Chapter Four

# Entitlements and Other Mandatory Spending

Entitlement programs provide benefits to all who are eligible to receive aid and choose to participate. Social Security, Medicare, Medicaid, food stamps, and farm price supports are major federal entitlements. Spending on these and other so-called mandatory programs (not including deposit insurance) accounts for more than one-half of all federal outlays. In 1995, this category is expected to cost $845 billion--about 12 percent of gross domestic product (GDP).

Under current law, outlays for mandatory programs are expected to increase at an average annual rate of 6.8 percent between 1995 and 2000. Under the Congressional Budget Office's (CBO's) baseline with discretionary spending adjusted for inflation after 1998, the rest of federal spending is projected to rise by an average of 3.4 percent a year during the same period. If current policies continue, entitlements could constitute nearly two-thirds of all federal spending by early in the next century. The aging of the baby-boom generation is expected to drive the fraction still higher over succeeding decades. Hence, the job of managing the growth of federal spending will be largely a matter of controlling the growth of mandatory outlays.

Spending on entitlement programs is primarily determined by the programs' rules that govern eligibility, the extent of participation, benefit levels, and the cost of providing noncash benefits, not by the annual appropriation process. A variety of other factors also increase or decrease outlays for entitlements, including demographic shifts, changes in providers' practices, and rates of inflation. Annual entitlement spending is, therefore, only partly under the direct control of the Congress.

The total that is spent on entitlements has grown rapidly since the early 1960s. As a share of GDP, however, much of the increase had already 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 about 11 percent in 1975. Since then, the share of national production committed to entitlement programs has grown more slowly and is expected to be about 13 percent by 2000.

## Factors Underlying the Growth in Mandatory Spending

The largest force behind this continued growth in entitlement spending is the rapid rise in spending on Medicare and Medicaid. Although growth in these two programs has slowed in the past year, federal spending on them is expected to increase at an annual rate of about 10.3 percent between 1996 and 2000 if they are not changed. By contrast, spending on other entitlements is expected in grow at an annual rate of about 4.9 percent during that period without any changes in those programs. One convenient way of analyzing growth in entitlement spending is to break it down by its major causes--growth in caseloads, automatic increases in benefits, growing use of medical services, and other factors (see Table 4-1).

Mounting caseloads account for about one-quarter of the growth in entitlement programs--driving up spending by an estimated $15 billion in 1996 and $68 billion in 2000, compared with this year's outlays. More than half of that growth is concentrated in the Social Security, Medicare, and Supplemental Security Income programs and is largely traceable to the continued "greying" of the U.S. population and the growing prevalence of disability. Much of the rest is in Medicaid. Among the three largest entitlement programs, caseload growth--even without any other changes--is expected to push up outlays in 2000 by 7 percent in relation to 1995 in both Social Security and Medicare and by 20 percent in Medicaid.

Automatic increases in benefits account for about one-third of the growth in entitlement programs. All of the major retirement programs grant automatic cost-of-living adjustments (COLAs) to their beneficiaries. COLAs, which are pegged to the overall consumer price index, are expected to average more than 3 percent a year through 2000. In 1995, outlays for programs with COLAs are already more than $400 billion, and COLAs are expected to add an extra $10 billion in 1996 and $80 billion in 2000. Recent studies have suggested that the consumer price index overestimates the true level of inflation that consumers face. A change in the methods of col-

**Table 4-1.**
**Sources of Growth in Mandatory Spending (By fiscal year, in billions of dollars)**

| | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Projected 1995 Spending | 845 | 845 | 845 | 845 | 845 |
| Sources of Growth | | | | | |
| Growth in caseloads | 15 | 28 | 41 | 55 | 68 |
| Cost-of-living adjustments | 10 | 26 | 43 | 62 | 80 |
| Other automatic increases in benefits[a] | 6 | 15 | 24 | 32 | 41 |
| Other increases in Medicaid and Medicare[b] | 20 | 38 | 60 | 85 | 112 |
| Other growth in average Social Security benefits[c] | 5 | 8 | 11 | 15 | 20 |
| Irregular number of benefit payments[d] | -3 | 0 | 0 | 0 | 5 |
| Change in outlays of credit reform liquidating accounts | -1 | -3 | -4 | -6 | -7 |
| Other | 2 | 3 | 5 | 9 | 9 |
| Total | 53 | 117 | 181 | 252 | 327 |
| Projected Spending | 899 | 962 | 1,026 | 1,097 | 1,173 |

SOURCE: Congressional Budget Office.

a. Automatic increases in Food Stamp benefits, Medicare reimbursement rates, and the earned income tax credit under formulas specified by law.

