1990

Savings from CBO Baseline	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1993	1994	1995	1996	1997	
Reduce Pensions to Medicaid Nursing Home Residents						
Budget Authority	65	65	70	70	75	340
Outlays	60	70	65	65	75	330
Verify Income Reported for Pension Purposes						
Budget Authority	30	50	70	90	110	350
Outlays	25	55	70	80	110	340
Recover Certain Medical Care Costs for Veterans from Third Parties						
Budget Authority	0	170	210	240	250	870
Outlays	0	170	210	240	250	870
Impose a $2 Medication Charge						
Budget Authority	45	55	55	60	65	280
Outlays	45	55	55	60	65	280
Increase Loan Fees by 0.625 Percentage Points						
Budget Authority	95	100	100	110	110	520
Outlays	95	100	100	110	110	520
Eliminate All Sunset Dates[a]						
Budget Authority	230	440	510	570	610	2,350
Outlays	230	450	510	550	610	2,350

NOTE: Savings include reductions in both direct spending and discretionary appropriations.

a. These amounts exclude possible savings in outlays, totaling $920 million, from eliminating the sunset date on another provision that limited compensation benefits for certain veterans rated as incompetent; a court injunction has barred future application of this OBRA-90 provision. Also excluded are savings, totaling less than $5 million, from eliminating the sunset date on an additional provision that modified medical care categories and copayment requirements.

The Omnibus Budget Reconciliation Act of 1990 (OBRA-90) included a number of provisions affecting veterans that contain "sunset dates"--dates when the provisions cease to apply. Although two of these sunset dates were subsequently delayed one year, all of them either have already passed or are in 1992 or 1993. Under the current budget rules, sunset dates achieve new savings each time the sunset date is pushed back for another year because the baseline from which temporary savings in program spending are measured reverts back to the original higher benefit level for the period after the sunset date. The effects of five of the provisions have been to:

o Limit to $90 the monthly pension for certain veterans without dependents

who are eligible for Medicaid coverage for care they are receiving in nursing homes (expires September 30, 1992);

- Authorize the Internal Revenue Service to help the Department of Veterans Affairs (VA) verify incomes reported by veterans, for the purpose of establishing eligibility for pensions and benefits (expires September 30, 1992);

- 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 to the veteran for the treatment of nonservice-connected disabilities (expires October 1, 1993);

- Impose a $2 copayment for pharmaceuticals that the VA provides on an outpatient basis to veterans who do not have service-connected disabilities rated 50 percent or more (expires September 30, 1992); and

- Raise the loan fees payable to the VA for VA-guaranteed housing loans by 0.625 percentage points (expired September 30, 1991; see ENT-65).

The option would make the effects of these provisions permanent by eliminating the sunset date in each case. If all five provisions were made permanent, savings during the 1993-1997 period would total about $2.3 billion.

The main advantage of this option is that it would convert the temporary savings achieved by these provisions of OBRA-90 into ongoing savings. The main disadvantage of the option is that certain veterans or their insurers would be worse off financially.

Chapter Five

Revenues

In 1991, federal spending amounted to 23.5 percent of gross domestic product (GDP), but federal revenue was only 18.7 percent of GDP. The resulting deficit of $269 billion increased the federal debt held by the public to $2.7 trillion. Even if the Congress complies with the Budget Enforcement Act, the cumulative deficit during the 1993-1997 budget period will still be about $1.2 billion, according to CBO's projections.

About 90 percent of federal revenue comes from income and payroll taxes. In 1991, the individual income tax raised 44 percent of federal revenue, while the payroll tax raised 38 percent and the corporate income tax raised 9 percent. The rest came from excise taxes, estate and gift taxes, customs duties, and fees.

The overall burden of federal taxes is moderately progressive, with higher-income families paying a greater share of their income in tax than lower-income families. CBO estimates that in 1989, the most recent year for which tax return information is available, families in the bottom income quintile paid about 9 percent of their income in federal tax, whereas families in the middle income quintile paid 19 percent and families in the top income quintile paid 26 percent. As a share of income, the burden of income taxes is relatively greater for higher-income families, while the burden of payroll and excise taxes is relatively greater for lower-income families. The individual income tax can be made more or less progressive by changing either the tax base or the rate schedule. To a lesser extent, the distribution of the payroll tax burden can be adjusted by changing the cap on wages that are subject to tax. Policymakers, however, have little control over how the burdens of other tax sources are distributed.

Federal taxes create incentives that affect the allocation of economic resources in the private sector. Some of these incentives promote public policy goals. For example, one rationale for deducting contributions to charity under the income tax is to encourage charitable activities. Other incentives, however, are the unwanted side effects from raising revenue for public purposes in socially acceptable ways. For example, the individual income tax--whose tax base is widely accepted as a measure of the ability to pay tax--discourages work and saving by taxing their return. Similarly, the corporate income tax encourages corporations to finance their operations with debt rather than equity by allowing deductions for interest payments though not for dividends.

This chapter presents a broad range of options for increasing federal revenue. The options raise different amounts of revenue and affect economic incentives differently. They also differ in the way they allocate economic resources among alternative uses and in the way they distribute the tax burden among taxpayers. Some options raise revenue from existing tax sources either by increasing tax rates, broadening tax bases, or expanding tax coverage to include additional taxpayers. Many of these options could be undertaken

quickly and easily because the taxes are already in place. The other options raise revenue from new tax sources such as a federal value-added tax (VAT). Many of these options would impose additional administrative costs on the federal government and additional compliance costs on taxpayers.

Although most of the spending options presented in this volume would take effect on October 1, 1992, the revenue options generally take effect on January 1, 1993. The excise and energy tax options have an earlier effective date, and the VAT option has a later one. The revenue estimates for the options, which the Joint Committee on Taxation prepared, may differ from estimates for similar provisions in specific tax bills as a result of differences in effective dates, transition rules, and technical details.

REV-01 RAISE MARGINAL TAX RATES FOR INDIVIDUALS AND CORPORATIONS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Individuals						
Raise Marginal Tax Rates to 16 Percent, 30 Percent, and 33 Percent	18.3	34.4	36.7	38.8	41.0	169.2
Add a 5 Percent Surtax	13.7	25.9	27.8	29.6	31.4	128.5
Raise the Top Marginal Tax Rates to 30 Percent and 33 Percent	9.0	17.0	18.4	19.5	20.6	84.6
Raise the Top Marginal Tax Rate to 33 Percent	3.6	6.7	7.2	7.3	7.4	32.2
Raise the Top Marginal Tax Rate to 33 Percent and Add a 38 Percent Bracket	10.7	20.1	21.4	21.7	21.9	95.9
Corporations						
Raise the Top Marginal Tax Rate to 35 Percent	1.7	2.8	2.8	2.9	3.1	13.1
Add a 5 Percent Surtax	3.2	5.6	5.9	6.1	6.3	27.1

SOURCE: Joint Committee on Taxation.

Rate increases have two advantages over other tax changes as a means for raising revenue. First, they do not add to costs of enforcement or compliance because they do not increase the complexity of the tax code or the record-keeping requirements of taxpayers. Second, the Treasury begins to receive the additional revenues relatively quickly because rate increases can be incorporated in withholding and estimated tax schedules. But rate increases have drawbacks as well. Higher tax rates reduce incentives to work and save, and intensify any inefficiencies associated with remaining preferences in the income tax code.

Individuals. Under current law, the income tax structure has three explicit marginal tax rates--15 percent, 28 percent, and 31 percent, with the marginal tax rate on capital gains capped at 28 percent. (The marginal tax rate is the percentage of an extra dollar of income that a taxpayer must pay in taxes.) Until 1996,

however, some high-income taxpayers will face effective marginal tax rates of more than 34 percent as their personal exemptions are phased out and their itemized deductions are limited.

Increasing all marginal tax rates on ordinary income by approximately 7 percent--to 16 percent, 30 percent, and 33 percent--would increase revenues by a large amount: about $169 billion in 1993 through 1997. The option would not increase taxes for those whose taxes are computed according to the alternative minimum tax, unless that tax rate were also increased (see REV-03). But families with tax credits would face a somewhat larger percentage increase in their tax liabilities than other taxpayers, and families whose earned income credit (EIC) gives them a tax refund might have to pay tax as a result of this option. All of the options that change the rate schedules assume that the maximum rate on capital gains would remain at 28 percent.

An alternative to a rate increase would be to impose a surtax on tax liability after credits. A surtax would have a different effect on taxpayers than raising an equivalent amount of revenues with higher marginal tax rates. Under a surtax, higher taxes would be paid by all taxpayers who now face a positive tax liability, even those who pay the alternative minimum tax. Yet, those whose tax liability was exactly offset by tax credits under current law would have no additional tax liability. Recipients of EIC refunds would also not be affected by this form of a surtax. A surtax would also increase taxes paid on capital gains. A 5 percent surtax applied to tax liability after credits would increase revenues by about $128 billion in 1993 through 1997 and increase the top statutory marginal tax rate to 32.6 percent.

Another option is to increase only the top two marginal tax rates. Increasing the current 28 percent rate to 30 percent and the 31 percent rate to 33 percent would raise revenues by about $85 billion in 1993 through 1997. For 1993, this option would increase taxes for married couples with taxable incomes over $36,950 and single filers with taxable income over $22,100.

The remaining two individual income tax options would affect only those taxpayers in the 31 percent bracket--less than 4 percent of all taxpayers. The first option would raise their tax rate to 33 percent. In 1993, this provision would affect couples with taxable income over $89,250 and single filers with taxable incomes over $53,550. The second option would also raise the 31 percent tax rate to 33 percent and would create a new 38 percent bracket for couples with taxable incomes in excess of $125,000 and individuals with taxable incomes above $75,000. About 1 million taxpayers would be in the new 38 percent bracket. Raising the 31 percent tax rate to 33 percent would increase revenues by about $32 billion dollars in 1993 through 1997. Raising the 31 percent tax rate to 33 percent and adding a 38 percent bracket would increase revenues by about $96 billion over the same time period.

Corporations. The top statutory tax rate on corporate income is 34 percent. Lower marginal rates apply to the first $75,000 of taxable income, but corporations with taxable income between $100,000 and $335,000 pay an additional 5 percent surtax in order to phase out the benefits of the lower marginal rates.

About $13 billion could be raised in 1993 through 1997 by increasing the top marginal rate to 35 percent. Although only 10 percent of corporate taxpayers pay the top rate, these firms earn approximately 90 percent of all corporate taxable income. Corporations that continue to pay the alternative minimum tax would be unaffected by the change, and those with unused credits could offset some of the tax increase.

An alternative to raising the top corporate rate would be to impose a surtax on tax liabilities after credits. A 2.4 percent surtax would raise about the same revenues as an increase in the top rate to 35 percent; under this surtax, the top rate would be 34.8 percent. A 5 percent surtax would raise $27 billion in

1993 through 1997. In contrast to a rate increase, a surtax would apply to corporate liabilities from the alternative minimum tax, and it would not expand the amount of credits that corporations could claim.

Changing the top corporate and individual rates, either directly or through a surtax, would affect the decision a business makes about its form of organization. Under current law, the individual income tax rate for most filers is below the corporate rate. Income earned by businesses organized as corporations is generally taxed at both the corporate and individual levels; income earned by noncorporate businesses is taxed only at the individual level. As a result, the tax system discourages use of the corporate form of organization. Increasing the difference between the corporate and individual rates would increase this disincentive, causing more businesses to abandon the corporate form in order to reduce their tax liability.

REV-02 AMEND OR REPEAL INDEXING OF INCOME TAX SCHEDULES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Suspend Indexing for 1993 (except for earned income credit)	4.0	9.0	10.6	10.9	10.3	44.8
Repeal Indexing (except for earned income credit)	4.0	13.3	24.8	36.9	49.2	128.1

SOURCE: Joint Committee on Taxation.

Under current law, the personal exemption, the standard deduction, the minimum and maximum dollar amounts for each tax rate bracket, the thresholds for the phaseout of personal exemptions, the limit on itemized deductions, and the earned income credit (EIC) are indexed annually to offset the effects of inflation. A repeal of indexing, beginning with the adjustment scheduled for 1993 (except for the EIC) would raise revenues by about $128 billion from 1993 through 1997, if the annual rate of inflation averages 3.5 percent over the period as projected. Revenues from the repeal would grow rapidly as the cumulative effects of inflation drive up the consumer price index. Although suspending indexing only for 1993 would raise the same amount of revenues in the first year, it would raise much less in later years--about $45 billion over the five-year period.

Repealing or suspending indexing would not burden all taxpayers equally. Among families with the same income, taxpayers who itemize would generally bear a smaller tax increase than those who use the standard deductions, and families with children would be affected more than families without children if the personal exemption were not indexed. Low-income families would have a smaller percentage drop in after-tax income than other families because they have little or no taxable income. At the same time, the percentage drop would also be small for families with the highest incomes because their benefit from the exemption has been phased out and most of them do not take the standard deduction. Given that the additional tax burden from repealing or suspending indexing would not be shared equally, some argue that a surtax or a general rate increase would be preferable (see REV-01).

An argument for retaining indexing is that it requires the Congress to decide explicitly on tax increases. Without indexing, inflation causes income to be taxed at a higher average rate, so tax liabilities increase faster than income.

REV-03 INCREASE THE ALTERNATIVE MINIMUM TAX RATE

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Individuals						
Raise the Alternative Minimum Tax Rate to 28 Percent	1.1	5.4	5.3	6.1	9.2	27.0
Corporations						
Raise the Alternative Minimum Tax Rate to 25 Percent	2.3	3.5	2.7	1.9	1.2	11.7

SOURCE: Joint Committee Taxation.

The alternative minimum tax (AMT) limits the use of tax preferences by taxpayers to reduce their tax liability. Increasing the AMT rate would raise revenues from the individuals and corporations that make the most use of tax preferences. Revenue gains from these rate increases are uncertain, however, because taxpayers can avoid the AMT to some extent by careful tax planning.

Raise the Individual AMT Rate to 28 Percent. The AMT for individuals is 24 percent of alternative taxable income in excess of the exemption amount--$40,000 for a joint return or $30,000 for a single return. The AMT rate was raised from 21 percent to 24 percent by the Omnibus Budget Reconciliation Act of 1990. The exemption is phased out for high-income taxpayers. Some adjustments and deductions that are allowed in computing regular taxable income are disallowed when computing taxable income for the alternative tax. These adjustments are of two types: deferral preferences, such as accelerated depreciation, excess intangible drilling costs, and profit or loss from long-term contracts; and exclusion preferences, such as the charitable deduction for appreciated property, itemized deductions of state and local taxes, some tax-exempt interest, percentage depletion, and miscellaneous itemized deductions.

Taxpayers must pay the larger of the regular tax or the AMT. To the extent that the individual AMT results from deferral preferences, one year's AMT can be credited against regular tax liability in future years. Thus, a portion of the revenue gain from a higher AMT rate results from a shift of some future tax liabilities to earlier years.

Increasing the AMT rate to 28 percent would raise about $27 billion in 1993 through 1997. Some preferences in the tax code are designed to encourage certain kinds of behavior, but taxpayers who pay the AMT are denied the full benefit of these preferences. Raising the AMT rate would further reduce these incentives by lowering the maximum combined tax benefit from these preferences for upper-income taxpayers.

This option would substantially increase the number of AMT filers. Unless taxpayers changed their behavior to avoid the AMT, this option would more than triple the number of filers who would owe an alternative tax from about 600,000 to nearly 2 million.

Raise the Corporate AMT Rate to 25 Percent. The AMT for corporations is 20 percent of their alternative taxable income. Corporations receive minimum tax credits for the tax

that arises from all preferences, not just deferral preferences--as is the case for individuals. Raising the AMT corporate rate to 25 percent would increase revenues by about $12 billion through 1997.

The corporate AMT largely ensures that corporations reporting profits to shareholders pay the corporate tax. Proponents of the minimum tax argue that it improves the perceived fairness of the tax system.

Critics maintain that the corporate AMT places a greater tax burden on rapidly growing and heavily leveraged corporations and provides corporations with an incentive to engage in tax-motivated transactions. For example, a firm that expects to pay the AMT may be able to reduce its tax by leasing its equipment, rather than owning the equipment and using the accelerated depreciation tax preference. Raising the AMT rate, therefore, would increase the use of these nonproductive tax-minimization transactions, as well as increase the disparity in the tax burden on new investment between those corporations that are hit by the AMT and those that are not.

REV-04 TAX ALL CORPORATE INCOME AT A 34 PERCENT RATE

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	1.9	3.3	3.4	3.5	3.6	15.6

SOURCE: Joint Committee on Taxation.

Under current law, corporate income is generally taxed at a 34 percent rate, but corporate taxable income up to $75,000 is subject to reduced tax rates of 15 percent and 25 percent. The tax benefit from reduced rates is worth up to $11,750. Taxable income above $75,000 is taxed at a 34 percent rate, although a 5 percent additional tax is imposed on taxable income between $100,000 and $335,000--creating a 39 percent tax bracket--to phase out the tax benefit from the reduced rates for more profitable corporations. As a result, only corporations with income of more than $335,000 are taxed as if all income were subject to a flat rate of 34 percent.

The reduced rates are intended to provide tax relief to small businesses. Of the approximately 1 million corporations that have positive corporate tax liabilities each year, about 90 percent qualify for reduced rates, although these corporations earn only about 10 percent of total corporate profits. This provision provides a competitive advantage to some small businesses as intended, but other taxpayers benefit as well. High-income individuals benefit because the provision allows them to shelter income as retained earnings in a corporation. These reduced rates and tax shelter opportunities were ended in 1987 for owners of personal service corporations, such as physicians, attorneys, and consultants, who often incorporated themselves in order to gain the tax benefit. Tax shelter opportunities remain, however, for other types of corporations. Other unintended recipients of the tax benefit are large businesses with low profits. Some of these large corporations, furthermore, may be able to control the timing of certain income and expenses in order to generate low taxable income--and the tax benefit--in certain years.

Even the intended beneficiaries of this tax benefit--low- to moderate-income owners of small businesses--do not necessarily need it. As an alternative to incorporation, small businesses could operate as sole proprietorships or partnerships, with their profits taxed under the individual income tax. In addition, many small businesses could continue to enjoy the advantages of incorporation by operating as S corporations, which must have 35 or fewer owners and satisfy other requirements. S corporations are taxed under the individual income tax like sole proprietorships and partnerships.

Eliminating reduced corporate rates and taxing all corporate income at the 34 percent rate would raise an estimated $15.6 billion from 1993 through 1997. One advantage of this option is that it would eliminate the 39 percent tax bracket. A corporation in this bracket is encouraged to undertake inefficient business strategies in order to reduce its tax rate. A disadvantage of this option, however, is that some low- to moderate-income owners of small corporate businesses would be adversely affected.

