STATEMENT OF

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BEFORE THE

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COMMITTEE ON THE BUDGET

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Mr. Chairman, I am pleased to appear today to discuss possible ways to control the federal deficit by reducing spending for benefit payments to individuals, most of which are entitlement programs. My remarks will concentrate on three general topics:

- The impact of last year's reductions in payments to individuals and the outlook for future program growth;
- The Administration's proposals contained in the fiscal year 1983 budget; and
- Some other options for reducing the deficit.

Reductions in the growth of federal spending are of particular concern because of the size of projected budget deficits. Despite a projected recovery from the present recession, the federal deficit will more than double over the next five years if no changes are made in current policies. On the basis of current policy, the Congressional Budget Office projects the deficit to rise from $109 billion in 1982, to $157 billion in 1983, and to $248 billion in 1987; this translates into an increase from 3.6 percent of the Gross National Product (GNP) in 1982 to 5 percent of the GNP beginning in 1984.[1] Though lower, the Administration's deficit figures, which take into account cuts proposed for 1983, are also very large. Thus, if the deficit is to be reduced and the budget eventually balanced, policy changes affecting either outlays or revenues--or a combination of the two--will be needed.

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1. See Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987 (February 1982).

Payments to individuals constitute about half of the federal budget--$366 billion in 1982.[2] Of this total, nearly two-thirds goes for retirement programs, the largest of which is Social Security. Means-tested programs directed toward low-income persons--including many elderly persons--account for only 18 percent of all outlays for payments to individuals. (Table 1 summarizes the distribution of the major components, and Table 2 shows CBO's projections for the largest of these programs, through fiscal year 1987.)

TABLE 1. MAJOR CATEGORIES OF FEDERAL BENEFIT PAYMENTS TO INDIVIDUALS

Category	Estimated 1982 Outlays in Billions of Dollars	Percent of Total
Social Insurance Programs		
Retirement[a]	229	63
Other	72	19
Means-tested Programs	65	18
Total Benefit Payments	366	100

SOURCE: Congressional Budget Office.

a. Includes all of Medicare outlays, although about 13 percent of benefits goes to disabled persons.

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2. See Congressional Budget Office, Reducing the Federal Deficit: Strategies and Options (February 1982).

TABLE 2. FEDERAL OUTLAYS FOR SELECTED PAYMENTS TO INDIVIDUALS (dollars in billions)

Major Program	Actual 1981	Estimated 1982	Baseline Projections 1983	Baseline Projections 1987
Retirement Programs				
Social Security	122.3	139.3	153.6	214.2
Medicare	42.5	49.7	58.2	103.1
Civil Service	17.7	19.8	22.0	31.6
Military	13.7	15.0	16.5	22.5
Railroad	5.3	5.3	5.7	7.2
Other Social Insurance Programs				
Unemployment Trust Fund	18.7	23.7	21.8	22.4
Social Security disability	17.3	18.8	20.0	23.5
Veterans' disability compensation	8.4	9.5	10.4	14.0
Postsecondary education	6.8	6.9	7.7	7.8
Means-tested Programs				
Aid to Families with Dependent Children	8.0	8.1	8.3	9.9
Supplemental Security Income	7.2	8.0	9.1	10.6
Veterans' pensions	3.7	3.6	3.5	3.5
Medicaid	16.4	17.9	20.1	30.5
Food Stamps	10.3	11.5	12.5	15.7
Other nutrition programs	5.0	4.6	4.9	6.6
Housing assistance programs	6.8	8.3	9.8	16.0
Other Social Insurance and Means-tested Programs	23.9	16.0	15.9	16.4
Total	334.0	366.0	400.0	555.5

SOURCE: Congressional Budget Office.

In considering reducing payments to individuals to lower the deficit, the Congress might also review some related tax expenditure provisions. Tax expenditures have much in common with entitlements since both provide benefits to all individuals who meet certain eligibility criteria. In 1982, tax provisions directed toward individuals are expected to reduce revenues by about $212 billion. About half of these tax expenditures are in the areas of education, training, health, and income security.

IMPACT OF LAST YEAR'S BUDGET DECISIONS FOR FISCAL YEAR 1982 AND BEYOND

Total savings in benefit payments to individuals from last year's budget decisions were originally estimated at about $12.3 billion, and they are, in fact, likely to be at least that large. These spending cuts primarily affected benefits from means-tested programs. Although such outlays represent only 18 percent of total benefit payments to individuals, cuts in the means-tested programs account for 40 percent of the reduction in benefit payments. Lower benefits, combined with more stringent income and eligibility standards, resulted in savings projected at $3.8 billion from the Aid to Families with Dependent Children (AFDC), child nutrition, and Food Stamp programs. In addition, Medicaid--the health care program for the poor--was cut by about $0.9 billion. Though the Medicaid reductions primarily lowered federal grants to the states, the states in turn are likely to respond by restricting eligibility and lowering benefits.