b. All growth not attributed to caseloads and automatic increases in reimbursement rates.

c. All growth not attributed to caseloads and cost-of-living adjustments.

d. Supplementary Security Income and veterans' compensation and pensions will pay 11 months of benefits in 1996, 13 in 2000, and 12 in other years.

lecting data on prices or in calculating the index, or a legislative change that tied COLAs to something less than the increase in the consumer price index, could substantially reduce the projected costs of automatic increases in benefit programs.[1]

Several other programs--chiefly Food Stamps, the two Medicare programs (Hospital Insurance and Supplementary Medical Insurance), and the earned income tax credit (EITC)--are also automatically indexed to inflation (except for the EITC, the consumer price index is not the measure of inflation used for those programs). The first program pays annual adjustments according to changes in the Department of Agriculture's Thrifty Food Plan index. Medicare's payments to providers (primarily hospitals and physicians) also climb, by law, in step with specialized price indexes for the medical sector. Moreover, the maximum EITC payment and the income thresholds above which the EITC begins to be phased out are automatically adjusted for inflation. Those indexation practices contribute an extra $6 billion in outlays in 1996 and $41 billion in 2000. The Medicaid program, however, is not reflected in those figures. The federal government essentially pays an agreed-upon share of the bills submitted to it by state programs, which obviously rise with inflation. Unlike Medicare, however, Medicaid has no federal reimbursement schedules that rise automatically. Medicaid thus falls into a category of programs that are indirectly, not directly, linked to inflation.

Another third or so of the growth in entitlement spending stems from increases in Medicare and Medicaid costs that cannot be attributed to growth in caseloads or automatic adjustments in reimbursements. First, as noted, Medicaid grows with inflation even though it is not formally indexed. Second, the health programs have faced steadily rising costs per participant, a trend known in Medicare jargon as "use" or "intensity"--a combination of more services per participant, more technological sophistication, and so forth. That residual growth in Medicare and Medicaid is projected to be $20 billion in 1996 and $112 billion in 2000.

In most retirement programs, the average benefit grows faster than the COLA alone would explain. Social Security is a prime example. Social Security benefits are tied to retirees' earnings during their working years, adjusted for increases in the cost of living after they retire. Because earnings have gone up faster than the cost of living, the average benefit for a new retiree exceeds the average monthly check of a long-time retiree whose last earnings may have been a decade or two ago and who has been receiving only cost-of-living adjustments since then. In addition, the growth in women's participation in the labor force means that more new retirees get benefits based on their own earnings rather than a smaller spouse's benefit. In Social Security alone, such phenomena are estimated to add $5 billion in 1996 and $20 billion by 2000.

Depending on variations in the calendar, three programs--Supplemental Security Income and veterans' compensation and pensions--may pay 11, 12, or 13 monthly checks in a fiscal year.[2] That practice dampens outlays in 1996 and swells them in 2000. Finally, other growth in benefit programs has many causes, among them rising benefits for new retirees in the Civil Service, Military, and Railroad Retirement programs (fundamentally the same phenomenon as in Social Security); larger average benefits in unemployment compensation, a program that lacks an explicit COLA but pays amounts that are automatically linked to the recent earnings of its beneficiaries; and increases in family support costs, largely at the discretion of state governments. All of those factors together, however, contribute just $9 billion of the total increase of more than $300 billion between 1995 and 2000. In sum, growth in caseloads, automatic adjustments for inflation, and growing use of medical services are the prime factors that are expected to push up outlays for entitlement and mandatory spending by almost 40 percent between 1995 and 2000.

1. The potential overestimate of inflation by the index, and the possible savings from changing the index itself or the use of the index in adjusting benefits or taxes, is discussed in more detail in Congressional Budget Office, "Is the Growth of the CPI a Biased Measure of Changes in the Cost of Living?" CBO Paper (October 1994).

2. The number of monthly benefit payments made during a fiscal year depends on whether October 1, the first day of the fiscal year, falls on a work day. If October 1 falls on a weekend, October benefits are paid on the last working day of September.

## The Balanced Budget Act

Federal spending on entitlements is also influenced by the Balanced Budget and Emergency Deficit Control Act of 1985 (Balanced Budget Act), which links legislated changes in spending on entitlements and other mandatory programs with legislated changes in governmental receipts. Under the act, an entitlement program can be increased only if another one is cut or taxes or fees are raised. Similarly, a tax can be cut only if another one 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 since 1990 that affect the relevant fiscal years.