REV-05 ELIMINATE OR LIMIT MORTGAGE INTEREST DEDUCTIONS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Eliminate Mortgage Interest Deductions	31.0	52.8	54.7	56.6	58.6	253.6
Reduce Maximum Mortgage Principal Eligible for Interest Deductions to $300,000	1.0	2.6	3.2	3.7	4.2	14.7
Limit Deductions to $12,000 per Return (Single) or $20,000 (Joint)	1.5	4.2	5.0	6.0	6.8	23.5
Limit Deductions for Second Homes	0.2	0.3	0.4	0.4	0.4	1.7

SOURCE: Joint Committee on Taxation.

A home is both the largest consumer purchase and the main investment for most Americans. The tax code has historically treated homes more favorably than other investments. Current law allows homeowners to deduct mortgage interest expenses, even though homes do not produce taxable income, and exempts most capital gains from home sales (see REV-15). Such preferential treatment has been defended as a benefit to neighborhoods because it encourages home ownership and home improvement. Some have argued, however, that these preferences are larger than needed to maintain high rates of home ownership. For example, Canada, which grants preferential tax treatment to capital gains from home sales, but does not allow deductions for mortgage interest, has achieved about the same rate of home ownership as the United States.

The tax advantages accorded to owner-occupied housing are also criticized because they encourage investment to shift into homes and away from less subsidized investments. This shift may contribute to a relatively low rate of investment in business assets in the United States compared with other developed countries that do not allow such large mortgage interest deductions. Currently, about one-third of national investment goes into owner-occupied housing, so even a modest shift of investment to other sectors could have important effects.

Tax preferences for owner-occupied homes could be reduced by limiting mortgage interest deductions. Under current law, interest is deductible on up to $1 million of debt used to acquire and improve first and second homes and up to $100,000 of other loans secured by a home, regardless of purpose (referred to as home-equity loans). Since 1991, no other type of consumer interest has been 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. One way for taxpayers to circumvent the limits on consumer and investment interest deductions is to finance consumer purchases and investments in assets other than homes with loans secured by homes.

The current limits on mortgage interest deductions are criticized for several reasons. The limits are so high that the tax code provides a generous subsidy even for relatively expensive homes. Further, only taxpayers who are fortunate enough to have substantial home equity are able to circumvent the limits on consumer and investment interest. For example, many homeowners are able to deduct interest on home-equity loans used to finance automobiles, while renters and those with small amounts of home equity are not allowed to deduct interest on auto loans. In addition, some find it unfair that the same limits apply to single taxpayers as to larger households.

Eliminate Interest Deductions. Eliminating the deductibility of mortgage interest would raise the taxes of about 37 million homeowners by an average of about $1,350 in 1993 and increase tax revenues by about $254 billion over the 1993-1997 period. Housing as an investment would be made more nearly equal with other investment opportunities, thus reducing what some see as an overinvestment in housing. Furthermore, eliminating the deduction would remove the opportunity for homeowners to circumvent tax laws denying the deductibility of interest on other types of expenditures. The major argument against eliminating the mortgage interest deduction is that the change would increase housing costs sharply for many homeowners, potentially making it impossible for them to afford their current homes. In addition, the prices of owner-occupied homes would fall, resulting in additional losses for current owners.

Reduce the Principal Eligible for Deduction. 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 800,000 taxpayers with large mortgages and increase revenues by about $15 billion over the 1993-1997 period. This change would reduce the tax subsidy currently going to the owners of relatively expensive homes, but would not affect the vast majority of homeowners. The lower limit, however, would hurt taxpayers in high-cost housing areas.

Cap Interest Deductions. About $24 billion in revenues could be raised in 1993 through 1997 by capping the mortgage interest deduction at $12,000 per single return, $20,000 per joint return, and $10,000 per return for married couples who file separately. These limits are much higher than the deductions claimed on most tax returns. For example, less than 2 percent of taxpayers who claimed home mortgage interest deductions in 1987 had deductions that exceeded these amounts; the average deduction for home mortgage interest was only about $4,900. Even in regions of the country with the highest housing costs, the annual interest payments for the average new mortgage in 1989 were under $17,000. At current mortgage interest rates, the proposed $20,000 cap would allow full interest deductions on mortgages as large as about $235,000. That amount is about double the average size of new mortgages closed in 1989.

Capping mortgage interest deductions would retain the basic tax incentive for home ownership without subsidizing the luxury component of the most expensive homes and vacation homes. Because the caps are higher than the deductions nearly all homeowners now take, the caps would affect home prices and homebuilding in only a small segment of the market. Moreover, because the caps are not indexed for inflation, their real value would gradually decline. By phasing down the deduction gradually, the effects on current homeowners and the homebuilding industry would be cushioned.

Like the other limits on interest deductions, the cap would be more confining in areas with higher housing costs. Further, in periods of high interest rates, recent homebuyers and those with adjustable-rate mort-

gages could find themselves affected by the limits, while longer-term owners with fixed-rate mortgages would not be.

Limit Interest Deductions for Second Homes. A final option would be to limit deductibility to interest on debt incurred 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. The proposal would raise about $1.7 billion in revenues in 1993 through 1997. Most second homes are vacation homes, and some people argue that nearly unlimited deductions for such a luxury are inappropriate when most interest on loans for education, medical expenses, and other consumer purchases is not deductible.

REV-06 ELIMINATE OR LIMIT DEDUCTIONS OF STATE AND LOCAL TAXES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Eliminate Deductions of State and Local Taxes	16.2	41.8	45.1	48.8	52.9	204.8
Limit Deductions to the Excess Over 1 Percent of Adjusted Gross Income	1.8	6.0	6.5	6.9	7.4	28.5
Prohibit Deductibility of Taxes Above Ceiling of 9 Percent of Adjusted Gross Income	1.8	6.3	6.8	7.2	7.4	29.5

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers may deduct state and local income, real estate, and personal property taxes from their adjusted gross income (AGI). The deductions mean, in effect, that the federal government subsidizes the state and local tax payments of taxpayers who itemize. This subsidy may cause itemizers to support higher levels of state and local services than they would otherwise; to the extent that that is true, the deductions may indirectly finance increased state and local government spending at the expense of other uses of federal revenues.

The Tax Reform Act of 1986 reduced the subsidy to state and local governments directly by repealing the deduction for state and local sales taxes, and indirectly by increasing the standard deduction and lowering marginal rates, thus reducing both the number of itemizers and the value of the deductions. The Omnibus Budget Reconciliation Act of 1990 further reduced total allowable deductions (other than medical expenses, casualty and theft losses, and investment interest) by an amount equal to 3 percent of a taxpayer's AGI in excess of $100,000.

Deductibility of state and local taxes has drawn criticism on several grounds. First, the deductions reduce federal tax liability only for itemizers and, because the value of an additional dollar of deductions increases with the marginal tax rate, the deductions are worth more to higher-bracket taxpayers. Second, deductibility favors wealthier communities: the higher the income level in a community, the more itemizers it will have, and the greater the likelihood that its residents will support a higher level of spending. Third, deductibility may discourage states and localities from financing services with nondeductible user fees, thereby discouraging efficient pricing of some services.

Supporters of deductibility argue that it is needed: 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. But a taxpayer who pays higher state and local taxes often receives more benefits from publicly provided services, such as public recreational facilities. In that case, the taxes are more like other payments for goods and services (for example,

private recreation) and should not be deductible. Supporters of deductibility also note that any higher public expenditures resulting from deductibility benefit all members of a community, including lower-income nonitemizers who do not receive a direct tax saving.

Eliminating or limiting the value of the state and local deduction could raise significant revenues. Eliminating deductibility would raise about $205 billion in 1993 through 1997. Alternatively, deductions could be permitted only for state and local tax payments above a fixed percentage of AGI. The average itemizer's state and local tax deductions exceed 1 percent of AGI in every state. If the floor were set at 1 percent, revenues in 1993 through 1997 would increase by about $29 billion. Another alternative would be to prohibit deductions above a fixed ceiling, which also might be a percentage of AGI. A ceiling set at 9 percent of AGI would increase revenues by a roughly similar amount--around $30 billion in 1993 through 1997. A floor and a ceiling, however, would have very different effects on incentives for state and local spending: with a floor, the incentive for increased spending would remain; with a ceiling, the incentive would be reduced.

REV-07 ELIMINATE OR LIMIT DEDUCTIONS FOR CHARITABLE GIVING

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Addition
Eliminate Deductions for Charitable Giving	2.7	18.1	19.0	20.0	21.3	81.1
Limit Deductions for Appreciated Property to Its Tax Basis	0.1	0.7	0.7	0.7	0.7	3.0
Limit Deductions to the Excess Over 2 Percent of Adjusted Gross Income	1.1	7.6	8.1	8.6	9.3	34.7

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers who itemize deductions can deduct the value of contributions they make to qualifying charitable organizations, but the amount of deductions cannot exceed 50 percent of adjusted gross income (AGI) in any year. In 1989, 28 million taxpayers itemized nearly $54 billion in charitable contributions, reducing federal revenues by more than $13 billion.

Eliminating the deductibility of charitable contributions would increase tax revenues by about $2.7 billion in 1993 and by $81 billion over the 1993-1997 period. In 1993, for example, the tax bills of more than 30 million taxpayers would be projected to rise by an average of about $600.

Critics of the deduction argue that while the government should support charitable activities, the electorate as a whole and not individual donors should make decisions about which activities deserve support. Furthermore, donations by people who do not itemize deductions receive no government subsidy.

Supporters of the provision counter that individual decisions about donations may be the best measure of which activities should receive government support and that, without deductibility, contributions would drop precipitously. Finally, taxpayers who choose to take the standard deduction may not pay lower taxes as a result of their donations, but the standard deduction actually provides greater tax benefits than their deductible expenditures would allow.

Limiting the deduction to a taxpayer's cost of an asset under the regular income tax would increase revenues by about $0.1 billion in 1993 and by $3 billion over five years. Taxpayers currently can deduct the fair market value of a contribution of appreciated property that has been held for more than 12 months, regardless of the tax basis of the property. (After July 1, 1992, the difference between the market value and the basis will be included in income under the alternative minimum tax, but not under the regular income tax.)

Critics of the existing provision argue that it allows taxpayers to deduct the entire value of contributed assets even though no tax has been paid on the gain from appreciation, thus providing preferential treatment of one kind of donation relative to other kinds. A

counterargument is that the provision encourages people to donate appreciated assets to eligible activities rather than passing them on to their heirs at death, when any gains go untaxed as income.

Allowing taxpayers to deduct only those contributions in excess of 2 percent of adjusted gross income would retain an incentive for increased giving but would raise revenues by allowing no tax reduction for typical amounts given. That change would completely disqualify the charitable deductions of about 18 million taxpayers in 1993 and reduce allowed deductions for an additional 13 million, increasing revenues by about $1.1 billion in 1993 and by $35 billion over the 1993-1997 period. Such a change would eliminate the tax incentive to donate to charitable causes for nearly 60 percent of the taxpayers who currently make and deduct contributions. In addition, it would encourage taxpayers who planned to make contributions over several years to lump them together into one tax year to qualify for a deduction under the 2 percent floor.

REV-08 LIMIT THE TAX BENEFIT OF ITEMIZED DEDUCTIONS TO 15 PERCENT

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	26.8	61.6	66.2	72.4	79.4	306.4

SOURCE: Joint Committee on Taxation.

Current law allows taxpayers to reduce taxable income by the amount of itemized deductions in excess of the standard deduction. Taxpayers who itemize may deduct state and local income and property taxes, home mortgage interest payments, contributions to charity, moving expenses, casualty and theft losses, and medical and dental expenses. Some itemized deductions are limited to the amount in excess of a percentage of adjusted gross income. In addition, certain itemized deductions are phased out at high income levels.

The tax benefit of itemized 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, by $2,800 for a taxpayer in the 28 percent bracket, and by $3,100 for a taxpayer in the 31 percent bracket. There is no tax benefit for the majority of taxpayers, who do not itemize deductions--most of whom are in the zero or 15 percent tax brackets. Among the one in four taxpayers who itemize, however, half are in tax brackets above 15 percent. This option would limit the tax benefit of itemized deductions to 15 percent for these higher-bracket taxpayers. The limit would increase tax revenues by $306 billion over five years.

Proponents of limiting the tax benefit of itemized deductions argue that it would make the income tax fairer and more efficient. They argue that it is unfair to provide a proportionately larger tax benefit to higher-income taxpayers than to lower-income taxpayers. In addition, the limit would effectively raise average tax rates on most middle- and upper-income taxpayers, making the tax law more progressive. Moreover, by reducing the extent to which tax subsidies distort the after-tax prices of goods, such as owner-occupied housing, the limit may improve economic efficiency.

However, some itemized deductions, such as health expenses and casualty losses, do not represent subsidies to voluntary activities, but rather reductions in the ability to pay income tax. Nonetheless, under this option, high-income taxpayers would pay tax on income used to defray such costs because their income would be taxed at rates above 15 percent, but costs would only be deductible at a 15 percent rate. Thus, an individual with unusually high medical bills, for example, could be taxed more heavily than another individual with the same ability to pay, but no medical bills.

Like other limits on itemized deductions, this option would create incentives for taxpayers to avoid the limit by converting itemized deductions into income reductions. 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, especially for those subject to the high-income phaseout for itemized deductions.

REV-09 DECREASE LIMITS ON CONTRIBUTIONS TO QUALIFIED PENSION AND PROFIT-SHARING PLANS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Addition
Decrease Limits for Defined Benefit Plans to the Social Security Wage Base (With Equivalent Reductions for Defined Contribution Plans)	1.3	3.7	4.1	4.5	4.5	18.1
Decrease the Limit for Deferrals in Salary Reduction Plans to $4,000	0.3	0.6	0.6	0.6	0.7	2.8

SOURCE: Joint Committee on Taxation.

Saving for retirement through employer-provided qualified pension and profit-sharing plans provides two tax advantages: the employment income contributed to qualified plans is not taxed until retirement, when an employee's marginal tax rate is often lower, and the investment income earned by the assets in qualified plans is effectively not taxed.

Decrease Limits on Employer Contributions. Retirement payments from defined contribution plans depend on annual contributions during a person's working years and on the subsequent investment earnings of those contributions. Current law limits contributions to such plans to 25 percent of compensation or $30,000 per employee, whichever is less.

Defined benefit plans specify the pension amount to be received in retirement, which is usually a percentage of preretirement earnings. Current law limits contributions to defined benefit plans so that annual benefits for pensions that begin at age 65 are no more than 100 percent of preretirement wages or $112,221 for 1992, whichever is less. For pensions that begin at an earlier age, this limit is reduced on an actuarial basis. When an employee is eligible for payments from both types of plans sponsored by the same employer, a combined limit applies--the lesser of 140 percent of wages or $140,276 for 1992.

These funding limits are far higher than the preretirement earnings of most workers. Fewer than 1 percent of employees earned more than $140,276 in 1991. Some people have questioned the need to subsidize such high levels of retirement income on the grounds that employees who accrue such large pensions are unlikely to need the tax incentive to provide adequately for their retirement.

Limiting funding for defined benefit plans to amounts necessary to pay benefits equal to the Social Security wage base ($55,500 in 1992), and making proportionate reductions in limits for defined contribution plans, would raise about $18 billion from 1993 through 1997 because more employment income would be subject to taxes. These limits would still be higher than the earnings of all but about 6 percent of earners.

One argument against reducing funding limits is that it would make participation less attractive to high-income business owners and top managers, and thus might discourage them from sponsoring these plans for both themselves and their employees. Although the higher-paid managers and owners may not need tax-advantaged pension plans to save adequately for retirement, their employees might. A further argument against reducing the limits is the desire to increase total saving. Limiting incentives for pension saving could reduce total saving.

Change Salary Reduction Plans. Salary reduction plans allow employees to choose to receive lower current (taxable) compensation and to defer the remainder of compensation as a contribution to the plan. These plans typically are called 401(k) plans after the provision of the tax code that authorizes them. Similar arrangements are possible for some workers in the nonprofit sector (403(b) tax-sheltered annuities), for federal workers, and for workers enrolled in some simplified employer plans (SEPs).

The Tax Reform Act of 1986 capped employee deferrals for 1987 in salary reduction arrangements at $7,000 in the case of 401(k) plans, SEPs, and the federal plan. The cap is indexed for inflation and reaches $8,728 by 1992. A separate cap of $9,500 applies for 403(b) tax-sheltered annuities. This cap is frozen until inflation raises the other caps above $9,500. If elective deferrals in all salary reduction plans were limited to $4,000 in 1992 and indexed thereafter, about $3 billion would be raised through 1997.

Lowering the limit would affect higher-income workers who are likely to provide adequately for their own retirement without the tax incentive. In addition, the majority of these plans are supplementary savings arrangements offered by firms that also have pension plans.

Higher limits provide a greater incentive for employers to initiate the plans, which benefit employees at all income levels. In particular, salary reduction plans seem to be more appealing to small employers who have traditionally been adverse to establishing pension plans. Lower limits may discourage small employers from offering what could be the only retirement benefit available to their employees. Lowering limits on salary reduction plans and not on other plans encourages traditional pensions, which are primarily defined benefit plans. Unlike defined benefit plans, salary reduction plans and other defined contribution plans do not discriminate against workers who change employers or drop out of the work force temporarily. In addition, the voluntary nature of salary reduction plans allows workers with spouses without coverage to save more for retirement than other workers.

REV-10 IMPOSE A 5 PERCENT TAX ON INVESTMENT INCOME OF PENSION PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	5.0	8.3	8.7	9.2	9.7	40.9

SOURCE: Joint Committee on Taxation.

Under normal income tax rules, deposits to savings accounts are not deductible from taxable income and the investment income those deposits earn is taxed annually. In contrast, most contributions to qualified pension and profit-sharing plans and to Individual Retirement Accounts (IRAs) are deductible, and the investment earnings of the plans accumulate tax-free. Taxation is deferred until the accumulated amounts are paid out, usually in retirement. The tax due in retirement is essentially the tax originally due on the contributions plus interest for the delay in payment. The investment income is, in effect, not taxed. A 5 percent tax on the realized investment income of pension and profit-sharing plans and of IRAs would raise about $41 billion over five years.

Taxing pension and profit-sharing plans and IRAs more favorably than other savings gives taxpayers an incentive to provide for retirement income. A low-rate tax on the realized investment income of these qualified plans and IRAs would retain much of the incentive for retirement saving. At the same time, it would reduce the inequality of taxation between the higher-paid and the longer-term employees who gain the most from the current tax treatment, and the lower-paid and more mobile workers who gain the least.

