REDUCING THE FEDERAL BUDGET:

STRATEGIES AND EXAMPLES,

FISCAL YEARS 1982-1986

The Congress of the United States

Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

PREFACE

This report was written in response to a request by 12 members of the House Budget Committee--Robert N. Giaimo, Chairman of the Committee during the 96th Congress, James R. Jones, Chairman of the Committee for the 97th Congress, Barber B. Conable, Jr., Bill Frenzel, Richard A. Gephardt, Delbert L. Latta, Norman Y. Mineta, Bill Nelson, Leon E. Panetta, Ralph S. Regula, Paul Simon, and Timothy E. Wirth--for a report on the possible strategies that could lead to a reduction in the size of the federal budget.

The report was prepared by all divisions of the Congressional Budget Office under the supervision of Alfred B. Fitt. Robert L. Faherty, Francis S. Pierce, and Patricia H. Johnston edited the manuscript and coordinated its preparation for publication. The final drafts were typed by Mary A. Anders, Linda Brockman, Jill Bury, Shirley Hornbuckle, Norma Leake, Andy McDonald-Houck, Kathleen M. Quinn, Janet Sale, and Janet Stafford. Barry J. Holt, Pierce J. Johnson, John D. Shillingburg, and Martin L. Skutnick also provided valuable assistance in the preparation of this report.

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

Alice M. Rivlin
Director

February 1981

ROBERT N. GIAIMO, CONN.
CHAIRMAN

JIM WRIGHT, TEX.
THOMAS L. ASHLEY, OHIO
LOUIS STOKES, OHIO
ELIZABETH HOLTZMAN, N.Y.
DAVID R. OBEY, WIS.
PAUL SIMON, ILL.
NORMAN Y. MINETA, CALIF.
JIM MATTOX, TEX.
JAMES R. JONES, OKLA.
STEPHEN J. SOLARZ, N.Y.
WILLIAM M. BRODHEAD, MICH.
TIMOTHY E. WIRTH, COLO.
LEON E. PANETTA, CALIF.
RICHARD A. GEPHARDT, MO.
BILL NELSON, FLA.
WILLIAM H. GRAY III, PA.

MACE BROIDE,
EXECUTIVE DIRECTOR
225-7200

NINETY-SIXTH CONGRESS

U.S. House of Representatives

COMMITTEE ON THE BUDGET

Washington, D.C. 20515

DELBERT L. LATTA, OHIO
JAMES T. BROYHILL, N.C.
BARBER B. CONABLE, JR., N.Y.
MARJORIE S. HOLT, MD.
RALPH S. REGULA, OHIO
BUD SHUSTER, PA.
BILL FRENZEL, MINN.
ELDON RUDD, ARIZ.

JAMES B. HEDLUND,
MINORITY STAFF DIRECTOR

September 30, 1980

Dr. Alice M. Rivlin
Director
Congressional Budget Office
Washington, D. C. 20515

Dear Dr. Rivlin:

On December 20, 1979, we requested a report from the Congressional Budget Office on possible strategies that could lead to a reduction in the size of the federal budget.

The CBO report that we received proved to be of substantial assistance in shaping Congressional budget decisions for Fiscal Year 1981. We believe that a second edition of such a report could be equally useful to the next Congress when it takes up Fiscal Year 1982 budget issues. We request that CBO make a thorough examination of programs and program areas that may have outlived their usefulness, may be beneficial but could be better targeted, or may fund functions more appropriately handled by other levels of government, or by the private sector, or may simply not be affordable if the budget is tight.

We suggest that for each example you show the outlay savings, not only from the CBO five-year current law projection, but also, where applicable, from the President's Fiscal Year 1982 budget recommendations as well.

We believe it would be useful if you would meet with staff members of our Committee prior to instituting this study so that the findings and recommendations can be of maximum use to us.

Thank you for your assistance.

Sincerely,

ROBERT N. GIAIMO
Chairman

TIMOTHY E. WIRTH

DELBERT L. LATTA

BARBER B. CONABLE, JR.