About 60 percent of the cuts in benefits to individuals were in programs not specifically targeted toward the poor (that is, programs that are not means-tested), although these programs altogether constituted 82 percent of this spending category. Moreover, reductions in the retirement programs make up only 25 percent of all cuts. No major changes were made, for example, in basic Social Security and other retirement benefits. Reductions in Social Security retirement will save only about $1.5 billion, or approximately 1 percent of the program's outlays. A change in Civil Service Retirement postponing the scheduled cost-of-living adjustment (COLA) from September to March will yield relatively larger savings of $0.5 billion. Changes in other social insurance programs include eliminating the federal trigger for unemployment insurance, and requiring proof of need for families with incomes above $30,000 and so-called "origination" fees for Guaranteed Student Loans.

Partly as a result of last year's cuts, growth in all benefit payments to individuals is expected to slow. Spending on these programs is projected to decline slightly as a proportion of GNP from 11 percent in 1981 to 10.5 percent in 1987.

These aggregate figures mask some major disparities between the means-tested and the retirement programs, however. In the means-tested programs, outlays are also projected to decline about 10 percent relative to GNP--from 2.1 percent of GNP in 1981 to 1.9 percent in 1987. These projections reflect the impact of last year's budget reductions and an expected decline in the number of families in poverty, especially those with young children.

Outlays for the retirement programs, in contrast, are projected to increase, rising from 7.1 percent of GNP in 1983 to 7.4 percent in 1987. These programs will keep pace with the expected real growth in GNP because the number of elderly persons drawing benefits each year will grow and because medical care costs are expected to continue rising rapidly. In addition, the automatic indexation of benefits will contribute to the growth of those programs as a proportion of federal outlays.

THE ADMINISTRATION'S PROPOSALS

In the budget for fiscal year 1983, the Administration has proposed large additional reductions in payments to individuals. The Administration estimates that these cuts will lower the deficit by $11.7 billion.[3] In addition, cuts in housing assistance and low-income energy assistance--which are payments to individuals but not entitlements--would bring the total to $12.8 billion. Citing rapid growth in this area and the need for reforms, the Administration has recommended changes in 18 entitlement programs. Social Security, which in 1983 will be nearly as large as all the other programs in this area combined, would be exempt from any cuts, however.

Although the magnitude and specific nature of the cuts the Administration is now recommending differ from the 1982 changes, the proposed 1983 reductions are again concentrated in programs

3. CBO reestimates of proposals in the Administration's budget are scheduled for release on February 25, 1982.

restricted to low-income persons. Cuts in means-tested programs account for over three-fifths--$7.7 billion--of the total savings in benefit payments to individuals, and would reduce outlays by 13 percent from CBO's baseline levels. The largest of these cuts would be a $2.3 billion (18 percent) reduction in food stamp outlays, a $2.0 billion (20 percent) reduction in Medicaid, and a $1.3 billion (16 percent) cut in AFDC. The effects of the food stamp reductions would fall particularly heavily on the working poor and the elderly; AFDC cuts would have more uniform effects across the entire recipient population.

In anticipation of the Administration's "New Federalism" initiative to be developed for fiscal year 1984, some of the changes proposed for the means-tested programs would give states additional responsibilities. For example, the Administration is proposing to shift as much as $2.2 billion in AFDC, Food Stamps, and Medicaid program costs to the states in 1983, by making states fully responsible for program administration and erroneous benefits, and for a greater proportion of Medicaid benefits. As with the 1982 changes, states can again be expected to reduce benefits to individuals in the programs affected.

Under the Administration's budget proposals, Medicare, federal civilian and military retirement, and Railroad Retirement would be cut, accounting for 31 percent of the reduction in payments to individuals. The Administration's estimated $2.5 billion in outlay savings in Medicare reflect a combination of reimbursement and benefit changes, but mostly the former. In addition, another $0.6 billion in additional revenues would be generated by taxing federal workers for Medicare. Annual adjustments in civil service and military retirement benefits would be restricted either to the change in the Consumer Price Index (CPI) or to the corresponding federal pay increase, whichever is lower. This change could generate large savings: the Administration estimates the amount would be about $600 million in 1983 for both programs.

The remaining reductions in benefit payments--9 percent of the total--are spread over various other programs. For example, the Guaranteed Student Loan program would be cut back by $0.8 billion, mainly by raising the cost of loans for participants and restricting eligibility to students with demonstrable need. Changes in the veterans' compensation program would reduce benefits for some disabled veterans and their families.

ALTERNATIVE APPROACHES TO RESTRICTING GROWTH IN PAYMENTS TO INDIVIDUALS

Alternative approaches to those proposed by the Administration are possible for restricting the growth of payments to individuals. The Congress might broaden the range of programs targeted for cuts by including changes in all retirement programs, for example, or in tax expenditures.

Besides the changes in some retirement programs the Administration has already proposed, other options could be considered and the scope broadened to include Social Security. Social

Security is more than half again as large as all the other retirement programs combined. Since the Social Security recipient population is so large, the burden of a benefit reduction generating sizable savings could be distributed widely, lessening the sacrifice for each individual beneficiary.