But the tax also would reduce retirement income or require larger contributions. And it would discourage some employers and workers from continuing their plans or setting up new ones. Finally, taxing the retirement income of qualified plans and IRAs might actually exacerbate inequality in retirement income among some currently covered workers. Employers currently offering qualified plans must provide benefits that do not discriminate in favor of the highly paid. If the tax reduced the number of such plans, fewer workers would be protected by requirements for equal treatment.

Taxing the realized investment income of qualified funds and IRAs would encourage these retirement funds to shift from bonds and short-term stock investments to long-term investments in growth stocks and real estate; a large share of the return on such investments comes from appreciation in value that is not realized until the asset is sold. That investment shift would expose retirement funds to greater risk and decrease their responsiveness to changing conditions; both effects may be particularly undesirable for retirement savings. Longer-term commitments by these large institutional investors could, however, benefit the entire economy by enabling corporations to focus more on long-term strategies to modernize production and to develop new products and markets.

REV-11 TAX NONRETIREMENT FRINGE BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Tax Some Health Insurance Premiums			(See ENT-50)			
Tax Life Insurance Premiums						
Income tax	1.7	2.5	2.6	2.7	2.8	12.3
Payroll tax[a]	0.9	1.2	1.2	1.3	1.3	5.9
Impose a 3 Percent Excise Tax on the Value of Nonretirement Fringe Benefits	2.9	4.3	4.7	5.1	5.5	22.5

SOURCE: Joint Committee on Taxation.

a. Estimates are net of reduced income tax revenues.

Employee compensation is taxable unless the tax code contains an explicit exception. Such exceptions apply to employer-paid nonretirement fringe benefits, most of which are excluded from the income and payroll tax bases even though they constitute current compensation to employees. Exempting fringe benefits from taxation reduces revenues substantially. For employer-paid health and life insurance premiums alone, the revenue loss will be about $39 billion in income taxes and $26 billion in payroll taxes in 1992. In addition, the law explicitly excludes from gross income employer-paid dependent care and miscellaneous benefits such as employee discounts, parking, athletic facilities, and educational assistance benefits. (This last exclusion is set to expire June 30, 1992.)

These exclusions can be criticized on the basis of both efficiency and fairness. They are inefficient to the extent that employees receive tax-free benefits that they might not purchase with after-tax income. The availability of tax-free services for some people tends to drive up prices, thus depriving others who may need the services as much or more. For example, employer-paid health insurance plans may have contributed to the demand for health care services, which in turn may have contributed to sharp rises in health care costs. The higher prices are paid by all who need health care, not just recipients of tax-free insurance.

Some observers view the exclusions as unfair because a taxpayer receiving no fringe benefits pays more tax than another with the same total income but a larger share in the form of fringe benefits. The tax savings from excluding fringe benefits are greater for people with higher incomes because they face higher marginal tax rates and because they typically receive more fringe benefits than do low-wage workers.

Making all fringe benefits taxable, however, would present problems in valuing benefits and in assigning their value to individual employees. Few valuation problems arise when the employer purchases goods or services and provides them to employees, but it

is more difficult to determine the value of a facility, such as a parking lot, provided by the employer. Further difficulties arise if the total value of the fringe benefits needs to be assigned to individual employees. In cases where the employer provides a service, such as day care, it might be considered unfair to assign the same value to all employees regardless of their level of use. It could be administratively complex, however, to assign values that depend on each worker's use. Further, the costs of collecting taxes on small fringe benefits (such as employee discounts) could exceed the revenue collected.

The per-employee value of employer-paid health and life insurance would be relatively easy to determine. The premiums paid for each employee could be reported on the employee's W-2 form and withholding computed as it is for other taxable income. That procedure is already done for some life insurance premiums (see below). Measuring insurance values would be more difficult when benefits are provided directly, as when employers provide medical care or reimburse employees for medical costs incurred under self-insurance plans.

Another way to tax nonretirement fringe benefits would be to impose the tax on employers, based on the total cost of the fringe benefits provided, rather than on employees. Although determining the total cost of fringe benefits would still present some difficulties, this option would eliminate the need to assign the value of fringe benefits to individual employees.

Tax Some Employer-Paid Health Insurance Premiums. Health insurance premiums are subject to nondiscrimination rules that limit the extent to which employer-paid health plans may favor higher-paid workers. Still, the present exclusion for employer-paid health insurance premiums has been criticized as unfair because taxpayers who pay for their own health insurance can only deduct medical expenses, including insurance payments, in excess of 7.5 percent of their adjusted gross income, and then only if they are itemizers. (Two options to tax some employer-paid health insurance premiums are described in ENT-50.)

Tax Employer-Paid Life Insurance Premiums. Premiums paid by employers for group term life insurance are currently excluded from taxable income, but the exclusion is limited to the cost of the first $50,000 of insurance and nondiscrimination rules apply. Employer-paid premiums in excess of this amount are taxable under both the income tax and the payroll tax. The exclusion is not available to the self-employed. Making all employer-paid premiums taxable would add about $12 billion to income tax revenues and about $6 billion to payroll-tax revenues from 1993 through 1997.

A difficulty with this option arises because many employers provide death benefits under pension plans as substitutes for life insurance. Employer contributions to pension plans are income-tax deferred (plus the first $5,000 of death benefits paid are tax exempt) and are exempt from the payroll tax. If employer-paid life insurance plans were made taxable, employers might choose to offer less life insurance and larger death benefits on pension plans instead.

Impose an Excise Tax on the Value of Nonretirement Fringe Benefits. An alternative to including employer-provided benefits in the income of recipients would be to impose on employers an excise tax on the value of the specific benefits that they provide. These benefits would include the full employer's share of health insurance, premiums to fund the first $50,000 of life insurance, dependent care, parking, athletic facilities, and employee discounts. A 3 percent tax, for example, would raise about $22.5 billion from 1993 through 1997. The bulk of these revenues would come from taxing employer-paid health insurance.

Under this option, employers would need to know only their total fringe benefit costs; they would not have to value the benefits paid to each employee. Because the 3 percent excise tax rate would be much lower than the

tax rate on wages, this option would maintain most of the incentives for employers to provide fringe benefits instead of taxable wages.

An excise tax could be criticized as unfair for two reasons: the tax rate would not rise with the income of employees, as it would if the benefits were subject to the income tax, and the tax might result in lower taxable wages for all employees, regardless of the benefits each receives.

REV-12 TAX THE INCOME-REPLACEMENT PORTION OF WORKERS' COMPENSATION AND BLACK LUNG BENEFITS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	1.2	3.5	3.6	3.8	4.0	16.1

SOURCE: Joint Committee on Taxation.

Revenue could be raised by taxing the portion of Workers' Compensation and Black Lung benefits that replaces income lost from work-related injuries or black lung disease (see also ENT-49). Taxing these benefits would add about $16.1 billion to revenues from 1993 through 1997. The remaining portion, which reimburses employees for medical costs (about 40 percent), would not be taxed.

Taxing the income-replacement portion of Workers' Compensation and Black Lung benefits would make the tax treatment of these entitlement benefits comparable to the treatment of unemployment benefits and of 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.)

Opponents of taxing these benefits note that legal or insurance settlements for non-work-related injuries are not taxable, even if a portion of them reimburses lost income. Hence, taxing Workers' Compensation benefits would treat these two types of compensation inconsistently.

REV-13 INCREASE TAXATION OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Retain the Current Income Thresholds						
Increase the Fraction of Benefits Included in Adjusted Gross Income to Tax up to 85 Percent of Benefits	2.7	5.6	6.2	6.9	7.7	29.1
Eliminate the Income Thresholds						
Tax 50 Percent of Benefits	3.9	9.7	10.0	10.3	10.6	44.5
Tax 85 Percent of Benefits	10.4	23.8	24.7	25.8	27.0	111.5

SOURCE: Joint Committee on Taxation.

Social Security and Railroad Retirement (Tier I) benefits constitute the federal government's largest entitlement commitment. These benefits could be reduced directly through changes in the benefit formula (see ENT-60 through ENT-63) or in cost-of-living adjustments (see ENT-59), or indirectly by including a greater portion in taxable income.

For the same reduction in the federal deficit, taxing a greater portion of these benefits would concentrate more of the burden on higher-income households than would, for example, freezing cost-of-living adjustments (COLAs), where the burden would also fall on lower-income households whose principal income source is Social Security. Attempts to curtail the cost of COLAs and, at the same time, protect the poor reduce the deficit very little. Because there is a lack of information on people's comprehensive incomes, protection must be given to many people who have low benefits but who also have other income. By comparison, the tax system can be used to reduce the deficit more substantially without harming low-income people. Many maintain that increased taxation of benefits is, therefore, a preferable way to achieve a given target of deficit reduction among the elderly and disabled.

Increased taxation of benefits could be regarded as a violation of long-held understandings about the implicit promises of the Social Security and Railroad Retirement programs at the time recipients were working and paying their payroll taxes. However, since the programs were instituted, numerous changes in Social Security and Railroad Retirement benefits, in the tax treatment of the benefits, and in the taxes used to fund them have been made.

The 1983 Social Security Amendments made Social Security and Tier I benefits partially taxable to higher-income households. Under current law, adjusted gross income (AGI) includes the lesser of one-half of Social Security and Tier I benefits or one-half of the excess of the taxpayer's combined income (AGI plus nontaxable interest income plus one-half of Social Security and Tier I benefits)

over a threshold amount. The threshold amount is $25,000 for single returns and $32,000 for joint returns. Because these thresholds are not indexed, a growing percentage of recipient households will be affected by this 1983 provision; the percentage of families who will pay taxes on their Social Security benefits is expected to grow from 16 percent in 1989 to 26 percent in 1997.

In the immediate future, taxes on Social Security and Tier I benefits could be increased by raising the fraction of benefits included in AGI or by eliminating or reducing the thresholds.

Increase the Fraction of Benefits Included in AGI. Under current law, employers pay one-half of workers' combined payroll taxes from before-tax income, while employees pay the remainder out of income that is taxed. That was the rationale for including half of Social Security and Tier I benefits in AGI.

Some people hold that these benefits should be taxed more like public employee pensions and those few private-sector pensions in which individuals make contributions from after-tax income. Under current law, a fraction of benefits from contributory pension plans is excluded from tax. That fraction, called the exclusion ratio, is based on the nominal amount of after-tax contributions employees make. The remaining share of these benefits is fully taxable. Because the ratio of after-tax contributions (the employee share of payroll taxes) to Social Security and Tier I benefits varies with each worker's earnings history and marital status, no single exclusion ratio is correct for all beneficiaries. Requiring the Social Security Administration to calculate separate exclusion ratios for each beneficiary would be administratively burdensome.

A 15 percent exclusion ratio--that is, including up to 85 percent of benefits in AGI--would make the tax treatment of Social Security for workers with high earnings roughly comparable to that of contributory pensions under current law, and would be more generous for those with lower earnings. Increasing includable benefits to 85 percent while maintaining current thresholds would raise about $29 billion from 1993 through 1997. That change would affect 25 percent of the couples and individuals receiving benefits in 1993.

Eliminate or Reduce the Thresholds. In addition to the thresholds, the tax code protects lower-income elderly households from income taxation through personal exemptions, the regular standard deduction, and an additional standard deduction for the elderly. Under current law, 80 percent of elderly couples and individuals with benefits pay no income tax on their benefits. If the thresholds on taxing benefits were eliminated, nearly $45 billion would be raised from 1993 through 1997, and the share of couples and individuals paying no tax on their benefits would decline to 37 percent.

Eliminating the thresholds would remove a tax preference that is not well-targeted toward those with lower incomes and would reduce tax disparities among middle-income households. Under current law, the fraction of income paid in income taxes by middle-income elderly families is less than half the fraction paid by nonelderly families with comparable incomes. In addition, for a comparable deficit reduction, eliminating the thresholds would reduce the disposable incomes of the lower-income elderly less than curtailing cost-of-living increases or similar measures.

A greater amount of revenue would be raised if eliminating the thresholds were combined with raising the fraction of benefits included in AGI. Eliminating the thresholds and including 85 percent of benefits in AGI would raise nearly $112 billion from 1993 through 1997.

An argument against completely eliminating the thresholds is that it would decrease the disposable incomes of elderly people with incomes below the median, while leaving the upper-income elderly unaffected. To minimize the effects on moderate-income recipients, the thresholds could instead be lowered--for example, to $12,000 for single

filers and $18,000 for joint returns. With up to 50 percent of benefits includable in AGI, these lower thresholds would raise about $24 billion from 1993 through 1997--only half the amount raised from including the same percentage with no thresholds. Lowering the thresholds to $12,000 and $18,000 while including 85 percent of benefits in AGI would raise $71 billion--roughly 60 percent of the amount from including 85 percent of benefits with no thresholds.

REV-14 PHASE OUT THE DEPENDENT-CARE CREDIT

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Phaseout Starting at:						
$30,000	0.1	1.0	1.1	1.2	1.3	4.7
$50,000	a	0.4	0.5	0.6	0.7	2.2
$65,000	a	0.2	0.3	0.3	0.4	1.2

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

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 allowed 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. Creditable expenses are limited to $2,400 for one child and $4,800 for two or more. Also, they cannot exceed the earnings of the taxpayer or, in the case of a couple, the earnings of the spouse with lower earnings. In 1989, about $2.4 billion in credits was claimed on 6 million tax returns.

About 40 percent of the credit benefits families with incomes of $50,000 or more. The cost of this credit could be reduced by targeting it more narrowly toward lower-income families. One way to target the subsidy would be to reduce the credit percentage as incomes rise. For example, reducing the credit percentage by 1 percentage point for each $1,500 of AGI more than $30,000 would raise about $4.7 billion from 1993 through 1997. This option would reduce the credit for about 40 percent of currently eligible families and would eliminate it for an another 25 percent of these families (those with AGI over $58,500). Alternatively, phasing out the credit between $50,000 and $78,500 would raise about $2.2 billion in the same period; this option would reduce the credit for about one-quarter of eligible families and eliminate it for another 10 percent. Finally, phasing out the credit between $65,000 and $93,500 would raise $1.2 billion in the same period, reducing the credit for about 10 percent of eligible families and eliminating it for another 5 percent.

Opponents of reducing the credit argue that it is not a subsidy, but rather a cost of being employed that the tax code should recognize. Opponents also argue that phasing out the credit would be undesirable because it would raise the marginal tax rate for taxpayers with incomes in the credit phaseout range, discouraging some from working.

If the credit were phased out, employees could seek other tax subsidies for dependent care by asking their employers to provide plans for dependent care assistance. For example, current law allows workers to put up to $5,000 of annual earnings into flexible spending accounts, which can then be used to pay for dependent care or other specified expenditures. Because the earnings contributed to these accounts are excluded from taxable income, participants can use them to purchase dependent care out of pretax income. To preclude taxpayers from using this alternative, which would offset some of the revenue gained from phasing out the credit, the Congress might want to consider placing limits on the use of this fringe benefit.

REV-15 TAX CAPITAL GAINS FROM HOME SALES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Tax 30 Percent of Gain	0.6	6.4	6.7	7.0	7.4	28.1
Tax Lifetime Gains in Excess of $125,000	a	0.5	0.5	0.5	0.6	2.2

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Capital gains on most assets are taxed when the assets are sold. Capital gains on home sales, however, generally escape taxation. The tax on the capital gain from the sale of a principal residence is deferred if the seller purchases another home of at least equal value within two years. If the gain does not become taxable during the homeowner's lifetime, the gain is never taxed at all. Further, taxpayers age 55 and older are allowed one opportunity to exclude up to $125,000 of gain from a home sale even if another home of equal or greater value is not purchased within two years. If the above provisions were replaced with a tax on 30 percent of capital gains from home sales, about $28 billion could be raised in 1993 through 1997. Instead, if lifetime gains in excess of $125,000 were fully taxed when realized, about $2.2 billion could be raised over the same period.

The preferential treatment of capital gains from home sales is only one of the ways in which the tax code strongly favors owner-occupied homes over other investments. (For a discussion of other ways, see REV-05.) All of these tax preferences divert savings from business investment to housing. One way to make the tax treatment of housing more like that of other assets would be to replace the capital gains deferral and exclusion provisions with a low-rate tax on gains from home sales.

If 30 percent of the gain from home sales were included in taxable income, the tax rate would be only 9.3 percent for taxpayers facing a 31 percent marginal tax rate, 8.4 percent for those in the 28 percent tax bracket, and 4.5 percent for those who are in the 15 percent tax bracket.

A tax on gains from home sales would discourage home sales in the same way that current law discourages taxpayers from selling other capital assets. In the case of home sales, that might discourage workers from relocating to take advantage of better job opportunities. The tax might also deter some homeowners (especially older taxpayers with large accrued gains) from changing homes as family requirements change.

The mobility of most homeowners could be protected by allowing all taxpayers to exempt the first $125,000 of gains on home sales from tax, while fully taxing the excess over this amount at the time of sale. If gains on the sale of a taxpayer's first home were less than $125,000, the unused portion could be applied to future home sales. This exclusion would actually increase the mobility of homeowners under age 55 relative to current law because they could move to homes of lesser value without incurring a tax so long as the gain on the home sold was less than $125,000.

Although this proposal would increase mobility for most homeowners, it would reduce it for those under age 55 whose homes have gains over $125,000. That additional gain could no longer be rolled over if a larger home were purchased and would be fully taxed as income.

Taxing gains on home sales without the rollover and exclusion allowed by current law would burden taxpayers with additional record keeping on home improvements. These records would be needed to establish the tax basis of a home upon sale. Currently, many taxpayers do not keep such records because the probability of any future tax on gains from a home sale is remote and the present value of such a tax is small. Record keeping would be further complicated by allowing a lifetime exemption of $125,000, especially when people buy and sell successive homes with different spouses.

For many homes, most of the gain is the result of inflation, and taxing inflationary gains seems unfair. Taxing inflationary gains may, however, be an appropriate way to offset the tax benefit homeowners enjoy from inflation by being able to deduct fully their mortgage interest payments, which include an inflation premium.

Any reduction in the tax benefit from home ownership would tend to lower the value of existing housing relative to other assets such as stocks. The loss in value would primarily hurt middle-income taxpayers because homes are their principal asset. If the tax benefit for home ownership needs to be reduced, limiting mortgage interest deductions instead of taxing gains on sale may be preferable, because taxing gains hinders mobility and imposes a greater record-keeping burden.