RICHARD A. GEPHARDT

NORMAN Y. MINETA

LEON E. PANETTA

RALPH S. REGULA

PAUL SIMON

JAMES R. JONES

BILL FRENZEL

BILL NELSON

CONTENTS

TABLES

CHAPTER I. INTRODUCTION

Federal spending has been growing steadily in recent years, both in absolute amounts and in relation to the Gross National Product (GNP). Spending grew from an average of 20.1 percent of GNP during the first half of the 1970s to 21.7 percent in the second half. In fiscal year 1980, unified budget outlays of $579.6 billion amounted to 22.6 percent of GNP, the highest proportion ever in peacetime. Projected fiscal year 1981 outlays of $660 billion will be an even higher proportion, 23.8 percent.

If current policies were to continue unchanged, with no new programs at all, federal spending would still go on growing during the next five years (see Table 1). This growth would not be as fast as the projected growth in the economy, so spending as a percent of GNP would decline by fiscal year 1986 to 21.7 percent--still a high figure by historical standards.

TABLE 1. CBO BASELINE OUTLAY PROJECTIONS, FISCAL YEARS 1982-1986 (In billions of dollars)

Outlays	1982	1983	1984	1985	1986
In Current Dollars	740	819	906	996	1,088
In Constant 1972 Dollars	307	310	314	315	316
As Percent of GNP	23.4	22.8	22.5	22.1	21.7

The areas of spending growth from any one year to the next are easy to identify. In fiscal year 1981, just four budget functions--defense, health, income security, and interest--will account for a rise in outlays of $88 billion. Federal spending in the aggregate for all other purposes will actually decline in 1981 (although within that aggregate there will be pluses to offset some of the minuses).

The reasons for spending growth are also easy to state. The Congress and the nation are evidently committed to large real increases for defense. Past Congresses have legislated other commitments as well: to the aged, the sick, the poor, the jobless, and the disabled, among others. Demographic forces drive up the costs of Social Security, Medicare, and other federal programs for the aged. A recession increases the cost of unemployment compensation, food stamps, Medicaid, welfare, and similar programs. Furthermore, the payments in many of the programs are adjusted at least once a year for inflation; the July 1980 cost-of-living increase mandated by law for Social Security has alone added $17 billion to fiscal year 1981 federal spending.

While it may be easy to identify the areas of federal spending growth and the reasons for that growth, what to do about it is another matter. The Congressional Budget Office (CBO) does not take a position on how much the federal government ought to spend, or on which activities of the government should be continued, expanded, contracted, or eliminated. The size of the government and its programs are for the Congress and the President, and ultimately for the voters, to decide. But if the Congress decides to cut back the size of the federal government, or slow down the growth of spending, it has many available strategies to achieve those ends, and within those strategies an even wider variety of specific actions. The rest of this report discusses those strategies and contains examples of possible actions.

BACKGROUND

Federal outlays in fiscal year 1980 can be divided into five broad categories:

	Billions of Dollars	Percent of Total
National Defense	124.0	21.4
Benefits to Individuals	285.1	49.2
Grants to States and Localities	57.1	9.9
Net Interest	52.5	9.1
All Other Federal Operations	60.9	10.4
Total	579.6	100.0

Projected spending for fiscal year 1981 will be distributed about the same way. Interest on the public debt must be paid, and defense spending will rise rather than fall (although some savings within the defense total are possible). Hence, restraint, if it is to occur, must take place in the remaining 70 percent of the budget. Because more than four-fifths of that 70 percent is governed by statutory formulas and entitlements, instead of by an annual appropriations decision, significant savings must depend on the alteration of those formulas and entitlements.

The 1980 Experience with Reconciliation

The Congressional Budget Act of 1974 contemplated that the Congress would occasionally need to amend permanent legislation in order to achieve its annual budget goals. The reconciliation process, so called because the underlying laws are changed to bring about spending and revenue results consistent with the adopted budget, was carried out for the first time in 1980 as part of a Congressional effort, ultimately frustrated by inflation and the 1980 recession, to balance the fiscal year 1981 budget.