This pay-as-you-go rule is qualified in several ways. For instance, increases in direct spending or tax cuts for designated emergencies are exempt from the requirement. That provision has only been used once--in March 1993, to extend Emergency Unemployment Compensation benefits. In addition, the Balanced Budget Act excludes the receipts and mandatory 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 maintain the balances in the trust funds.)

If the pay-as-you-go rule is violated, a sequestration--automatic cutbacks applying to nonexempt mandatory programs--must take place. 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. These rules leave a relatively small portion of mandatory spending to bear the brunt of a pay-as-you-go sequestration.

## Program Trends and Options

In addition to suggestions for curtailing spending in specific programs, broad approaches to restraining the growth of entitlement spending have been suggested. One would place a cap on spending; another would apply a means test to restrict eligibility for benefits.

Many proposals have surfaced in the past that are aimed at placing an enforceable cap on mandatory spending. Those generally would tie the growth of spending for individual programs to inflation and the increase in the size of the eligible population. Often a transitional growth factor would be added, allowing the new policy to be phased in. Most proposals would also establish an across-the-board sequestration procedure to prevent a breach of the cap. Many advocates of this approach, however, have not accompanied the call for a mandatory cap with policy proposals to achieve the reductions in individual programs that would be needed to avoid sequestration. And in many cases, such a sequestration would involve large percentage cuts in benefits.

An across-the-board sequestration of mandatory programs could not be carried out easily, particularly if it was large. Government benefit checks and other mandatory spending could not simply stop flowing after the cap was reached without disrupting the lives of millions of people. Agencies in the executive branch could estimate the likely shortfall resulting from the cap and adjust all future payments to account for the effect of the limit, but that would involve an enormous amount of bureaucratic discretion and uncertainty about which benefits would actually be provided. Moreover, the courts would probably be asked to respond to the conflict between the legislation that authorized the mandatory spending and a sequestration of that spending.[3]

Applying a means test to entitlement programs has also been suggested as a broad strategy for curbing the growth in this spending. One approach would control entitlements as a group through a form of means-testing under which benefits would be cut most for beneficiaries with the highest income. Several ways of carrying out this approach are discussed in ENT-68.

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3. For more information on using an enforceable cap, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1994-1998* (January 1993), p. 92.

The other options in this chapter would reduce the growth of entitlement spending on a program-by-program basis. For example, new program rules could limit who qualifies for benefits or reduce the amount of benefits provided (for example, see ENT-09, ENT-26, ENT-48, ENT-55, and ENT-63) or could reduce payments to providers of services (see ENT-33 through ENT-40 and ENT-49).

## Medicaid

Medicaid is a joint federal and state program that provides medical assistance for certain people with low income. Federal matching rates for payments for medical services under Medicaid are determined by a formula based on states' per capita income but can never be less than 50 percent or more than 83 percent. The overall matching rate amounts to about 57 percent of medical assistance payments. The federal government also pays 50 percent of most associated administrative costs and higher rates for some services.

Medicaid covers participants in such income support programs as Supplemental Security Income (SSI) and Aid to Families with Dependent Children (AFDC). Some other people who have slightly greater income, some who have high medical expenses, and selected groups targeted by recent program expansions--such as children and pregnant women in families with low income--are also covered. About 70 percent of Medicaid spending goes to the aged and disabled, although they represent about one-fourth of participants. A considerable portion of this money pays for long-term care services.

With projected federal outlays of $90 billion in 1995--more than 10 percent of entitlement spending--Medicaid dwarfs the other means-tested entitlement programs (see Table 4-2). Program outlays rose about 10 percent a year in the 1980s as a result of the rising costs of medical care, greater use of covered services, and expanded eligibility. Between 1989 and 1992, program growth shot up to an average annual rate of 25 percent. The unusually rapid growth was attributable to a number of factors, among them the recession, the rise of disproportionate share payments to hospitals, and states' efforts to shift activities funded with state-only dollars to the Medicaid program. The growth in Medicaid spending began to stabilize in 1993, and CBO expects that future growth will continue at about the pace of the 1980s. ENT-29 through ENT-32 and ENT-55 describe options that would control spending on Medicaid.

## Other Means-Tested Entitlement Programs

In addition to Medicaid, means-tested entitlement programs include Food Stamps; Supplemental Security Income, which is for the aged, blind, and severely 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 refundable portion of the EITC, which benefits low-income working families with children. At $104 billion in 1995, expenditures on other means-tested programs represent about 12 percent of entitlement spending.