REV-16 TAX CAPITAL GAINS HELD UNTIL DEATH

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Include Gains in Last Income Tax Return of Deceased	a	3.2	3.9	4.6	5.3	17.0
Enact Supplemental 10 Percent Estate Tax	a	0.5	0.5	0.6	0.6	2.3
Enact Carryover Basis	a	a	1.4	1.7	2.0	5.2

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

A capital gain or loss is the difference between the current value of an asset and the owner's "basis," which is defined as the initial cost of the asset plus the cost of any subsequent improvements and minus any depreciation deductions. When an asset is sold, the capital gain or loss is said to be realized, and that gain or loss generally is included in taxable income. If an asset is given away, as from a parent to a child, the basis is carried over to the person receiving the asset, and the full gain on the asset is taxable income when the asset is sold.

An exception occurs when an asset is held until death and then distributed to heirs. In this case, the basis of the asset is "stepped up" to its value as of the date of death. When an inherited asset is sold, therefore, only the gain accruing after the death of the donor is subject to tax; the gain accruing before the donor's death is never taxed as income. The estate of the donor may be taxed under the separate estate tax, but this tax applies equally to assets that have previously been taxed under the income tax and to accrued capital gains that have never been taxed.

Gains held until death could be taxed as income by one of three methods. They could be included as income on the final income tax return of the deceased; they could be subject to a supplemental tax rate on the estate tax; or, by requiring that the decedent's basis be carried over with the inherited asset, they could be taxed as income when an heir sells the underlying asset.

Tax Gains on Final Return of the Decreased. Taxing gains held at death on the final income tax return of the decedent would raise $17.0 billion from 1993 through 1997. Under this option, gains on assets inherited by the spouse would not be taxed; instead, the decedent's basis would be carried over with the inherited assets. Gains on assets given to charity would also not be taxed. Gains on other assets would be included in taxable income, but three exclusions would be allowed. First, to ease the problem of documenting basis, an alternative basis of one-half of an asset's current value could be elected. Second, the existing $125,000 exclusion on the gain from sale of a principal residence could be claimed if it had not already been used. Third, an additional

$75,000 exclusion would be allowed for any remaining gains. Under those rules, roughly one-tenth of decedents would have gains subject to tax. Taxes paid would be deductible from the gross estate for determining estate taxes.

Tax Gains on the Estate Tax. Alternatively, levying an additional 10 percent estate tax on gains held at death would raise $2.3 billion from 1993 through 1997. Under this option, gains subject to tax would be determined as described above. The tax, however, could be offset by any unused credits allowed under the estate tax. Because of these credits, few people would owe additional tax under this option. Only about 1 percent of the estates of decedents currently pay the estate tax and the fraction paying the additional tax on gains would be about the same.

Tax Gains When Realized by Heirs. A third option, carrying over the decedent's basis in an asset to the heirs and taxing the gain when the asset is sold, would raise $5.2 billion from 1993 through 1997. Under this option, the basis of an inherited asset could be set at one-half its current value if the actual basis were lower or could not be determined. In addition, the basis of all assets in the estate would be stepped up by value-based shares of any estate tax paid. Carryover basis would leave the largest fraction of gains in an estate subject to tax, but the amount of tax would depend on when and what assets the heirs decided to sell.

Gains held at death have not previously been taxed as income, although proposals for doing so have been advanced. A Treasury Department study completed under President Johnson recommended taxing gains as income on a decedent's final tax return. In 1976, the House Ways and Means Committee considered language for either an additional estate tax or for carryover basis. The Tax Reform Act of 1976 enacted carryover basis, but it was postponed in 1978 and repealed in 1980 before taking effect.

Taxing gains at death, through either the last income tax return or the estate tax, would reduce the incentive for investors to hold assets until death in order to avoid tax. Current law encourages taxpayers to hold on to assets longer than they otherwise would, which distorts their investment portfolios and may hinder the flow of capital to activities with higher rates of return. The Tax Reform Act of 1986 strengthened that "lock-in" effect by increasing tax rates on capital gains realized before death. Reducing lock-in is one of the advantages of reducing the income tax rate on realized capital gains; taxing gains at death would also reduce lock-in but without the revenue loss caused by reducing the tax rate on realized gains.

Carryover basis would not achieve the same unambiguous reduction in lock-in that would be achieved by the other two options. Knowing that one's accrued gains will ultimately be taxed lessens the incentive to hold an asset until death. But an heir receiving an asset with a low basis would have a stronger incentive to hold on to the asset than under current law, which steps up the basis to its value at the date of death.

One of the main drawbacks to taxing gains at death is that the family of the deceased might be forced to sell assets to pay the tax. Having to sell illiquid assets at an inopportune time can reduce their value substantially; having to sell a family farm or business would impose a particular hardship on families wanting to continue the enterprise. Forced sales would not occur under carryover basis because no tax on gains held at death would be due until the heirs chose to sell the assets. The problem would also be mitigated by taxing gains held at death through the estate tax, which permits family members who continue to operate a family farm or business to defer payment for five years and then spread their repayments over the next 10 years. In addition, under the estate tax, the value of family farms and businesses can be based on their

current use rather than on their market value, which reduces the amount of taxable gains.

Another drawback is the difficulty of determining the basis of assets on closely held businesses, personal property, and assets for which adequate records cannot be found. That difficulty was one of the main arguments made by those urging the delay and repeal of carryover basis in 1978 and 1980. Documenting the basis would be particularly difficult immediately after passage of a law to tax gains held until death because people currently planning to hold assets until death might not have kept adequate records. Once a tax on gains had taken effect, people would have reason to begin keeping better records. In the interim, the problem of determining basis could be reduced by invoking a minimum basis rule such as the one made for the revenue estimates above, which assumes that the basis would be at least as high as half of the current value. Records are most frequently missing for assets that have been held for a long time, and because of inflation the basis of these assets is frequently less than half of current value. Finally, if gains held at death were taxed under the estate tax, most taxpayers would be exempt because of the high credit allowed against that tax.

REV-17 DECREASE THE EXEMPTION AND BROADEN THE BASE FOR ESTATE AND GIFT TAXES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Lower the Credit	a	1.0	1.1	1.3	1.5	4.9
Include Life Insurance Proceeds in the Base	a	0.1	0.2	0.2	0.3	0.8
Substitute a Deduction for the State Credit	a	0.5	0.5	0.6	0.7	2.3

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on transfers at death. The estate and gift taxes together constitute a unified transfer tax: one progressive tax is imposed on cumulative transfers during life and at death. The estate and gift tax rates in 1993 will range from 18 percent on the first $10,000 of transfers to 50 percent on transfers of more than $2.5 million. The benefits of graduated rates will be phased out for estates worth more than $10 million.

The cumulative amount of estate and gift taxes is reduced by a unified credit. The tax is first computed without any exemption and then the credit is subtracted to determine the amount of tax payable. Since 1986, the amount of the credit has been $192,800, effectively exempting the first $600,000 of transfers from estate and gift tax. The unified credit also is phased out for estates valued above $10 million.

Lower the Credit. Lowering the credit to exempt only the first $300,000 of transfers from tax would raise $4.9 billion from 1993 through 1997 by increasing taxes on about 15 percent of estates. Although the majority of estates would still be untaxed, many large homes, family farms, and small businesses would be made subject to tax. Lowering the credit would increase the tax on midsized estates. In some cases, the assets of midsized estates might have to be liquidated to pay the tax--an issue that concerned the Congress when it voted to increase the credit in 1981. A great deal of wealth consists, however, of capital gains that have never been taxed (see REV-16). Higher estate taxes would be a means of taxing these gains.

Broaden the Base. Another means of increasing revenues from estate and gift taxes would be to broaden their base--for example, by including proceeds of life insurance policies or by substituting a deduction for the credit now available for state inheritance and gift taxes. Making life insurance proceeds subject to estate and gift taxes would raise $0.8 billion from 1993 through 1997. A difficulty with that proposal is that it would provide an incentive to seek substitutes for life insurance. Many employers, for example, might substitute survivor benefits under pension plans for life insurance and, since contributions to pension plans are tax-deferred, revenues under this alternative eventually could decline relative to current law.

Replacing the state inheritance and gift tax credit with a deduction would raise $2.3 bil-

lion from 1993 to 1997. Because the value of an additional dollar of deductions increases with the marginal tax rate, however, maintaining the credit at a reduced level might be preferable. A partial credit of 8 percent of state inheritance and gift taxes would raise about the same amount of revenue as substituting a deduction.

REV-18 EXPAND MEDICARE AND SOCIAL SECURITY COVERAGE

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Expand Medicare Coverage to State and Local Government Employees Not Now Covered	1.2	1.7	1.7	1.6	1.6	7.8
Expand Social Security Coverage to All New State and Local Government Employees	0.3	1.1	1.9	2.7	3.5	9.5

NOTE: These estimates do not include the effect of any increases in benefit payments that would result from the option. These would be small over this five-year period. Estimates are net of reduced income tax revenues.

Government workers remain the largest group of workers not paying Medicare and Social Security payroll taxes, even though legislation during the past decade mandated participation by certain groups of federal, state, and local government workers. All federal workers were required to pay Medicare payroll taxes beginning in 1983. Federal employees hired after December 31, 1983, were required to pay Social Security payroll taxes. State and local workers hired after March 31, 1986, were required to pay Medicare payroll taxes. The Omnibus Budget Reconciliation Act of 1990 expanded Social Security and Medicare coverage to include state and local government workers not covered by any retirement plan.

If state and local workers hired before April 1, 1986, were required to pay Medicare payroll taxes, and all new state and local workers were required to pay Social Security payroll taxes, then coverage of state and local workers would resemble that of federal workers and would reduce the inequity of benefits received in relation to payroll taxes paid.

Although expanding Medicare and Social Security payroll taxes to include more state and local workers would increase the government's liability for future program benefits, additional revenues would more than offset increased benefits for a long time. Under current law, many state and local employees will qualify for Social Security and Medicare benefits based on other employment in covered jobs or their spouses' employment. These workers will thus receive benefits in return for a smaller amount of lifetime payroll taxes than those paid by people who work continuously in covered employment. This inequity is especially apparent for Medicare benefits: over 90 percent of retired state and local government workers receive benefits but only about 70 percent worked in a covered state or local government job. Inequitable treatment is less of a problem in the case of Social Security benefits because these benefits are reduced for retired government workers who have worked a substantial portion of their careers in employment not covered by Social Security.

Expand Medicare Coverage to State and Local Government Workers Not Now Covered. Expanding Medicare coverage to state and local government workers hired before April 1, 1986, would raise nearly $8 billion from 1993 through 1997. In recent years, this option has been considered during the budget reconciliation process and has been included in the President's budget.

Expand Social Security Coverage to All New State and Local Government Workers. Expanding Social Security coverage to all new state and local government workers would raise more than $9 billion from 1993 through 1997 and would ultimately improve the retirement benefits of these workers. It would benefit new state and local government workers and their families in three ways. First, because of the portability of coverage, newly hired workers would find it easier to qualify for disability and survivors' benefits under Social Security than under many public employee benefit programs. Second, Social Security eligibility is not lost if the employee changes jobs. Third, because Social Security benefits are calculated on the basis of indexed wages, while benefits from public pension plans are calculated on the basis of nominal wages for a given amount of covered wages, younger and short-service workers would receive more generous retirement benefits from Social Security than from public pension plans.

State and local governments would have to pay the employer's share of Social Security taxes on new employees if coverage were made mandatory. Since state and local government participation in Social Security is now voluntary, those states with a low percentage of covered employees would bear much of the cost of mandatory coverage. Representatives of some states and localities argue that the change would impose heavy financial and administrative burdens on them.

REV-19 REPEAL THE MEDICARE TAXABLE MAXIMUM

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	2.6	5.6	6.0	6.5	7.1	27.8

NOTE: Estimates are net of reduced income tax revenues.

Under current law, wages above the taxable maximum ($130,200 in 1992) are exempt from all payroll taxes, including the Medicare Hospital Insurance tax. Each year the taxable maximum is increased by the change in the national average wage. For workers now paying Hospital Insurance taxes, only about 5 percent of wages--earned by about 2 percent of workers--are above the taxable maximum. If the taxable maximum for Medicare were repealed beginning in 1993, revenue would increase by about $28 billion from 1993 through 1997.

Repealing the Medicare taxable maximum would provide needed funds to the Medicare trust fund. In 1991, the fund's trustees projected that the fund will begin to show a negative cash flow in 1995 and will be exhausted by 2005. Repealing the Medicare taxable maximum would also lessen the regressivity of the Medicare payroll tax by ending the current situation in which workers earning more than the taxable maximum pay a smaller share of their income in payroll taxes than do other workers.

Opponents of this option argue that the advantages mentioned above would be outweighed by the costs of increasing the subsidy high-wage workers pay to other workers. High-wage workers currently subsidize other workers through their higher tax payments because participants in the Medicare program receive the same benefits regardless of how much they paid in payroll taxes. Repealing the Medicare taxable maximum would broaden the gap between taxes paid and benefits received by high-wage workers, thereby increasing this subsidy.

Leaving the taxable maximum where it is and increasing the Medicare tax rate from 1.45 percent to 1.55 percent for employers and employees would raise about the same amount of revenue over five years as would repealing the taxable maximum. Funding Medicare benefits in this manner would be less likely to increase the subsidy that high-wage workers pay to other workers, but it would also maintain the regressivity of the Medicare payroll tax and lessen the overall progressivity of the federal tax system.

REV-20 INDEX THE UNEMPLOYMENT INSURANCE TAXABLE WAGE BASE

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	0.1	0.5	0.9	1.3	1.5	4.4

NOTE: Estimates are net of reduced income tax revenues.

The Unemployment Insurance (UI) program is financed primarily by federal and state payroll taxes on employers. The federal UI tax is imposed on the first $7,000 of wages per worker. Credits against the federal UI tax rate are used to induce states to establish state wage bases that conform to or exceed the federal wage base. All states have adopted a state wage base of at least $7,000, and most states provide an automatic adjustment to prevent the state wage base from falling behind the federal wage base. Because the federal UI wage base has been increased only three times since 1940, when it was $3,000, the proportion of wages in covered employment subject to the federal tax has fallen from more than 90 percent in 1940 to less than 35 percent today. The ratio of the overall balance of state trust funds to total covered wages and salaries has also fallen from 3.1 percent in 1970 to 2.0 percent in 1990, and it is expected to fall even more in the next couple of years.

Indexing the federal UI wage base by linking it to the change in the national average wage--as is done with the Social Security wage base--would maintain the current relationship between covered wages and unemployment taxes, assuming no change takes place in state UI tax schedules. Moreover, because UI benefits grow with wages, it would preserve the current relationship between per capita tax payments and per capita benefits.

Indexing the wage base, beginning January 1, 1993, would increase combined federal and state UI revenues by almost 5 percent. At the same time, it would reduce the federal budget deficit by about $4.4 billion from 1993 through 1997 and lessen the regressivity of the UI tax. Because both the federal and state UI taxes are counted as revenue to the federal government, increases in both revenue sources lessen the federal budget deficit.

Federal UI tax revenues would rise nearly in proportion to future increases in the federal tax base. In contrast, aggregate state UI tax revenues might rise less than proportionately for two reasons. First, states that now have tax bases higher than the federal base--about two-thirds of states--might not be affected by indexing for several years. Second, states with adequate UI trust fund balances might choose to offset the effects of an increased wage base by reducing their tax rates. Indexing the wage base would concentrate the tax increase on wages of workers now earning more than the current tax base; this change would make the UI tax somewhat less regressive than it is now.

Opponents argue that indexing the wage base is not needed to maintain adequate trust fund balances and that it would lead to higher labor costs and more unemployment in some states. In addition, they argue that because states are now charged interest on loans from the federal UI program, incentives are already in place to encourage responsible state fiscal behavior without indexing the federal wage base.

REV-21 REDUCE TAX CREDITS FOR REHABILITATING OLDER BUILDINGS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Repeal Credit for Nonhistoric Structures and Reduce Credit for Historic Structures to 15 Percent	0.1	0.1	0.1	0.2	0.2	0.6
Repeal Both Credits	0.1	0.2	0.3	0.3	0.3	1.2

SOURCE: Joint Committee on Taxation.

Tax credits for rehabilitation are intended 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 certified as historic structures by the Department of the Interior 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 to the extent that it discourages the destruction of historically noteworthy buildings. This objective, however, might be accomplished at a lower cost by retaining a credit only for the renovation of certified historic buildings and lowering the credit rate. Some surveys have indicated that a 15 percent credit would be sufficient to cover the extra costs both of obtaining certification and of undertaking rehabilitation of historic quality. If the credit for historic structures were reduced to 15 percent and the credit for nonhistoric structures were repealed, revenue gains over the 1993-1997 period would be $0.6 billion. Repeal of both credits would raise $1.2 billion over the same period.

REV-22 TAX CREDIT UNIONS LIKE OTHER THRIFT INSTITUTIONS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Tax All Credit Unions	0.3	0.6	0.6	0.7	0.7	2.9
Tax Credit Unions with More Than $10 Million in Assets	0.2	0.5	0.6	0.6	0.6	2.5

SOURCE: Joint Committee on Taxation.

Credit unions, organized for the benefit of members and operated without profit, are not subject to federal income taxes and hence are treated more favorably than competing thrift institutions, such as savings and loan institutions and mutual savings banks. Taxing all credit unions like other thrift institutions would raise $2.9 billion in 1993 through 1997. Taxing only credit unions with assets above $10 million, which represent about 25 percent of the total number of credit unions, would raise about $0.4 billion less.

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 them to be more like profit-seeking corporations than nonprofit mutual organizations.

Since 1951, credit unions have come to resemble those other thrift institutions in certain respects. Credit union membership is no longer limited to people sharing a "common bond," generally a place of employment; since 1982, credit unions have been allowed to extend their services to others, including members of other organizations. 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 more than 60 million today, indicating that credit unions, like taxable thrifts, now effectively serve the general public. Moreover, credit unions are becoming more like savings and loans and mutual savings banks in the services they offer. A significant number of credit unions now offer such services as first and second mortgages, direct deposit, automatic teller access, preauthorized payments, credit cards, safe deposit boxes, and discount brokerage services.

Taxable thrift institutions argue that the tax-exempt status of credit unions gives them a competitive advantage that is no longer justified by differences in potential membership or available services. Credit unions contend, however, that the original reason for their special tax treatment--that they operate without profit and solely for the benefit of their members--continues to justify their special status. Credit unions also point out that their depositors tend to manage them more closely, since their statutes generally require the boards of directors to be drawn from the membership--a management structure whose goal is not just to make profits.