The Omnibus Reconciliation Act of 1980 contained provisions amending scores of statutes. Its estimated effects for fiscal year 1981 were to reduce spending by $4.6 billion and to increase revenues by $3.6 billion. Over the five years 1981-1985, those totals were projected to be $50.3 billion and $29.2 billion, respectively.

The savings achievements through reconciliation did not come easily. More than 100 conferees met off and on for more than two months. The bill that finally cleared the Congress on December 3, 1980, legislated reductions in airport and highway spending, in child nutrition programs, in Medicare and Medicaid reimbursement formulas, in eligibililty for Social Security disability payments and for extended unemployment insurance benefits, in various veterans' entitlements, and in many other federal programs.

The Second Session of the 96th Congress made other changes that were not technically part of the reconciliation process but were consistent with its spirit. For example, it ended the states' entitlements under general revenue sharing, saving $2.3 billion in 1981 alone, and it began phasing out most of the grant programs of the Law Enforcement Assistance Administration, saving about $150 million in 1981.

While the Reconciliation Act fell short of achieving all the savings contemplated in the First Concurrent Budget Resolution for 1981, the Congress nevertheless demonstrated that reconciliation can be accomplished. The mechanism for securing comprehensive Congressional decisions about ending or lowering federal spending commitments is in place, and it works.

Tax Subsidies and User Charges

On the revenue side of the budget, the Congress used the reconciliation process to make a number of changes in the Internal Revenue Code. In particular, the act restricted the use of tax-exempt bonds to finance a below-market interest rate for home mortgages, thereby limiting a rapidly growing tax subsidy.

Such tax subsidies are often called tax expenditures because, in principle, their purposes could also be achieved by the appropriation of budget authority to be expended in the form of grants or loans. They influence the size of the federal deficit (or surplus) in just the same fashion as direct spending programs. When a tax subsidy is halted, the resulting savings can be used to fund some other program, or to reduce the national debt, or to help finance a tax cut.

By restricting the use of tax-exempt bonds for home mortgages, the Reconciliation Act avoided an estimated $21.5 billion revenue loss during the next five years. That sum eventually will be devoted to direct spending programs, or to reducing the deficit, or to cutting taxes, as the Congress decides.

User charges for particular government services present the same issues. For example, if national park visitors and private plane owners are required to pay more of the costs of the federal services they receive, funds will be freed up for other purposes, possibly for more parks and more air safety, but also possibly for lowering the burden on taxpayers generally. This report therefore includes not only a number of examples of changing tax subsidies, but also several involving higher user charges.

STRATEGIES FOR RESTRICTING GROWTH

Achieving Management Efficiencies

It is probably true that every agency of the federal government could manage its resources better than it does. Savings could unquestionably be achieved through efficiencies, reducing paperwork, simplifying procurement, lessening the number of consultants employed, increasing the proportion of competitive procurements, and the like. Though the desirability of such efforts cannot be overstated, this report does not treat them in detail, for they are mainly matters in which the Executive Branch must take the lead. Until specific management efficiency proposals are advanced by the Administration, it will be difficult to estimate the benefits that might accrue in the form of lower spending or a less cumbersome federal government.

Taking Short-Run Actions

The government can take a number of actions to put an immediate brake on spending. Imposing federal hiring freezes, pay caps, limits on official travel, and the like, bring prompt savings, as do delaying projects and deferring maintenance. Such actions also provide a clear signal of the government's determination to economize and to cut back. But by their nature they are pauses rather than policy changes; for the long haul, the Congress will still have to find a way to cope with the ongoing pressures that have driven federal spending steadily upward.

Setting Across-the-Board Rules

The Congress could adopt a number of general rules for itself that, if followed, might achieve very large and continuing savings.