In recent years, caseloads in the AFDC and Food Stamp programs increased significantly before stabilizing in 1994. During that period, real (that is, inflation-adjusted) AFDC benefit levels declined. Federal spending for the refundable portion of the EITC rose from about $1 billion in the early 1980s to $9 billion in 1993, largely as a result of the expansions included in the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1990 (OBRA-90). As a result of changes in OBRA-93 that increased benefits for families, spending for the EITC is projected to more than double, from $11 billion in 1994 to $23 billion in 1997, before leveling off. ENT-29, ENT-53, ENT-54, and ENT-55 would reduce federal spending on certain means-tested programs by targeting benefits more narrowly and limiting federal payments for administering some of those programs.

The subsidized component of the Federal Stafford Loan Program is another means-tested entitlement. Through it students can borrow to attend postsecondary educational institutions. The annual budgetary cost of Stafford loans--as well as that of other federal loan and loan guarantee programs--consists of the present value of current and expected fu-

**Table 4-2.**
**CBO Baseline Projections for Mandatory Spending (By fiscal year, in billions of dollars)**

| | Actual 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|---|
| | **Means-Tested Programs** | | | | | | |
| Medicaid | 82 | 90 | 100 | 111 | 123 | 136 | 149 |
| Food Stamps[a] | 25 | 26 | 27 | 29 | 30 | 32 | 32 |
| Supplemental Security Income | 24 | 24 | 24 | 29 | 32 | 35 | 40 |
| Family Support | 17 | 18 | 18 | 19 | 19 | 20 | 20 |
| Veterans' Pensions | 3 | 3 | 3 | 3 | 3 | 3 | 3 |
| Child Nutrition | 7 | 8 | 8 | 9 | 9 | 10 | 10 |
| Earned Income Tax Credit | 11 | 17 | 20 | 23 | 24 | 25 | 26 |
| Student Loans[b] | 3 | 4 | 3 | 3 | 3 | 3 | 3 |
| Other | 3 | 3 | 4 | 4 | 5 | 5 | 5 |
| Total, Means-Tested Programs | 177 | 194 | 208 | 229 | 248 | 268 | 290 |
| | **Non-Means-Tested Programs** | | | | | | |
| Social Security | 317 | 334 | 352 | 371 | 390 | 411 | 433 |
| Medicare | 160 | 176 | 196 | 217 | 238 | 262 | 286 |
| Subtotal | 476 | 510 | 548 | 587 | 628 | 673 | 720 |
| Other Retirement and Disability | | | | | | | |
| Federal civilian[c] | 40 | 42 | 43 | 46 | 48 | 50 | 53 |
| Military | 27 | 28 | 29 | 31 | 32 | 35 | 37 |
| Other | 5 | 5 | 5 | 5 | 5 | 5 | 6 |
| Subtotal | 72 | 75 | 77 | 81 | 85 | 90 | 96 |
| Unemployment Compensation | 26 | 22 | 23 | 24 | 26 | 27 | 28 |
| Other Programs | | | | | | | |
| Veterans' benefits[d] | 18 | 17 | 17 | 18 | 19 | 20 | 21 |
| Farm price supports | 10 | 10 | 9 | 9 | 8 | 8 | 8 |
| Social services | 6 | 6 | 6 | 6 | 6 | 6 | 6 |
| Credit reform liquidating accounts | -7 | 1 | e | -2 | -3 | -6 | -6 |
| Other | 11 | 11 | 11 | 10 | 10 | 11 | 9 |
| Subtotal | 37 | 45 | 43 | 41 | 39 | 39 | 39 |
| Total, Non-Means-Tested Programs | 612 | 651 | 691 | 733 | 778 | 829 | 882 |
| | **Total** | | | | | | |
| Total Mandatory Spending | 789 | 845 | 899 | 962 | 1,026 | 1,097 | 1,173 |

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 domestic discretionary spending; Medicare premium collections are classified 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.

e. Less than $500 million.

ture subsidies for loans that originate in the specific year. Stafford loans are much less directed toward needy students than Pell grants, which are made by the main discretionary program providing aid to postsecondary students. CBO's baseline projections show program costs for Stafford loans and other student loans averaging about $3 billion through 2000. ENT-25 and ENT-26 would reduce the federal cost of Stafford loans by reallocating part of the cost to students and their families.