The credit union industry also argues that only undercapitalized unions would be subject to tax because such credit unions would need to earn profits in order to build up their capital. Collecting a tax on their profits would make it more difficult for undercapitalized credit unions to build up needed capital. Healthy credit unions, however, are not obli-

gated to earn any profits. They could avoid doing so and thus escape the tax by paying higher deposit rates or charging lower loan rates.

Such arguments by the credit union industry may be countered in several ways. First, competing thrift institutions that are profitable but undercapitalized pay taxes. Second, when undercapitalized financial institutions report losses, they can recoup some of their losses from the Treasury as offsets against taxes paid in previous years. Finally, to the extent that credit unions pass their profits on to members, much of the profits would be taxed as income to the members.

REV-23 REPEAL TAX PREFERENCES FOR EXTRACTIVE INDUSTRIES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Repeal Expensing of Intangible Drilling, Exploration, and Development Costs	0.6	0.9	0.9	0.8	0.8	4.0
Repeal Percentage Depletion	0.5	0.9	1.0	1.0	1.0	4.5

SOURCE: Joint Committee on Taxation.

Under the normal tax rules for cost recovery, purchases of capital assets such as plant and equipment cannot be fully deducted when purchased. Instead, the purchase price must be capitalized as a business asset and written off at a prescribed rate over the asset's useful life either through depreciation or depletion. These rules also apply to so-called self-constructed assets, which are constructed by the user rather than purchased. Although oil and gas wells and mineral mines are self-constructed assets, they enjoy special cost-recovery rules. The expensing of certain exploration and development costs, including intangible drilling costs, allows an immediate write-off of costs that would otherwise have to be capitalized and written off more slowly. Percentage depletion allows write-offs that often exceed capitalized costs.

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. For corporations engaged in extracting hard minerals and for so-called integrated producers of oil and gas who also operate sizable refineries, expensing is limited to 70 percent of these costs, with the remaining 30 percent deducted over a 60-month period.

Percentage depletion allows a certain percentage of a property's gross income to be deducted, regardless of the actual capitalized costs. Nonintegrated oil and gas companies are allowed to deduct 15 percent of the gross income from oil and gas production up to 1,000 barrels per day. (Integrated oil and gas producers are required to use normal cost depletion to recover capitalized costs.) Hard mineral producers are also allowed to use percentage depletion at varying statutory rates. Minerals eligible for percentage depletion include sand (5 percent), coal (10 percent), iron ore (14 percent), dimension stone and mollusk shells (14 percent), oil shale (15 percent), gold (15 percent), and uranium (22 percent). The allowance for percentage depletion is limited to 100 percent of the net income from an oil and gas property and 50 percent of the net income from a hard mineral property.

Because percentage depletion depends on the value of production rather than the amount of capitalized costs, it is more akin to a production subsidy than a method of cost recovery. However, the subsidy provides little or no incentive to develop or expand production from marginal properties, since net income limits the amount of percentage depletion. Higher production costs for marginal

properties reduce net income, limiting the amount of percentage depletion allowed.

Percentage depletion and the expensing of exploration and development costs encourage oil and gas production and extracting hard minerals, but the incentives are not available to all producers on an equal basis. Integrated oil and gas producers are denied percentage depletion deductions that others receive. Furthermore, most corporations can expense only 70 percent of their exploration and development costs including intangible drilling costs, while noncorporate producers can expense all of them. Finally, because percentage depletion and expensed exploration and development costs are tax preferences under the alternative minimum tax, producers who pay the minimum tax must defer or even forgo these deductions, while producers who pay the regular income tax may take them currently.

One can make several arguments for repealing expensing and percentage depletion. First, these provisions allocate capital to drilling and mining that could be used more productively elsewhere in the economy. Second, they encourage the use of scarce domestic oil and gas resources, which may lead to a greater reliance on foreign energy producers in the future. Third, their effectiveness in encouraging production is lessened by their failure to provide all producers with the same incentive.

Repealing the expensing of intangible drilling costs and other exploration and development costs would raise about $4 billion in 1993 through 1997, assuming that the costs of dry holes, unproductive mines, and worthless mineral rights could still be expensed. Repealing percentage depletion would raise approximately $4.5 billion over the same five-year period.

REV-24 REPEAL THE POSSESSIONS TAX CREDIT

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Repeal the Credit	1.7	3.1	3.3	3.4	3.6	15.0
Replace the Credit with a Wage Credit	0.2	0.4	0.5	0.5	0.6	2.2

SOURCE: Joint Committee on Taxation.

Income earned by U.S. corporations operating in Puerto Rico or any U.S. possession is generally treated as foreign-source income, and the U.S. federal tax on such income is offset by the foreign tax credit (FTC) for any tax paid to the possession. However, a possessions corporation may claim a possessions tax credit instead of the FTC. A U.S. corporation may elect to be a possessions corporation if it has received at least 80 percent of its gross income for the last three years from sources within Puerto Rico or another U.S. possession and at least 75 percent of such income was derived from the active conduct of a trade or business. Because the possessions tax credit is equal to the U.S. tax on qualified income earned in U.S. possessions, the credit effectively exempts such income from federal tax.

The objective of the possessions tax credit has been to promote employment in U.S. possessions. Certainly, a substantial fraction of employment in Puerto Rico is in possessions corporations: in 1987, 82 percent of manufacturing jobs were in possessions corporations, according to a recent study by the Internal Revenue Service (IRS). But critics argue that the credit has provided tax benefits to certain businesses that are overly generous for the jobs they have created. For example, pharmaceutical manufacturers, who received 54 percent of the tax benefits in 1987, accounted for only 18 percent of employment in possessions corporations. Tax benefits averaged 267 percent of compensation for drug manufacturers and 95 percent of compensation overall for Puerto Rican possessions corporations, according to the IRS.

Moreover, despite complex limits, the primary incentive of the credit is to reallocate artificially the income from intangible assets developed in the United States to possessions rather than to encourage investment in tangible capital, such as plant and equipment. The Tax Reform Act of 1986 and subsequent regulations imposed further limitations, but the credit remains a substantial tax expenditure. Repealing the credit would increase revenues by $15 billion over five years.

Critics of the credit argue that a better targeted subsidy, such as a wage credit, would be a more cost-effective way to promote employment. The Treasury Department in 1985 proposed a wage credit equal to 60 percent of wages up to the federal minimum wage and 20 percent of wages between one and four times the minimum wage. The wage credit would replace the possessions tax credit and the foreign tax credit on income from possessions for qualifying corporations. The Treasury proposal would also continue providing possessions tax credits for five years on the active business income of qualifying corporations. Despite the grandfather provision, the wage credit would raise more than $2 billion during the 1993-1997 period.

One argument against repealing the possessions tax credit is that it is necessary to stimulate investment by U.S. firms in Puerto Rican high-technology manufacturing, such as pharmaceuticals and electronics. The wage credit option, by shifting the tax subsidy from capital to labor, would tend to reduce the capital intensity of possessions corporations over the long run. However, by subsidizing only labor, the wage credit might stimulate more employment than the broader possessions tax credit. In addition, the wage credit would apply even at relatively high wages to minimize the substitution of low-wage for high-wage jobs.

Another argument against repeal is that it would cause unemployment in the subsidized industries, as well as in other sectors that sell products and services to the possessions corporations and their employees. The generous transition rule and new wage subsidies in the second option are intended to minimize these disruptions.

REV-25 ELIMINATE PRIVATE-PURPOSE, TAX-EXEMPT BONDS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Eliminate All Private-Purpose, Tax-Exempt Bonds	0.2	0.5	1.0	1.4	1.9	5.0
Raise Cap and Extend Volume Limits to New Issues of All Private-Purpose Bonds	a	0.2	0.3	0.4	0.6	1.5

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

State and local governments have for many years issued bonds exempt from federal taxation to finance public investments such as schools, highways, and water and sewer systems. Beginning in the 1970s, these governments began to issue a growing dollar volume of tax-exempt bonds to finance quasi-public facilities, such as ports and airports, and private-sector projects, such as housing and shopping centers. These bonds eventually became known as "private-purpose" bonds because the ultimate users of the tax-exempt financed facilities were private nongovernmental entities.

Private-purpose, tax-exempt bonds include mortgage revenue bonds for rental housing and single-family homes for low-income and middle-income households; industrial development bonds (IDBs), which private firms use for a wide variety of purposes; student loan bonds, which state authorities issue to increase the funds available for guaranteed student loans; and bonds for nonprofit institutions, such as hospitals and universities.

Although private-purpose bonds provide subsidies for activities that arguably are worthwhile, tax-exempt financing is not the most efficient way to provide assistance. With a direct subsidy, the benefit would go entirely to the borrower; with tax-exempt financing, it is shared by the borrower of funds and the investor in tax-exempt bonds. In addition, because tax-exempt financing is a tax expenditure instead of a budget outlay, the Congress does not routinely review it as part of the annual budget process.

The Congress has placed restrictions on tax-exempt financing several times, beginning in 1968. During the 1980s, these restrictions included limiting the volume of new issues of tax-exempt bonds for some activities and setting expiration dates on the use of tax-exempt financing for other activities. Some of the expiration dates, however, have been routinely postponed.

The Tax Reform Act of 1986 made the alternative minimum tax applicable to interest earned on newly issued, private-purpose bonds and placed a single state-by-state limit on the volume of new issues of IDBs, student loan bonds, and housing and redevelopment bonds. The new state volume limits, which are more restrictive than those previously in force, are the greater of $50 per resident or $150 million a year. Bonds for publicly owned airports, ports, and solid waste disposal

facilities and bonds for nonprofit 501(c)(3) organizations (primarily hospitals and educational institutions) are exempt from the limits on issues of new bonds. Large private universities and certain other nonprofit institutions may not issue tax-exempt bonds if they already have more than $150 million in tax-exempt debt outstanding.

If the Congress were to eliminate tax exemption for all new issues of private-purpose bonds, revenue gains would be about $5 billion in 1993 through 1997. This amount assumes that at least some construction of airports and sewage and solid waste facilities would qualify for tax-exempt financing as governmental in nature. Eliminating the tax exemption would eventually raise the cost of the services provided by nonprofit hospitals and other facilities that currently qualify for tax-exempt financing, but the cost increase would be small and gradual.

Including all bonds for private nonprofit and quasi-public facilities in a single state volume limit, while raising the limits beginning in 1993 to, say, $75 per capita or $200 million a year, would increase revenues by $1.5 billion in 1993 through 1997. Those changes would curb the growth of all private-purpose bonds without sharply reducing their use. The curb would primarily affect bond issues for nonprofit hospitals, which are not included in the current cap. Advocates of limiting or eliminating those bonds question the need for any subsidy when the supply of hospital beds seems to be adequate; opponents hold that such limitations will raise health care costs. Bonds for airport facilities, such as departure gates, for the exclusive private use of airlines under long-term leases would also be curtailed. Public airport facilities, such as runways and control towers, however, could continue to be financed with tax-exempt bonds as government facilities.

REV-26 FURTHER RESTRICT DEDUCTIONS FOR BUSINESS MEALS AND ENTERTAINMENT

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Disallow Deductions for Half of Business Meal and Entertainment Expenses	1.6	3.4	3.4	3.5	3.6	15.5

SOURCE: Joint Committee on Taxation.

The tax code generally does not allow deductions for personal living costs, but it allows full deductions for ordinary and necessary business expenses. Expenses for meals, entertainment, and travel are deductible only if they are clearly related to business and are not deemed to be "lavish and extravagant" under the circumstances. Moreover, only 80 percent of the expenses for meals and entertainment meeting these conditions can be deducted. The Congress imposed these restrictions out of a concern that some taxpayers were deducting personal living expenses as business expenses. The restrictions could be tightened further by lowering the 80 percent limit. For example, limiting deductions to 50 percent of expenses for business meals and entertainment would raise revenues by $15.5 billion in 1993 through 1997.

Separating the component of expenses for meals and entertainment that represents ordinary and necessary business expenses from the part that represents personal consumption is inevitably arbitrary. Therefore, a 50 percent limit may appear reasonable to some, while others may regard it as too stringent.

REV-27 AMORTIZE A PORTION OF ADVERTISING COSTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	3.3	5.9	4.4	2.9	1.7	18.2

SOURCE: Joint Committee on Taxation.

Under the income tax, the ordinary costs of doing business can be fully deducted as they are incurred or paid, but capital expenditures cannot. Instead, capital expenditures to purchase assets with useful lives that extend beyond the current tax year must be capitalized. They are then deducted at prescribed rates as the assets wear out in order to match costs with income. Advertising is treated as an ordinary business cost that can be fully deducted when incurred, since providing information about a product is considered essential to its sale.

Because advertising often contributes to brand recognition that may last for years, capitalizing a portion of advertising costs and deducting it over several years might improve the matching of business costs with income. Requiring 20 percent of all advertising costs to be capitalized and deducted on a straight-line basis over four years would raise about $18 billion from 1993 through 1997.

Because advertising is not always easy to identify, this option would require complex rules to distinguish advertising costs from other ordinary business costs. Some costs, such as those of notifying customers of price changes, redesigning product packaging, or changing store displays, might or might not be viewed as advertising. Moreover, because the useful life of advertising depends on its unknown effect on customers, any amortization rate would be arbitrary.

Amortizing a portion of advertising costs would raise the after-tax cost of advertising and discourage its use. Some people support this approach on the grounds that advertising is socially wasteful. But it also may be socially useful because it gives customers a greater choice of products by promoting product diversity.

REV-28 IMPOSE A VALUE-ADDED TAX

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Addition
5 Percent Rate, with Comprehensive Base	0	90.0	134.0	140.0	147.0	511.0
5 Percent Rate, with Food, Housing, and Medical Care Excluded	0	47.0	70.0	73.0	77.0	267.0

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are based on an effective date of January 1, 1994, and are net of reduced income and payroll tax revenues, but do not reflect added administrative costs.

A value-added tax (VAT) is a form of general sales tax used in more than 50 countries, including 20 of the 25 members of the Organization for Economic Cooperation and Development. It is typically administered by taxing the total value of sales of all businesses, but allowing businesses to claim a credit for taxes paid on their purchases of raw materials, intermediate materials, and capital goods from other businesses. As a result, only sales to consumers end up being taxed.

A 5 percent VAT on a broad consumption base (as defined in Table 6) would increase net revenues by about $90 billion in fiscal year 1994 and by roughly $511 billion through 1997. Most VATs, however, do not tax such a broad base. The typical European VAT, for example, excludes food, housing, and medical care. In addition, financial services are partly excluded because they are difficult to tax. A 5 percent VAT on a narrower base (as defined in Table 6) would net $47 billion in 1994 and about $267 billion through 1997. These revenue estimates assume that collections would not begin until January 1, 1994, because the Internal Revenue Service would need more than a year to set up a VAT.

A VAT might be preferable to an income tax increase because it would not discourage saving and investment by taxing their return. In addition, a broad-based VAT with a single rate would distort economic decisions less than would an equal revenue increase in selective consumption taxes. The VATs that have been enacted in other countries, however, include many tax preferences and multiple rates. Such a VAT would distort consumption choices more than a single-rate, broad-based VAT and could be more distorting than higher income tax rates.

Because a VAT is added to the price of products, adopting one would cause an initial jump in the overall price level because the consumer price index and other price indices are computed on a tax-inclusive basis. The increase in the price level, however, would not necessarily lead to further inflation, depending on how the Federal Reserve responded. Many experts believe that the Federal Reserve would adjust the money supply in a way that would maintain nominal income. Under this scenario, macroeconomic models generally predict little inflation beyond the initial price jump.

A major drawback of the VAT is that it is a regressive tax, especially when its burden is measured relative to annual income, because, on an annual basis, the ratio of consumption to income is lower for higher-income families. CBO estimates that for a broad-based VAT

the burden on families in the bottom income quintile (as a percentage of their annual income) would be about three times as large as the burden on families in the top income quintile. A VAT would appear less regressive if income and consumption were measured over a longer period of time because income and consumption nearly match over a lifetime, even though income tends to fluctuate more than consumption on an annual basis.

Table 6.
The Size of Two Possible Tax Bases for a Value-Added Tax, 1990

Items Included in Tax Base	Amount (Billions of dollars)
Broad Tax Base	
Total Personal Consumption in Gross National Product	3,657
New Residential Construction	195
Subtotal	3,852
Exclusions from the Base[a]	
Rental value of housing	-570
Net foreign travel expenditures	-1
Religious and welfare activities	-92
Subtotal	-663
Total	3,189
Narrower Tax Base	
Total Personal Consumption in Gross National Product	3,657
Exclusions from the Base[a]	
Rental value of housing	-570
Net foreign travel expenditures	-1
Religious and welfare activities	-92
All medical care (including insurance)	-536
Food consumed at home	-415
Food furnished to employees	-11
Food produced for farm consumption	-1
Brokerage, banking, and life insurance services	-178
Local transit (excluding taxis)	-5
Clubs and fraternal organizations	-7
Tolls for roads and bridges	-2
Private education and research	-69
Subtotal	-1,887
Total	1,770

SOURCE: Congressional Budget Office based on national income and product accounts.

a. The excluded amount assumes that the specified consumption is taxed at a zero rate.

A VAT could be made slightly less regressive by granting tax preferences for the goods and services low-income people generally consume, although such exemptions would substantially increase costs of enforcement and compliance and would reduce revenues. Another way to lessen the VAT's regressivity would be to allow additional exemptions or refundable credits for low-income people under the federal income tax. That would reduce the revenue gain, however, and would cause many people to file tax returns who otherwise would have no need to file.

Another drawback of the VAT is that, like any new tax, it would impose additional administrative costs on the federal government and additional compliance costs on businesses. If the United States adopted a VAT that was similar to those used in Europe, these costs could be quite substantial. CBO estimates that administering such a VAT would cost $750 million to $1.5 billion annually, and complying with it would cost $4 billion to $7 billion annually. These costs could be reduced by exempting small businesses from collecting this tax and by taxing as many goods and services as possible at the same rate.

A national sales tax could be used instead of a VAT to tax consumption. Because a sales tax is collected entirely at the retail level, however, the incentive to evade the tax would be much greater under the sales tax than under the VAT. Moreover, because the sales tax lacks an effective credit mechanism for taxes paid on business purchases, such purchases could end up being taxed by mistake. Given these drawbacks, most countries with general consumption taxes have chosen a VAT over a sales tax.

Other ways to tax a broad consumption base are possible, but they have never been

tried. A tax on consumed income, for example, would tax consumption by taxing income that was not saved. Under a consumed-income tax, all contributions to qualified saving accounts would be deductible. Moreover, withdrawals from these accounts could be made at any time for any purpose, but the withdrawals would be added to other income not saved and would be taxed. A graduated rate schedule--like the rate schedule of the individual income tax--could be used to make the consumed-income tax less regressive than a VAT. In addition, the costs of administering and complying with a consumed-income tax could be held down by making it part of the current income tax.