Less Indexing. If the Congress repealed all automatic indexing of entitlements, and instead made an annual across-the-board decision about the degree to which the government can afford to protect citizens against inflation, the largest and least controlled upward pressure on federal spending would be brought under the discipline of the budget process. The rule might resemble that now followed for adjusting federal white-collar pay, under which the President recommends a stated percentage that becomes effective unless the Congress acts to alter it.

Annually Adjusted Charges. Another general rule the Congress could enact would be to key the price of all services for which the government makes a charge to the cost of the provided service, and adjust that charge annually. To involve large sums, the rule would have to apply to more than such things as park fees and publication sales; it would have to include the user charges for highways, waterways, air travel, and the like.

Variable Interest Subsidies. When the government borrows money at one rate and lends it to a person or a firm at a lower rate, someone must pay the difference. The government makes

84-656 0 - 81 - 2

millions of such loans, amounting to billions of dollars, every year. But there is often no regular procedure for adjusting the interest rate charged by the government to reflect changes in the interest rate the government must pay.

The Congress could enact a rule that interest subsidies in every federal credit program be keyed to the government's borrowing costs at the time the loan is made. If the interest charged in a given program was fixed at 6 percent when the legislation was passed and the federal borrowing rate was 9 percent, a loan made now, when the government borrows at 15 percent, would have an interest rate of either 10 or 12 percent depending on whether the Congress had prescribed a proportionate or a three-percentage-point subsidy.

The Congress could go further and require that all future federal loans bear interest at least equal to the government's borrowing costs, with the further subsidy, if any, to take the form of an annually appropriated amount for the forgiveness of principal. The grant now hidden in most federal lending programs would thus become explicit and subject to frequent review.[1]

Consolidating and Reducing Grants to the States

Definite outlay savings can be achieved if the Congress combines multiple and related categorical grant programs into a single block grant and appropriates a new total that is less than the sum of the parts.

There are several arguments for such a course. One often made is that the states are closer to the actual problems and can do a better job than the Congress in allocating the dollars involved. This raises the prospect that program goals might not suffer even though the dollars were fewer. State and local officials have occasionally expressed a willingness to accept lower totals in return for the greater flexibility and lesser complexity inherent in a block grant.

---

1. The estimated present value of the interest subsidy from new federal lending activity in 1980 alone was $23.7 billion; see Budget of the United States Government, Fiscal Year 1982, Special Analyses, Table F-11, p. 193.

Another argument for combining categorical into block grants is that doing so will necessarily reduce the amount of paper to be processed, while at the same time eliminating the vexing inconsistencies in funding cycles, application due dates, grantee eligibility rules, and the like, that are the hallmarks of related categorical grant programs.

Combining multiple categorical grant programs into a block grant will also probably result in some administrative savings at the federal level, but the amount is unlikely to be large or capable of precise prediction. Furthermore, what is saved at the national level may be lost at the state level; someone must make the plan, approve the proposal, write the check, audit the books, and do the other detailed work for each program.

The federal government would also pay a price for the savings that might come from this strategy. Block grant funds would certainly not be spent for the identical purposes, or in the same proportions, or by the same localities, or for the same beneficiaries, as the funds previously targeted by the Congress in the categorical grants that made up the new block grant. If this were not so, there would be little point to the consolidation. It is almost equally certain that those who were disappointed with the manner in which block grant funds were distributed would return to the Congress seeking a new set of arrangements.

For example, the Community Development Block Grant (CDBG) program legislated in 1974 combined seven separate categorical programs. CDBG funds ($3.9 billion in 1980) can be spent for the same purposes as the previous programs, which includes encouraging private economic development. Even so, the Congress in 1977 targeted a new $400 million categorical program for private economic development, Urban Development Action Grants (UDAG), and subsequently raised its authorized level to $675 million.

In summary, the consolidation of categorical programs into block grants can lead to a reduction in federal spending, but the savings will be significant only if the Congress appropriates less for the single new program than it did for all the old programs, and only if it resists future claimants who do not like the outcome of state and local allocation decisions under the block grant system.