## Social Security and Other Retirement and Disability Programs

Spending on Social Security, the largest entitlement program, is expected to be $334 billion in 1995 and to provide benefits to more than 43 million elderly and severely disabled workers and members of their families. Outlays for benefits have grown over the years as a result of the inclusion of new groups among those deemed eligible for benefits, more recipients among existing eligible groups, cost-of-living increases in benefits, and the higher real earnings--hence higher benefits--of newly retired workers. The Social Security Amendments of 1983 made major changes in the program to improve its financial standing. Although most changes involved financing and coverage, others delayed annual cost-of-living increases to recipients and made some benefits subject to taxation. The amendments also increased the age of eligibility for full retirement benefits from 65 to 67, phasing in the change 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 2000. The increase in the number of aged people benefiting from Social Security has slowed in recent years. Although that trend will continue for several more years, as the relatively small group of people born during the 1930s becomes eligible, it will be partially offset by the aging of the baby boomers as they move into their late 40s and early 50s, when disability incidence rates are higher.

Although the Social Security program has special rules under the Balanced Budget Act and is not included in the pay-as-you-go budget discipline, it nonetheless accounts for two-fifths of entitlement spending; cutting it would reduce the total budget deficit. Options to alter the program's benefit structure are considered in ENT-59 through ENT-62. In addition, restraint on the annual cost-of-living adjustment for Social Security is a major component of ENT-67, which considers all non-means-tested retirement and disability entitlements.

Other retirement and disability programs--which will cost $75 billion in 1995, or about 9 percent of entitlement spending--are dominated by the government's civilian and military retirement programs. Spending on these programs is influenced by factors similar to those affecting Social Security, and outlays are expected to increase at like rates in CBO's baseline. ENT-50 and ENT-67 contain options that would modify benefits for former federal workers.

## 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 is expected to provide $176 billion in benefits in 1995 through two related programs: Hospital Insurance (HI), which covers certain costs of hospital stays and some other institutional services used by elderly and disabled enrollees, and Supplementary Medical Insurance (SMI), which primarily pays for the services of physicians and other providers of outpatient health care. Spending has been fueled in recent years not only by growth in the eligible population but also by increases in the intensity and cost of medical services used by enrollees. A number of legislative changes have been made in recent years to constrain program growth.

CBO projects that HI outlays will rise at a nominal rate of about 8.4 percent a year between 1995 and 2000 and that SMI costs will increase at a nominal rate of 12.9 percent a year. Thus, without change, Medicare will account for 24 percent of entitlement spending in 2000, compared with 21 percent in 1995. ENT-33 through ENT-41 and ENT-49 consider a variety of options to limit payments to providers of medical services; ENT-42 through ENT-48 discuss several ways of increasing beneficiaries' payments.

## Aid to Jobless Workers

Two entitlement programs that provide assistance specifically to unemployed workers are the federal/state unemployment compensation (UC) program and the much smaller federal Trade Adjustment Assistance (TAA) program. CBO's baseline for the UC program projects slow growth between 1995 and 2000, rising to around $28 billion in 2000. Unemployment compensation is included in the federal budget, but state laws set most of the benefit and tax provisions in the regular state programs, which provide the vast majority of benefits. Thus, states can generally 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 limiting regular UC benefits.

The TAA program offers income-replacement benefits, training, and related services to workers unemployed as a result of import competition. In 1994, this program provided about $200 million in benefits and services to around 25,000 recipients. ENT-51 would eliminate the TAA program.

## Non-Means-Tested Veterans' Programs

Veterans' benefits constitute another category of federal entitlement spending. CBO projects that non-means-tested entitlement spending for veterans' compensation, readjustment benefits, life insurance, and housing programs will total about $17 billion in 1995, or about 2 percent of all entitlement spending during that year. ENT-63 through ENT-65 would restrict federal spending on veterans' benefits by limiting eligibility for certain programs and raising costs to participants. In addition, ENT-62 would reduce Social Security disability payments for some people who also receive veterans' compensation.

## Farm Price Supports

Farm programs support producers through direct cash payments, subsidies for exports, direct government purchases, and constraints on production and imports. Most farm programs are governed by the 1990 farm bill, which expires this year. The current support varies by commodity. Direct payments, which are the bulk of federal outlays, go to producers of corn and other feed grains, wheat, cotton, and rice. Most export subsidies are for wheat. The government purchases dairy products and constrains imports to support milk prices. The government also supports producers of peanuts, tobacco, and sugar by different combinations of production controls, import restraints, and price-supporting loan programs. For those crops and dairy products, most of the support farmers receive is through market prices that are kept artificially high by the government programs. Producers of livestock, fruits and vegetables, and many other crops receive no direct government assistance.

CBO projects spending for farm price and income support programs and other mandatory programs related to agriculture to be $10 billion in 1995, down from $11 billion in 1994 and $16 billion in 1993. The farm price and income support programs funded through the Department of Agriculture's Commodity Credit Corporation dominate this category of mandatory spending. (Agriculture also benefits from programs funded through appropriations. Such discretionary programs, including agricultural research and extension, some export promotion programs, and farm loan programs, are covered in Chapter 3.)