REV-29 INCREASE EXCISE TAXES ON TOBACCO AND ALCOHOLIC BEVERAGES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Increase Cigarette Tax to 48 Cents per Pack	2.9	3.9	3.8	3.8	3.7	18.1
Increase All Alcoholic Beverage Taxes to $16.00 per Proof Gallon	3.8	4.9	4.9	4.9	5.0	23.5
Index Cigarette and Alcohol Tax Rates for Inflation	0.2	0.6	0.9	1.3	1.6	4.6

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Federal alcohol and tobacco taxes raised more than $12 billion in 1991, including $3.8 billion from the tax on distilled spirits, $3.0 billion from the tax on beer, $0.5 billion from taxes on wines and champagnes, and $5.0 billion from taxes on tobacco. The Omnibus Budget Reconciliation Act of 1990 increased the federal excise tax on tobacco and most alcoholic beverages, raising an additional $4 billion annually by 1994.

Smoking and drinking can create costs to society that are not reflected in the prices of tobacco and alcoholic beverages. Examples of these "external costs" include higher health insurance costs to cover the medical expenses associated with smoking and drinking, the presumptive effects of cigarette smoking on the health of nonsmokers, and not least the loss of lives and property in alcohol-related accidents.

To the extent that excise taxes raise the price and reduce consumption of tobacco and alcoholic beverages, tax increases can further reduce the total external costs smoking and drinking produce. However, if those external costs primarily come from heavy or abusive consumption, then higher taxes on tobacco and alcoholic beverages might unduly penalize moderate and infrequent smokers and drinkers.

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 smoking and drinking does to themselves. Teenagers, in particular, may not be prepared to evaluate the long-term effects of smoking and drinking. Evidence suggests that teenage smoking and drinking declines in response to higher prices for tobacco and alcoholic beverages. A number of national medical organizations have supported a substantial increase in the existing federal excise tax on tobacco in the interests of reducing teenage smoking.

Taxes on tobacco and alcoholic beverages are regressive when compared with annual family income; that is, taxes are a greater percentage of income for low-income families than for middle- and upper-income families. (See Congressional Budget Office, *Federal*

Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels, August 1990.)

Increase the Cigarette Tax. The current federal excise tax on cigarettes is scheduled to rise to 24 cents a pack beginning January 1, 1993. Raising the federal excise tax on cigarettes to 48 cents a pack on January 1, 1993, would increase net revenue by about $18 billion between 1993 and 1997.

Increase Taxes on Alcoholic Beverages. Current federal excise taxes on beer and wine remain much lower than the federal excise tax on distilled spirits in terms of the 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 $18.00 per barrel results in a tax of about 10 cents per ounce of alcohol (assuming an alcoholic 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 alcoholic content of 11 percent).

Increasing the federal excise tax to $16.00 per proof gallon for all alcoholic beverages effective January 1, 1993, would raise $23.5 billion between 1993 and 1997. A tax of $16.00 per proof gallon would result in a tax of 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.

Index Cigarette and Alcohol Tax Rates for Inflation. Indexing cigarette and alcoholic beverage tax rates annually beginning January 1, 1993, for inflation during the preceding year would raise $4.6 billion between 1993 and 1997. Indexing these taxes would prevent inflation from eroding real tax rates and would avoid the need for abrupt increases in the future.

An alternative to indexing would be to convert current unit taxes on quantities of these goods to ad valorem taxes, which equal a percentage of the manufacturers' price. This method would link tax revenues to price increases, although revenue would be tied to prices of taxed goods, not the general price level. A shortcoming of the ad valorem tax is that it might create incentives for manufacturers to lower sales prices artificially to company-controlled wholesalers in order to avoid part of the tax.

REV-30 INCREASE ENERGY TAXES

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Impose Tax on Domestic and Imported Oil ($5 per barrel)	18.7	22.4	22.8	23.3	23.8	111.0
Impose Oil Import Fee ($5 per barrel)	8.8	10.8	11.3	11.8	12.3	54.9
Increase Motor Fuel Taxes by 12 Cents per Gallon	10.9	11.0	10.8	10.9	11.2	54.8
Impose Tax on Diesel Fuel Used by Motorboats (20.1 cents per gallon)	a	a	a	a	a	0.1
Impose Broad-Based Tax on Energy Consumption (5 percent of value)	13.4	16.6	17.4	18.2	19.0	84.6

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. Increases in federal government expenditures for energy products under these options are not estimated. The revenue estimates are based on CBO's baseline oil price forecast of $21.30 per barrel in 1993, rising to $24.80 per barrel in 1997. The effective date for all of these options is October 1, 1992.

a. Less than $50 million.

Increasing energy taxes could raise significant amounts of revenue, encourage conservation by making energy more expensive, reduce pollution, and decrease the country's dependence on foreign oil suppliers. Despite a drop in oil imports during the Persian Gulf War, the United States depends on foreign sources for nearly half of its oil and about one-fifth of its total energy. Recent experience illustrates that this dependence on foreign sources exposes the U.S. economy to potential interruptions in energy supplies and to volatile energy prices.

Imposing new or higher energy taxes would raise energy prices and reduce energy consumption, thus helping to promote conservation. To the extent that taxes on oil reduce the demand for imported oil, foreign suppliers would absorb part of the tax through lower world oil prices. To the extent that energy taxes reduce energy consumption, the taxes would also reduce carbon dioxide emissions and could, therefore, contribute to efforts to reduce global warming.

Energy taxes could have widely different effects in different parts of the country. For example, taxes that increase the relative price of fuel oil would have the greatest consumer impact on the Northeast, and taxes that increase the relative price of gasoline would have the greatest consumer impact on the West. (See Congressional Budget Office, *The Budgetary and Economic Effects of Oil Taxes*, April 1986.)

Some analysts argue that stockpiling oil is 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. This argu-

ment is based on the premise that, aside from the problem of interruptions in supply, world energy prices accurately reflect real resource costs and thus already provide an appropriate incentive for energy conservation.

Impose an Excise Tax on Domestic and Imported Oil. An excise tax of $5 per barrel on all crude oil and refined petroleum products--both domestically produced and imported--would raise revenues by about $23 billion per year. It could increase the price of a gallon of gasoline or fuel oil by as much as 12 cents.

A tax on oil would increase the price that consumers must pay, giving them an incentive to use less oil either through conservation efforts or by switching to an alternative source of energy such as natural gas or coal. The tax would cause oil reserves to decline in value, and coal and gas reserves to increase in value. These shifts in value would discourage the exploration and production of oil and would encourage the production of coal and natural gas.

An oil tax, whether on all oil or only imported oil, would raise the costs for industries that use oil as the primary production input (for example, petrochemicals and paints). Consequently, domestic companies in these industries would find it more difficult to compete with foreign companies that would pay less for oil.

Impose an Oil Import Fee. As an alternative to an excise tax on all oil, the Congress could impose the tax only on imported crude oil and refined petroleum products. An oil import fee of $5 per barrel would raise revenues by about $11 billion per year.

An oil import fee would allow domestic suppliers to charge a higher price and still remain competitive with imports, providing an incentive to increase domestic production and a windfall to some domestic oil producers. Like the tax on all oil, the fee would also maintain incentives for conservation by increasing energy prices. These effects would reduce U.S. dependence on foreign oil in the short term, although long-term dependence might be increased if U.S. oil supplies were depleted faster. Opponents of an oil import fee argue that the United States should take advantage of cheap foreign oil to preserve the more costly U.S. reserves for future use.

Because an oil import fee would reduce demand and prices for imported oil, such important U.S. trading partners as Canada, Mexico, and the United Kingdom might object to it. Exempting oil imports from these trading partners, however, would substantially reduce the fee's revenue potential because imports from these countries now account for about one-quarter of U.S. oil imports. An import fee also might violate the General Agreement on Tariffs and Trade (GATT), although disagreement exists on whether oil import fees are exempted from GATT based on national security grounds.

An oil import fee would have different effects in different regions of the country. On net, it would benefit oil-producing states because producers would receive higher prices, but oil-consuming states--especially in the Northeast--would bear much of the burden of the tax and of the higher prices U.S. oil producers receive.

An oil import fee would cause expenditures for oil products to increase by about 10 percent, but only about half of this increase in expenditures would result in added federal revenues. The remainder would increase the income of domestic oil producers. Thus, the price increase compared with the revenue collected would be higher for an oil import fee than for most other taxes on selected products.

Increase Motor Fuel Excise Taxes. Federal motor fuel taxes are currently 14.1 cents per gallon of gasoline and 20.1 cents per gallon of diesel fuel, of which 2.5 cents per gallon goes into the general fund until October 1, 1995, when tax rates are scheduled to drop by 2.5

cents per gallon. The rest goes into the Highway Trust Fund and several related trust funds.

State governments also impose gasoline and diesel taxes ranging from 8 cents to 25 cents per gallon. Twenty-six states increased motor fuel tax rates in 1991. However, compared with motor fuel tax rates in other countries, many of them well over $1.00 a gallon, U.S. tax rates are still among the lowest in the world.

An additional 12 cent federal tax on motor fuels would raise revenues by almost $1 billion per year for each cent per gallon of tax. Because the average national price of all grades of gasoline has dropped from a peak of about $1.39 per gallon in March 1981 to under $1.20 in the fall of 1991 (a reduction of 40 percent in real terms), an additional tax of 12 cents per gallon would not put the total cost of gasoline above what consumers have already experienced. If the additional tax revenues were used to support additional spending from the Highway Trust Fund that otherwise would not be made, they would not reduce the deficit. One way to make the additional revenues available for deficit reduction would be to retain them in the general fund.

The 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, some proponents of the tax view it as an appropriate charge for the costs of pollution and road congestion associated with automobile use. As with other tax increases, however, the incentive to evade the tax would undoubtedly increase, possibly requiring stepped-up administration.

Opponents of increasing motor fuel tax rates argue that it would impose an unfair 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. These costs are much higher in densely populated areas, primarily in the Northeast, whereas per capita consumption of motor fuel is highest in sparsely populated states, mostly in the West.

Tax Diesel Fuel Used by Motorboats. Currently, gasoline used in motorboats for noncommercial purposes is subject to the same 14.1 cents per gallon tax that is imposed on gasoline used in highway vehicles. In contrast, diesel fuel used in motorboats is not subject to taxation, whereas diesel fuel used in highway vehicles is taxed at a rate of 20.1 cents per gallon. Taxing the diesel fuel used in motorboats for noncommercial purposes at the same rate of 20.1 cents per gallon would raise about $29 million annually, and $144 million from 1993 through 1997.

Impose a Broad-Based Tax on All Energy. An alternative to selective excise taxes would be a broad-based tax on all forms of energy consumption. A national energy tax would heighten incentives for conservation and reduce consumption of all forms of energy. In addition, it would raise much more revenue at a lower rate than selective taxes. The tax could be levied as a fraction of the value of fuel or could be based either on units produced (such as barrels of oil, tons of coal, cubic feet of gas) or on the heat content of the fuel measured in British thermal units (Btus).

Unlike a Btu or per-unit tax, a tax on the retail value of energy would not change relative fuel prices and would not encourage consumers to switch from one form of energy to another. Tax evasion, however, would be a problem with such a tax because a large number of retailers would be involved in collecting it. If the tax were imposed at an earlier stage of the distribution process, tax evasion would be less of a problem, but the tax would then distort relative prices because different fuels have different markups at the retail level. These distortions, however, would be smaller than for taxes on selected fuels.

A 5 percent tax on the value of energy consumption, including coal, petroleum, natural gas, hydroelectricity, and nuclear power, would raise an average of $18 billion per year in revenues.

REV-31 IMPOSE A CARBON-BASED EXCISE TAX ON FOSSIL FUELS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
CO_2 Stabilization Tax	23.9	35.1	36.3	37.7	39.2	172.3
CO_2 Reduction Tax	10.4	25.6	41.3	57.1	72.5	206.9

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Recent scientific evidence on the potential for global warming through an intensified greenhouse effect has prompted concern about the level of fossil fuel use. Temperature changes could result from increasing concentrations of certain trace gases that trap excess solar heat in the atmosphere and thus affect the Earth's climate. The most abundant trace gas is carbon dioxide (CO_2), which is produced when fossil fuels are burned. An excise tax proportional to the carbon content of coal, oil, and natural gas could generate substantial revenues, promote energy conservation, and reduce domestic emissions of CO_2.

Imposing a carbon-based tax at the points where fossil fuels enter the economy--minemouth, wellhead, or dockside for imports--could discourage fossil fuel use and reduce subsequent carbon dioxide emissions. The tax rates on fossil fuels could be calibrated either to discourage future increases in CO_2 emissions or to reduce emissions from current levels by some target date. These tax rates would be indexed for inflation, so the incentive for CO_2 abatement would not decline. The relative carbon content of coal, oil, and natural gas would dictate the specific tax rate for each fuel. Since each fuel emits different amounts of CO_2 per unit of useful energy obtained, the tax would not only discourage fossil fuel use, but would encourage switching from higher-emitting fuels to lower-emitting fuels.

A CO_2 stabilization tax of approximately $30 (in 1993 dollars) per ton of carbon content of the three fossil fuels could nearly eliminate the projected growth in carbon dioxide emissions over the next 10 years. This tax rate, based on average carbon content, is equivalent to a tax of approximately $18.00 per ton of coal, $4.00 for each barrel of oil, and about $0.50 per thousand cubic feet of natural gas (in 1993 dollars). In terms of current prices of fossil fuels, the tax equals about 50 percent of the delivered price of coal and about 10 percent of the prices of refined petroleum and natural gas. Such a tax would raise about $172 billion in additional revenue from 1993 through 1997.

More stringent emission targets--such as those discussed during international negotiations--would require higher tax rates. A CO_2 reduction tax equal to $120 (in 1993 dollars) per ton of carbon content of fossil fuels could reduce emissions from current levels by more than 10 percent by the year 2000. The potential economic impact of such a high tax rate, however, might warrant phasing it in. Phasing in this tax over 10 years could raise nearly $207 billion in revenues from 1993 through 1997 (by which time the tax rate would be approximately $70, in 1993 dollars). A phased-in tax could reduce CO_2 emissions in the United States by about 6 percent to 10 percent of current levels by the year 2000. Unfortunately, U.S. action might not signifi-

cantly reduce global CO_2 concentrations, if other countries did not make similar efforts.

Critics of policies aimed at reducing CO_2 emissions contend that the scientific evidence concerning the potential adverse effects of atmospheric CO_2 may not warrant immediate efforts to reduce U.S. fossil energy use, since adjusting to lower energy use would be costly, especially in the energy extraction and processing industries and in energy-intensive manufacturing sectors. The impact of making energy more expensive would reduce growth in the U.S. living standards in the medium term. Moreover, alternative means of slowing global warming could be carried out in both the United States and other countries, including controls on other greenhouse gases, efforts to slow deforestation, research and development into new technologies for improving energy efficiency, and the use of alternative energy sources that do not emit CO_2. Another alternative to raising energy prices through an excise tax on carbon is to adjust to a warmer globe. This would be justified if the adjustment costs that result from warming were less than the adjustment costs of a tax or other method of reducing warming.

REV-32 IMPOSE AN EXCISE TAX ON WATER POLLUTANTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	1.4	1.9	1.9	1.9	1.9	9.1

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. Revenue estimates assume that emissions do not increase over the projection period and that the tax will not increase pollution abatement.

More than 60,000 facilities discharge nearly 300 billion gallons of wastewater each day directly into lakes, rivers, estuaries, and oceans. Taxing pollutants contained in the wastewater could raise a substantial amount of revenue and could create incentives for additional abatement.

One common indicator of water quality is biological oxygen demand (BOD). BOD measures the effect of pollutants that encourage algae growth, which in turn depletes oxygen necessary to sustain much aquatic life. About 14 million pounds of such pollutants are discharged each day from point sources. Nearly 13 million pounds are discharged by publicly owned treatment works (POTWs); most of the rest is discharged by paper and pulp mills, food processors, metal producers, and chemical plants.

To the extent that too little pollution abatement occurs under current regulations, an excise tax could increase the level of pollution control in an economically efficient manner if the tax rate were set higher than the marginal cost of abatement--that is, the cost to affected firms of eliminating an additional pound of pollutant. In addition, the tax would provide all firms, even those complying with current standards, with an incentive to try constantly to lower pollution emissions. The process of collection, and the observed responses of firms, would provide information that could be used to calibrate future charges and other controls.

The cost of controlling another pound of BOD at POTWs and many industries regulated under the Clean Water Act averages between 40 cents and 70 cents per pound removed. A charge on BOD discharges of 50 cents per pound could encourage many manufacturing facilities and POTWs that face lower abatement costs to reduce pollution. Assuming that the 14 million pounds per day of BOD discharges continue to be emitted, a tax at this level would raise $9.1 billion between 1993 and 1997. Revenues could be lower, however, if additional abatement measures are taken. Since some wastewater treatment processes reduce several pollutants simultaneously, discouraging one pollutant might also encourage reducing others.

To simplify carrying out a BOD-based water pollution excise tax, the discharge levels that are specified in the permits issued to every source of water pollution by state or federal governments could be used as the basis for levying a BOD tax. Levying a tax on effluent from POTWs, as well as from large industrial dischargers, would include all significant point sources of effluent in the charge system. POTWs could recover costs by raising residential and commercial sewer bills and by increasing the fees charged to industrial sources that pipe wastewater to the facilities. Including POTWs in the tax system might be more politically acceptable if the revenues were placed in a revolving fund used to finance greater public investment in equipment to control pollution. Alternatively, the tax

might be levied only on industrial sources of water pollution, excluding POTWs; doing so would limit the number of collection points and would reduce revenue by about 90 percent.

Currently, 36 states and territories operate their own water pollution permitting programs under federal approval. Many of those states also collect revenues from fees based on the permits. These states might oppose a federal tax scheme if it were perceived as reducing their own fee revenues.

In addition, under current environmental control laws, facilities that discharge water pollutants must incur the costs needed to comply with regulations, but are not charged for allowable discharges. Taxing dischargers for those continuing emissions would place an additional burden on those facilities and would raise the cost of producing many goods.