Reducing Growth in Entitlement Programs

About half of all federal spending is for benefits to individuals, so the Congress must examine this broad category if it wishes to restrain the federal budget. But practically all such benefits are entitlements, meaning that those who meet the eligibility rules get prescribed payments (in cash or in services); the payment does not depend on an annual appropriations decision by the Congress. Even where the Congress has technically retained control over the annual funding level of a benefit program, as it has with food stamps, in practice the costs are still driven by the numbers of people who meet the eligibility rules.

The largest category of federal spending for payments to individuals is in connection with Social Security and other retirement and disability programs. Benefits of this kind amounted to 28 percent of all 1980 outlays (see Table 2). Because more people will qualify for these programs in 1981, and because their compensation will have been higher than that of the people who have left the rolls because of death, 1981 outlays will be about $6 billion more than in 1980.

Real growth of the kind just described will be dwarfed by the nominal growth stemming from the indexation of benefit levels for inflation. Every major federal income support program--defined to include any program accounting for at least 1 percent of 1980 spending--is automatically indexed by law at least once a year, with the following exceptions: unemployment compensation, Aid to Families with Dependent Children (AFDC), and service-connected disability payments to veterans.

Even when not explicitly indexed by law, most of the benefit programs are indexed in fact. This is true, for example, of veterans' service-connected disability payments, which the Congress has increased every year in line with inflation; and of health programs like Medicare, which perforce rise in cost as health care charges rise; and of the Guaranteed Student Loan program, as students borrow more to meet higher tuitions and as the interest subsidy they receive rises along with government borrowing costs.

It follows that restraining growth in entitlement programs will require some combination of less generous benefit levels, less generous indexing, stricter eligibility rules so that fewer people qualify, and phasing out of whole programs.

As an example of deciding on less generous benefit levels, the Congress could impose an actuarial reduction on the pensions of federal employees who retire at an early age, just as it has imposed such a reduction on early Social Security retirees; or it could increase the 7 percent retirement contribution paid by most federal civilian employees to some higher rate.

TABLE 2. OUTLAYS FOR BENEFITS TO INDIVIDUALS, FISCAL YEAR 1980

Program	Outlays (millions of dollars)	Percent of All Outlays	Means-Tested?
Retirement and Disability			
Armed forces	12,127	2.09	No
Federal civilian	14,739	2.56	No
Railroad	4,737	0.82	No
Miners	1,840	0.32	No
Veterans	11,689	2.02	Partially
Social Security	116,573	20.13	No
Subtotal	161,705	27.93	
Health			
Medicare	35,025	6.05	No
Medicaid	13,957	2.41	Yes
Federal civilian retirees	631	0.11	No
Veterans' hospital & medical	6,276	1.08	Partially
All other	2,694	0.47	Partially
Subtotal	58,583	10.12	
Education			
College student aid	3,683	0.64	Yes
Guaranteed loan interest subsidy	1,408	0.24	No
Social Security student benefits	1,976	0.34	No
Veterans' education benefits	2,342	0.40	No
Subtotal	9,409	1.63	
Unemployment Compensation	18,004	3.11	No
Public Assistance			
Subsidized housing	5,377	0.93	Yes
Nutrition programs	4,802	0.83	Mostly
Food stamps	9,117	1.57	Yes
SSI for aged, blind, and disabled	6,411	1.11	Yes
AFDC and other welfare	7,308	1.26	Yes
Earned income tax credit	1,275	0.22	Yes
Low-income energy assistance	1,564	0.27	Yes
Refugees	368	0.06	Yes
Subtotal	36,222	6.26	
Miscellaneous	1,155	0.20	---
Grand Total	285,078	49.24	---

SOURCE: Congressional Budget Office.

Less generous automatic indexing might take the form of dropping the automatic provision entirely, as described earlier in this report, or of adjusting benefits by the lesser of price or wage index changes, as described later.

Stricter eligibility rules could take the form, for example, of gradually raising the "normal" Social Security retirement qualification age from 65 to 68, or of limiting the medical expense income tax deduction to those whose expenses of that kind exceed 10 percent of income, instead of 3 percent as now.