The deficit reduction options in this chapter focus on adjustments to current programs that would reduce net spending, rather than wholesale policy changes that might be considered during this year's farm bill deliberations. Although they would adjust rather than revamp current policy, the effects of some options are large. ENT-06, which would steadily reduce target prices for the major crops, for example, would cut Commodity Credit Corporation outlays by about 50 percent in 2000. ENT-07 through ENT-09 and ENT-13 through ENT-16 consider other ways to cut federal spending for the commodity support programs. ENT-10 through ENT-12 would lower federal outlays by cutting programs that subsidize or promote exports of farm commodities.

## User Fees and Other Changes in Direct Spending

Fees can be charged to users of resources, facilities, or services provided by the federal government to raise funds to help pay for them and to promote their more efficient use. Options describing modified or higher fees in a variety of areas are included in this chapter (ENT-01 through ENT-05, ENT-17, ENT-18, ENT-21 through ENT-24, ENT-27, ENT-69, and ENT-70). For example, the federal government could index nuclear waste disposal fees for inflation or establish charges for airport takeoff and landing slots.

Receipts from fees would be treated under the Balanced Budget Act like spending changes in entitlements or mandatory programs if the legislation changing the fees originated in an authorizing committee. In that case, the added receipts from fees would be credited to the pay-as-you-go scorecard.

## ENT-01 CHARGE MARKET PRICES FOR ELECTRICITY SOLD BY POWER MARKETING ADMINISTRATIONS

| | Annual Added Receipts (Millions of dollars) | | | | | Cumulative Five-Year Addition |
|---|---|---|---|---|---|---|
| | 1996 | 1997 | 1998 | 1999 | 2000 | |
| Addition to Current-Law Receipts | 0 | 1,000 | 1,000 | 1,000 | 1,000 | 4,000 |

Hydroelectric power generated at 129 federally owned plants is sold by power marketing administrations (PMAs), which are agencies of the Department of Energy. In recent years these federally owned hydroelectric plants have generated about 6 percent of the electricity sold in the United States. Under current law, the PMAs must first offer to sell most of this power to rural electric cooperatives, municipal utilities, and other publicly owned utilities (collectively known as preference customers). Any excess PMA power not purchased by preference customers can be sold to investor-owned utilities. Current law requires that these sales be made at cost. This option would eliminate the requirement to offer PMA power first to preferred customers and would allow the PMAs to sell it to the highest bidder. It would also eliminate requirements that the Bonneville Power Administration give preference to consumers in the Northwest over other regions and acquire electricity to meet demands by its customers.

The federal government charges an average of about 2.5 cents per kilowatt-hour (kwh) for this power. PMA electricity prices vary widely among hydroelectric projects. In 1994, PMA wholesale electricity prices ranged from 3.25 cents per kwh to less than 1 cent per kwh. Determining the market value of PMA power at each of the government's hydroelectric projects would require open competition among preferred customers, privately owned utilities, and new customers. As a preliminary estimate of the market value of PMA power, the Congressional Budget Office looked at the average price of non-PMA wholesale power transactions in regions of the country served by the PMAs. The average price for this power was about 4.5 cents per kwh in 1992.

By eliminating the public power preference and selling the power to the highest bidder, the federal government could increase annual power receipts by about $1 billion. The additional revenues could be used by the PMAs to repay the $14 billion cost of constructing existing plants. In addition, the current practice of selling power below market rates leads to levels of electricity consumption in PMA service areas that are inconsistent with the government's energy conservation and environmental objectives.

Conversely, critics of this option argue that large rate increases that could result from it would adversely affect regional economies. Those who would continue to reserve PMA power for use by public utilities maintain that this is a more appropriate use of the government's hydroelectric resources than allowing private companies to profit from the sale of public resources. Proponents of the status quo also say that publicly owned utilities have encouraged widespread use of electricity (especially in rural areas) at low rates.

ENT-02 IMPROVE PRICING FOR COMMERCIAL AND RECREATIONAL USES OF PUBLIC LANDS

| Addition to Current-Law Receipts | Annual Added Receipts (Millions of dollars) 1996 | 1997 | 1998 | 1999 | 2000 | Cumulative Five-Year Addition |
|---|---|---|---|---|---|---|
| Raise Grazing Fees | 5 | 13 | 17 | 17 | 17 | 69 |
| Reform Federal Water Policies | 15 | 15 | 25 | 30 | 30 | 115 |
| Raise Recreation Fees at Federal Facilities | 175 | 172 | 181 | 188 | 196 | 912 |

The federal government owns and manages nearly 650 million acres of land in the United States. This land is used for a wide variety of purposes, including grazing, recreation, and water reclamation. For most commercial and some recreational uses, the government is compensated--often by fees. In some cases, those fees 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 reducing commercial and recreational activity.