REV-33 IMPOSE EXCISE TAXES ON AIR POLLUTANTS

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars) 1993	1994	1995	1996	1997	Cumulative Five-Year Addition
			Stationary Sources			
Impose a Tax of $150 per Ton on SO_x	2.0	2.7	2.7	2.6	2.6	12.4
Impose a Tax of $250 per Ton on NO_x	1.6	2.1	2.1	2.1	2.1	10.0
Impose a Tax of $1,000 per Ton on VOCs	7.7	10.2	10.2	10.2	10.2	48.4
Impose a Tax of $150 per Ton on Particulate Matter	0.6	0.8	0.8	0.8	0.8	3.7
			Mobile Sources			
Impose a One-Time Emission Tax (Averaging $250 per Vehicle) on New Automobiles and Light Trucks	2.0	2.6	2.7	2.8	2.8	13.0

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. Unless otherwise noted, the revenue estimates assume that emissions do not increase over the projection period and that the tax will not increase pollution abatement.

Excise taxes levied on air pollutants that lend themselves most readily to taxation--sulfur oxides (SO_x), nitrogen oxides (NO_x), volatile organic compounds (VOCs), carbon monoxide (CO), and particulate matter (PM)--could raise revenues. Moreover, excise taxes could create incentives for developing more efficient abatement technology. However, in the four options that tax pollution from stationary sources, the tax rates specified here are well below the average firm's cost of reducing pollution at the margin. Some firms with low control costs would possibly engage in some additional abatement in response to the taxes. However, these taxes should not reduce industry pollution levels significantly. The tax on mobile sources (vehicles) is set above the average cost of reducing emissions at the margin and, therefore, could reduce pollution levels significantly. (See REV-30, REV-31, and REV-36 for other taxes that might affect emissions of air pollutants.)

The pollutants SO_x and NO_x are considered primarily responsible for acid rain, which is thought to degrade surface waters, damage forests and crops, and increase the incidence of respiratory ailments. Large industrial sources, notably coal-fired electric utilities, emit significant quantities of these pollutants. Ozone pollution is produced when NO_x and VOCs, which are emitted by industrial sources as well as by automobiles and trucks, combine in the presence of sunlight and other compounds. The resulting pollution has kept about 100 U.S. cities from attaining the cur-

rent health-based ozone standard. Particulate matter can carry heavy metals and cancer-causing organic compounds into the lungs, thus increasing the incidence and severity of respiratory diseases. Carbon monoxide can also pose direct health hazards.

With some minor exceptions, firms subject to air pollution standards must incur the costs needed to comply with regulations, but are not charged for allowable emissions. As with other pollution charges, taxing emissions would place an additional burden on some producers and would raise the price of goods whose production or use emits air pollutants.

The marginal cost of pollution control for stationary sources varies, given the numerous industrial and other sources. The tax rates considered here can be interpreted as supplementing current regulatory controls. They are not high enough to encourage any significant additional pollution control by industry beyond that required by current regulations. Polluters with marginal control costs lower than the taxes might be induced to take advantage of pollution control options not required by the Clean Air Act, thus reducing emissions of air pollutants below current levels in the least expensive way possible. Although the taxes considered here are not indexed for inflation, indexing tax rates would prevent inflation from eroding either the abatement potential of the taxes or the real value of revenues to the federal government.

Tax Emissions of SO_x and NO_x from Stationary Sources. Taxes of $150 per ton on SO_x emissions and $250 per ton on NO_x emissions levied on electric utilities and large manufacturing plants would raise roughly $12.4 billion for SO_x and $10.0 billion for NO_x through 1997, based on projected levels of the two pollutants under current regulations. However, these estimates do not include reductions of expected pollution levels that may result from regulations carrying out Title I of the Clean Air Act Amendments of 1990 because these regulations have not yet been issued. The present monitoring and reporting system for stationary sources, operated by the Environmental Protection Agency (EPA) and state regulators, could be adapted to support implementation of these taxes. The administrative burdens would be minimized if the taxes were based on the terms granted in air pollution permits.

Taxes of this magnitude could promote some additional abatement of pollution. Some electric utilities and manufacturing plants might be able to switch to lower-sulfur coals for less cost than paying the tax, and others might choose to operate their most heavily emitting plants less frequently. The tax would be too low, however, to encourage the installation of SO_x control devices. If the tax of $250 per ton on NO_x emissions were imposed, methods currently available that can reduce NO_x emissions at roughly the same cost as the tax might be more widely adopted.

Tax Emissions of VOCs from Stationary Sources. Stationary sources of volatile organic compounds range from huge industrial facilities such as chemical plants, petroleum refineries, and coke ovens to small sources such as bakeries and dry cleaners. Their vast number and diversity make it difficult to estimate emissions and costs of abatement. A tax of $1,000 per ton on stationary-source VOC emissions could elicit better information, since sources would be forced to compute or estimate tax liability, and might promote some abatement. The tax would generate $48.4 billion in revenues from 1993 through 1997.

The advantage of a broad-based tax is that it captures small sources, which are estimated to be responsible for approximately 80 percent of all VOC emissions from stationary sources. Since small sources of VOCs are not currently subject to regulation, a broad-based VOC tax might be administratively more difficult to carry out than a tax limited to large sources. Confining the tax to large stationary sources would reduce revenues to $2.3 billion annually. Alternatively, the broad basis for the tax could be preserved if the tax on small sources were assessed on estimated emissions based on technologies used rather than on measured emissions.

Tax Emissions of PM from Stationary Sources. A tax of $150 per ton of particulate matter would raise roughly $3.7 billion through 1997, based on projected levels of emissions under current regulations and amounts specified in current air pollution permits. The present monitoring and reporting system for stationary sources, operated by the EPA and state regulators, could be adapted to support implementing these taxes. The administrative burdens would be minimized if taxes were based on the terms granted in air pollution permits. Some electric utilities and manufacturing plants might install improved electrostatic precipitators, wet scrubbers, or other equipment designed to reduce PM emissions in order to reduce their tax burdens.

Tax Emissions of NO_x, VOCs, and CO from Mobile Sources. A one-time tax imposed on new automobiles and light trucks, based on estimated pollution emission rates and current regulations and averaging $250 per vehicle, could provide $13 billion in revenues from 1993 through 1997 while reducing auto emissions. The current "gas-guzzler" excise tax is levied on new automobiles based on their fuel efficiency. Similarly, an emission tax could be calculated on the emission certification tests required under existing law for every new vehicle.

Title II of the Clean Air Act Amendments of 1990 called for more stringent tail-pipe emission standards for automobiles and light trucks. The cost of these stricter standards has been estimated at between $61 and $139 per vehicle for new cars and light trucks. Thus, a tax based on grams emitted per mile and averaging $250 per vehicle could encourage the purchase and manufacture of low-polluting and more fuel-efficient vehicles (see REV-36). The revenue estimates presented here take into account projected growth in new car sales and assume that new cars meet, on average, current tail-pipe standards. If new cars become cleaner over time, or if a slowdown in the economy reduces new car sales, revenues may be lower than projected.

Since earlier-model vehicles account for more than 90 percent of light-duty vehicles in use, applying a grams-per-mile emission charge to earlier-model vehicles could encourage owners of these vehicles to retire them sooner in favor of new, lower-emitting vehicles and so could reduce pollution levels. In addition, an emission tax on earlier-model vehicles might offset the incentive that the excise tax on new vehicles would give owners to keep their older vehicles. Older vehicles have been excluded from the estimate above because of the administrative problems of collecting a tax on older vehicles and the difficulty of determining how high the tax would have to be to encourage retirement of vehicles. Since relatively more older vehicles are owned by lower-income households, a tax on older vehicles might be regressive.

REV-34 DOUBLE THE SEC FEE ON SECURITIES TRANSACTIONS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	0.1	0.1	0.1	0.1	0.1	0.4

SOURCE: Joint Committee on Taxation.

Current law requires securities exchanges to pay a transaction fee yearly to the Securities and Exchange Commission (SEC). The amount of that fee is now 1/300th of 1 percent of the dollar value of certain securities sales. In 1991, the fee raised an estimated $61 million. Doubling the fee would increase revenues over the 1993-1997 period by $0.4 billion.

The transaction fee was part of the original Securities and Exchange Act of 1934, which created the SEC. It was set at 1/500th of 1 percent and applied to all securities sold on national exchanges. Subsequent amendments have raised the fee to its current level and created some exemptions, most notably on transactions of securities issued or guaranteed by the U.S. government and on the sales of bonds, debentures, and other debt securities. The transaction fee currently applies only to common and preferred stock, warrants, and rights to subscribe.

Proponents of increasing the fee argue that it is lower than the stock transfer taxes assessed by most other industrialized nations. Even if multiplied many times over, the fee would remain relatively small and would not have many of the negative consequences associated with stock transfer taxes, such as distorting trading decisions, severely penalizing realized capital gains, and raising the cost of capital.

Opponents point out that through the securities transaction fee and other charges, the SEC already raises from "users" more than 100 percent of its annual budget outlays, and that the higher the fee goes, the more it will distort decisionmaking. An increase in the fee could create distortions, particularly since it would raise the cost of equity transactions, but not the cost of debt transactions. The responsiveness of buyers and sellers to increased transaction costs is unknown, but many observers believe it to be substantial. Therefore, even a small increase in the fee could lead some market participants to desert U.S. exchanges for foreign ones.

REV-35 AUCTION OFF IMPORT QUOTAS FOR TEXTILES, APPAREL, AND SUGAR

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Addition to CBO Baseline	2.5	2.7	2.9	3.0	3.2	14.4

As a means of protecting domestic producers, the United States imposes quotas on various imports, including textiles, apparel, steel, machine tools, sugar, peanuts, cheese, and beef. Such quotas increase the price at which the imports can be sold to a level that is higher than the cost of the products to the foreign exporters. (Without the quotas, the price would equal the cost.) This price difference represents an economic rent that different parties can capture, depending on how the quota rights are distributed.

Currently, the U.S. government negotiates quotas for U.S. imports with foreign governments. This system allows foreign exporters or their governments to capture the quota rents. If the United States were instead to sell the quotas at auction to the highest bidder, the U.S. government would receive the quota rents back from the foreign countries as revenues from the auctions. In addition, the prices at which the quotas would sell at auction would provide the information needed to calculate the tariff rates that would provide equivalent protection to domestic industry, should the government wish to do so. For an equivalent amount of protection, tariffs are generally less damaging to the economy than quotas.

The United States and foreign governments have set many quotas by agreement, with the understanding that foreigners would receive the rents. Before holding quota auctions, these agreements would have to be renegotiated, and the foreign governments probably would not willingly consent to the loss of rents without some form of compensation. Alternatively, the United States could hold the auctions without the consent of the countries with agreements, but doing so might lead to retaliation by those countries. Some of the quotas (in particular, the textile and apparel quotas) will probably be phased out over the coming years, so some of the rents may be temporary. Because there are tariffs as well as quotas on many of these products, however, the increased imports that would result from a phaseout should increase tariff revenue collections and thereby at least partially offset any lost rents.

CBO estimates that auctions of U.S. quotas on imports of textiles, apparel, and sugar would raise approximately $2.5 billion in 1993 and $14.4 billion over the 1993-1997 period. Auctions of other import quotas would raise much less revenue because the quotas are less substantial in scope, are scheduled to be eliminated, or do not severely restrict the imports that they cover. For example, quotas on steel imports have generally gone unfilled for several years and are scheduled to expire on March 31, 1992. Proposals in the Uruguay Round of the General Agreement on Tariffs and Trade to phase out import quotas for textiles and apparel and to convert import quotas to tariffs for agricultural goods are not factored into the estimates presented here. Further, the estimated values of all import quotas are based on a number of assumptions relating to exchange rates, the business cycle, and other economic variables. Unforeseen changes in these variables could significantly affect the values of these quotas.

REV-36 EXTEND THE GAS-GUZZLER TAX TO COVER MORE VEHICLES AND ELIMINATE THE CAFE PROGRAM

Addition to CBO Baseline	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1993	1994	1995	1996	1997	
Extend Gas-Guzzler Tax to Cars and Light Trucks with Fuel Efficiencies Below:						
27.5 miles per gallon	4.3	4.3	4.3	4.3	4.3	21.5
40.5 miles per gallon	7.2	7.2	7.2	7.2	7.2	36.0

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. The effective date for these options is October 1, 1992.

Two government programs directly attempt to encourage sales of fuel-efficient motor vehicles: the gas-guzzler tax and the corporate average fuel economy (CAFE) standards. Under the gas-guzzler tax, sales of passengers cars with fuel economy ratings below 22.5 miles per gallon (MPG) are taxed, starting at $1,000 per vehicle and increasing to $7,700 per vehicle for cars rated at less than 12.5 MPG. Sales of light trucks, including passenger vans and recreational vehicles, are exempt.

The gas-guzzler tax applies mainly to the more expensive vehicles and, hence, falls on higher-income drivers. Little fuel conservation results from the tax because it applies to a small percentage of vehicles and because the demand for expensive cars is not particularly responsive to the magnitude of the change in price that the tax causes. Moreover, even if the current tax successfully discourages purchases of extremely inefficient cars, it does not encourage car buyers to choose the more efficient models among those not taxed.

Stronger incentives for raising average fuel economy exist under the CAFE program. The program assesses a civil penalty on automakers whose average fleet efficiency falls short of the standard--in 1991, 27.5 MPG for cars and 20.2 MPG for light trucks. The penalty equals $5 for every 0.1 MPG that a manufacturer's average fleet efficiency falls short of the standard, multiplied by the total number of cars or trucks sold.

The CAFE standards have increased fuel efficiency, but not as much as the Congress envisioned. They may also have increased the costs of producing vehicles more than was necessary to improve fuel economy. Those higher costs constitute a hidden tax. Under the program, manufacturers have strong incentives to meet the CAFE standard by shifting the mix of vehicles they sell. They may subsidize sales of smaller, more fuel-efficient models to avoid the costs of improving fuel economy on their larger models. They may also subsidize sales of models within the light-truck class as substitutes for passenger cars that serve the same market segment (for example, vans, which are defined as light trucks, may substitute for station wagons). Because the CAFE standards apply separately to an automaker's sales of domestic and foreign-made vehicles, manufacturers also may reduce the domestic content of domestic vehicles or even relocate assembly plants to have them classified as foreign-made. These activities have lowered the improvement in overall fuel economy and raised production costs.

This option would extend the gas-guzzler tax to all light-duty vehicles (passenger cars and light trucks) that are rated below a specified fuel economy and would eliminate the civil penalty assessed on automakers who do not meet the CAFE standard. Two variations of this option establish different minimum tax thresholds: taxing all vehicles rated below 27.5 MPG (the current CAFE standard for passenger cars) or taxing all vehicles rated below 40.5 MPG (which includes almost all vehicles). The tax would apply equally to all light-duty vehicles that achieve the same fuel economy. It would be set on a sliding scale, starting at $200 per vehicle for the most efficient models (27.5 MPG in the first case or 40.5 MPG in the second case) and rising to $7,700 per vehicle (the current gas-guzzler tax rate for vehicles achieving less than 12.5 MPG). For example, the tax for vehicles rated at 25 MPG (the fuel economy with the greatest sales) would be $450 under the first variation and $800 under the second one.

The first variation, would raise about $4.3 billion in 1993 and $21.5 billion from 1993 through 1997. The second variation would raise about $7.2 billion in 1993 and $36.0 billion over the 1993-1997 period. These revenue gains are net of revenues lost from the repeal of the CAFE penalties.

Aside from raising revenue, the main advantage of adopting this option is that economic efficiency in the automobile industry would increase. Manufacturers would not have to adjust the mix of vehicles they sell in order to avoid paying CAFE penalties under the option; therefore, they could specialize in producing vehicles in which they have a comparative advantage. Because an extended gas-guzzler tax would replace the hidden tax associated with CAFE standards, vehicle prices on average would probably not rise by the full amount of the new tax. This new tax could do the job that the CAFE program has been doing, only more efficiently.

A disadvantage of this option is that it could be regressive, falling disproportionately on lower-income purchasers of new vehicles. Two reasons account for this: first, depending on the tax schedule adopted, the change in the cost of the vehicle may represent a greater fraction of family income for low-income families; second, low-income families may suffer more from the loss of implicit subsidies to small cars and light trucks that the CAFE program created. The distributional consequences of the expanded gas-guzzler tax could be mitigated in two ways. First, an income tax credit could reimburse low-income car purchasers who buy the most efficient models. Second, a gas-guzzler tax/gas-sipper subsidy program could be implemented. Under this type of program, purchasers of inefficient cars would pay a gas-guzzler tax, and purchasers of more efficient models would receive a subsidy. Several legislative proposals for deficit neutral gas-guzzler/gas-sipper programs were introduced in 1991.

Another disadvantage of this option is that it may slow down the replacement of older and therefore relatively less efficient vehicles by raising new vehicle prices.

If reduced fuel consumption is the ultimate policy goal, increasing the motor fuels tax may be a more direct and effective way to achieve this than broadening the gas-guzzler tax (see REV-30). Excise taxes on motor fuels increase the cost of driving and affect the entire fleet immediately, whereas the gas-guzzler tax only affects the fleet gradually as old vehicles are replaced with new ones. Motor fuel tax increases also have the advantage of not discouraging replacement of older vehicles.