Phasing out some entitlement programs could be done according to specific criteria:

Is the program obsolete? U.S. merchant seamen have been entitled since 1798 to free, all-inclusive health care from the federal government, at a current annual cost of about $170 million. Arguably the reasons for the commitment have long since vanished, but the program continues.

Is the program duplicative? Social Security benefits for unmarried dependent students aged 18 to 21 were enacted in 1965, when the government had no college student grant program. Since then the Congress has put in place a comprehensive set of student aid programs to ensure that no one's access to college will be barred by financial need; but Social Security student benefits continue as before, at an annual cost of nearly $2 billion.

Is the entitlement justified by need but not awarded according to need? In 1948, the Congress enacted an extra income tax exemption for people aged 65 and over, on the general theory that the elderly were likely to have suffered an income loss. But the entitlement includes all elderly taxpayers, with the result that the 7.4 percent with incomes over $50,000 receive 17 percent of the $2.2 billion in tax relief provided by the extra exemption.

Is the entitlement well designed to achieve the stated purpose? Trade Adjustment Assistance benefits go to American workers laid off because of foreign competition, at a likely cost of about $2.5 billion in 1981. But the program seems to have small effects in helping the affected workers to seek or obtain less vulnerable employment, so that little "adjustment" may be occurring.

All of the measures discussed in this report involve exceedingly difficult and contentious political value judgments. The inclusion of illustrative examples is not meant as an assertion that any ought to be carried out, or that arguments against the described changes may not outweigh those for the changes. But if the Congress is to bring down federal spending as a percent of the Gross National Product, something of the sort described here will have to happen.

CHAPTER II. BUDGET REDUCTION EXAMPLES

This chapter contains brief descriptions of 105 possible actions to affect the federal budget. They are listed in the same order as the budget function categories to which they apply. A few affect more than one function; these have been assigned to the function on which the proposal has the largest dollar impact.

The list of 105 potential changes is by no means exhaustive; many others could be added. The inclusion of an item on the list, or its omission from it, does not imply a recommendation by the Congressional Budget Office (CBO). The items discussed are simply illustrative examples.

The savings estimates contained in this chapter for direct spending programs are calculated against CBO's preliminary five-year budget projections (the "CBO baseline") for fiscal years 1982-1986, unless a different source is specifically cited. The CBO baseline is not a forecast of what will happen. Rather, it is intended to answer the question: What might the federal budget look like in each of the next five years if the policies embodied in the budget actions taken by the Congress through December 31, 1980, were continued unchanged--except for adjustments to reflect inflation and demographic changes?

Each item also includes estimated savings resulting from the CBO option, using President Carter's fiscal year 1982 budget recommendations as the base for the calculation. If the resulting estimate is the same as that derived from the CBO baseline, only one estimate is given. In those cases where savings from the Carter budget differ from those against the CBO baseline, both are displayed and the difference is accounted for in the text.

When the item involves revenue rather than spending changes, the revenue gain of the CBO option applies both to the CBO baseline and to the Carter Budget. If President Carter has made a related proposal, the item shows the gain against the CBO baseline from both the CBO option and the Carter budget proposal.

The estimated savings or revenue gains shown for the separate items cannot be added to a grand total because some of the proposals are alternatives to others, and because some may affect the expenditures of other federal programs in ways that are difficult to estimate precisely.

In general, the savings estimates assume that the proposal under discussion will take effect on October 1, 1981. If a different effective date is assumed, it is stated in the discussion of the item. This is particularly the case with those proposals involving reductions in tax subsidies; there the date used is the earliest feasible one that is consistent with fairness and practicality.

All of the savings estimates in this report are preliminary. They will be updated in mid-March 1981 to reflect any changes to the CBO baseline projections stemming from possible revisions in economic assumptions, and from detailed analysis of new programmatic information in President Carter's fiscal year 1982 budget, or as it may be amended by President Reagan.