Much of the rapid growth in retirement benefits has resulted from automatic COLAs. In the last three years, the CPI--which determines most federal COLAs--has risen faster than wages. Thus, retirement benefits have maintained their purchasing power, while wages of the working population have fallen in real terms. In addition, the CPI contains a flaw in its treatment of housing costs, which results in overestimating price increases during periods of rapidly rising home mortgage interest rates. Consequently, the CPI has risen faster than other price indexes during the last five years.

While the expansion in federal outlays for retirement benefits is a concern in and of itself, the growth in Social Security benefits has also contributed to another now widely recognized problem, namely, the low balances in the trust funds that finance the system. Even if, as has been proposed by several Administrations, the Old Age and Survivors Insurance (OASI) trust fund were permitted to borrow from the Disability Insurance (DI) and Hospital Insurance (HI) funds indefinitely, the combined balances are now projected to have unacceptably low reserves in 1984.

A change in the COLA for retirement programs including both portions of federal retirement, railroad retirement, and Social Security, could achieve large short-run savings. This approach would affect both current and new beneficiaries, helping to slow the growth in outlays for benefits. On the other hand, although nominal benefits would not fall, a decline in real benefits could place a burden on recipients who have no other financial resources.

One potential change in the automatic COLA in federal retirement programs would reduce the adjustment to two-thirds of the increase in the CPI. Some or all of the remaining one-third could be granted at the Congress' discretion, perhaps depending on the extent of budget stringency, on the condition of the programs' finances, or on real wage growth. If this change were implemented with the July 1982 and March 1983 COLAs and no discretionary supplements were made, savings would be $6 billion in 1983 and $28 billion per year by 1987. (To some extent these savings could be offset by greater benefits under and participation in SSI for individuals also covered by the retirement programs.)

Alternatively, smaller savings could be achieved by permanently delaying the annual COLA for Social Security and Railroad Retirement from July 1 to October 1. The COLA for Civil Service Retirement, already changed from twice to once a year, could be delayed from March to June. This would be equivalent to about a 2 percent reduction in benefits, producing savings of $2.5 billion in 1983 and $4.3 billion in 1987. (Here again some of the savings may be offset by increased SSI costs.)

A third change--limiting the COLA to the lower of the CPI or a wage index--would generate no immediate savings under current projections. It would, however, result in smaller increases in benefits in future years if wages again rise at a slower pace than prices. This change would provide particularly important protection for the Social Security trust funds, since outlay savings would be larger in years when trust fund revenues--which are directly related to the growth of wages--are also low. Moreover, choosing the lower of a wage or price index would prevent retirees' benefits from rising faster than workers' earnings.

In addition to the broad indexation options, which would affect all beneficiaries in the various retirement programs, more limited changes affecting only specific groups are also possible. In Social Security, for example, benefits for children of early retirees could be eliminated, or the earnings test could be retained for beneficiaries aged 70 and 71. Availability of children's benefits to families with early retirees may increase the incentive for workers under 65 to retire while their children are still eligible for benefits. Cancelling these benefits for persons retiring in 1983 would save about $30 million in 1983 and $600 million in 1987, in part by discouraging early retirement. Retaining the earnings test for persons aged 70 and 71 would affect persons who are relatively well off, saving $400 million in 1983 and $690 million by 1987. Since the effects of both of these options would be concentrated on relatively small groups, however, the income reduction to each affected beneficiary would be much greater than for reforms in the COLAs yielding comparable total savings.

Another way to broaden the base of reductions in benefits to individuals would be to consider changing various tax expenditures that currently result in substantial revenue losses to the federal government. One approach would be to include in taxable income certain benefit payments to individuals--such as those in the retirement area--which are currently tax-exempt. Another approach would reduce tax expenditures that now tend to create perverse incentives. An example is the employer-paid portion of health insurance premiums, which are now entirely exempt from taxation. Instead, premium costs above $150 per month could be included as taxable income in 1983 and indexed thereafter. Besides increasing federal revenues by $2.6 billion in 1983 (and by $8.0 billion in 1987), this option would be likely to narrow the scope of employer-provided health insurance, prompting people to economize in their use of medical care. Ultimately, this could help curb health-care costs.

Another possibility--and one that could raise still larger revenues--would be to terminate the deductibility of consumer interest payments. This deduction encourages consumers to buy on credit and discourages saving, particularly in times of high inflation. Withdrawal of this deduction would yield additional revenues of $1.2 billion in 1983 and $9.6 billion in 1987.

CONCLUSION

In summary, last year's budget decisions and the Administration's current proposals both focus reductions in benefit payments to individuals on programs that are directed toward low-income people. Partly as a result of the changes already enacted, the means-tested programs are projected to decline as a portion of GNP (assuming that current policies will continue). This decline will be greater if proposals such as the Administration's are enacted.

In contrast, the retirement portion of benefit payments to individuals--and Social Security, in particular--is expected to grow rapidly. The options I have discussed for further reduction in entitlements therefore focus on those retirement programs. In particular, modifications in their automatic COLAs could yield large short-run savings. In addition, altering or eliminating certain tax expenditures provides another way to reduce the deficit.

Thank you, Mr. Chairman. That concludes my prepared statement. I will be happy to answer any questions the Committee may have.