**Grazing Fees.** The Forest Service and the Bureau of Land Management administer the practice of livestock grazing on approximately 262 million acres of public rangelands in the West. Those lands provide ranchers with approximately 31,000 grazing allotments and, at current leasing rates, approximately 20.9 million animal unit months (AUMs) of grazing each year. In 1990, the appraised value of public rangeland in six Western states varied between $5 and $10 per AUM. A 1993 study indicated that the Forest Service and the Bureau of Land Management spent $4.60 per AUM to manage their rangelands for grazing. By contrast, the 1994 permit fee was set at $1.98 per AUM under the fee formula established by the Congress. The weighted average lease rate for grazing on private lands in the 11 Western states in 1993 was $10.03 per AUM. Thus, the current fee structure may represent a subsidy for many of the ranchers who participate in the program and creates a wide disparity between public and private charges for grazing.

Various proposals have been introduced in the Congress 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.

A recent proposal called for an annual increase in the grazing fee. Under the proposal, the fee would reach $3.96 per AUM over a period of three years. The fee would then be tied to a forage value index based on private land rents. The proposal would also impose a 20 percent to 50 percent levy on ranchers who lease their grazing rights to others and grant a 30 percent reduction in the fee to permit holders participating in rangeland conservation programs. These modifications would lead to an increase in federal receipts, measured against current law, of approximately $69 million during the 1996-2000 period. These figures are the amounts that would be left in the Treasury after deducting the additional receipts that would be paid to states and counties as a result of increased grazing fees, but they do not reflect any additional appropriations for range improvements that could result from 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. (Current law requires permit holders to own a base property near the federal lease tract). 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 surrounding the lease tract.

**Water Sales.** The Bureau of Reclamation's primary purpose is to provide water for agriculture in the Western states. Irrigation water is made available through long-term contracts with water districts that are composed of individual farmers. Water prices charged under these contracts are generally much lower than the true market value of the water. In agriculture, the charges rarely cover the federal costs associated with water projects. Federal water is often provided at less than its full cost for some agricultural commodities, such as cotton, which are subject to price support programs.

In recent years, the Congress has considered several reforms aimed at increasing receipts from agricultural users of federal water and reducing subsidies to those users. Many of these reforms were enacted for the Central Valley Project (CVP) in California, the largest of the bureau's projects. Among other provisions, the Central Valley Project Improvement Act of 1992 (CVPIA) set aside water for fish and wildlife, introduced a graduated pricing system for agricultural users of CVP water, imposed environmental surcharges on all CVP water use, and allowed water transfers. There are, however, other opportunities for price reform that the act does not address.

One reform would require farmers receiving federal irrigation water under new or renewed water contracts to pay the full cost of that water if they use it to grow commodities for which they receive crop price support payments. Another reform would require that farms of more than 960 acres be charged the full cost of federal irrigation water. (Current law contains that requirement but is often circumvented because of the vague definition of the term "farm.") These two reforms are examples of changes in the current system that could increase savings when irrigation water is supplied by the federal government. Under provisions of the CVPIA, which are not yet in effect, California farms that receive CVP water--including a majority of farms larger than 960 acres--will pay the full cost for approximately 10 percent of their water. Restructuring pricing for water sold outside the CVP and applying full-cost prices to the remaining 90 percent of the CVP water allocations would increase federal receipts from water sales. Reducing commodity program payments throughout the West would produce additional savings. Taken together, these reforms could increase receipts by at least $95 million during the 1996-2000 period. Commodity program payments could decrease by $20 million during the same period, for total savings of $115 million over five years.

**Recreation Fees.** All federal agencies that hold major tracts of land 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. The Congress approved new and expanded fees for 1994, but they will still cover only a small portion of the direct service costs. For example, in 1995, the National Park Service will spend an estimated $237 million on visitor services and will recover less than $71 million in fees. Requiring the Park Service to charge fees to cover these direct costs as well as associated collection costs would shift that burden to the beneficiaries of the services and improve pricing of public land use. Such fees would lower net federal outlays by $175 million in 1996 and by $912 million over five years.