Appendix

Spending and Taxation Options by Budget Function

050 National Defense

DEF-01	Increase Planned Reductions of Military Personnel and Forces	18
DEF-02	Cancel the Remainder of the B-2 Bomber Program	20
DEF-03	Retire Minuteman II Missiles	22
DEF-04	Retire the B-1 Bomber Fleet	23
DEF-05	Reduce Spending on Intelligence Activities	25
DEF-06	Reduce Spending on DOE Warhead Activities	27
DEF-07	Cancel the Small ICBM (Midgetman)	29
DEF-08	Terminate Production of D5 Missiles	31
DEF-09	Limit SDI to an ABM-Compliant Ballistic Missile Defense and Continue Research	33
DEF-10	Defer Procurement of New Aircraft Carrier	35
DEF-11	Terminate the SSN-21 Program	37
DEF-12	Cancel Procurement of Additional TAGOS Ships	39
DEF-13	Reduce Procurement of DDG-51 Destroyers	40
DEF-14	Cancel the Air Force's F-22 Aircraft Program	41
DEF-15	Cancel the Upgrade of the Navy's F/A-18 Fighter	43
DEF-16	Delay the Navy's AX Aircraft	45
DEF-17	Cancel the Advanced Air-to-Air Missile	47
DEF-18	Cancel the Kinetic Energy Anti-Satellite Weapon Program	49
DEF-19	Reduce Funding for the Modernization of Armored Systems	51
DEF-20	Cancel the Army's ADATS Program	53
DEF-21	Streamline the National Defense Stockpile	54
DEF-22	Cancel the C-17 Airlift Aircraft	56
DEF-23	Delay Development and Production of New Weapons for One Year	58
DEF-24	Limit Payments for Independent R&D	60
DEF-25	Cancel the National Aerospace Plane	62
DEF-26	Increase Separations of Air Force Enlisted Personnel	64
DEF-27	Make Additional Reductions in the Officer Corps	67
DEF-28	Limit Military Pay Raises	69
DEF-29	Terminate Reserve Retirement Benefits	71
DEF-30	Deny Unemployment Compensation to Service Members Who Voluntarily Leave Military Service	73

DEF-31 Change Budgeting Method for Wage Board Pay Raises 74
DEF-32 Cut Reserve Strength 75
DEF-33 Reduce Drills for Noncombat Reserve Units 77
DEF-34 Reduce Per Capita Use of Hospital Services 78
DEF-35 Increase Charges for Direct Military Health Care Services 80
DEF-36 Charge Retired Military Personnel Premiums for Military Health Care 81
DEF-37 Close the Uniformed Services University of the Health Sciences 83
DEF-38 Adopt Short, Unaccompanied Tours for Europe 85
DEF-39 Reduce Optempo and Unit Training Costs 87
DEF-40 Reduce Funding for Classroom Training 89
DEF-41 Continue Civilian Hiring Freeze 91
DEF-42 Revamp Military Family Housing 93
DEF-43 Increase the States' Share of Army National Guard Costs 95

150 International Affairs

DEF-44 Reduce Security Assistance 96
DEF-45 Consolidate Overseas Broadcasting 98
DEF-46 Reduce Eximbank Credits 99
DEF-47 Phase Out Special Defense Acquisition Fund 100

REV-35 Auction Off Import Quotas for Textiles, Apparel, and Sugar 351

250 General Science, Space, and Technology

DOM-01 Cancel New Spacecraft Development Projects in a Major NASA Program for Space Science and Applications 106
DOM-02 Reduce the Overhead Rate on Federally Sponsored University Research 107
DOM-03 Cancel the NASA Development Program for the Advanced Solid Rocket Motor 109
DOM-04 Cancel the Superconducting Super Collider 111
DOM-05 Cancel Spending for the Space Exploration Initiative 113
DOM-06 Cancel the NASA Space Station Program 115

270 Energy

DOM-07 Eliminate Further Funding for the Clean Coal Technology Program 116
DOM-08 Reduce Department of Energy Acquisitions of Crude Oil for the Strategic Petroleum Reserve 118

ENT-01 Reduce Subsidies Provided by the Rural Electrification Administration 187

ENT-02 Require Department of Energy to Raise Rates for Federal Hydroelectric Power to Speed Debt Repayment 189

REV-23 Repeal Tax Preferences for Extractive Industries 327

300 Natural Resources and Environment

DOM-09 Eliminate Below-Cost Timber Sales from National Forests 119
DOM-10 Eliminate Federal Grants for Construction of Wastewater Treatment Plants 120
DOM-11 De-emphasize Permanence in Superfund Cleanups; Emphasize Land-Use Controls and Containment Methods 122
DOM-12 Eliminate Health Assessments Done at Superfund Sites by the Agency for Toxic Substances and Disease Registry 123
DOM-13 Substitute Private Financing for Government Financing of the Superfund Program to the Maximum Extent Possible 124

ENT-03 Improve Pricing for Commercial and Recreational Uses of Public Lands 191
ENT-04 Change Revenue-Sharing Formula from a Gross- to a Net-Receipt Basis for Commercial Activities on Federal Lands 195
ENT-05 Index Nuclear Waste Disposal Fees for Inflation 197

REV-30 Increase Energy Taxes 340
REV-31 Impose a Carbon-Based Excise Tax on Fossil Fuels 343
REV-32 Impose an Excise Tax on Water Pollutants 345
REV-33 Impose Excise Taxes on Air Pollutants 347
REV-36 Extend the Gas-Guzzler Tax to Cover More Vehicles and Eliminate the CAFE Program 352

350 Agriculture

DOM-14 Reduce Federal Support for Agricultural Research and Extension Activities 125
DOM-15 Reduce USDA Spending for Export Marketing and International Activities 126
DOM-16 Streamline the Operation of Farm Agencies' Field Offices 127

ENT-06 Reduce Deficiency Payments to Farmers Participating in USDA Commodity Programs by Lowering Target Prices 198
ENT-07 Eliminate the 0/92 and 50/92 Programs for Participants in USDA Commodity Programs ... 200

ENT-08 Replace Deficiency Payments in the Wheat, Feed Grains, Cotton, and Rice Programs with Declining Direct Payments 201
ENT-09 Raise the Proportion of Each Farmer's Base Acreage Ineligible for Deficiency Payments from 15 Percent to 25 Percent 202
ENT-10 Restrict Eligibility for Benefits from Price Support Programs and Reduce the Payment Limitation 203
ENT-11 Eliminate the Price Support Program for Wool and Mohair 205
ENT-12 Eliminate the Honey Program 206
ENT-13 Reduce Loan Guarantees Made Under the USDA's Export Credit Programs, and Eliminate Loans to Especially Risky Borrowers 207
ENT-14 Eliminate the Export Enhancement Program 208
ENT-15 Eliminate the Market Promotion Program 209
ENT-16 Reduce Costs for the Dairy Price Support Program by Requiring Producer Contributions 210
ENT-17 End the Federal Crop Insurance Program and Replace It with Standing Authority for Disaster Assistance 211

370 Commerce and Housing Credit

DOM-17 End Small Business Administration Loans and Loan Guarantees 128
DOM-18 Discontinue Postal Subsidies for Not-for-Profit Organizations 130
DOM-19 Scale Back the Rural Rental Housing Assistance Program 132
DOM-20 Scale Back the Housing Loan Program for Rural Homeowners 134
DOM-21 Reduce the Budget of the Export Administration 136
DOM-22 Eliminate the Trade Promotion Activities of the International Trade Administration or Charge the Beneficiaries 137

ENT-18 Auction Licenses to Use the Radio Spectrum 213
ENT-19 Impose a Royalty Payment on Communications Users of the Radio Spectrum 215
ENT-20 Charge for Examinations of State-Chartered Banks 217

REV-05 Eliminate or Limit Mortgage Interest Deductions 294
REV-15 Tax Capital Gains from Home Sales 313
REV-16 Tax Capital Gains Held Until Death 315
REV-22 Tax Credit Unions Like Other Thrift Institutions 325
REV-26 Further Restrict Deductions for Business Meals and Entertainment 333
REV-27 Amortize a Portion of Advertising Costs 334
REV-34 Double the SEC Fee on Securities Transactions 350

400 Transportation

DOM-23 Reduce Federal Aid for Mass Transit 138
DOM-24 Eliminate Airport Grants-in-Aid 139
DOM-25 Eliminate Regulation of Motor Carriers and Abolish the Interstate Commerce Commission 140

ENT-21 Establish Charges for Airport Takeoff and Landing Slots 218
ENT-22 Establish User Fees for Air Traffic Control Services 219
ENT-23 Impose User Fees on the Inland Waterway System ... 220

450 Community and Regional Development

DOM-26 Eliminate Certain Rural Development Programs 141
DOM-27 End Funding for the Economic Development Administration 143
DOM-28 Eliminate the Appalachian Regional Commission 144
DOM-29 Eliminate or Restrict Community Development Block Grants 145
DOM-30 Reduce Federal Support for Tennessee Valley Authority Activities 147

REV-21 Reduce Tax Credits for Rehabilitating Older Buildings 324
REV-25 Eliminate Private-Purpose, Tax-Exempt Bonds 331

500 Education, Training, Employment, and Social Services

DOM-31 Eliminate Ancillary Vocational Education Programs 148
DOM-32 Eliminate Education Programs That Have Largely Achieved Their Purpose 150
DOM-33 Eliminate State Student Incentive Grants 152
DOM-34 Eliminate or Reduce Funding to School Districts for Impact Aid 153
DOM-35 Eliminate Untargeted Funding for Mathematics and Science Education 155
DOM-36 Reduce Pell Grant Funding by Tightening the Definition of Independent Students 156
DOM-37 Eliminate Federal Funding for Campus-Based Student Aid 157
DOM-38 Eliminate or Reduce Funding for the Arts and Humanities 159
DOM-39 Consolidate Social Service Programs and Reduce Their Budgets 160

ENT-24 Reduce Interest Subsidies for Stafford Loans 222
ENT-25 Require Postsecondary Institutions to Share the Risk of Defaults on Stafford Loans 224

ENT-26 Require Postsecondary Institutions to Pay a Co-origination Fee on Stafford Loans 226
ENT-27 Replace Stafford and SLS Loans with Direct Loans ... 227
ENT-28 Limit the Growth of Foster Care Administrative Costs to 10 Percent per Year 229
ENT-52 End or Scale Back Trade Adjustment Assistance 262

REV-07 Eliminate or Limit Deductions for Charitable Giving 299
REV-14 Phase Out the Dependent-Care Credit 312

550 Health

DOM-40 Reduce the Maternal and Child Health Care Block Grant and the Preventive Health Services Block Grant 161
DOM-41 Reduce Funding for Research Supported by the National Institutes of Health 162

ENT-29 Tighten Medicaid's Estate-Recovery Processes and Rules for Long-Term Care 230
ENT-30 Combine Funding to States for the Costs of Administering AFDC, Medicaid, and Food Stamps into a Single Indexed Grant 232
ENT-31 Prefund the Government's Share of Federal Retirees' Health Insurance 234
ENT-32 Reform the Federal Employees Health Benefits Program by Modifying Hospital Reimbursement ... 236

REV-11 Tax Nonretirement Fringe Benefits 305
REV-29 Increase Excise Taxes on Tobacco and Alcoholic Beverages 338

570 Medicare

ENT-33 Eliminate the Disproportionate Share Adjustment for Most Hospitals in Medicare's Prospective Payment System 238
ENT-34 Reduce Medicare's Payments for the Indirect Costs of Patient Care That Are Related to Hospitals' Teaching Programs 240
ENT-35 Reduce Medicare's Direct Payments for Medical Education 241
ENT-36 Eliminate Medicare's Additional Payments to Sole Community Hospitals and Medicare-Dependent Hospitals 242
ENT-37 Eliminate Return-on-Equity Payments for Proprietary Skilled Nursing Facilities 243
ENT-38 Freeze Medicare's Prospective Payment System Rates for One Year 244
ENT-39 Continue Medicare's Transition to Prospective Rates for Facility Costs in Hospital Outpatient Departments 245

ENT-40 Charge a Fee for SMI Claims That Are Not Billed Electronically 246
ENT-41 Reduce Medicare's Payment for Intraocular Lenses to $100 247
ENT-42 Freeze Medicare's SMI Reimbursement Rates for One Year 248
ENT-43 Collect 20 Percent Coinsurance on All Home Health and Skilled Nursing Facility Services Under Medicare 249
ENT-44 Increase the Premium for Physicians' Services Under Medicare to 30 Percent of Program Costs .. 250
ENT-45 Increase and Index Medicare's Deductible for Physicians' Services 251
ENT-46 Collect 20 Percent Coinsurance on Clinical Laboratory Services Under Medicare 252
ENT-47 Relate the Premium for Physicians' Services Under Medicare to Enrollees' Incomes 253
ENT-48 Increase the SMI Coinsurance Rate to 25 Percent 254
ENT-49 Tax a Portion of the Insurance Value of Medicare Benefits 255
ENT-50 Tax Employer-Paid Health Insurance 257

REV-19 Repeal the Medicare Taxable Maximum 322

600 Income Security

DOM-42 Reduce Federal Rental Subsidies by Shifting Some Costs to the States or Tenants 163
DOM-43 Maintain the Current Number of Housing Assistance Commitments 165
DOM-44 Shift Housing Assistance from New Construction to Vouchers 166
DOM-45 Eliminate HOPE Grants for Low-Income Home Ownership 168
DOM-46 Eliminate Special-Purpose HUD Grants 170
DOM-47 Modify the Fee Structure for Local and State Agencies That Administer Federal Housing Programs 171
DOM-48 Eliminate or Scale Back Low-Income Home Energy Assistance 172

ENT-30 Combine Funding to States for the Costs of Administering AFDC, Medicaid, and Food Stamps into a Single Indexed Grant 232
ENT-51 Reduce Federal Employee Retirement Benefits 259
ENT-52 End or Scale Back Trade Adjustment Assistance 262
ENT-53 Increase Targeting of Child Nutrition Subsidies 263
ENT-54 Eliminate Small Food Stamp Benefits 265
ENT-55 Eliminate the $50 Child Support Payment to AFDC Families 266
ENT-56 Reduce the $20 Exclusion from Income in Supplemental Security Income 267
ENT-57 Reduce the Federal Matching Rate and Increase Fees in the Child Support Enforcement Program 268

ENT-58 Impose a Fee for Federal Administration of SSI State Supplementary Payments 270

REV-09 Decrease Limits on Contributions to Qualified Pension and Profit-Sharing Plans 302

REV-10 Impose a 5 Percent Tax on Investment Income of Pension Plans and Individual Retirement Accounts 304

REV-12 Tax the Income-Replacement Portion of Workers' Compensation and Black Lung Benefits 308

REV-20 Index the Unemployment Insurance Taxable Wage Base 323

650 Social Security

ENT-59 Restrict Cost-of-Living Adjustments in Non-Means-Tested Benefit Programs 271

ENT-60 Reduce the Replacement Rate Within Each Bracket of the Social Security Benefit Formula 275

ENT-61 Eliminate Social Security Benefits for Children of Retirees Aged 62-64 276

ENT-62 Lengthen the Social Security Benefit Computation Period by Three Years 277

ENT-63 Consider Veterans' Compensation When Determining Social Security Disability Income Payments 278

REV-13 Increase Taxation of Social Security and Railroad Retirement Benefits 309

REV-18 Expand Medicare and Social Security Coverage 320

700 Veterans Benefits and Services

DOM-49 Close or Convert Inefficient or Underused Facilities in Veterans' Hospitals 173

DOM-50 Promote More Efficient Management and Delivery of Health Care for Veterans 174

ENT-64 Restrict Eligibility for Veterans' Compensation Payments 280

ENT-65 Raise the Loan Fee for Housing Loans Guaranteed by the Department of Veterans Affairs 282

ENT-66 Eliminate "Sunset" Dates on Provisions for Veterans in the Omnibus Budget Reconciliation Act of 1990 283

750 Administration of Justice

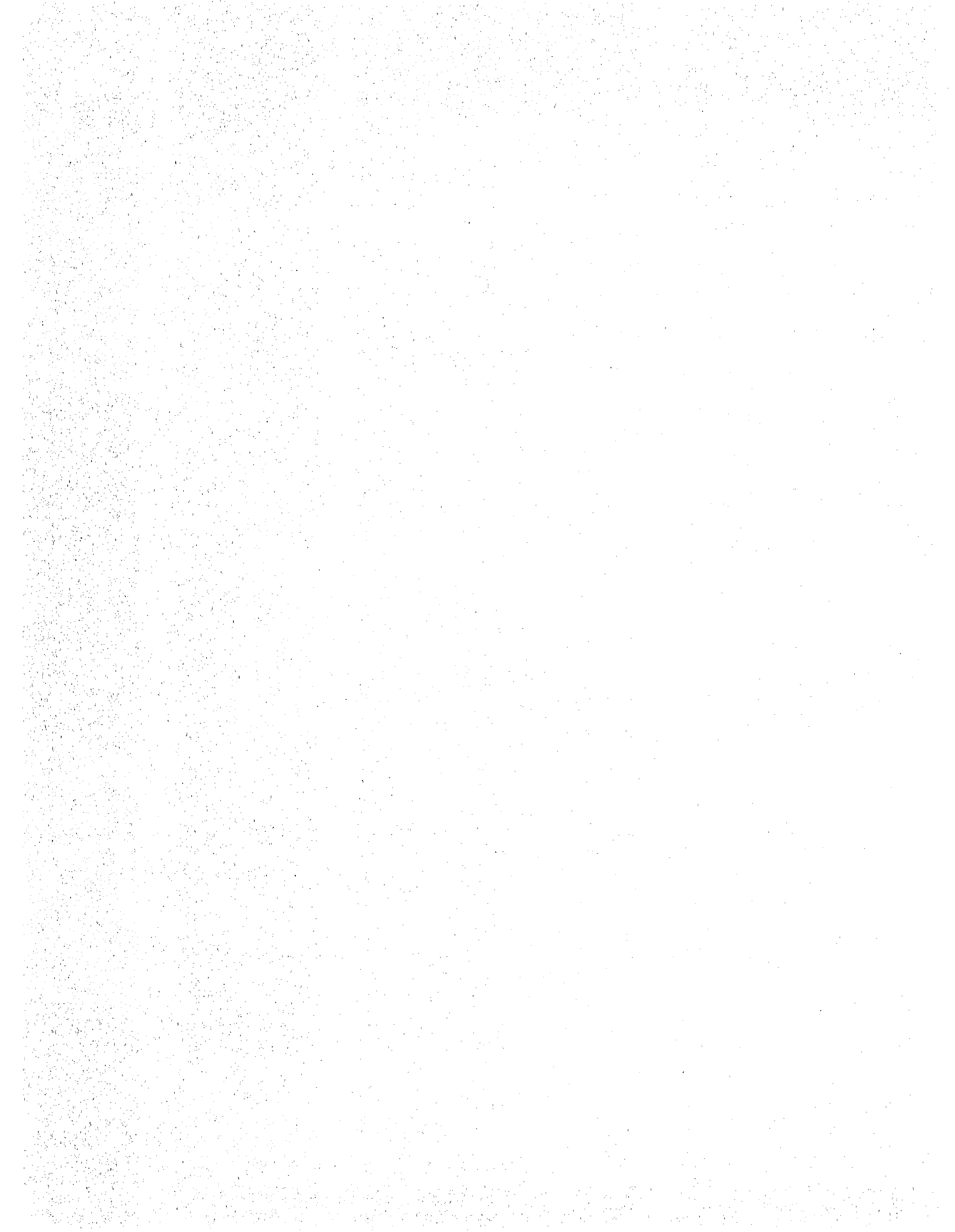
DOM-51 Reduce Funding for Law Enforcement Control of Illegal Drugs 176

DOM-52 End Funding for the Legal Services Corporation 178

850 General Purpose Fiscal Assistance

REV-06 Eliminate or Limit Deductions of State and Local Taxes 297
REV-24 Repeal the Possessions Tax Credit 329

ISBN 0-16-036104-4
90000
9 780160 361043



CONGRESSIONAL BUDGET OFFICE
Second and D Streets, S.W.
Washington, D.C. 20515

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, $300

FIRST-CLASS MAIL
POSTAGE & FEES PAID
C.B.O.
WASHINGTON, D.C.
PERMIT No. G-70