Arguments against additional increases in fees reflect the view that the national parks and public lands are a vital and accessible part of our national heritage. The social benefits of visits to the parks--especially for the elderly and the poor--far exceed the government costs. Visits should be encouraged, not discouraged by increasing fees.

Additional increases, however, would shift the costs of police protection and other services from the taxpayers to the users of parks. 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-03 CHANGE THE REVENUE-SHARING FORMULA FROM A GROSS-RECEIPT TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

| Savings from Current-Law Spending | Annual Savings (Millions of dollars) 1996 | 1997 | 1998 | 1999 | 2000 | Cumulative Five-Year Savings |
|---|---|---|---|---|---|---|
| Budget Authority | 170 | 180 | 185 | 190 | 195 | 920 |
| Outlays | 135 | 175 | 180 | 190 | 195 | 875 |

The federal government owns nearly 650 million acres of public lands--nearly one-third of the U.S. land mass. These public lands contain a rich supply of renewable and nonrenewable 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 its resources. 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 they did not receive from the federal lands within their boundaries.

The federal 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.

In most cases, the U.S. Forest Service is required to allot 25 percent of its gross receipts from commercial activities in the national forests to the respective states and counties. The Department of the Interior allots 4 percent of its timber receipts, an average of 18 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the Department 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, national forests affected by protection of the spotted owl and the Oregon and California grant lands--payments to states and counties are made on the basis of an average of payments made in the past.

Federal savings would be substantial if the Congress required these agencies to deduct their full program costs from their gross receipts before paying the states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and would accrue receipt shares totaling about $670 million in 1996.

Certain federal costs could 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. Payments under the PILT program would increase if net program receipts were shared and the Congress appropriated such an increase. These additional payments have been netted out of the projected savings. Changing the revenue-sharing formula from a gross-receipt to a net-receipt basis would reduce net federal outlays by $875 million over the 1996-2000 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 alleviate that hardship, the federal agencies could switch gradually to the net-receipt basis over a period of several years.

## ENT-04 INDEX NUCLEAR WASTE DISPOSAL FEES FOR INFLATION; ELIMINATE THE DEFERRED PAYMENT OPTION

| Addition to Current-Law Receipts | Annual Added Receipts (Millions of dollars) 1996 | 1997 | 1998 | 1999 | 2000 | Cumulative Five-Year Addition |
|---|---|---|---|---|---|---|
| Index Fees for Inflation | 19 | 40 | 64 | 86 | 110 | 319 |
| Collect Deferred Payments | 0 | 880 | 1,100 | 0 | 0 | 1,980 |

The Nuclear Waste Policy Act of 1982 established the Nuclear Waste Fund (NWF) to finance the development of storage and permanent disposal facilities for spent nuclear fuel and high-level radioactive waste; the first permanent repository is not expected to open before 2010. In April 1983, the Department of Energy published a rule requiring electric utilities to pay one mill (one-tenth of a cent) into the fund for each kilowatt-hour of electricity sold from a nuclear power plant. The rule provided three payment options for the fees assessed on nuclear power generated before April 1983, one of which was to pay a lump sum with accrued interest before a utility shipped its first wastes for disposal.

The one-mill fee has remained constant since the rule's inception, although the general price level (measured by the gross domestic product deflator) has risen more than 45 percent since 1983. Based on current Congressional Budget Office projections, annual inflation adjustments starting in 1996 would raise $319 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 inflation has eroded its value, and that indexing equitably allocates the costs between present and future operators of nuclear power plants (and their electricity consumers). 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--approximately 10 percent of total system costs--if the fee remains fixed.

The Energy Department argued against automatic indexing in a November 1990 report, asserting that its 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 problems of under- or overfunding.

Another proposal would affect the 13 (out of 70) nuclear utilities that have so far avoided paying any fees or interest for pre-1983 electricity because they selected the deferred payment option. The fees amount to $880 million, and interest charges through September 1994 total $975 million. Requiring the utilities to pay the fees by 1997 and the interest by 1998 would raise about $2 billion, including the post-1994 interest. Such a requirement might also be fairer to the 57 utilities that have already paid their fees on pre-1983 electricity, perhaps in part because they accepted the government's initial timetable for opening a repository by 1998.

One argument against eliminating the deferred-payment option is that shifting receipts from the future (albeit an uncertain point in the future) to the present has no real impact on federal indebtedness. Another is that the purported gain in fairness is either illusory or wrongly conceived. If investors believe that fees and interest will in fact have to be paid at some point, the market values of the 13 utilities presumably already reflect these NWF liabilities; and if the utilities have benefited from a shrewd choice of payment option, it would not be fair to reduce that benefit by changing the rules in midstream.